

KT&G Corporation

**Interim Separate Financial Statements
September 30, 2014 and 2013**

KT&G Corporation
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September 30, 2014 and 2013

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Report on Review of Interim Financial Statements

To the Board of Directors and Shareholders of
KT&G Corporation

Reviewed Financial Statements

We have reviewed the accompanying interim separate financial statements of KT&G Corporation. These financial statements consist of the separate statement of financial position KT&G Corporation (the Company) as of September 30, 2014, and the related separate statements of comprehensive income for the three-month and nine-month periods ended September 30, 2014 and 2013, and the statements of changes in equity and cash flows for the nine-month periods ended September 30, 2014 and 2013, and a summary of significant accounting policies and other explanatory notes, expressed in Korean won.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these separate financial statements in accordance with the International Financial Reporting Standards as adopted by the Republic of Korea ('Korean IFRS') 1034, *Interim Financial Reporting*, and for such internal control as management determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to issue a report on these interim separate financial statements based on our reviews.

We conducted our reviews in accordance with the quarterly and semi-annual review standards established by the Securities and Futures Commission of the Republic of Korea. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the Republic of Korea and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our reviews, nothing has come to our attention that causes us to believe the accompanying interim separate financial statements do not present fairly, in all material respects, in accordance with the Korean IFRS 1034, *Interim Financial Reporting*.

Other Matters

We have audited the separate statement of financial position of KT&G Corporation as of December 31, 2013, and the related separate statements of comprehensive income, changes in equity and cash flows for the year then ended, in accordance with auditing standards generally accepted in the Republic of Korea. We expressed an unqualified opinion on those financial statements in our audit report dated February 12, 2014. These financial statements are not included in this review report. The separate statement of financial position as of December 31, 2013, presented herein for comparative purposes, is consistent, in all material respects, with the above audited statement of financial position as of December 31, 2013.

The accompanying interim separate financial statements as of and for the nine-month period ended September 30, 2014, have been translated into US dollars solely for the convenience of the reader and have been translated on the basis set forth in Note 33 to the interim separate financial statements.

Review standards and their application in practice vary among countries. The procedures and practices used in the Republic of Korea to review such financial statements may differ from those generally accepted and applied in other countries. Accordingly, this report is for use by those who are informed about Korean review standards and their application in practice.

Seoul, Korea
November 13, 2014

The report is effective as of November 13, 2014, the review report date. Certain subsequent events or circumstances, which may occur between the review report date and the time of reading this report, could have a material impact on the accompanying separate interim financial statements and notes thereto. Accordingly, the readers of the review report should understand that there is a possibility that the above review report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

KT&G Corporation
Interim Separate Statements of Financial Position
September 30, 2014 and December 31, 2013

