

KT&G CORPORATION AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2010 and 2009

(With Independent Auditors' Report Thereon)

Contents

	Page
Independent Auditors' Report	1
Consolidated Statements of Financial Position	3
Consolidated Statements of Comprehensive Income	5
Consolidated Statements of Changes in Equity	6
Consolidated Statements of Cash Flows	9
Notes to the Consolidated Financial Statements	10

Independent Auditors' Report

Based on a report originally issued in Korean

The Board of Directors and Shareholders
KT&G Corporation:

We have audited the accompanying consolidated statements of financial position of KT&G Corporation and its subsidiaries (the "Group") as of December 31, 2010 and 2009, and the related consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended. Management is responsible for the preparation and fair presentation of these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Republic of Korea. 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, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of KT&G Corporation and its subsidiaries as of December 31, 2010 and 2009 and the results of its operations, the changes in its equity and its cash flows for the years then ended in conformity with Korean International Financial Reporting Standards.

The accompanying consolidated financial statements as of and for the year ended December 31, 2010 have been translated into United States dollars solely for the convenience of the reader. We have audited the translation and, in our opinion, the consolidated financial statements expressed in Korean won have been translated into dollars on the basis set forth in note 4 to the consolidated financial statements.

Without qualifying our opinion, we draw attention to the following:

As discussed in note 32 to the consolidated financial statements, the Group and the Korean government are defendants in lawsuits claiming damages of ₩584 million for the effects of smoking. The final outcome of these lawsuits cannot be predicted. Accordingly, no provisions have been made in the accompanying consolidated financial statements.

As discussed in note 32 to the consolidated financial statements, the Group maintains a contract with the farmers under which they are to grow green ginseng and, once the product becomes six years old, sell the ginseng to the Group. The amount paid to the farmers in accordance with the contract is recognized in long-term advance payment and advance payment.

KPMG Samjong Accounting Corp.
Seoul, Korea
February 22, 2011

This report is effective as of February 22, 2011, the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying consolidated financial statements and notes thereto. Accordingly, the readers of the audit report should understand that there is a possibility that the above audit report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Statements of Financial Position

As of December 31, 2010 and 2009

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2010 Korean won	2010 U.S. dollars (note 4)	2009 Korean won
Assets				
Property, plant and equipment	6,15	₩ 1,510,838	\$ 1,326,576	₩ 1,471,555
Intangible assets	7	63,145	55,444	55,700
Investment property	8,15	121,483	106,667	104,115
Equity accounted investment	5,9	1,597	1,402	1,584
Available-for-sale financial assets	5,10,31	314,177	275,860	442,083
Other financial assets	15,31	646	567	286
Long-term deposits in MSA Escrow Fund	11,31,32	132,414	116,264	118,121
Long-term advance payments	32	138,895	121,956	133,362
Long-term prepaid expenses		6,280	5,516	6,412
Long-term trade and other receivables	12,30,31	114,540	100,570	130,047
Deferred income tax assets	28	11,067	9,717	8,169
Total non-current assets		2,415,082	2,120,539	2,471,434
Inventories	13	1,497,034	1,314,456	1,509,079
Current available-for-sale financial assets	5,10,31	1,000	878	1,957
Current other financial assets	31	15,273	13,410	926
Prepaid tobacco excise and other taxes		177,043	155,451	169,440
Trade and other receivables	12,30,31	626,409	550,012	600,804
Advance payments	32	41,544	36,477	43,614
Prepaid expenses		22,360	19,634	11,805
Cash and cash equivalents	14,31	981,314	861,633	316,672
		3,361,977	2,951,951	2,654,297
Assets held for sale	5,15,33	-	-	46,152
Total current assets		3,361,977	2,951,951	2,700,449
Total assets	5	₩ 5,777,059	\$ 5,072,490	₩ 5,171,883

See accompanying notes to the consolidated financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Statements of Financial Position (Continued)

As of December 31, 2010 and 2009

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2010 Korean won	2010 U.S. dollars (note 4)	2009 Korean won
Equity				
Ordinary shares	1,16	₩ 954,959	\$ 838,493	₩ 954,959
Other capital surplus	16	5,333	4,683	5,321
Treasury shares	17	(216,827)	(190,383)	(226,945)
Gain on reissuance of treasury shares		482,129	423,328	468,274
Reserve	18	2,179,227	1,913,449	2,075,269
Retained earnings	19	1,151,358	1,010,939	704,012
Equity attributable to owners of the parent	31	4,556,179	4,000,509	3,980,890
Non-controlling interests		42,130	36,992	27,112
Total equity		4,598,309	4,037,501	4,008,002
Liabilities				
Long-term borrowings	15,21,31	1,540	1,352	2,026
Long-term trade and other payables	22,31	22,880	20,090	23,028
Long-term advance receipts	25	10,935	9,601	10,216
Defined benefit liabilities	24	48,324	42,431	35,445
Provision		2,220	1,949	2,258
Deferred income tax liabilities	28	167,503	147,074	167,345
Total non-current liabilities		253,402	222,497	240,318
Short-term borrowings	15,23,31	66,507	58,396	94,532
Current portion of long-term borrowings	15,21,31	506	444	448
Trade and other payables	22,31	301,211	264,476	326,598
Advance receipts		9,335	8,196	23,516
Income taxes payable	29	222,932	195,743	128,419
Tobacco excise and other taxes payable		324,857	285,237	350,050
Total current liabilities		925,348	812,492	923,563
Total liabilities	5	1,178,750	1,034,989	1,163,881
Total equity and liabilities		₩ 5,777,059	\$ 5,072,490	₩ 5,171,883

See accompanying notes to the consolidated financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income

For the years ended December 31, 2010 and 2009

In millions of won
and thousands of U.S. dollars,
except earnings per share

	Note	2010 Korean won	2010 U.S. dollars (note 4)	2009 Korean won
Sales	5,30	₩ 3,461,418	\$ 3,039,265	₩ 3,626,353
Cost of sales	30	(1,446,708)	(1,270,269)	(1,553,263)
Gross profit		2,014,710	1,768,996	2,073,090
Other income	26	139,607	122,581	61,496
Selling expenses	26	(592,523)	(520,259)	(669,043)
General and administrative expenses	26	(328,531)	(288,463)	(178,682)
Employee welfare fund		(12,492)	(10,969)	(19,500)
Other expense	26	(80,677)	(70,838)	(111,625)
Profit from operations	5	1,140,094	1,001,048	1,155,736
Net finance income (costs)	27	265,869	233,443	6,327
Share of loss of associates	9	(288)	(252)	(185)
Profit before income taxes		1,405,675	1,234,239	1,161,878
Income tax expense		(374,886)	(329,165)	(311,784)
Profit for the period		₩ 1,030,789	\$ 905,074	₩ 850,094
Other comprehensive income:				
Available-for-sale financial assets, net of tax	10,27,28	₩ (110,759)	\$ (97,251)	₩ 101,055
Exchange differences				
on translating foreign operations, net of tax	28	(6,637)	(5,827)	(3,044)
Actuarial gains (losses), net of tax	24,28	(7,590)	(6,664)	20,416
Other comprehensive income (expense) for the period, net of tax		(124,986)	(109,742)	118,427
Total comprehensive income for the period		₩ 905,803	\$ 795,332	₩ 968,521
Profit attributable to:				
- Owners of the parent		₩ 1,031,824	\$ 905,983	₩ 851,091
- Non-controlling interests		(1,035)	(909)	(997)
		₩ 1,030,789	\$ 905,074	₩ 850,094
Total comprehensive income attributable to:				
- Owners of the parent		₩ 907,461	\$ 796,788	₩ 968,973
- Non-controlling interests		(1,658)	(1,456)	(452)
		₩ 905,803	\$ 795,332	₩ 968,521
Earnings per share in won and U.S. dollars:				
Basic and diluted	29	₩ 8,109	\$ 7.12	₩ 6,630

See accompanying notes to the consolidated financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Statements of Changes in Equity

For the year ended December 31, 2010

<i>In millions of won</i>	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non- controlling interest	Total equity
Balance at January 1, 2010	₩ 954,959	5,321	(226,945)	468,274	2,075,269	704,012	3,980,890	27,112	4,008,002
Total comprehensive income for the period:									
Profit for the period	-	-	-	-	-	1,031,824	1,031,824	(1,035)	1,030,789
Other comprehensive income:									
Available-for-sale financial assets, net of tax	-	-	-	-	(110,759)	-	(110,759)	-	(110,759)
Exchange differences on translating foreign operations, net of tax	-	-	-	-	(6,637)	-	(6,637)	-	(6,637)
Actuarial losses, net of tax	-	-	-	-	-	(6,967)	(6,967)	(623)	(7,590)
Total other comprehensive income	-	-	-	-	(117,396)	(6,967)	(124,363)	(623)	(124,986)
Total comprehensive income for the period	-	-	-	-	(117,396)	1,024,857	907,461	(1,658)	905,803
Transactions with owners and others, recorded directly in equity:									
Dividends	-	-	-	-	-	(356,157)	(356,157)	-	(356,157)
Disposal of treasury shares	-	-	10,118	13,855	-	-	23,973	-	23,973
Transfer to unconditional reserve	-	-	-	-	203,000	(203,000)	-	-	-
Transfer to reserve for research and human resource development	-	-	-	-	60,000	(60,000)	-	-	-
Transfer from reserve for research and human resource development	-	-	-	-	(15,000)	15,000	-	-	-
Transfer from reserve for loss on reissuance of treasury shares	-	-	-	-	(26,646)	26,646	-	-	-
Issuance of subsidiaries' share capital	-	12	-	-	-	-	12	16,676	16,688
Total transactions with owners and others	-	12	10,118	13,855	221,354	(577,511)	(332,172)	16,676	(315,496)
Balance at December 31, 2010	₩ 954,959	5,333	(216,827)	482,129	2,179,227	1,151,358	4,556,179	42,130	4,598,309

See accompanying notes to the consolidated financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Statements of Changes in Equity (Continued)

For the year ended December 31, 2010

<i>In thousands of U.S. dollars</i>	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non- controlling interest	Total equity
Balance at January 1, 2010	\$ 838,493	4,672	(199,267)	411,164	1,822,169	618,151	3,495,382	23,806	3,519,188
Total comprehensive income for the period:									
Profit for the period	-	-	-	-	-	905,983	905,983	(909)	905,074
Other comprehensive income:									
Available-for-sale financial assets, net of tax	-	-	-	-	(97,251)	-	(97,251)	-	(97,251)
Exchange differences on translating foreign operations, net of tax	-	-	-	-	(5,827)	-	(5,827)	-	(5,827)
Actuarial losses, net of tax	-	-	-	-	-	(6,117)	(6,117)	(547)	(6,664)
Total other comprehensive income	-	-	-	-	(103,078)	(6,117)	(109,195)	(547)	(109,742)
Total comprehensive income for the period	-	-	-	-	(103,078)	899,866	796,788	(1,456)	795,332
Transactions with owners and others, recorded directly in equity:									
Dividends	-	-	-	-	-	(312,720)	(312,720)	-	(312,720)
Disposal of treasury shares	-	-	8,884	12,164	-	-	21,048	-	21,048
Transfer to unconditional reserve	-	-	-	-	178,242	(178,242)	-	-	-
Transfer to reserve for research and human resource development	-	-	-	-	52,682	(52,682)	-	-	-
Transfer from reserve for research and human resource development	-	-	-	-	(13,171)	13,171	-	-	-
Transfer from reserve for loss on reissuance of treasury shares	-	-	-	-	(23,395)	23,395	-	-	-
Issuance of subsidiaries' share capital	-	11	-	-	-	-	11	14,642	14,653
Total transactions with owners and others	-	11	8,884	12,164	194,358	(507,078)	(291,661)	14,642	(277,019)
Balance at December 31, 2010	\$ 838,493	4,683	(190,383)	423,328	1,913,449	1,010,939	4,000,509	36,992	4,037,501

See accompanying notes to the consolidated financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Statements of Changes in Equity (Continued)

For the year ended December 31, 2009

<i>In millions of won</i>	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non- controlling interest	Total equity
Balance at January 1, 2009	₩ 954,959	2,869	(226,945)	468,274	1,825,710	451,406	3,476,273	27,564	3,503,837
Total comprehensive income for the period:									
Profit for the period	-	-	-	-	-	851,091	851,091	(997)	850,094
Other comprehensive income:									
Available-for-sale financial assets, net of tax	-	-	-	-	101,055	-	101,055	-	101,055
Exchange differences on translating foreign operations, net of tax	-	-	-	-	(3,044)	-	(3,044)	-	(3,044)
Actuarial gains, net of tax	-	-	-	-	-	19,871	19,871	545	20,416
Total other comprehensive income	-	-	-	-	98,011	19,871	117,882	545	118,427
Total comprehensive income for the period	-	-	-	-	98,011	870,962	968,973	(452)	968,521
Transactions with owners and others, recorded directly in equity:									
Dividends	-	-	-	-	-	(360,357)	(360,357)	-	(360,357)
Reacquisition of treasury shares	-	-	(103,999)	-	-	-	(103,999)	-	(103,999)
Retirement of treasury shares	-	-	103,999	-	-	(103,999)	-	-	-
Transfer to unconditional reserve	-	-	-	-	169,000	(169,000)	-	-	-
Transfer from reserve for research and human resource development	-	-	-	-	(15,000)	15,000	-	-	-
Expiration of employee share options	-	2,452	-	-	(2,452)	-	-	-	-
Total transactions with owners and others	-	2,452	-	-	151,548	(618,356)	(464,356)	-	(464,356)
Balance at December 31, 2009	₩ 954,959	5,321	(226,945)	468,274	2,075,269	704,012	3,980,890	27,112	4,008,002

See accompanying notes to the consolidated financial statements.

KT&G CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the years ended December 31, 2010 and 2009

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2010 Korean won	2010 U.S. dollars (note 4)	2009 Korean won
Cash flows from operating activities				
Cash generated from operations	34	₩ 1,098,707	\$ 964,710	₩ 1,183,842
Income tax paid		(253,596)	(222,668)	(352,729)
Net cash from operating activities		845,111	742,042	831,113
Cash flows from investing activities				
Interest received		20,547	18,041	10,721
Investment income received				
from long-term deposits in MSA Escrow Fund		1,244	1,092	-
Dividends received		2,056	1,806	215
Proceeds from sale of property, plant and equipment		35,726	31,369	18,638
Proceeds from sale of intangible assets		1,016	892	64
Proceeds from sale of assets held for sale		100,830	88,533	-
Proceeds from sale of available-for-sale financial assets		265,678	233,276	2,346
Proceeds from sale of investments in associates		-	-	1
Collection of loans		47,796	41,967	25,671
Withdrawal of guarantee deposits		39,793	34,940	17,308
Purchases of property, plant and equipment		(211,636)	(185,825)	(152,248)
Acquisition of intangible assets		(13,606)	(11,947)	(5,892)
Acquisition of investment property		-	-	(323)
Purchases of equity accounted investment		-	-	(500)
Purchases of available-for-sale financial assets		(39,923)	(35,054)	(11,995)
Increase in loans		(16,023)	(14,068)	(10,403)
Payments for guarantee deposits		(49,004)	(43,027)	(20,187)
Payments for long-term deposits in MSA Escrow Fund		(13,625)	(11,963)	(18,055)
Settlement of financial derivatives		-	-	(4,410)
Others, net		(16,517)	(14,505)	653
Net cash provided by (used in) investing activities		154,352	135,527	(148,396)
Cash flows from financing activities				
Interest paid		(2,717)	(2,386)	(4,976)
Dividends paid		(356,157)	(312,720)	(360,357)
Proceeds from short-term borrowings		45,832	40,243	75,262
Increase in deposits received		5,633	4,946	2,953
Proceeds from issuance of subsidiaries' share capital		16,688	14,653	-
Disposal of treasury shares		28,395	24,932	-
Repayment of long-term borrowings		(429)	(377)	(280)
Repayment of short-term borrowings		(62,941)	(55,265)	(83,227)
Decrease in deposits received		(6,968)	(6,119)	(3,593)
Reacquisition of treasury shares		-	-	(103,999)
Net cash used in financing activities		(332,664)	(292,093)	(478,217)
Net increase in cash and cash equivalents		666,799	585,476	204,500
Cash and cash equivalents at beginning of year		316,672	278,051	110,245
Effect of exchange rate fluctuation on cash held		(2,157)	(1,894)	1,927
Cash and cash equivalents at end of year		₩ 981,314	\$ 861,633	₩ 316,672

See accompanying notes to the consolidated financial statements.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

1. Organization and Description of Business

KT&G Corporation (the "Parent Company"), which is engaged in manufacturing and selling tobacco, was established on April 1, 1987 as Korea Monopoly Corporation, a wholly-owned enterprise of the Korean government, pursuant to the Korea Monopoly Corporation Act, in order to secure financing and to promote and develop, through efficient management, the monopoly business of red ginseng and tobacco. On April 1, 1989, the Parent Company changed its name to Korea Tobacco and Ginseng Corporation pursuant to the Korea Tobacco and Ginseng Corporation Act. Also, pursuant to the Act on Management Reform and Privatization of Public Enterprises, proclaimed on August 28, 1997 and enforced on October 1, 1997, the Parent Company was excluded from the application of the Act for the Management of Government Invested Enterprises. Accordingly, the Parent Company became an entity existing and operating under the Commercial Code of Korea. The Korean government sold 28,650,000 shares of the Parent Company to the public during 1999 and the Parent Company listed its shares on the Korea Exchange (formerly, the Korea Stock Exchange) on October 8, 1999. On December 27, 2002, the Parent Company changed its name again to KT&G Corporation from Korea Tobacco and Ginseng Corporation.

As of December 31, 2010, the Parent Company has four manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 137 branches for the sale of tobacco throughout the country. Also, the Parent Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Parent Company is located in Pyeongchon-dong, Daedeok-gu, Daejeon.

Pursuant to the Korean government's privatization program and management reorganization plan, on December 28, 1998, the shareholders approved a plan to separate the Parent Company into two companies by setting up a subsidiary for its red ginseng business segment effective January 1, 1999. The separation was accomplished by the Parent Company's contribution of the assets and liabilities in the red ginseng business segment into a wholly-owned subsidiary, Korea Ginseng Corporation.

On October 17, 2002 and October 31, 2001, the Parent Company listed 35,816,658 and 45,400,000 Global Depositary Receipts ("GDR") (each GDR representing the right to receive one-half share of an ordinary share of the Parent Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program. Also, on June 25, 2009, the market of the Parent Company's GDR was changed from the BdL market to the Euro MTF in the Luxembourg Stock Exchange.

The ownership of the Parent Company's issued ordinary shares as of December 31, 2010 is held as follows:

<i>Shareholder</i>	<i>Number of shares</i>	<i>Percentage of ownership</i>
Industrial Bank of Korea	9,510,485	6.93%
Employee Share Ownership Association	3,970,401	2.89%
Treasury shares	9,643,697	7.02%
Others	114,167,914	83.16%
	<u>137,292,497</u>	<u>100.00%</u>

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

2. Basis of Preparation

(a) Statement of Compliance

The consolidated financial statements have been prepared in accordance with Korean International Financial Reporting Standards ("K-IFRS"), as prescribed in the Act on External Audit of Corporations. K-IFRS is effective from the fiscal year beginning on or after January 1, 2011 and the Group early-adopted K-IFRS from 2009.

(b) Basis of Measurement

The consolidated financial statements have been prepared under the historical cost basis except as described in the accounting policy below on financial instruments, inventories valued at net realizable value and share-based payments.

(c) Use of Estimates and Judgments

The preparation of the consolidated financial statements in conformity with K-IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements is included in the following notes:

- Classification of investment property – note 8
- Deferred revenue – note 25.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year is included in the following notes:

- Measurement of defined benefit obligations – note 24
- Provisions and contingencies – note 32.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies

(a) Basis of Consolidation

Subsidiaries

A subsidiary is an entity controlled by the Group, where control is the power to govern the financial and operating policies of the entity so as to obtain benefit from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing the control. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. If a member of the Group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements.

Profit or loss and each component of other comprehensive income are attributed to owners of the Parent Company and to non-controlling interests. Total comprehensive income is attributed to owners of the Parent Company and to non-controlling interests even if this results in non-controlling interests having a deficit balance.

Associate

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. The investment in an associate is initially recognized at cost and the carrying amount is increased or decreased to recognize the Group's share of the profit or loss and changes in equity of the associate after the date of acquisition. If an associate uses accounting policies other than those of the Group for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in applying the equity method.

Transactions Eliminated on Consolidation

Intra-group balances and transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign Currencies

These consolidated financial statements are presented in Korean won, which is the Parent Company's functional currency that is the currency of the primary economic environment in which the Group operates.

Foreign currency transactions are initially recorded using the spot exchange rate between the functional currency and the foreign currency at the date of the transaction. At the end of each reporting period, foreign currency monetary items are translated using the closing rate. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements are recognized in profit or loss in the period in which they arise. When gains or losses on non-monetary items are recognized in other comprehensive income, exchange components of those gains or losses are recognized in other comprehensive income. Conversely, when gains or losses on non-monetary items are recognized in profit or loss, exchange components of those gains or losses are recognized in profit or loss.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(b) Foreign Currencies (Continued)

If the functional currency of foreign operations differs from the Group's presentation currency, assets and liabilities for each statement of financial position presented (including comparatives) are translated using the exchange rate at the date of that statement of financial position and income and expenses for each statement of comprehensive income presented (including comparatives) are translated using the exchange rates at the dates of the transactions. All resulting exchange differences are recognized in other comprehensive income.

(c) Property, Plant and Equipment

Property, plant and equipment are initially measured at cost and after initial recognition, are carried at cost less accumulated depreciation and accumulated impairment losses. The cost of property, plant and equipment includes expenditure arising directly from the construction or acquisition of the asset, any costs directly attributable to bringing the asset to the location and condition necessary for them to be capable of operating in the manner intended by management and the initial estimate of the costs of dismantling and removing the item and restoring the site on which they are located. In addition, in the preparation of the opening K-IFRS consolidated statement of financial position on the date of transition to K-IFRS, the Group measures some land at deemed cost which is fair value at the date of transition in accordance with K-IFRS No.1101.

Subsequent costs are recognized in the carrying amount of property, plant and equipment at cost or, if appropriate, as separate items if it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing are recognized in profit or loss as incurred.

Property, plant and equipment, except for land and other tangible fixed assets, are depreciated on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives are as follows:

	Useful lives (years)
Buildings and structures	4 ~ 60
Machinery and vehicles	2 ~ 20
Tools, furniture and fixtures	4 ~ 5

Each part of property, plant and equipment with a cost that is significant in relation to the total cost is depreciated separately.

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate. The change is accounted for as a change in an accounting estimate.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(d) Intangible Assets

Intangible assets are measured initially at cost and after initial recognition, are carried at cost less accumulated amortization and accumulated impairment losses. Intangible assets consist of industrial property rights, rights to facility usage and other intangible asset. Intangible assets are amortized on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. The residual value of intangible assets is assumed to be zero. However, as there are no foreseeable limits to the periods over which rights to facility usage and some of industrial property right are expected to be available for use, these intangible assets are regarded as having indefinite useful lives and not amortized.

The estimated useful lives were as follows:

	Useful lives (years)
Industrial property rights	10 ~ 20 or indefinite
Rights to facility usage	indefinite
Other intangible assets	15

The amortization period and the amortization method for intangible assets with a finite useful life are reviewed at each financial year-end. The useful lives of intangible assets that are not being amortized are reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for those assets. If it is appropriate to change, such a change is accounted for as a change in an accounting estimate.

(e) Investment Property

Properties held to earn rental or for capital appreciation are classified as investment properties. Investment properties are measured initially at its cost including transaction costs and after initial recognition, are carried at cost less accumulated depreciation and accumulated impairment losses.

Subsequent costs are recognized in the carrying amount of investment property at cost or, if appropriate, as separate items if it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing are recognized in profit or loss as incurred.

Investment properties, except for land, are depreciated on a straight-line basis over 10 ~ 60 years, the estimated useful lives. Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate. The change is accounted for as a change in an accounting estimate.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(f) Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

The cost of inventories is determined by the weighted-average method for merchandise, finished goods, by-products, work-in-progress and tobacco leaf in raw materials, by the moving-average method for raw materials and supplies; and by the specific identification method for all other inventories.

When inventories are sold, the carrying amount of those inventories is recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories are recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, is recognized as a reduction in the amount of inventories and recognized as an expense in the period in which the reversal occurs.

Tobacco leaf inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognized industry practice. The estimated amounts of inventories in current assets which are not expected to be realized within 12 months are ~~₩~~403,082 million and ~~₩~~362,594 million, respectively, as of December 31, 2010 and 2009.

(g) Non-derivative Financial Assets

The Group classifies a non-derivative financial asset into the following four categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables or available-for-sale financial assets, relating to recognition and measurement of financial assets. The Group recognizes financial assets in the consolidated statement of financial position when the Group becomes a party to the contractual provisions of the financial asset. The Group derecognizes financial assets from the consolidated statement of financial position when the contractual rights to the cash flows from the financial asset expire or the Group transfers the contractual rights to receive the cash flows on the financial asset in a transaction in which and all the risks and rewards of ownership of the financial asset are substantially transferred. If the Group retains substantially all the risks and rewards of ownership of the transferred financial assets, the Group continues to recognize the transferred financial asset and recognizes financial liabilities for the consideration received.

Non-derivative financial assets comprise investments in equity and debt securities, long-term deposits in MSA Escrow Fund, trade and other receivables and cash and cash equivalents. When non-derivative financial assets are recognized initially, the Group measures it at its fair value plus, in the case of financial assets not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(g) Non-derivative Financial Assets (Continued)

Financial Assets at Fair Value through Profit or Loss

Financial assets are classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition transaction costs are recognized in profit or loss when incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

Held-to-maturity Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity are classified as held-to-maturity investments. After initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method.

Loans and Receivables

Loans and receivables are trade receivables, loans and other receivables with fixed or determinable payments that are not quoted in an active market. After initial recognition, loans and receivables are measured at amortized cost using the effective interest method except for short-term receivables of which the effect of discounting is immaterial.

Available-for-sale Financial Assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables. Subsequent to initial recognition, they are measured at fair value and changes therein are recognized directly in other comprehensive income, except for impairment losses and foreign exchange gains and losses on monetary available-for-sale financial asset. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost. When the financial asset is derecognized or impairment losses is recognized, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss. Dividends on an available-for-sale equity instrument are recognized in profit or loss when the Group's right to receive payment is established.

Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand, demand deposits and 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. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date. Bank overdrafts are included as a component of cash and cash equivalents for the purpose of the consolidated statement of cash flows.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(h) Non-derivative Financial Liabilities

The Group classifies non-derivative financial liabilities into financial liabilities at fair value through profit or loss or other financial liabilities in accordance with the substance of the contractual arrangement and the definitions of financial liabilities. The Group recognizes financial liabilities in the consolidated statement of financial position when the Group becomes a party to the contractual provisions of the financial liability and removes financial liabilities from the consolidated statement of financial position when the financial liability is extinguished.

Non-derivative financial liabilities comprise borrowings and trade and other payables. When non-derivative financial liabilities are recognized initially, the Group measures it at its fair value minus, in the case of financial liabilities not at fair value through profit or loss, transaction costs that are directly attributable to the issue of the financial liability.