<i>(in millions of Korean won and thousands of U.S. dollars)</i>	Notes	September 30, 2014 Korean won	September 30, 2014 U.S. dollars (Note 33)	December 31, 2013 Korean won
Assets				
Non-current assets				
Property, plant and equipment	9	₩ 1,191,456	\$ 1,134,072	₩ 1,182,763
Intangible assets	10	22,018	20,957	21,191
Investment property	4,11,13	141,504	134,689	146,034
Investments in associates	14	60,225	57,324	60,225
Investments in subsidiaries	14	1,200,883	1,143,045	1,166,478
Available-for-sale financial assets	4,5,6	304,174	289,524	296,391
Long-term deposits in MSA Escrow Fund	4,5,8,31	270,793	257,750	219,760
Long-term prepaid expenses		4,410	4,199	4,798
Long-term trade and other receivables	4,5,7,13,32	122,718	116,807	134,498
		<u>3,318,181</u>	<u>3,158,367</u>	<u>3,232,138</u>
Current assets				
Inventories	15	815,068	775,812	939,744
Other financial assets	4,5,16	640,000	609,176	660,000
Prepaid tobacco excise and other taxes		378,523	360,292	262,770
Trade and other receivables	4,5,7,32	860,462	819,019	721,468
Advance payments		41,161	39,178	16,472
Prepaid expenses		2,696	2,567	3,879
Cash and cash equivalents	4,5,16	333,761	317,686	245,838
		<u>3,071,671</u>	<u>2,923,730</u>	<u>2,850,171</u>
Assets held for sale	12	-	-	3
Total assets		<u>₩ 6,389,852</u>	<u>\$ 6,082,097</u>	<u>₩ 6,082,312</u>
Equity				
Capital stock	1,17	₩ 954,959	\$ 908,966	₩ 954,959
Other capital surplus	17	3,582	3,410	3,582
Treasury shares	18	(339,059)	(322,729)	(339,059)
Gain on reissuance of treasury shares	18	492,032	468,334	492,032
Reserve	19	3,510,455	3,341,381	3,411,099
Retained earnings	20	639,223	608,436	509,820
Total equity		<u>5,261,192</u>	<u>5,007,798</u>	<u>5,032,433</u>
Liabilities				
Non-current liabilities				
Long-term trade and other payables	4,5,21,32	26,563	25,284	28,269
Long-term advance receipts		2,690	2,560	3,676
Net defined benefit liability	23	82,277	78,314	60,273
Deferred income tax liabilities		58,423	55,609	53,823
		<u>169,953</u>	<u>161,767</u>	<u>146,041</u>
Current liabilities				
Borrowings	4,5,22	4,794	4,563	4,920
Trade and other payables	4,5,21,32	367,107	349,426	402,389
Advance receipts		2,654	2,525	17,231
Income taxes payable		141,806	134,976	136,285
Tobacco excise and other taxes payable		442,346	421,042	343,013
		<u>958,707</u>	<u>912,532</u>	<u>903,838</u>
Total liabilities		<u>1,128,660</u>	<u>1,074,299</u>	<u>1,049,879</u>
Total liabilities and equity		<u>₩ 6,389,852</u>	<u>\$ 6,082,097</u>	<u>₩ 6,082,312</u>

The accompanying notes are an integral part of these interim separate financial statements.

The US dollar figures are provided for information purposes only and do not form part of the separate financial statements. Refer to Note 33.

KT&G Corporation
Interim Separate Statements of Comprehensive Income
Three-Month Periods Ended September 30, 2014 and 2013

	Notes	Period Ended September 30		
		2014 Korean won	2014 U.S. dollars (Note 33)	2013 Korean won
<i>(in millions of Korean won and thousands of U.S. dollars, except per share amounts)</i>				
Sales				
Manufacture of tobacco		₩ 669,567	\$ 637,319	₩ 601,424
Real estate		29,725	28,293	32,744
Exports of leaf tobacco and others		23,094	21,982	12,800
	31,32	<u>722,386</u>	<u>687,594</u>	<u>646,968</u>
Cost of sales				
Manufacture of tobacco		(235,423)	(224,085)	(215,187)
Real estate		(16,099)	(15,323)	(18,608)
Exports of leaf tobacco and others		(14,938)	(14,218)	(8,813)
	15,25,32	<u>(266,460)</u>	<u>(253,626)</u>	<u>(242,608)</u>
Gross profit				
Selling and administrative expenses	24,25	(157,829)	(150,228)	(158,940)
		<u>298,097</u>	<u>283,740</u>	<u>245,420</u>
Operating income				
Other income	24,32	39,895	37,974	11,581
Other expenses	24,32	(5,985)	(5,697)	(106,239)
Net other income				
Finance income	26	30,674	29,197	9,905
Finance cost	26	(170)	(162)	(177)
Net finance income				
		<u>30,504</u>	<u>29,035</u>	<u>9,728</u>
Profit before income tax				
Income tax expense	27	(88,061)	(83,820)	(88,456)
Profit for the period				
		<u>₩ 274,450</u>	<u>\$ 261,232</u>	<u>₩ 72,034</u>
Other comprehensive income(loss), net of tax				
Items that will not be reclassified to profit or loss:				
Remeasurements of the net defined benefit liability		₩ (94)	\$ (89)	₩ (2,728)
Items that will be reclassified subsequently to profit or loss:				
Change in value of available-for-sale financial assets		(9,473)	(9,017)	18,730
Other comprehensive income(loss) for the period, net of tax				
		<u>(9,567)</u>	<u>(9,106)</u>	<u>16,002</u>
Total comprehensive income for the period				
		<u>264,883</u>	<u>252,126</u>	<u>88,036</u>
Earnings per share attributable to the equity holders of the Company during the period (in won)				
Basic and diluted earnings per share	28	<u>₩ 2,180</u>	<u>\$ 2.00</u>	<u>₩ 572</u>

The accompanying notes are an integral part of these interim separate financial statements.
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KT&G Corporation
Interim Separate Statements of Comprehensive Income
Nine-Month Periods Ended September 30, 2014 and 2013

	Notes	Period Ended September 30		
		2014 Korean won	2014 U.S. dollars (Note 33)	2013 Korean won
<i>(in millions of Korean won and thousands of U.S. dollars, except per share amounts)</i>				
Sales				
Manufacture of tobacco		₩ 1,853,414	\$ 1,764,148	₩ 1,715,177
Real estate		110,987	105,642	71,041
Exports of leaf tobacco and others		60,460	57,548	42,703
	31,32	<u>2,024,861</u>	<u>1,927,338</u>	<u>1,828,921</u>
Cost of sales				
Manufacture of tobacco		(668,803)	(636,591)	(609,135)
Real estate		(64,770)	(61,651)	(34,571)
Exports of leaf tobacco and others		(39,276)	(37,385)	(27,308)
	15,25,32	<u>(772,849)</u>	<u>(735,627)</u>	<u>(671,014)</u>
Gross profit				
Selling and administrative expenses	24,25	(467,925)	(445,388)	(459,866)
		<u>784,087</u>	<u>746,323</u>	<u>698,041</u>
Operating income				
Other income	24,32	27,890	26,546	39,556
Other expenses	24,32	(24,117)	(22,955)	(75,658)
Net other income				
Finance income	26	55,505	52,832	33,049
Finance cost	26	(648)	(617)	(15,562)
Net finance income				
		<u>54,857</u>	<u>52,215</u>	<u>17,487</u>
Profit before income tax				
Income tax expense	27	(205,322)	(195,433)	(216,359)
Profit for the period				
		<u>₩ 637,395</u>	<u>\$ 606,696</u>	<u>₩ 463,067</u>
Other comprehensive income(loss), net of tax				
Items that will not be reclassified to profit or loss:				
Remeasurements of the net defined benefit liability		₩ (595)	\$ (566)	₩ (2,699)
Items that will be reclassified subsequently to profit or loss:				
Change in value of available-for-sale financial assets		(5,165)	(4,918)	13,674
Other comprehensive income(loss) for the period, net of tax				
		<u>(5,760)</u>	<u>(5,484)</u>	<u>10,975</u>
Total comprehensive income for the period				
		<u>631,635</u>	<u>601,212</u>	<u>474,042</u>
Earnings per share attributable to the equity holders of the Company during the period (in won)				
Basic and diluted earnings per share	28	₩ 5,063	\$ 5.00	₩ 3,678

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KT&G Corporation
Interim Separate Statements of Changes in Equity
Nine-Month Periods Ended September 30, 2014 and 2013

(in millions of Korean won)

	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
Balance at January 1, 2013	₩ 954,959	₩ 3,582	₩ (339,059)	₩ 492,032	₩ 3,039,034	₩ 752,766	₩ 4,903,314
Total comprehensive income							
Profit for the period	-	-	-	-	-	463,067	463,067
Other comprehensive income							
Change in value of available-for-sale financial assets	-	-	-	-	13,675	-	13,675
Remeasurements of the net defined benefit liability	-	-	-	-	-	(2,699)	(2,699)
Total other comprehensive income (loss)	-	-	-	-	13,675	(2,699)	10,976
Total comprehensive income	-	-	-	-	13,675	460,368	474,043
Transactions with equity holders of the Company	-	-	-	-	-	-	-
Cash dividends	-	-	-	-	-	(402,876)	(402,876)
Other reserve	-	-	-	-	317,000	(317,000)	-
Transfer from reserve for research and human resources development	-	-	-	-	30,000	(30,000)	-
Total transactions with equity holders of the Company	-	-	-	-	347,000	(749,876)	(402,876)
Balance at September 30, 2013	₩ 954,959	₩ 3,582	₩ (339,059)	₩ 492,032	₩ 3,399,709	₩ 463,258	₩ 4,974,481
Balance at January 1, 2014	₩ 954,959	₩ 3,582	₩ (339,059)	₩ 492,032	₩ 3,411,099	₩ 509,820	₩ 5,032,433
Total comprehensive income							
Profit for the period	-	-	-	-	-	637,395	637,395
Other comprehensive income							
Change in value of available-for-sale financial assets	-	-	-	-	(5,165)	-	(5,165)
Remeasurements of the net defined benefit liability	-	-	-	-	-	(595)	(595)
Total other comprehensive income (loss)	-	-	-	-	(5,165)	(595)	(5,760)
Total comprehensive income	-	-	-	-	(5,165)	636,800	631,635
Transactions with equity holders of the Company	-	-	-	-	-	-	-
Cash dividends	-	-	-	-	-	(402,876)	(402,876)
Transfer from reserve for research and human resources development	-	-	-	-	(47,479)	47,479	-
Other reserve	-	-	-	-	152,000	(152,000)	-
Total transactions with equity holders of the Company	-	-	-	-	104,521	(507,397)	(402,876)
Balance at September 30, 2014	₩ 954,959	₩ 3,582	₩ (339,059)	₩ 492,032	₩ 3,510,455	₩ 639,223	₩ 5,261,192