Financial Liabilities at Fair Value through Profit or Loss

Financial liabilities are classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition transaction costs are recognized in profit or loss when incurred. Financial liabilities at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

Other Financial Liabilities

Other financial liabilities are those non-derivative financial liabilities that are not classified as financial liabilities at fair value through profit or loss. After initial recognition, other financial liabilities are measured at amortized cost using the effective interest method except for short-term liabilities of which the effect of discounting is immaterial.

(i) Derivative Financial Instruments

Derivatives are recognized initially at fair value. Attributable transaction costs are recognized in profit or loss when incurred.

A hedge of the exposure to changes in fair value of a recognized asset or liability or an unrecognized firm commitment that is attributable to a particular risk is accounted for as a fair value hedge. A hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction is accounted for as a cash flow hedge.

At the inception of the hedge, the Group formally designates the hedging relationship and the Group's risk management objective and strategy for undertaking the hedge and documents identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Group will assess the hedging instrument's effectiveness. The Group assesses the hedge effectiveness on an ongoing basis throughout the financial reporting periods for which the hedge was designated.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(i) Derivative Financial Instruments (Continued)

Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

Fair Value Hedges

The gain or loss from remeasuring the hedging instrument designated as a fair value hedge at fair value and the gain or loss on the hedged item attributable to the hedged risk is recognized in profit or loss.

Cash Flow Hedges

The portion of the gain or loss on the hedging instrument designated as a cash value hedge that is determined to be an effective hedge is recognized in other comprehensive income and the ineffective portion of the gain or loss on the hedging instrument is recognized in profit or loss. The associated gain or loss that has been recognized in other comprehensive income is reclassified from equity to profit or loss in the same period or periods during which the hedged forecast transaction affects profit or loss. If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, the associated gains and losses that were recognized in other comprehensive income are removed and included in the initial cost or other carrying amount of the asset or liability.

If the hedging instrument expires or is sold, terminated or exercised or the hedge no longer meets the criteria for hedge accounting or the Group revokes the designation, the hedge accounting is discontinued prospectively. The cumulative gain or loss on the hedging instrument that has been recognized in other comprehensive income is reclassified from equity to profit or loss when the forecast transaction occurs. If the transaction is no longer expected to occur, the cumulative gain or loss that had been recognized in other comprehensive income is immediately reclassified from equity to profit or loss.

Changes in the fair value of derivatives that are not designated as hedging instrument or do not meet the criteria for hedge accounting are recognized immediately in profit or loss.

As of December 31, 2010, the Group does not have derivative financial instruments.

(j) Non-current Assets Held for Sale

The Group classifies a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use, and measures it at the lower of its carrying amount and fair value less costs to sell.

A non-current asset which is classified as held for sale or which is part of a disposal group classified as held for sale is not depreciated.

The Group recognizes an impairment loss for write-down of the asset (or disposal group) to fair value less costs to sell and a gain for increase in fair value less costs to sell of an asset, but not in excess of the cumulative impairment loss that has been recognized previously in accordance with K-IFRS No.1036 *Impairment of Assets*.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(k) Revenue Recognition

The Group's revenue categories consist of goods sold, services and other income.

Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods, the Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Group and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the years ended December 31, 2010 and 2009 were ₩3,363,885 million and ₩3,772,203 million, respectively.

Revenue from the building lotting-out construction contracts is recognized upon delivery when the significant risks and rewards of ownership of the goods are transferred to the buyer.

Revenue associated with the transaction involving the rendering of services is recognized by reference to the stage of completion of the transaction at the end of the reporting period when the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Group, the stage of completion of the transaction at the end of the reporting period can be measured reliably and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably. When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue is recognized only to the extent of the expenses recognized that are recoverable.

Revenue arising from the use by others of the Group assets yielding interest, royalties and dividends is recognized when it is probable that the economic benefits associated with the transaction will flow to the Group and the amount of the revenue can be measured reliably.

In addition, interest is recognized using the effective interest method, royalties are recognized on an accrual basis in accordance with the substance of the relevant agreement and dividends are recognized when the shareholders' right to receive is established.

(l) Impairment of Non-financial Assets

The Group assesses at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the Group estimates the recoverable amount of the asset. Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, irrespective of whether there is any indication that it may be impaired. If there is any indication that an asset may be impaired, recoverable amount is estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, the Group determines the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

The recoverable amount is measured as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. If the recoverable amount of an asset or cash-generating unit is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. That reduction is recognized in profit or loss.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(m) Impairment of Financial Assets

The Group assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired, except a financial asset at fair value through profit or loss. A financial asset or group of financial assets is considered to be impaired if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset. For specific financial assets such as trade receivables, if the Group determines that no objective evidence of impairment exists for and individually assessed financial asset, it collectively assesses them for impairment. The objective evidence that the group of loans and receivables is impaired includes an increased number of delayed payments and an adverse change in national or local economic conditions that correlate with defaults on the assets in the group.

The amount of the impairment loss on financial assets carried at amortized cost is measured as 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. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognized in profit or loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. The reversal does not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal is recognized in profit or loss.

The amount of the impairment loss on financial assets carried at cost is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

When a decline in the fair value of an available-for-sale financial asset has been recognized in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment even though the financial asset has not been derecognized. Impairment losses recognized in profit or loss for an investment in an equity instrument classified as available for sale are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in profit or loss.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(n) Income Taxes

Income tax expense comprises current tax expense and deferred tax expense. Current and deferred taxes are recognized as an expense included in profit or loss for the period, except to the extent that the tax arises from a transaction which is recognized in other comprehensive income or directly in equity.

Current tax expense is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period. Current tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and liabilities are recognized for temporary differences which are differences between the carrying amount of an asset or liability in the consolidated statement of financial position and its tax base, the carryforward of unused tax losses and unused tax credits. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted by the end of the reporting period.

The Group recognizes a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries and associates, except to the extent that the Group is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future.

The Group recognizes a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries and associates, to the extent that, and only to the extent that it is probable that the temporary difference will reverse in the foreseeable future; and taxable profit will be available against which the temporary difference can be utilized.

The carrying amount of a deferred tax asset is reviewed at the end of each reporting period. The Group reduces the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of these deferred tax assets to be utilized. Such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

(o) Dividends

The dividends declared to holders of equity instruments after the reporting period are not recognized as a liability at the end of the reporting period.

(p) Equity Capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the equity transaction are recognized as a deduction from equity, net of any tax effects.

If the Group reacquires its own equity instruments, those instruments ("treasury shares") are presented as a deduction from total equity. The gain or loss on the purchase, sale, issue or cancellation of treasury shares is not recognized in profit or loss but recognized directly in equity.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(q) Provisions, Contingent Assets and Contingent Liabilities

Provisions are recognized when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The risks and uncertainties that inevitably surround many events and circumstances are taken into account in reaching the best estimate of a provision. Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement is recognized when, and only when, it is virtually certain that reimbursement will be received if the Group settles the obligation. The reimbursement is treated as a separate asset.

Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision is reversed.

In addition, with regard to returns, the Group recognizes revenue, net of estimated returns and provides for the estimated liability at the time revenue is recognized. The related estimated cost of returns is added to the cost of sales or selling, general and administrative expenses. At the point of return, differences arising from estimates are recognized as cost of sales or selling, general and administrative expenses.

(r) Employee Benefits

Short-term Employee Benefits

Short-term employee benefits are employee benefits that are due to be settled within 12 months after the end of the period in which the employees render the related service. When an employee has rendered service to the Group during an accounting period, the Group recognizes the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

The Group recognizes the expected cost of profit-sharing and bonus payments if the Group has a present legal or constructive obligation to make such payments as a result of past events; and a reliable estimate of the obligation can be made.

Retirement Benefits: Defined Contribution Plans

With regard to the defined contribution plan, when an employee has rendered service to the Group during a period, the Group recognizes the contribution payable to a defined contribution plan in exchange for that service as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the end of the reporting period, the Group recognizes that excess as an asset (prepaid expense) to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(r) Employee Benefits (Continued)

Retirement Benefits: Defined Benefit Plans

The Group classifies retirement benefits plans other than defined contribution plans as defined benefit plans. The defined benefit liabilities are calculated at the present value of the defined benefit obligations less the fair value of the plan assets at the end of the reporting period.

In determining the present value of its defined benefit obligations and the related current service cost, the Group uses the projected unit credit method.

With regard to actuarial gains and losses which arise from application of actuarial assumptions, the Group recognizes all actuarial gains and losses in other comprehensive income. Actuarial gains and losses recognized in other comprehensive income are recognized immediately in retained earnings and are not reclassified to profit or loss in a subsequent period.

Termination benefits

The Company recognizes termination benefits as a liability and an expense when, and only when, the Company is demonstrably committed to terminating the employment of an employee or group of employees before the normal retirement date or providing termination benefits as a result of an offer made in order to encourage voluntary redundancy.

(s) Deferred Revenue

With regard to ginseng sales, the Group uses the customer loyalty program to provide customers with incentives to buy its goods. If a customer buys goods, the Group awards the customer points which can be redeemed in the future for free or discounted goods. The fair value of the consideration received or receivable in respect of the initial sale is allocated between the points and the other components of the sale. The consideration allocated to the points is estimated by considering the fair value of ginseng provided to customers for the redemption of points and expected rate and timing of redemption. The Group recognizes the consideration allocated to the points as revenue when the points are redeemed and the Group fulfils its obligations to supply awards.

(t) Share-based Payment Transactions

For equity-settled share-based payment transactions, the Group measures the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the Group cannot estimate reliably the fair value of the goods or services received, the Group measures their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

For share-based payment transactions in which the terms of the arrangement provide either the Group or the counterparty with the choice of whether the Group settles the transaction in cash or by issuing equity instruments, the Group accounts for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the Group has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

3. Significant Accounting Policies (Continued)

(u) Earnings per Share

The Group presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss for the period attributable to owners of the Parent Company by the weighted-average number of shares outstanding during the period.

Diluted EPS is determined by adjusting the profit or loss for the period attributable to owners of the Parent Company and the weighted-average number of shares outstanding for the effects of all dilutive potential shares, which comprise employee share options.

(v) Segments Reporting

A segment is a distinguishable component of the Group that is engaged in providing products or services, which is determined based on the Group's internal report that is regularly reviewed by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Group has four operating segments - manufacturing and selling tobacco (the "Tobacco" segment), manufacturing and selling ginseng products (the "Ginseng" segment), sales or rent of real estate (the "Real Estate" segment) and other operations. The Group's geographical segment information is not included in the consolidated financial statements since segment revenues, segment assets and segment liabilities from external customers attributed to an individual foreign country are immaterial. The prices agreed between the Group companies for intra-group transactions are based on normal commercial practices which would apply between independent businesses.

(w) New Standards and Interpretations Not Yet Adopted

The new and amended standards and interpretations that have been issued but are not yet effective as of December 31, 2010 have not been applied in preparing the consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statement of the Group, except for K-IFRS No. 1109 *Financial Instruments*. The extent of the impact of adopting this standard on the consolidated financial statements has not been determined.

4. Basis of Translating Financial Statements

The consolidated financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩1,138.90 to \$1, the basic exchange rate on December 31, 2010, solely for the convenience of the reader. This translation should not be construed as a representation that any or all of the amounts shown could be converted into United States dollars at this or any other rate.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

5. Operating Segments

(a) Details of the Group's operating segment are summarized as follows:

Operating segments	Principal operation
Tobacco	Manufacturing and selling of tobaccos
Ginseng	Manufacturing and selling of red ginseng
Real estate	Selling and renting of real estates
Others	Manufacturing and selling of medicines and others

(b) Segment information on revenue and profit from operations for the year ended December 31, 2010 was as follows:

<i>In millions of won</i>	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Total segment sales	₩ 2,397,649	897,446	100,972	151,488	3,547,555	(86,137)	3,461,418
Less: Inter-segment sales	19,645	50,384	3,912	12,196	86,137	(86,137)	-
External sales	2,378,004	847,062	97,060	139,292	3,461,418	-	3,461,418
Profit from operations	924,035	226,569	(16,046)	13,285	1,147,843	(7,749)	1,140,094

(c) Segment information on revenue and profit from operations for the year ended December 31, 2009 was as follows:

<i>In millions of won</i>	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Total segment sales	₩ 2,510,839	810,290	258,674	154,401	3,734,204	(107,851)	3,626,353
Less: Inter-segment sales	13,616	65,292	2,294	26,649	107,851	(107,851)	-
External sales	2,497,223	744,998	256,380	127,752	3,626,353	-	3,626,353
Profit from operations	853,767	209,243	77,455	14,843	1,155,308	428	1,155,736

(d) Segment information on assets and liabilities as of December 31, 2010 was as follows:

<i>In millions of won</i>	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Assets:							
Segment assets	₩ 3,371,806	932,606	131,313	114,443	4,550,168	(98,182)	4,451,986
Equity accounted investments	842,951	15,890	-	-	858,841	(857,244)	1,597
Available-for-sale financial assets	314,937	-	-	240	315,177	-	315,177
	4,529,694	948,496	131,313	114,683	5,724,186	(955,426)	4,768,760
Unallocated assets							1,008,299
Total assets	₩						5,777,059
Liabilities:							
Segment liabilities	₩ 900,008	138,583	-	58,147	1,096,738	(85,489)	1,011,249
Unallocated liabilities							167,501
Total liabilities	₩						1,178,750

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

5. Operating Segments (Continued)

(e) Segment information on assets and liabilities as of December 31, 2009 was as follows:

<i>In millions of won</i>	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Assets:							
Segment assets	₩ 3,305,202	841,364	157,932	112,558	4,417,056	(63,006)	4,354,050
Equity accounted investments	723,160	8,252	-	-	731,412	(729,828)	1,584
Available-for-sale financial assets	443,800	-	-	240	444,040	-	444,040
Assets held-for-sale	23,245	-	-	22,907	46,152	-	46,152
	4,495,407	849,616	157,932	135,705	5,638,660	(792,834)	4,845,826
Unallocated assets							326,057
Total assets	₩						5,171,883
Liabilities:							
Segment liabilities	₩ 863,367	113,692	-	76,455	1,053,514	(56,978)	996,536
Unallocated liabilities							167,345
Total liabilities	₩						1,163,881

(f) Revenues from major customers of which revenues amount to 10 percent or more of the Group's total revenues for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Segment	Major customer		
Tobacco	Alokozay International Ltd.	₩ 483,308	477,080

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

6. Property, Plant and Equipment

(a) Changes in property, plant and equipment for the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		Land, buildings and structures	Machinery and vehicles	Tools, furniture, fixtures and other	Construction- in-progress	Total
Cost:						
Balance at January 1, 2010	₩	1,196,109	981,089	271,729	69,340	2,518,267
Additions		5,859	41,263	33,774	130,740	211,636
Disposals		(6,315)	(46,123)	(67,565)	(123)	(120,126)
Net exchange difference		(2,374)	(2,321)	(46)	(252)	(4,993)
Other		69,318	29,527	1,385	(110,316)	(10,086)
Balance at December 31, 2010	₩	1,262,597	1,003,435	239,277	89,389	2,594,698
Accumulated depreciation and impairment:						
Balance at January 1, 2010	₩	(266,932)	(585,791)	(193,989)	-	(1,046,712)
Disposals		1,879	38,457	65,979	-	106,315
Depreciation		(32,173)	(73,281)	(38,364)	-	(143,818)
Net exchange difference		82	349	27	-	458
Other		(103)	-	-	-	(103)
Balance at December 31, 2010	₩	(297,247)	(620,266)	(166,347)	-	(1,083,860)
Carrying amount:						
Balance at January 1, 2010	₩	929,177	395,298	77,740	69,340	1,471,555
Balance at December 31, 2010	₩	965,350	383,169	72,930	89,389	1,510,838

Other changes for the year ended December 31, 2010 include the carrying amount of construction-in-progress transferred to operating expenditures and inventories amounting to ₩957 million and ₩9,449 million, respectively, and the carrying amount of investment property transferred to land and buildings amounting to ₩247 million.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

6. Property, Plant and Equipment (Continued)

(b) Changes in property, plant and equipment for the year ended December 31, 2009 were as follows:

<i>In millions of won</i>		Land, buildings and structures	Machinery and vehicles	Tools, furniture, fixtures and other	Construction- in-progress	Total
Cost:						
Balance at January 1, 2009	₩	1,169,943	972,038	244,203	57,120	2,443,304
Additions		20,980	18,138	26,030	87,100	152,248
Disposals		(14,458)	(20,802)	(3,922)	-	(39,182)
Net exchange difference		(1,760)	(2,011)	(116)	(2,343)	(6,230)
Other		21,404	13,726	5,534	(72,537)	(31,873)
Balance at December 31, 2009	₩	1,196,109	981,089	271,729	69,340	2,518,267
Accumulated depreciation and impairment:						
Balance at January 1, 2009	₩	(238,505)	(545,099)	(155,709)	-	(939,313)
Disposals		3,153	18,111	3,551	-	24,815
Depreciation		(32,486)	(73,923)	(41,937)	-	(148,346)
Impairment		-	(657)	-	-	(657)
Net exchange difference		66	243	48	-	357
Other		840	15,534	58	-	16,432
Balance at December 31, 2009	₩	(266,932)	(585,791)	(193,989)	-	(1,046,712)
Carrying amount:						
Balance at January 1, 2009	₩	931,438	426,939	88,494	57,120	1,503,991
Balance at December 31, 2009	₩	929,177	395,298	77,740	69,340	1,471,555

Other changes for the year ended December 31, 2009 include the amount transferred to non-current assets held for sale amounting to ₩23,245 million. The Group recognized ₩657 million of impairment loss on the machinery of the Wanju plant relating to discontinued production of medicine products for the year ended December 31, 2009.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

7. Intangible Assets

(a) Changes in intangible assets for the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		Industrial property rights	Rights to facility usage	Other intangible assets	Intangible assets under development	Total
Cost:						
Balance at January 1, 2010	₩	9,299	20,750	9,733	31,135	70,917
Additions		485	4,303	5,028	3,790	13,606
Disposals		(200)	(864)	-	(181)	(1,245)
Net exchange difference		-	-	(28)	-	(28)
Other		360	-	1,024	(1,384)	-
Balance at December 31, 2010	₩	9,944	24,189	15,757	33,360	83,250
Accumulated amortization and impairment:						
Balance at January 1, 2010	₩	(7,818)	-	(6,752)	(647)	(15,217)
Disposals		94	-	-	-	94
Amortization		(88)	-	(1,236)	-	(1,324)
Impairment		(83)	-	(3,598)	-	(3,681)
Net exchange difference		-	-	23	-	23
Balance at December 31, 2010	₩	(7,895)	-	(11,563)	(647)	(20,105)
Carrying amount:						
Balance at January 1, 2010	₩	1,481	20,750	2,981	30,488	55,700
Balance at December 31, 2010	₩	2,049	24,189	4,194	32,713	63,145

The Group recognized ₩3,415 million of impairment loss on the intangible assets relating to the acquisition of the sales network in the United States and ₩266 million of impairment loss on the intangible assets relating to the development of synthesis technology for the year ended December 31, 2010.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

7. Intangible Assets (Continued)

(b) Changes in intangible assets for the year ended December 31, 2009 were as follows:

<i>In millions of won</i>		Industrial property rights	Rights to facility usage	Other intangible assets	Intangible assets under development	Total
Cost:						
Balance at January 1, 2009	₩	9,404	19,964	8,527	27,172	65,067
Additions		159	764	1,006	3,963	5,892
Disposals		-	(64)	-	-	(64)
Net exchange difference		-	-	(27)	-	(27)
Other		(264)	86	227	-	49
Balance at December 31, 2009	₩	9,299	20,750	9,733	31,135	70,917
Accumulated amortization and impairment:						
Balance at January 1, 2009	₩	(7,557)	-	(5,576)	-	(13,133)
Amortization		(263)	-	(1,229)	-	(1,492)
Impairment		-	-	-	(647)	(647)
Net exchange difference		-	-	17	-	17
Other		2	-	36	-	38
Balance at December 31, 2009	₩	(7,818)	-	(6,752)	(647)	(15,217)
Carrying amount:						
Balance at January 1, 2009	₩	1,847	19,964	2,951	27,172	51,934
Balance at December 31, 2009	₩	1,481	20,750	2,981	30,488	55,700

The Group recognized ₩647 million of impairment loss on the intangible assets under development due to the relinquishment of the industrial property rights for the year ended December 31, 2009.

(c) Expenditures not capitalized for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Cost of sales	₩	812	768
Selling expenses		11,652	5,402
General and administrative expenses		9,898	14,943
	₩	22,362	21,113

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

8. Investment Property

(a) Changes in investment property for the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		Land	Buildings	Total
Cost:				
Balance at January 1, 2010	₩	15,385	117,885	133,270
Transfer to property, plant and equipment		-	(350)	(350)
Transfer from assets held for sale		21,165	4,355	25,520
Balance at December 31, 2010	₩	36,550	121,890	158,440
Accumulated depreciation and impairment:				
Balance at January 1, 2010	₩	-	(29,155)	(29,155)
Depreciation		-	(3,855)	(3,855)
Impairment		-	(1,437)	(1,437)
Transfer to property, plant and equipment		-	103	103
Transfer from assets held for sale		-	(2,613)	(2,613)
Balance at December 31, 2010	₩	-	(36,957)	(36,957)
Carrying amount:				
Balance at January 1, 2010	₩	15,385	88,730	104,115
Balance at December 31, 2010	₩	36,550	84,933	121,483

The Group recognized ₩1,437 million of impairment loss on the investment property transferred from assets held for sale due to the cancellation of the contract.

(b) Changes in investment property for the year ended December 31, 2009 were as follows:

<i>In millions of won</i>		Land	Buildings	Total
Cost:				
Balance at January 1, 2009	₩	15,385	117,562	132,947
Subsequent expenditure		-	323	323
Balance at December 31, 2009	₩	15,385	117,885	133,270
Accumulated depreciation and impairment:				
Balance at January 1, 2009	₩	-	(25,617)	(25,617)
Depreciation		-	(3,538)	(3,538)
Balance at December 31, 2009	₩	-	(29,155)	(29,155)
Carrying amount:				
Balance at January 1, 2009	₩	15,385	91,945	107,330
Balance at December 31, 2009	₩	15,385	88,730	104,115

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

8. Investment Property (Continued)

- (c) The amounts recognized in profit or loss from investment property for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Rental income	₩	17,177	16,880
Direct operating expense		(3,855)	(3,538)
Impairment losses on investment property		(1,437)	-
	₩	11,885	13,342

- (d) The carrying amount and the fair value of investment property as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010		2009	
		Fair value	Carrying amount	Fair value	Carrying amount
Land	₩	228,882	36,550	207,717	15,385
Buildings		111,183	84,933	111,184	88,730
	₩	340,065	121,483	318,901	104,115

9. Equity Accounted Investment

- (a) Equity accounted investments as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won, except percentage of ownership</i>			2010		2009	
Associate	Location	Principal operation	Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Cosmo Tobacco Co., Ltd.	Mongolia	Manufacturing and selling tobacco	40.00%	₩ -	40.00%	₩ -
Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	25.34%	645	29.46%	572
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00%	952	20.00%	1,012
				₩ 1,597		₩ 1,584

Cosmo Tobacco Co., Ltd. was in the process of liquidation as of December 31, 2010 and 2009. The Group has discontinued application of the equity method to Cosmo Tobacco Co., Ltd. as the carrying amount of investment in Cosmo Tobacco Co., Ltd. has been reduced to zero due to accumulated deficit.

In 2010, Lite Pharm Tech, Inc. exercised asymmetric paid-in capital increase and consequently, the Group's percentage of ownership decreased from 29.46% to 25.34%. With relation to the transaction, the Parent Company recognized an increase of ₩300 million in its ownership of associates as a gain in the consolidated statement of comprehensive income for the year ended December 31, 2010.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

9. Equity Accounted Investment (Continued)

(b) Changes in equity accounted investments for the year ended December 31, 2010 were as follows:

In millions of won

Associate		Balance at beginning of period	Acquisition	Share of profit or loss of associates	Other	Balance at end of period
Lite Pharm Tech, Inc.	₩	572	-	(227)	300	645
Korean Carbon Finance, Inc.		1,012	-	(60)	-	952
	₩	1,584	-	(287)	300	1,597

(c) Changes in equity accounted investments for the year ended December 31, 2009 were as follows:

In millions of won

Associate		Balance at beginning of period	Acquisition	Share of profit or loss of associates	Disposal	Balance at end of period
Korea Islet Transplantation, Inc.	₩	72	-	(71)	(1)	-
Lite Pharm Tech, Inc.		692	-	(120)	-	572
Korean Carbon Finance, Inc.		506	500	6	-	1,012
	₩	1,270	500	(185)	(1)	1,584

(d) Summarized financial information on associates as of and for the year ended December 31, 2010 was as follows:

In millions of won

Associate		Total assets	Total liabilities	Revenue	Profit or loss
Lite Pharm Tech, Inc.	₩	3,887	1,342	938	(896)
Korean Carbon Finance, Inc.		4,858	100	1,213	(305)

(e) Summarized financial information on associates as of and for the year ended December 31, 2009 was as follows:

In millions of won

Associate		Total assets	Total liabilities	Revenue	Profit or loss
Lite Pharm Tech, Inc.	₩	3,366	1,425	902	(409)
Korean Carbon Finance, Inc.		5,108	45	764	46

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

10. Available-for-sale Financial Assets

(a) Changes in available-for-sale financial assets for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Balance at beginning of period	₩	444,040	304,270
Acquisitions		39,923	11,995
Net changes in fair value before tax		(141,998)	129,558
Disposals		(26,788)	(1,783)
Balance at end of period	₩	315,177	444,040
Consolidated statements of financial position:			
- Current	₩	1,000	1,957
- Non-current		314,177	442,083
	₩	315,177	444,040

(b) Available-for-sale financial assets as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>		2010	2009
Available-for-sale debt instruments:			
- Government and municipal bonds	₩	240	2,196
- Corporate bonds		20,340	2,040
Total available-for-sale debt instruments		20,580	4,236
Available-for-sale equity instruments:			
Listed			
- Yonhap Television News (YTN)		30,839	38,967
- Crystal Genomics Co., Ltd.		-	1,748
- Oscotech, Inc.		1,022	780
- Shinhan Financial Group Co., Ltd.		212,042	173,161
- Rexahn Pharmaceuticals, Inc.		8,152	4,878
- Celltrion, Inc.		-	195,462
- Genematrix, Inc.		-	708
		252,055	415,704
Unlisted			
- Dream Hub PFV Co., Ltd.		12,732	15,975
- Migami, Inc.		3,988	3,365
- Other unlisted available-for-sale equity instruments		25,822	4,760
		42,542	24,100
Total available-for-sale equity instruments		294,597	439,804
Total available-for-sale financial assets	₩	315,177	444,040

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

10. Available-for-sale Financial Assets (Continued)

- (c) The fair value of listed available-for-sale equity instruments is principally based on quoted prices in an active market.

The Group disposed of all of its interest in Celltrion, Inc. and recognized ~~₩~~239,748 million of gain on sale of available-for-sale financial assets as other income in the statement of comprehensive income for the year ended December 31, 2010.

The fair value of Dream Hub PFV Co., Ltd. which does not have a market price in an active market is measured at the value per share determined by the net asset valuation model.