The accompanying notes are an integral part of these interim separate financial statements.

KT&G Corporation
Interim Separate Statements of Changes in Equity
Nine-Month Periods Ended September 30, 2014 and 2013

(in thousands of U.S. dollars) (Note 33)

	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
Balance at January 1, 2014	\$ 908,966	\$ 3,410	\$ (322,729)	\$ 468,334	\$ 3,246,811	\$ 485,266	\$ 4,790,058
Total comprehensive income							
Profit for the period	-	-	-	-	-	606,696	606,696
Other comprehensive income							
Change in value of available-for-sale financial assets	-	-	-	-	(4,918)	-	(4,918)
Remeasurements of the net defined benefit liability	-	-	-	-	-	(566)	(566)
Total other comprehensive loss	-	-	-	-	(4,918)	(566)	(5,484)
Total comprehensive income(loss)	-	-	-	-	(4,918)	606,130	601,212
Transactions with equity holders of the Company							
Cash dividends	-	-	-	-	-	(383,472)	(383,472)
Transfer from reserve for research and human resources development	-	-	-	-	(45,192)	45,192	-
Other reserve	-	-	-	-	144,680	(144,680)	-
Total transactions with equity holders of the Company	-	-	-	-	99,488	(482,960)	(383,472)
Balance at September 30, 2014	<u>\$ 908,966</u>	<u>\$ 3,410</u>	<u>\$ (322,729)</u>	<u>\$ 468,334</u>	<u>\$ 3,341,381</u>	<u>\$ 608,436</u>	<u>\$ 5,007,798</u>

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KT&G Corporation
Interim Separate Statements of Cash Flows
Nine-Month Periods Ended September 30, 2014 and 2013

	Notes	Period Ended September 30		
		2014 Korean won	2014 U.S. dollars (Note 33)	2013 Korean won
<i>(in millions of Korean won and thousands of U.S. dollars)</i>				
Cash flows from operating activities				
Cash generated from operations	30	₩ 784,096	\$ 746,332	₩ 755,987
Income tax paid		(193,363)	(184,051)	(212,218)
Net cash generated from operating activities		<u>590,733</u>	<u>562,281</u>	<u>543,769</u>
Cash flows from investing activities				
Interest received		22,819	21,720	24,611
Investment income received from long-term deposits in MSA Escrow Fund		1,107	1,054	845
Dividends received		7,796	7,420	6,889
Proceeds from sale of property, plant and equipment		5,635	5,363	5,552
Proceeds from sale of intangible assets		-	-	1
Proceeds from sale of assets held for sale		55	52	7,471
Proceeds from sale of investments in subsidiaries		84	80	-
Decrease in loans		11,148	10,611	10,175
Decrease in guarantee deposits		16,389	15,600	12,934
Decrease in other financial assets		20,000	19,037	470,000
Acquisition of property, plant and equipment		(88,016)	(83,777)	(84,559)
Acquisition of intangible assets		(873)	(831)	(1,242)
Acquisition of investment property		(77)	(74)	(1,422)
Acquisition of investments in subsidiaries		(3,244)	(3,087)	(25,746)
Acquisition of available-for-sale financial assets		(19,700)	(18,751)	-
Increase in loans		(2,265)	(2,156)	(32,339)
Increase in guarantee deposits		(17,743)	(16,889)	(12,777)
Increase in long-term deposits in MSA Escrow Fund		(52,036)	(49,530)	(41,772)
Net cash provided by(used in) investing activities		<u>(98,921)</u>	<u>(94,158)</u>	<u>338,621</u>
Cash flows from financing activities				
Dividends paid	29	(402,876)	(383,472)	(402,876)
Increase in deposits received		1,654	1,574	3,083
Decrease in deposits received		(2,730)	(2,599)	(3,273)
Net cash used in financing activities		<u>(403,952)</u>	<u>(384,497)</u>	<u>(403,066)</u>
Net increase in cash and cash equivalents		87,860	83,626	479,324
Cash and cash equivalents at the beginning of period		245,838	233,998	266,720
Exchange income(loss) on cash and cash equivalents		63	60	(66)
Cash and cash equivalents at the end of period		<u>₩ 333,761</u>	<u>\$ 317,684</u>	<u>₩ 745,978</u>

The accompanying notes are an integral part of these interim separate financial statements.

The US dollar figures are provided for information purposes only and do not form part of the separate financial statements. Refer to Note 33.

KT&G Corporation

Notes to Interim Separate Financial Statements

September 30, 2014 and 2013, and December 31, 2013

1. Information

General information about KT&G Corporation (the "Company") is as follows.

The Company, which is engaged in manufacturing and selling tobaccos, 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 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 Company was excluded from the application of the Act for the Management of Government Invested Enterprises. Accordingly, the Company became an entity existing and operating under the Commercial Code of Korea. The Korean government sold 28,650,000 shares of the Company to the public during 1999 and the Company listed its shares on the Korea Exchange (formerly the Korea Stock Exchange) on October 8, 1999. On December 27, 2002, the Company changed its name again to KT&G Corporation from Korea Tobacco and Ginseng Corporation.

As of September 31, 2014, the Company has three manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 131 branches for the sale of tobacco throughout the country. Also, the 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 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 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 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 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 Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program. Also, on June 25, 2009, the market of the Company's GDR was changed from the BdL Market to the Euro MTF in the Luxembourg Stock Exchange.

KT&G Corporation
Notes to Interim Separate Financial Statements
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The ownership of the Company's issued ordinary shares as of September 31, 2014, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee share ownership association	2,483,393	1.81%
Others	113,904,922	82.96%
	125,898,800	91.70%
Treasury shares	11,393,697	8.30%
	137,292,497	100.00%

2. Significant Accounting Policies

The principal accounting policies applied in the preparation of these separate financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

2.1 Basis of Preparation

These separate interim financial statements as of and for the nine-month periods ended September 30, 2014, have been prepared in accordance with Korean IFRS 1034, *Interim financial reporting*. The principles used in the preparation of these financial statements are based on Korean IFRS and interpretations effective as of September 30, 2014, or early adopted.

(a) New and amended standards adopted by the Company

The Company newly applied the following amended and enacted standards for the annual period beginning on January 1, 2014:

Amendments to K-IFRS 1032, *Financial Instruments: Presentation*

According to the amendment of K-IFRS 1032, *Financial Instruments: Presentation*, it is clarified that a right to offset must be legally enforceable in all of the circumstances not being contingent on a future event, and if an entity can settle amounts in a manner such that the outcome is, in effect, equivalent to net settlement, the entity will meet the net settlement criterion. There is no significant impact of the application of this amendment on the separate financial statements.

KT&G Corporation

Notes to Interim Separate Financial Statements

September 30, 2014 and 2013, and December 31, 2013

Amendment to K-IFRS 1039, *Financial Instruments: Recognition and Measurement*

Amendment to K-IFRS 1039, *Financial Instruments: Recognition and Measurement*, allows the continuation of hedge accounting for a derivative that has been designated as a hedging instrument in a circumstance in which that derivative is novated to a central counterparty (CCP) as a consequence of laws or regulations. There is no significant impact of the application of this amendment on the separate financial statements.

Enactment of K-IFRS 2121, *Levies*

K-IFRS 2121, *Levies*, is applied to a liability to pay a levy imposed by a government in accordance with the legislation. The interpretation requires that the liability to pay a levy is recognized when the activity that triggers the payment of the levy occurs, as identified by the legislation (the obligating event). There is no significant impact of the application of this amendment on the separate financial statements.