The other unlisted available-for-sale equity instruments that do not have a market price in an active market and whose fair value cannot be reliably measured and available-for-sale debt instruments whose fair value is similar to their carrying amount, are measured at cost.

11. Long-term Deposits in MSA Escrow Fund

- (a) Long-term deposits in MSA Escrow Fund as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>		2010	2009
MMF	₩	74,167	4,874
T-Bill		-	57,287
T-Note		58,247	55,960
	₩	132,414	118,121

- (b) As discussed in notes 32 to the consolidated financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the years ended December 31, 2010 and 2009 are ~~₩~~13,625 million and ~~₩~~18,055 million, respectively.
- (c) Investment income on long-term deposits in MSA Escrow Fund for the years ended December 31, 2010 and 2009 are ~~₩~~4,637 million and ~~₩~~23 million, respectively.
- (d) Long-term deposits in MSA Escrow Fund are measured at quoted prices in an active market.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

12. Trade and Other Receivables

(a) Trade and other receivables as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>		2010		2009	
		Current	Non-current	Current	Non-current
Loans to employees	₩	19,300	43,092	24,031	68,176
Loans		898	7,130	1,242	6,669
Other receivables		67,093	-	53,461	-
Guarantee deposits		-	64,318	-	55,202
Accrued income		2,204	-	573	-
Trade receivables		536,914	-	521,497	-
	₩	626,409	114,540	600,804	130,047

(b) Trade and other receivables as of December 31, 2010 and 2009 have been reported in the consolidated statements of financial position net of allowances as follows:

<i>In millions of won</i>		2010		2009	
		Current	Non-current	Current	Non-current
Gross trade and other receivables	₩	635,218	114,540	611,041	130,047
Allowance account:					
- Other receivables		(1,934)	-	(2,202)	-
- Trade receivables		(6,875)	-	(8,035)	-
		(8,809)	-	(10,237)	-
Net trade and other receivables	₩	626,409	114,540	600,804	130,047

(c) Changes in the allowance account for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Balance at beginning of period	₩	10,237	9,575
Impairment		473	720
Reversal of impairment		(216)	(46)
Write-off		(1,682)	(12)
Net exchange difference		(3)	-
Balance at end of period	₩	8,809	10,237

Impairment losses and reversal of impairment losses on trade and other receivables are included as part of other expense and income in the consolidated statements of comprehensive income.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

12. Trade and Other Receivables (Continued)

- (d) The aging schedule of trade and other receivables which were past due but not impaired as of December 31, 2010 and 2009 is as follows:

<i>In millions of won</i>		2010	2009
Within 1 month	₩	48,739	62,770
Between 1 and 2 months		64,936	71,921
Beyond 2 months		17,131	15,536
	₩	130,806	150,227

There is no significant concentration of credit risk with respect to trade and other receivables since trade and other receivables, excluding export trade receivables, are widely dispersed amongst a number of customers. The Group holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

- (e) Details of trade and other receivables that are measured at amortized cost as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>	Effective interest rate	2010		Effective interest rate	2009	
		Current	Non-current		Current	Non-current
Loans to employees	3.00~5.68%	₩ 19,287	43,066	3.00~5.68%	₩ 23,985	68,067
Loans	3.29~8.47%	898	3,554	7.29~8.47%	1,242	2,885
Guarantee deposits	3.00~8.47%	-	61,719	3.00~8.47%	-	53,059
		₩ 20,185	108,339		₩ 25,227	124,011

There is no material difference between the carrying amount and their fair value except the above trade and other receivables, due to the short-term duration of the majority of trade and other receivables.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

13. Inventories

(a) Inventories as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>		2010	2009
Merchandise, net of loss on the write-down of inventories	₩	7,914	2,623
Finished goods, net of loss on the write-down of inventories		238,009	207,308
Work-in-progress, net of loss on the write-down of inventories		312,920	318,780
Raw materials, net of loss on the write-down of inventories		869,053	878,360
Supplies		25,941	25,256
By-products		7,542	5,650
Completed buildings		-	53,816
Buildings under construction		381	-
Sites for building lotting-out construction		9,449	-
Goods-in-transit		25,825	17,286
	₩	1,497,034	1,509,079

(b) The amount of inventories recognized as an expense for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Cost of sales:			
- Loss on the write-down of inventories	₩	164	-
- Reversal of loss on the write-down of inventories		-	(3,807)
Other expense:			
- Loss on retirement of inventories		6,251	4,154
	₩	6,415	347

14. Cash and Cash Equivalents

Cash and cash equivalents as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>		2010	2009
Cash on hand	₩	5,079	6,796
Demand deposits		110,260	76,983
Short-term investment assets		865,975	232,893
	₩	981,314	316,672

Cash equivalents mainly include short-term deposits with an original maturity of three months or less. The carrying amount of cash and cash equivalents approximates their fair value.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

15. Pledged Assets

- (a) The following assets were pledged as collateral for the Group's borrowings and others as of December 31, 2010:

In millions of won

Asset	Carrying amount	Type	Received amount	Collateralized amount	Lender/Leaseholder
Land, buildings and structures and investment property	₩ 67,018	Short-term borrowings	₩ 25,900	60,150	Hana Bank and others
Investment property	32,722	Long-term borrowings	2,045		
		Leasehold deposits received	2,583	3,429	Korea Life Insurance Co., Ltd. and others
	₩ 99,740		₩ 30,528	63,579	

- (b) The following assets were pledged as collateral for the Group's borrowings and others as of December 31, 2009:

In millions of won

Asset	Carrying amount	Type	Received amount	Collateralized amount	Lender/Leaseholder
Land, buildings and structures, investment property and non-current assets held for sale	₩ 70,087	Short-term borrowings	₩ 40,914	60,150	Hana Bank and others
Investment property	34,184	Long-term borrowings	2,474		
		Leasehold deposits received	2,496	3,445	Korea Life Insurance Co., Ltd. and others
	₩ 104,271		₩ 45,884	63,595	

- (c) Other financial assets restricted in use as of December 31, 2010 and 2009 were as follows:

In millions of won

	2010	2009
Security deposits for checking accounts	₩ 6	6
Collateral for borrowings	640	100
	₩ 646	106

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

16. Share Capital

(a) Details of share capital as of December, 2010 and 2009 were as follows:

<i>In won, except number of shares</i>	2010	2009
Number of ordinary shares:		
- Authorized	800,000,000	800,000,000
- Issued	137,292,497	137,292,497
- Outstanding	127,648,800	127,198,800
Par value	₩ 5,000	5,000

The Parent Company has, thus far, reacquired and retired 53,699,400 shares of treasury share. Accordingly, as of December 31, 2010, the Parent Company's ordinary share differs from the aggregate par value of issued shares by ₩268,497 million.

(b) Changes in the number of shares for the years ended December 31, 2010 and 2009 were as follows:

<i>Number of shares</i>	2010			2009		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning of year	137,292,497	(10,093,697)	127,198,800	138,792,497	(10,093,697)	128,698,800
Reacquisition of treasury shares	-	-	-	-	(1,500,000)	(1,500,000)
Retirement of treasury shares	-	-	-	(1,500,000)	1,500,000	-
Disposal of treasury shares	-	450,000	450,000	-	-	-
End of year	137,292,497	(9,643,697)	127,648,800	137,292,497	(10,093,697)	127,198,800

(c) Changes in the other capital surplus for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>	2010	2009
Balance at beginning of year	₩ 5,321	2,869
Expiration of employee share options	-	2,452
Issuance of subsidiaries' share capital	12	-
Balance at end of year	₩ 5,333	5,321

The employee share options were settled in cash and terminated for the year ended December 31, 2009. Consequently, the employee share option reserve was reclassified to the other capital surplus.

The other capital surplus increased by ₩12 million as Yungjin Pharm. Ind. Co., Ltd. issued share capital to the Employee Share Ownership Association and shareholders for the year ended December 31, 2010.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

17. Treasury Shares

(a) Changes in the treasury shares for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won, except number of shares</i>	2010		2009	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Balance at beginning of year	10,093,697	₩ 226,945	10,093,697	₩ 226,945
Reacquisition of treasury shares	-	-	1,500,000	103,999
Retirement of treasury shares	-	-	(1,500,000)	(103,999)
Disposal of treasury shares	(450,000)	(10,118)	-	-
Balance at end of year	9,643,697	₩ 216,827	10,093,697	₩ 226,945

(b) Changes in gain on reissuance of treasury shares for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>	2010	2009
Balance at beginning of year	₩ 468,274	468,274
Gain on reissuance of treasury shares before tax	18,278	-
Less: tax at 24.2%	(4,423)	-
Gain of reissuance of treasury shares, net of tax	13,855	-
Balance at end of year	₩ 482,129	468,274

18. Reserves

(a) Details of reserves as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>	2010	2009
Available-for-sale financial assets reserve	₩ 18,034	128,793
Exchange differences on translating foreign operations	(5,476)	1,161
Legal reserve	602,937	602,937
Voluntary reserve	1,563,732	1,342,378
	₩ 2,179,227	2,075,269

(b) Available-for-sale financial assets reserve as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>	2010	2009
Available-for-sale financial assets reserve before tax	₩ 23,120	165,119
Tax effect	(5,086)	(36,326)
	₩ 18,034	128,793

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

18. Reserves (Continued)

(c) Legal Reserve

The Korean Commercial Code requires the Company to appropriate a legal reserve in an amount equal to at least 10% of cash dividends for each accounting period until the reserve equals 50% of stated capital. The legal reserve may be used to reduce a deficit or may be transferred to ordinary shares in connection with a free issue of shares.

(d) Details of voluntary reserve as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Reserve for business rationalization	₩	12,851	12,851
Reserve for research and human resource development		60,000	15,000
Reserve for loss on reissuance of treasury shares		-	26,646
Reserve for business expansion		698,881	698,881
Unconditional reserve		792,000	589,000
	₩	1,563,732	1,342,378

Reserve for Business Rationalization

Until December 10, 2002 under the Special Tax Treatment Control Law, investment tax credits were allowed for certain investments. The Parent Company was, however, required to appropriate from retained earnings, the amount of tax benefits received, and transfer such amount into a reserve for business rationalization.

Effective December 11, 2002, the Parent Company was no longer required to establish a reserve for business rationalization despite tax benefits received for certain investments and, consequently, the existing balance is now regarded as a voluntary reserve.

Reserve for Business Expansion

Reserve for business expansion was a legal reserve under the Korea Tobacco and Ginseng Corporation Act, which was abrogated on September 1, 1997, consequently, the existing balance has been regarded as a voluntary reserve since then.

Other Reserves

Reserves for research and human resource development and loss on reissuance of treasury shares were appropriated in order to utilize certain tax deduction benefits through the early recognition of future expenditures. These reserves are restored to retained earnings in accordance with the relevant tax laws. Such reserves are taken back into taxable income in the year of restoration. Reserves without specific purposes are restored to retained earnings by a resolution at a general meeting of shareholders.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

19. Retained Earnings

Changes in retained earnings for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Balance at beginning of year	₩	704,012	451,406
Transfer from reserve for research and human resource development		15,000	15,000
Transfer from reserve for loss on reissuance of treasury shares		26,646	-
Transfer to reserve for research and human resource development		(60,000)	-
Transfer to unconditional reserve		(203,000)	(169,000)
Profit for the period		1,030,789	850,094
- Less: non-controlling interests		1,035	997
Actuarial gains (losses), net of tax		(7,590)	20,416
- Less: non-controlling interests		623	(545)
Dividends		(356,157)	(360,357)
Retirement of treasury shares		-	(103,999)
Balance at end of year	₩	1,151,358	704,012

20. Statements of Appropriation of Retained Earnings

Statements of appropriation of retained earnings of the Parent Company, KT&G Corporation, for the years ended December 31, 2010 and 2009 are as follows:

Date of appropriation for 2010: March 4, 2011

Date of appropriation for 2009: February 26, 2010

<i>In millions of won</i>		2010	2009
Unappropriated retained earnings:			
Balance at beginning of year	₩	2,452	(77,904)
Retirement of treasury shares		-	(103,999)
Profit for the period		931,127	744,942
Actuarial gains (losses), net of tax		(4,439)	16,924
Balance at end of year before appropriation		929,140	579,963
Transfer from voluntary reserves:			
Reserve for research and human resource development		-	15,000
Reserve for loss on reissuance of treasury shares		-	26,646
		-	41,646
Unappropriated retained earnings available for appropriation		929,140	621,609
Appropriation of retained earnings:			
Dividends (note 35)		(382,946)	(356,157)
Reserve for research and human resource development		-	(60,000)
Unconditional reserve		(544,000)	(203,000)
		(926,946)	(619,157)
Unappropriated retained earnings to be carried over to subsequent year	₩	2,194	2,452

Statements of appropriation of retained earnings were prepared based on the non-consolidated financial statements of the Parent Company.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

21. Long-term Borrowings

Long-term borrowings as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>	Maturity	Annual interest rate		2010		2009	
				Current	Non-current	Current	Non-current
Borrowings for energy facilities	March 15, 2013	2.25%	₩	281	351	280	631
Borrowings for environmental facilities	March 31, 2017	4.29%		225	1,189	168	1,395
			₩	506	1,540	448	2,026

The Group has been guaranteed by Facilities Management Corporation relating to the above borrowings.