2.2 Subsidiaries and Associates

These separate financial statements are prepared and presented in accordance with K-IFRS No. 1027. The Company applied the cost method to investments in subsidiaries and associates in accordance with K-IFRS No.1027. The carrying amount of investment in Korea Ginseng Corporation under previous Korean Generally Accepted Accounting Principles on the date of transition to K-IFRS is considered to be the deemed cost of investments in subsidiaries on the date of transition. Dividends from a subsidiary or associate are recognized in profit or loss when the right to receive the dividend is established.

2.3 Segment Reporting

Operating segments are reported in the consolidated financial statements in accordance with Korean-IFRS 1108, *Operating Segments*.

2.4 Foreign Currency Translation

(a) *Functional and presentation currency*

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The financial statements are presented in Korean won, which is the controlling entity's functional and presentation currency.

(b) *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss.

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Exchange differences arising on non-monetary financial assets and liabilities such as equity instruments at fair value through profit or loss and available-for-sale equity instruments are recognized in profit or loss and included in other comprehensive income, respectively, as part of the fair value gain or loss.

2.5 Cash and Cash Equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less.

2.6 Financial Assets

2.6.1 Classification and Measurement

The Company classifies its financial assets in the following categories: financial assets at fair value through profit or loss, available-for-sale financial assets, loans and receivables, and held-to-maturity financial assets. Regular purchases and sales of financial assets are recognized on trade date.

Regular purchases and sales of financial assets are recognized on the trade date. At initial recognition, financial assets are measured at fair value plus, in the case of financial assets not carried at fair value through profit or loss, transaction costs. Transaction costs of financial assets carried at fair value through profit or loss are expensed in the statement of income. After the initial recognition, available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables, and held-to-maturity investments are subsequently carried at amortized cost using the effective interest rate method.

Changes in fair value of financial assets at fair value through profit or loss are recognized in profit or loss and changes in fair value of available-for-sale financial assets are recognized in other comprehensive income. When the available-for-sale financial assets are sold or impaired, the fair value adjustments recorded in equity are reclassified into profit or loss.

2.6.2 Impairment

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or a group of financial assets that can be reliably estimated.

Impairment of loans and receivables is presented as a deduction in an allowance account. Impairment of other financial assets is directly deducted from their carrying amount. The Company writes off financial assets when the assets are determined to be no longer recoverable.

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The objective evidence that a financial asset is impaired includes significant financial difficulty of the issuer or obligor; a delinquency in interest or principal payments; or the disappearance of an active market for that financial asset because of financial difficulties.

2.6.3 Derecognition

If the Company transfers a financial asset and the transfer does not result in derecognition because the Company has retained substantially of all risks and rewards of ownership of the transferred asset due to a recourse in the event the debtor defaults, the Company continues to recognize the transferred asset in its entirety and recognizes a financial liability for the consideration received. The related financial liability is classified as 'borrowings' in the statement of financial position.

2.7 Trade Receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets. Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less allowance for doubtful accounts.

2.8 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 ₩ 251,425 million and ₩ 316,168 million as of September 30, 2014 and December 31, 2013, respectively.

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2.9 Non-current Assets (or disposal group) Held for Sale

Non-current assets (or disposal group) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell.

2.10 Property, Plant and Equipment

All property, plant and equipment are stated at historical cost less depreciation and accumulated impairment loss. Historical cost includes expenditures directly attribute to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between their cost and their residual values over their estimated useful lives, as follows:

Buildings	10 - 60 years
Structures	10 - 40 years
Machinery	10 - 12 years
Vehicle	4 years
Tools and equipment	4 years
Supplies	4 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within 'other income and expenses, net' in the statement of comprehensive income.

2.11 Borrowing Costs

Borrowing costs incurred in the acquisition or construction of a qualifying asset are capitalized in the period when it is prepared for its intended use, and investment income earned on the temporary investment of borrowings made specifically for the purpose obtaining a qualifying asset is deducted from the borrowing costs eligible for capitalization during the period. Other borrowing costs are recognized as expenses for the period in which they are incurred.