22. Trade and Other Payables

(a) Trade and other payables as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>		2010		2009	
		Current	Non-current	Current	Non-current
Leasehold deposits received	₩	60	21,697	25	23,028
Trade payables		44,381	-	46,346	-
Withholdings		126,793	1,183	134,784	-
Accrued expenses		110,866	-	103,941	-
Other payables		19,111	-	41,502	-
	₩	301,211	22,880	326,598	23,028

(b) Details of trade and other payables that are measured at amortized cost as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>	Effective interest rate		2010		Effective interest rate		2009	
			Current	Non-current			Current	Non-current
Leasehold deposits received	3.00~5.68%	₩	-	21,697	3.00~5.68%	₩	-	23,028

There is no material difference between the carrying amount and their fair value except the above trade and other payables, due to the short-term duration of the majority of trade and other payables.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

23. Short-term Borrowings

Short-term borrowings as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>	Description of borrowings	Annual interest rate		2010	2009
Local currency	Customer credit contracts	2.05~4.95%	₩	32,960	43,863
	General purpose borrowings	3.00~7.00%		33,547	41,914
	Borrowings on notes	7.10%		-	3,000
	Discount on commercial note	-		-	4,589
Foreign currency	General purpose borrowings	-		-	1,166
			₩	66,507	94,532

The Group has entered into a customer credit contract with the National Agricultural Cooperative Federation ("NACF") and other financial institutions. The financial institutions pay past-due trade receivables for customers and the Group has provided guarantees to the financial institutions for customers. The amount paid by the financial institutions is recognized as short-term borrowings on the consolidated statement of financial position.

The Group has entered into a discount on the commercial note agreement with Hana Bank and other financial institutions. Trade receivables discounted in respect of which the Group remained contingently liable are recognized as short-term borrowings on the consolidated statement of financial position.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

24. Retirement Benefits Plan

The Group operates both defined benefit and defined contribution plans.

According to these defined benefit plans, the Group pays retirement benefits calculated under the plan's benefit formula at the time employees leave the Group. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method.

(a) The components of retirement benefit for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Defined benefit costs:			
Current service costs	₩	34,296	40,468
Interest costs		8,758	7,257
Expected returns on plan assets		(7,364)	(6,270)
Gains (losses) on the settlement of the plan		287	(279)
	₩	35,977	41,176
Defined contribution costs:			
Contributions recognized as expense	₩	960	365
	₩	36,937	41,541

The Group recognized contributions payable amounting to ₩83 million and ₩74 million as trade and other payables (accrued expenses) in the consolidated statements of financial position as of December 31, 2010 and 2009, respectively.

The Group recognized termination benefits amounting to ₩50,002 million as an expense for the year ended December 31, 2010. With regard to the termination benefits, the Group recognized trade and other payables (accrued expenses) amounting to ₩1,695 in the consolidated statements of financial position as of December 31, 2010.

(b) Changes in defined benefit liabilities for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Balance at beginning of year	₩	35,445	73,994
Retirement benefits		35,977	41,176
Actuarial gains (losses) before tax		9,353	(25,829)
Payments into plan assets		(17,558)	(32,926)
Payments, including the amount transferred to the defined contribution plan		(14,420)	(20,969)
Changes in accrued expenses		(470)	-
Net exchange difference		(3)	(1)
Balance at end of year	₩	48,324	35,445
Statements of financial position:			
- Present value of retirement benefit obligations	₩	176,811	163,006
- Fair value of plan assets		(128,487)	(127,561)
Defined benefit liabilities	₩	48,324	35,445

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

24. Retirement Benefits Plan (Continued)

(c) Changes in defined benefit obligations for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Balance at beginning of year	₩	163,006	175,939
Current service costs		34,296	40,468
Interest costs		8,758	7,257
Gains (losses) on the settlement of the plan		287	(279)
Actuarial gains (losses) before tax		8,745	(25,159)
Payments, including the amount transferred to the defined contribution plan		(36,784)	(35,219)
Changes in accrued expenses		(1,494)	-
Net exchange difference		(3)	(1)
Balance at end of year	₩	176,811	163,006

(d) Changes in plan assets for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Balance at beginning of year	₩	127,561	101,945
Expected return on plan assets		7,364	6,270
Actuarial gains (losses) before tax		(608)	670
Payments into plan assets		17,558	32,926
Payments, including the amount transferred to the defined contribution plan		(22,364)	(14,250)
Changes in accrued expenses		(1,024)	-
Balance at end of year	₩	128,487	127,561

Actual returns on plan assets for the years ended December 31, 2010 and 2009 are ₩6,756 million and ₩6,940 million, respectively.

Expected rates of return are determined taking into account the current level of expected returns on risk-free investments, the historical level of risk premium associated with other invested assets, and the expectations for future returns on such assets.

(e) The amount of actuarial gains (losses) for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Actuarial gains (losses) before tax	₩	(9,353)	25,829
Tax effect		1,763	(5,413)
	₩	(7,590)	20,416

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

24. Retirement Benefits Plan (Continued)

(f) The components of plan assets as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Short-term trading financial assets	₩	94,192	109,511
Available-for-sale financial assets		33,680	8,590
Others		615	9,460
	₩	128,487	127,561

As of December 31, 2010 and 2009, short-term trading financial assets include severance insurance of ₩3,272 million and ₩12,405 million, respectively, which continue to be covered by the existing retirement benefits plan.

(g) The principal actuarial assumptions as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Rate of salary increases		3.00%~6.00%	4.00%~6.00%
Discount rate		4.30%~5.00%	4.81%~5.80%
Expected rate of return on plan assets		3.78%~5.44%	4.48%~6.00%

For the purpose of calculating present value of the defined benefit obligations, the Group used the discount rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds consistent with the currency and estimated term of the defined benefit obligations.

(h) Sensitivities in respect of the key assumptions used to measure the defined benefit plan were as follows:

<i>In millions of won</i>		1 percentage point increase	1 percentage point decrease
Rate of salary increases:			
- Increase (decrease) in defined benefit obligations	₩	16,617	(13,175)
- Increase (decrease) in retirement benefits before tax		4,300	(2,751)
Discount rate:			
- Increase (decrease) in defined benefit obligations		(15,338)	16,179
- Increase (decrease) in retirement benefits before tax		(1,352)	2,537
Expected rate of return on plan assets:			
- Increase (decrease) in retirement benefits before tax		(1,186)	1,139

The effect on defined benefit obligations is as of December 31, 2010. The effect on retirement benefits before tax is for the year ended December 31, 2010.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

25. Deferred Revenue

Changes in deferred revenue included in long-term advance receipts for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Balance at beginning of period	₩	9,682	7,764
Revenue deferred		5,672	9,092
Revenue recognized		(4,934)	(7,174)
Balance at end of period	₩	10,420	9,682

26. Profit from Operations

(a) Employee benefit costs for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Salaries	₩	387,501	408,924
Retirement benefits		36,937	41,541
Termination benefits		50,002	-
Employee welfare		42,988	41,815
	₩	517,428	492,280

(b) Depreciation and amortization for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Depreciation	₩	147,673	151,884
Amortization		1,324	1,492
	₩	148,997	153,376

(c) Details of other income for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Foreign currency transaction gain	₩	21,590	30,204
Foreign currency translation gain		1,717	1,184
Reversal of impairment losses on trade and other receivables		216	46
Gain on sale of equity accounted investment		300	-
Gain on sale of property, plant and equipment		101,886	17,033
Gain on sale of intangible assets		24	-
Others		13,874	13,029
	₩	139,607	61,496

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

26. Profit from Operations (Continued)

(d) Details of selling expenses for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Salaries	₩	167,462	182,578
Retirement and termination benefits		36,823	15,194
Employee welfare		21,775	20,478
Travel		8,070	6,906
Communications		2,426	2,420
Utilities		5,443	4,827
Taxes and dues		15,497	14,904
Supplies		1,919	2,328
Rent		16,113	11,112
Depreciation		33,328	35,361
Amortization		320	306
Repairs and maintenance		5,826	3,498
Vehicles		7,264	7,517
Insurance		995	853
Commissions		81,570	100,531
Freight and custody		35,827	32,062
Conferences		1,612	4,688
Advertising		133,981	216,319
Training		3,128	1,208
Prizes and rewards		1,492	551
Normal research and development		11,652	5,402
	₩	592,523	669,043

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

26. Profit from Operations (Continued)

(e) Details of general and administrative expenses for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Salaries	₩	71,394	60,799
Retirement and termination benefits		18,637	11,663
Employee welfare		6,392	6,985
Travel		2,815	2,431
Communications		2,751	2,715
Utilities		1,642	1,788
Taxes and dues		1,995	2,523
Supplies		1,623	2,722
Rent		4,948	6,937
Depreciation		14,376	17,757
Amortization		899	1,072
Repairs and maintenance		2,249	1,766
Vehicles		1,613	1,564
Insurance		291	371
Commissions		63,972	31,474
Freight and custody		1,013	-
Conferences		1,895	767
Advertising		111,821	3,013
Training		7,030	6,274
Prizes and rewards		1,277	1,118
Normal research and development		9,898	14,943
	₩	328,531	178,682

(f) Details of other expenses for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Foreign currency transaction loss	₩	23,880	40,697
Foreign currency translation loss		5,755	17,708
Impairment loss on trade and other receivables		473	720
Donations		30,934	32,628
Loss on sale of property, plant and equipment		2,386	7,496
Impairment loss on property, plant and equipment		-	657
Loss on sale of intangible assets		159	-
Impairment loss on intangible assets		3,681	647
Impairment loss on investment property		1,437	-
Loss on retirement of inventories		6,251	4,154
Others		5,721	6,918
	₩	80,677	111,625

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

27. Net Finance Costs

(a) Details of net finance costs (income) for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Finance cost:			
- Interest costs	₩	3,255	4,815
- Loss on sale of available-for-sale financial assets		1,214	-
- Loss on transaction of financial derivatives		-	1,711
		4,469	6,526
Finance income:			
- Interest income		(23,541)	(12,052)
- Dividend income		(2,056)	(215)
- Investment income on long-term deposits in MSA Escrow Fund		(4,637)	(23)
- Gain on sale of available-for-sale financial assets		(240,104)	(563)
		(270,338)	(12,853)
Net finance costs (income)	₩	(265,869)	(6,327)

(b) Details of interest costs for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Related financial liabilities:			
- Short-term borrowings	₩	2,396	4,370
- Trade and other payables		549	510
- Others		310	(65)
	₩	3,255	4,815

(c) Details of interest income for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Related financial assets:			
- Deposits	₩	19,988	7,496
- Available-for-sale financial assets		362	245
- Trade and other receivables		3,191	4,311
	₩	23,541	12,052

(d) Details of finance income recognized in other comprehensive income for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>	2010			2009		
	Before tax	Tax effect	Net of tax	Before tax	Tax effect	Net of tax
Gains (losses) on available-for-sale financial assets:						
Net change in fair value	₩ 96,892	(21,317)	75,575	₩ 130,121	(28,627)	101,494
Less: reclassified to profit or loss	(238,890)	52,556	(186,334)	(563)	124	(439)
	₩ (141,998)	31,239	(110,759)	₩ 129,558	(28,503)	101,055

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

28. Income Taxes

- (a) The Group was subject to income taxes on taxable income at the following normal tax rates.

Taxable income 2009 and thereafter	2009	2010 & 2011	Tax rate Thereafter
Up to ₩200 million	12.1%	11.0%	11.0%
Over ₩200 million	24.2%	24.2%	22.0%

In December 2009, the Korean government postponed the reduction of the corporate income tax rate (including resident tax) from 24.2% to 22%, until 2012.

- (b) The components of income tax expense (benefit) for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>	2010	2009
Current income tax expense	₩ 347,955	271,617
Adjustments recognized in the period for current tax of prior periods	109	14,161
Changes in temporary difference	(2,740)	59,523
Total income tax expense	345,324	345,301
Tax expense (benefit) recognized outside profit or loss	29,562	(33,517)
Income tax expense	₩ 374,886	311,784

- (c) Current and deferred tax expense that were recognized outside profit or loss for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>	2010	2009
Current:		
- Gain on reissuance of treasury shares	₩ (4,423)	-
- Actuarial gains (losses)	1,763	(5,413)
	(2,660)	(5,413)
Deferred:		
- Net changes in fair value of available-for-sale financial assets	31,239	(28,503)
- Net exchange difference	983	399
	32,222	(28,104)
Tax expense (benefit) recognized outside profit or loss	₩ 29,562	(33,517)

The Group recognized tax expense related to gain on reissuance of treasury shares directly in equity and tax expense related to actuarial gains (losses), gain (loss) on valuation of available-for-sale assets and net exchange difference in other comprehensive income.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

28. Income Taxes (Continued)

- (d) The income tax expense calculated by applying statutory tax rates to the Group's profit before tax for the period differs from the actual tax expense in the consolidated statements of comprehensive income for the years ended December 31, 2010 and 2009 for the following reasons:

<i>In millions of won except tax rate information</i>		2010	2009
Profit before tax	₩	1,405,675	1,161,878
Normal tax rate		24.2%	24.2%
Expense for income taxes at normal tax rate	₩	340,147	281,150
Adjustment:			
- Tax effects of permanent differences	₩	4,257	3,447
- Investment tax credits		(1,984)	(3,271)
- Additional income taxes for prior period		148	9,131
- Tax effects of profit of subsidiaries		30,992	20,177
- Others		1,326	1,150
Income tax expense	₩	374,886	311,784
Effective tax rate		26.7%	26.8%

- (e) Deferred tax expense (benefit) relating to the origination and reversal of temporary differences for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Deferred tax liabilities at end of year	₩	(156,436)	(159,176)
Deferred tax liabilities at beginning of year		(159,176)	(99,653)
Deferred tax expense (benefit)	₩	(2,740)	59,523

- (f) Deferred tax assets and liabilities are measured using the tax rate to be applied for the period in which temporary differences are expected to be realized.
- (g) The net deferred tax liabilities are reflected in the consolidated statements of financial position after offsetting assets and liabilities where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred income taxes relate to the same fiscal authority.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

28. Income Taxes (Continued)

(h) Changes in deferred tax assets and liabilities for the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		Balance at beginning of period	Credited to profit (charged to loss)	Charged comprehensive income	Balance at end of period
Available-for-sale financial assets	₩	9,448	413	-	9,861
Accrued expense		22,917	(2,209)	-	20,708
Donations in excess of tax limit		89	(89)	-	-
Defined benefit liabilities		(1,284)	2,250	-	966
Undistributed earnings of associates and subsidiaries		(141,131)	(30,992)	-	(172,123)
Foreign currency translations		3,907	(2,594)	-	1,313
Treasury shares		(8,565)	382	-	(8,183)
Changes in fair value of available-for-sale financial assets		(36,326)	-	31,239	(5,087)
Voluntary reserve		(16,348)	7,158	-	(9,190)
Provision for advanced depreciation		(4,722)	-	-	(4,722)
Others		12,839	(3,801)	983	10,021
	₩	(159,176)	(29,482)	32,222	(156,436)

(i) Changes in deferred tax assets and liabilities for the year ended December 31, 2009 were as follows:

<i>In millions of won</i>		Balance at beginning of period	Credited to profit (charged to loss)	Charged comprehensive income	Balance at end of period
Available-for-sale financial assets	₩	8,800	648	-	9,448
Accrued expense		22,012	905	-	22,917
Sales		7,157	(7,157)	-	-
Donations in excess of tax limit		8,606	(8,517)	-	89
Defined benefit liabilities		6,119	(7,403)	-	(1,284)
Undistributed earnings of associates and subsidiaries		(120,954)	(20,177)	-	(141,131)
Foreign currency translations		(6,055)	9,962	-	3,907
Treasury shares		(8,565)	-	-	(8,565)
Changes in fair value of available-for-sale financial assets		(7,823)	-	(28,503)	(36,326)
Voluntary reserve		(12,070)	(4,278)	-	(16,348)
Provision for advanced depreciation		(4,722)	-	-	(4,722)
Others		7,842	4,598	399	12,839
	₩	(99,653)	(31,419)	(28,104)	(159,176)

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

28. Income Taxes (Continued)

- (j) As of December 31, 2010 and 2009, the aggregate amounts of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognized were ₩4,216 million and ₩4,191 million, respectively.
- (k) The income taxes payable and income taxes refund before offsetting as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		2010	2009
Income taxes payable	₩	347,956	272,633
Income taxes refund		(125,185)	(144,370)
	₩	222,771	128,263

29. Earnings per Share

Basic and diluted earnings per share for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won, except share information</i>		2010	2009
Profit attributable to owners of the Parent Company	₩	1,031,824	851,091
Weighted-average number of ordinary shares outstanding		127,251,814	128,372,302
Basic and diluted earnings per share in won	₩	8,109	6,630

30. Transactions and Balances with Related Companies

- (a) Details of parent and subsidiary relationships as of December 31, 2010 and 2009 were as follows:

Subsidiary	Location	Next most senior parent	Percentage of ownership					
			2010			2009		
			Parent	Sub-sidiary	Total	Parent	Sub-sidiary	Total
Korea Ginseng Corporation	Korea	The Company	100.00%	- 100.00%	100.00%	- 100.00%	- 100.00%	100.00%
Yungjin Pharm. Ind. Co., Ltd. ^{(*)1}	Korea	The Company	53.00%	- 53.00%	55.50%	- 55.50%	- 55.50%	55.50%
Tae-a Industry Co., Ltd.	Korea	The Company	100.00%	- 100.00%	100.00%	- 100.00%	- 100.00%	100.00%
KT&G Tutun Mamulleri								
Sanayi ve Ticaret A.S. ^{(*)2}	Turkey	The Company	99.99%	- 99.99%	99.99%	- 99.99%	- 99.99%	99.99%
Korea Tabacos do Brasil Ltda.	Brazil	The Company	99.90%	- 99.90%	99.90%	- 99.90%	- 99.90%	99.90%
KT&G Pars ^{(*)3}	Iran	The Company	99.99%	- 99.99%	99.99%	- 99.99%	- 99.99%	99.99%
KT&G Rus L.L.C. ^{(*)4}	Russia	The Company	100.00%	- 100.00%	100.00%	- 100.00%	- 100.00%	100.00%
KGC Life & Gin Co., Ltd.								
(formerly, KGC Sales Co., Ltd.) ^{(*)5}	Korea	The Company	100.00%	- 100.00%	- 100.00%	100.00%	- 100.00%	100.00%
KT&G Bio Corp. ^{(*)6}	Korea	The Company	100.00%	- 100.00%	100.00%	- 100.00%	- 100.00%	100.00%
Global Trading, Inc. ^{(*)7}	USA	The Company	100.00%	- 100.00%	-	-	-	-
Purpleland								
Development Co., Ltd. ^{(*)8}	Korea	The Company	100.00%	- 100.00%	-	-	-	-
Korea Ginseng HK, Ltd.	Hong Kong	Korea Ginseng Corporation	- 99.99%	99.99%	- 99.99%	99.99%	- 99.99%	99.99%
Cheong Kwan Jang								
Taiwan Corporation	Taiwan	Korea Ginseng Corporation	- 100.00%	100.00%	- 100.00%	100.00%	- 100.00%	100.00%
Korean Red Ginseng Corp., Inc.	USA	Korea Ginseng Corporation	- 100.00%	100.00%	- 100.00%	100.00%	- 100.00%	100.00%
Korea Ginseng (China) Corp.	China	Korea Ginseng Corporation	- 100.00%	100.00%	- 100.00%	100.00%	- 100.00%	100.00%

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

30. Transactions and Balances with Related Companies (Continued)

- (*1) Yungjin Pharm. Ind. Co., Ltd. increased paid-in capital by way of Employee Share Ownership Association and shareholder allocation and the Parent Company's investments in subsidiaries increased by ₩15,664 million for the year ended December 31, 2010.
- (*2) KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. increased paid-in capital by way of shareholder allocation and the Parent Company's investments in subsidiaries increased by ₩19,044 million for the year ended December 31, 2009.
- (*3) KT&G Pars increased paid-in capital by way of investment in kind and the Parent Company's investments in subsidiaries increased by ₩4,037 million for the year ended December 31, 2009.
- (*4) KT&G Rus L.L.C. increased paid-in capital by way of shareholder allocation and the Parent Company's investments in subsidiaries increased by ₩75,814 million for the year ended December 31, 2010.
- (*5) In 2010, the Parent Company acquired all the shares of KGC Life & Gin Co., Ltd. (formerly, KGC Sales Co., Ltd.) for ₩4,934 million from Korea Ginseng Corporation, which is a subsidiary of the Parent Company. The Parent Company recognized investments in subsidiaries at the carrying amount of ₩1,500 million in the financial statements of Korea Ginseng Corporation. Accordingly, the Parent Company recognized a decrease in other capital surplus amounting to ₩3,434 million. After the acquisition, KGC Life & Gin Co., Ltd. increased paid-in capital by way of shareholder allocation and the Parent Company's investments in subsidiaries increased by ₩21,000 million for the year ended December 31, 2010.
- (*6) The Parent Company established KT&G Bio Corp. for the year ended December 31, 2009.
- (*7) The Parent Company acquired all the shares of Global Trading, Inc. for the year ended December 31, 2010.
- (*8) The Parent Company established Purpleland Development Co., Ltd. for the year ended December 31, 2010.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

30. Transactions and Balances with Related Companies (Continued)

(b) Significant transactions which occurred in the normal course of business with related companies for the years ended December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>				
<i>Sales Company</i>	<i>Purchase Company</i>		2010	2009
KT&G Corporation	Korea Ginseng Corporation	₩	4,670	12,790
KT&G Corporation	Yungjin Pharm. Ind. Co., Ltd.		225	174
KT&G Corporation	Tae-a Industry Co., Ltd.		14	1
KT&G Corporation	KGC Life & Gin Co., Ltd.		22	2
KT&G Corporation	Purpleland Development Co., Ltd.		4	-
KT&G Corporation	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		4,176	7,943
KT&G Corporation	KT&G Pars		2,590	6,825
KT&G Corporation	KT&G Rus L.L.C.		6,557	485
KT&G Corporation	Global Trading, Inc.		6,545	-
Korea Ginseng Corporation	KT&G Corporation		1,702	2,096
Korea Ginseng Corporation	Yungjin Pharm. Ind. Co., Ltd.		1,269	1,089
Korea Ginseng Corporation	Tae-a Industry Co., Ltd.		24	13
Korea Ginseng Corporation	Korea Ginseng HK, Ltd.		8,741	33,630
Korea Ginseng Corporation	Cheong Kwan Jang Taiwan Corporation		18,408	14,477
Korea Ginseng Corporation	Korean Red Ginseng Corp., Inc.		4,197	4,003
Korea Ginseng Corporation	Korea Ginseng (China) Corp.		9,369	-
Korea Ginseng Corporation	KGC Life & Gin Co., Ltd.		6,792	10,073
Yungjin Pharm. Ind. Co., Ltd.	KT&G Corporation		-	43
Yungjin Pharm. Ind. Co., Ltd.	KGC Life & Gin Co., Ltd.		-	8
Tae-a Industry Co., Ltd.	KT&G Corporation		13,312	13,616
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	KT&G Pars		1,738	4,555
Korea Tabacos do Brasil Ltda.	KT&G Corporation		-	191
		₩	90,355	112,014

The Parent Company received dividends from Korea Ginseng Corporation amounting to ₩30,000 million and ₩30,000 million for the years ended December 31, 2010 and 2009, respectively. Korea Ginseng Corporation received dividends from KGC Life & Gin Co., Ltd. (formerly, KGC Sales Co., Ltd.) amounting to ₩700 million for the year ended December 31, 2009.

The above intra-group transactions are eliminated in preparing the consolidated financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

30. Transactions and Balances with Related Companies (Continued)

(c) Account balances with related companies as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>			
Creditor	Debtor	2010	2009
KT&G Corporation	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. ₩	17,642	13,437
KT&G Corporation	KT&G Pars	22,114	18,883
KT&G Corporation	KT&G Rus L.L.C.	8,159	5,487
KT&G Corporation	Global Trading, Inc.	11,248	-
Korea Ginseng Corporation	KT&G Corporation	2,289	2,238
Korea Ginseng Corporation	Yungjin Pharm. Ind. Co., Ltd.	330	82
Korea Ginseng Corporation	Korea Ginseng HK, Ltd.	-	5,511
Korea Ginseng Corporation	Cheong Kwan Jang Taiwan Corporation	9,288	5,998
Korea Ginseng Corporation	Korea Red Ginseng Corp., Inc.	2,284	1,641
Korea Ginseng Corporation	Korea Ginseng (China) Corp.	8,641	-
Korea Ginseng Corporation	KGC Life & Gin Co., Ltd.	1,023	1,378
Yungjin Pharm. Ind. Co., Ltd.	Korea Ginseng Corporation	212	212
Korea Ginseng HK, Ltd.	Korea Ginseng Corporation	2,939	-
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	KT&G Pars	-	1,623
		₩	
		86,169	56,490

The above intra-group balances are eliminated in preparing the consolidated financial statements.

(d) Details of guarantees provided for related companies as of December 31, 2010 and 2009 were as follows:

<i>In thousands of U.S. dollars and euro</i>			2010		2009	
Guarantee provider	Guarantee recipient	Type of guarantee	Limit	Exercise	Limit	Exercise
KT&G Corporation	KT&G Rus L.L.C.	Guarantee on foreign currency letter of credit opened	€ 2,063	2,063	€ 7,267	-
Korea Ginseng Corporation	Korea Ginseng HK, Ltd.	Payment guarantee on borrowing	-	-	\$ 7,500	1,000

(e) Details of key management personnel compensation for the years ended December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>		2010	2009
Short-term employee benefits	₩	17,410	9,252
Post-employment benefits		1,242	6,470
	₩	18,652	15,722

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

31. Risk Management

(a) Overview

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- currency risk
- interest rate risk
- other market price risk.

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk and the Group's management of financial risk including quantitative disclosures.

(b) Risk Management Framework

The purpose of managing financial risks is to identify the potential risk factors that may affect the Group's financial performance, and minimize, eliminate and avoid it to the extent that is acceptable. One of the principal responsibilities of the treasury department is to manage the financial risks arising from the Group's underlying operations. The treasury department monitors and manages the financial risk arising from the Group's underlying operations in accordance with the risk management policies and procedures authorized by the board of directors. Also, the treasury department provides an internal report analyzing the nature and exposure level on financial risks to Risk Management Committee of the Group. The Risk Management Committee prepares the overall strategy for financial risk management, and evaluates the effectiveness of the financial risk management. In addition, the internal auditor consistently observes the compliance of the risk management policy and procedure, and reviews the risk exposure limit of the Group. The Group holds derivative financial instruments to hedge its specific financial risks such as currency risk.

Credit Risk

The Group has transacted with customers with high credit ratings to manage credit risk, and has implemented and operated policies and procedures for credit enhancements of the financial assets. Counterparty credit risk is managed by evaluating its credit rating and limiting the aggregate amount and duration of exposure before sales commence, and the Group has been provided collateral and guarantees. The credit ratings of all counterparties and the level of collateral and guarantees are reviewed regularly. Analysis of financial assets past due has been reported quarterly and appropriate measures have been taken to secure the Group's assets.

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of December 31, 2010 and 2009 is as follows:

<i>In millions of won</i>		2010	2009
Available-for-sale financial assets	₩	315,177	444,040
Long-term deposits in MSA Escrow Fund		132,414	118,121
Trade and other receivables		740,949	730,851
Other financial assets		15,919	1,212
Cash and cash equivalents		981,314	316,672

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

31. Risk Management (Continued)

(c) Management of Financial Risks

Export trade receivables to overseas clients, including Alokozay International Limited are ₩235,636 million and ₩229,096 million, and equal to 37.7% and 43.9% of the aggregate trade receivables, respectively, as of December 31, 2010 and 2009. The Group's trade receivables mentioned above were insured against non-payment up to USD 38,525 thousand and USD 36,200 thousand by export guarantee insurance with the Korea Export Insurance Corporation, respectively, as of December 31, 2010 and 2009. The Group has no significant concentration of customer credit risk since trade and other receivables, excluding the above export trade receivables, are widely dispersed amongst a number of customers.

The Group has made deposits on cash, cash equivalents and long-term deposits in NACF and several financial institutions with high credit ratings, thus the credit risks from these financial institutions are very limited.

Liquidity Risk

The Group has exposure to the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Group's management has established short-term and long-term financial management plans to manage the liquidity risk, and analyzed cash outflows occurred and cash outflows budgeted, so as to match the maturity structure of financial assets and financial liabilities. The Group's management determines whether or not the financial liabilities are repayable with the operating cash flows and cash inflows from financial assets. The Group entered into an overdraft agreement with the NACF to manage the temporary liquidity risk.

The maturity analysis with a residual contractual maturity of financial liabilities as of December 31, 2010 and 2009 is as follows:

<i>In millions of won</i>	Carrying amount	Contractual cash flow	Residual contractual maturity			
			Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
As of December 31, 2010:						
Derivative financial liabilities	₩ -	-	-	-	-	-
Non-derivative financial liabilities	265,850	267,607	135,650	117,221	14,428	308
	₩ 265,850	267,607	135,650	117,221	14,428	308
As of December 31, 2009:						
Derivative financial liabilities	₩ -	-	-	-	-	-
Non-derivative financial liabilities	311,848	313,983	178,668	123,591	9,192	2,532
	₩ 311,848	313,983	178,668	123,591	9,192	2,532

The above financial liabilities are presented at the nominal value of undiscounted future cash flows as of the earliest period at which the Group can be required to pay.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

31. Risk Management (Continued)

(c) Management of Financial Risks (Continued)

Currency Risk

The Group has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates arising from the export and import of tobacco. The Group's management has measured the currency risk internally and regularly, and has entered into foreign currency option contracts to hedge foreign currency risk in case of need.

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>	2010			2009		
	USD	EUR	Other currency	USD	EUR	Other currency
Assets:						
Cash and cash equivalents	₩ 11,461	1,340	477	3,889	1,673	264
Trade and other receivables	285,230	9,877	988	324,358	8,946	2
Long-term deposits in MSA Escrow Fund	132,414	-	-	118,121	-	-
	₩ 429,105	11,217	1,465	446,368	10,619	266
Liabilities:						
Trade and other payables	₩ 11,199	18,774	231	21,923	24,853	-
Short-term borrowings	77	-	-	479	16,934	-
	₩ 11,276	18,774	231	22,402	41,787	-

As of December 31, 2010 and 2009, the effects of a 10% strengthening or weakening of functional currency against foreign currencies other than functional currency on profit before tax were as follows:

<i>In millions of won</i>	2010		2009	
	10% strengthening	10% weakening	10% strengthening	10% weakening
USD	₩ 41,783	(41,783)	42,397	(42,397)
EUR	(756)	756	(3,117)	3,117
Other currency	123	(123)	27	(27)
	₩ 41,150	(41,150)	39,307	(39,307)

The above sensitivity analysis was applied to monetary assets and liabilities denominated in foreign currencies other than the functional currency at the end of the reporting period.

Interest Rate Risk

The Group has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. As of December 31, 2010 and 2009, the amount of borrowings issued at variable rates is ₩24,045 million and ₩40,655 million, respectively. There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

31. Risk Management (Continued)

(c) Management of Financial Risks (Continued)

Other Market Price Risk

The Group has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Other market price risk arises from available-for-sale equity instruments held for investments. The Group's management has monitored the mix of debt and equity instruments in its investment portfolio based on market indices. Material investments within the portfolio are managed on an individual basis and all buy and sell decisions are approved by the Group's management.

As of December 31, 2010 and 2009, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income were as follows:

<i>In millions of won</i>		2010		2009	
		5% increase	5% decrease	5% increase	5% decrease
Other comprehensive income before tax	₩	13,338	(13,338)	25,536	(25,536)
Tax effect		(2,934)	2,934	(5,618)	5,618
	₩	10,404	(10,404)	19,918	(19,918)

(d) Management of Capital Risk

The fundamental goal of capital management is the maximization of shareholders' value by means of the stable dividend policy and the retirement of treasury shares. The capital structure of the Group consists of equity and net debt deducting cash and cash equivalents and current financial instruments from borrowings. The Group applied the same financial risk management strategy that was applied in the previous period.

As of December 31, 2010 and 2009, the Group defines net debt and equity attributable to owners of the Parent as follows:

<i>In millions of won</i>		2010	2009
Net debt:			
Debts (borrowings)	₩	68,552	97,006
Less:			
- Cash and cash equivalents		(981,314)	(316,672)
- Current other financial assets		(15,273)	(926)
- Current available-for-sale financial assets		(1,000)	(1,957)
	₩	(929,035)	(222,549)
Equity attributable to owners of the Parent	₩	4,556,179	3,980,890

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

31. Risk Management (Continued)

(e) Fair Value of Financial Instruments

The carrying amount and the fair value of financial instruments as of December 31, 2010 and 2009 are summarized as follows:

<i>In millions of won</i>	2010		2009	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets:				
Financial assets measured at fair value				
- Available-for-sale financial assets	₩ 315,177	315,17	444,040	444,040
- Long-term deposits in MSA Escrow Fund	132,414	132,414	118,121	118,121
- Other financial assets	15,919	15,919	1,212	1,212
- Cash and cash equivalents	981,314	981,314	316,672	316,672
	₩ 1,444,824	1,444,824	880,045	880,045
Financial assets measured at amortized cost				
- Trade and other receivables	₩ 740,949	740,949	730,851	730,851
	₩ 2,185,773	2,185,773	1,610,896	1,610,896
Liabilities:				
Financial liabilities measured at fair value				
	₩ -	-	-	-
Financial liabilities measured at amortized cost				
- Trade and other payables	₩ (197,299)	(197,299)	(214,842)	(214,842)
- Long-term borrowings	(1,540)	(1,540)	(2,026)	(2,026)
- Short-term borrowings	(66,507)	(66,507)	(94,532)	(94,532)
- Current portion of long-term borrowings	(506)	(506)	(448)	(448)
	₩ (265,852)	(265,852)	(311,848)	(311,848)
	₩ (265,852)	(265,852)	(311,848)	(311,848)

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

31. Risk Management (Continued)

(e) Fair Value of Financial Instruments (Continued)

The Fair Value Hierarchy

The Group classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The level of fair value hierarchy is as follows:

-
- Level I The quoted prices in active markets for identical assets or liabilities
 - Level II The inputs that are observable for the asset or liability, either directly or indirectly
 - Level III The inputs for the asset or liability that are not based on observable market data
-

The fair value measurements classified by fair value hierarchy as of December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>		Level I	Level II	Level III	Total
As of December 31, 2010:					
Financial assets					
- Available-for-sale financial assets	₩	252,294	40,403	22,480	315,177
- Long-term deposits in MSA Escrow Fund		132,414	-	-	132,414
- Other financial assets		15,919	-	-	15,919
- Cash and cash equivalents		981,314	-	-	981,314
	₩	1,381,941	40,403	22,480	1,444,824
As of December 31, 2009:					
Financial assets					
- Available-for-sale financial assets	₩	417,900	2,040	24,100	444,040
- Long-term deposits in MSA Escrow Fund		118,121	-	-	118,121
- Other financial assets		1,212	-	-	1,212
- Cash and cash equivalents		316,672	-	-	316,672
	₩	853,905	2,040	24,100	880,045

As Genematrix, Inc. was listed on KOSDAQ in the year ended December 31, 2009, available-for-sale equity instruments in Genematrix, Inc. were transferred from Level III to Level I.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

32. Contingent Liabilities and Financial Commitments

- (a) The Group deposited some proportion of sales in accordance with the Tobacco Master Settlement Agreement ("MSA") under the Escrow Statute of the United States government, related to the export of tobacco to the United States. The MSA Escrow Funds are maintained to pay the medical expenses of tobacco purchasers who have suffered health effects as a result of smoking. The unused portion of this fund will be refunded to the Group 25 years from the date that the fund was established. The Group recorded as long-term deposits the amounts paid into the MSA Escrow Funds of state governments in the United States against potential litigation and damages related to the export of tobacco into the United States.
- (b) As of December 31, 2010, tobacco lawsuits claiming damages of ₩584 million were filed against the Group and the Korean government. The plaintiffs have asserted that the Group and the Korean government did not perform their obligations to notify smokers of the potential health hazards of smoking. Additionally, as of December 31, 2010, the Group is involved in 11 lawsuits as a defendant for alleged damages totalling ₩5,247 million. The amount of the liability the Group may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of December 31, 2010.

After the reporting period, the Group won two tobacco lawsuits claiming damages of ₩484 million in the second trial on February 15, 2011.

- (c) As of December 31, 2010, the Group has entered into letter of credit agreements with Korea Exchange Bank and other banks with a limit set at USD53,300 thousand and JPY128,000 thousand.
- (d) As of December 31, 2010, the Group's trade receivables from the export of cigarettes were insured against non-payment up to USD 38,525 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.
- (e) As of December 31, 2010, the Group has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD70,000 thousand by Korea Exchange Bank and others.
- (f) As of December 31, 2010, the Group has maintained a contract with the farmers who grow six-year old green ginseng for purchase volume guarantees and recorded advance payments to the farmers amounted to ₩210,288 million in accordance with the contract.
- (g) The Group entered into an overdraft agreement with a limit of ₩10,000 million with the NACF and a discount on the commercial note agreement with a limit of ₩13,000 million with Hana Bank and other financial institutions as of December 31, 2010.
- (h) As of December 31, 2010, the Group provided two blank notes, 13 notes amounting to ₩14,200 million and five blank checks to Dae Han Investment Banking Corporation and others as collateral for its borrowings and trade agreements. As of December 31, 2010, one lost note provided as collateral is in the process of nullification.
- (i) As of December 31, 2010, the Group and 28 other companies, which form the Samsung Corporation – National Pension Service Joint Consortium, were guaranteed ₩240,000 million by Seoul Guarantee Insurance Co., Ltd. related to the Yongsan International Commercial Development Project.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

33. Non-current Assets Held for Sale

In 2006, the Group determined to dispose of land located in Pyeongtaek City, Gyeonggi-do for the purposes of improving its financial structure and investments in property, and entered into a contract to sell the land. The transacting party may terminate the contract if the land is not included in the area for development by Pyeongtaek City. Also, the Group entered into a contract to sell land located in Yongsan and Eulji-ro, Seoul for the year ended December 31, 2009.

The Group recognized non-current assets held for sale at the lower of its carrying amount and fair value less costs to sell. Non-current assets held for sale as of December 31, 2010 and 2009 are as follows:

<i>In millions of won</i>		2010	2009
Land located in Pyeongtaek City, Gyeonggi-do	₩	-	22,906
Land located in Yongsan, Seoul		-	2,521
Land located in Eulji-ro, Seoul		-	20,725
	₩	-	46,152

In 2010, the land located in Pyeongtaek City, Gyeonggi-do was reclassified to investment property due to the cancellation of the contract. The Group disposed of the land located in Yongsan and Eulji-ro, Seoul, for the year ended December 31, 2010 and recognized a ₩77,585 million gain on sale of property, plant and equipment.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

34. Cash Flows from Operating Activities

Details of cash generated from operations for the years ended December 31, 2010 and 2009 were as follows:

<i>In millions of won</i>	2010	2009
Profit for the years	₩ 1,030,789	850,094
Adjustments for:		
- Income tax expense	374,886	311,784
- Finance costs	4,469	6,526
- Finance income	(270,338)	(12,853)
- Depreciation	147,673	151,884
- Amortization	1,324	1,492
- Retirement and termination benefits	86,939	41,541
- Foreign currency translations loss	5,755	17,708
- Loss on the write-down of inventories	164	-
- Impairment loss on trade and other receivables	473	720
- Loss on sale of property, plant and equipment	2,386	7,496
- Impairment loss on property, plant and equipment	-	657
- Loss on sale of intangible assets	159	-
- Impairment loss on intangible assets	3,681	647
- Impairment loss on investment assets	1,437	-
- Other expense	7,237	4,154
- Share of loss of associates	287	191
- Share of gain of associates	-	(6)
- Reversal of loss on the write-down of inventories	-	(3,807)
- Foreign currency translations gain	(1,717)	(1,184)
- Gain on sale of property, plant and equipment	(101,886)	(17,033)
- Gain on sale of intangible assets	(24)	-
- Reversal of impairment loss on trade and other receivables	(216)	(46)
- Gain on sale of equity accounted investment	(300)	-
- Other income	-	(94)
	1,293,178	1,359,871
Changes in working capital:		
- Trade and other receivables	(51,650)	17,697
- Advance payments	(3,599)	(28,083)
- Prepaid expenses	(2,143)	(3,595)
- Prepaid tobacco excise and other taxes	(7,603)	32,333
- Inventories	14,122	48,067
- Trade and other payables	(23,947)	(122,072)
- Advance receipts	(13,257)	(46,045)
- Tobacco excise and other taxes payable	(25,193)	(20,147)
- Payment of retirement benefits	(81,201)	(54,184)
Cash generated from operations	₩ 1,098,707	1,183,842

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2010 and 2009

35. Dividends

Dividends and dividends per share proposed or declared before the consolidated financial statements were authorized for issue but not recognized as a distribution to owners during the years ended December 31, 2010 and 2009 are as follows:

<i>In millions of won, except share information and dividends per share</i>	2010	2009
Number of shares receivable dividend	127,648,800	127,198,800
Dividends per share in won	₩ 3,000	2,800
Total Dividends	382,946	356,157

36. Date of Authorization for Issue

The consolidated financial statements were authorized for issue on January 19, 2011, at the Board of Directors meeting.