2.12 Government Grants

Government grants are recognized at their fair values when there is reasonable assurance that the

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grant will be received and the Company will comply with the conditions attaching to it. Government grants related to assets are presented by deducting the grants in arriving at the carrying amount of the assets, and grants related to income are deferred and presented by deducting the related expenses for the purpose of the government grants.

2.13 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, facility usage rights and other intangible assets. 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 facility usage rights and some of the industrial property rights are expected to be available for use, these intangible assets are regarded as having indefinite useful lives and not amortized.

The estimated useful lives are as follows:

Industrial property rights	10 - 20 years or indefinite
Facility usage rights	Indefinite
Other intangible assets	4 years

Amortization periods and amortization methods for intangible assets with finite useful lives are reviewed at the end of each reporting period. The useful lives of intangible assets that are not being amortized are reviewed at the end of each reporting period to determine whether events and circumstances continue to support indefinite useful life assessment for those assets. The change is accounted for as a change in an accounting.

2.14 Investment Property

Property held to earn rentals or for capital appreciation or both is classified as investment property. Investment property is measured initially at its cost. After recognition as an asset, investment property is carried at cost less accumulated depreciation and impairment losses. Investment property, except for land, is depreciated using the straight-line method over their useful lives from 10 to 60 years.

2.15 Impairment of Non-financial Assets

Goodwill or intangible assets with indefinite useful lives are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Non-financial assets, other than goodwill, that suffered impairment

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are reviewed for possible reversal of the impairment at each reporting date.

2.16 Financial Liabilities

(a) Classification and measurement

Financial liabilities at fair value through profit or loss are financial instruments held for trading. Financial liabilities are classified in this category if incurred principally for the purpose of repurchasing them in the near term. Derivatives that are not designated as hedges or bifurcated from financial instruments containing embedded derivatives are also categorized as held-for-trading.

The Company classifies non-derivative financial liabilities, except for financial liabilities at fair value through profit or loss, financial guarantee contracts and financial liabilities that arise when a transfer of financial assets does not qualify for derecognition, as financial liabilities carried at amortized cost and presented as 'trade payables', 'borrowings', and 'other financial liabilities' in the statement of financial position.

Preferred shares that provide for a mandatory redemption at a particular date are classified as liabilities. Interest expenses on these preferred shares calculated using the effective interest method are recognized in the statement of income as 'finance costs', together with interest expenses recognized on other financial liabilities.

(b) Derecognition

Financial liabilities are removed from the statement of financial position when it is extinguished, for example, when the obligation specified in the contract is discharged, cancelled or expired or when the terms of an existing financial liability are substantially modified.

2.17 Financial Guarantee Contracts

Financial guarantees contracts provided by the Company are initially measured at fair value on the date the guarantee was given. Subsequent to initial recognition, the Company's liabilities under such guarantees are measured at the higher of the amounts below and recognized as 'other financial liabilities':

- the amount determined in accordance with Korean IFRS 1037, *Provisions, Contingent Liabilities and Contingent Assets*; or
- the initial amount, less accumulated amortization recognized in accordance with Korean IFRS1018, *Revenue*.

2.18 Trade Payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is

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due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

2.19 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of comprehensive income over the period of the borrowings using the effective interest method. The Company recognizes borrowings as current assets unless it has an unconditional right to delay the settlement of the borrowing.

2.20 Compound Financial Instruments

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially on the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

2.21 Provisions

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation and the increase in the provision due to passage of time is recognized as interest expense.

2.22 Income Tax Expense

Interim period income tax expense is accrued based on the best estimate of the weighted average annual income tax rate expected for the full financial year, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

2.23 Employee Benefits

(a) Defined benefit liability

The Company operates various pension schemes. The schemes are generally funded through payments to insurance companies or trustee-administered funds, determined by periodic actuarial calculations. The Company has both defined benefit and defined contribution plans.

A defined contribution plan is a pension plan under which the Company pays fixed contributions into a separate entity. The Company has no legal or constructive obligations to pay further

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contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. For defined contribution plans, the Company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Company has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense when they are due. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in the future payments is available.

A defined benefit plan is a pension plan that is not a defined contribution plan. Typically defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognized in the statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognized past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Past-service costs are recognized immediately in income, while costs are amortized over the vesting period.

(b) Termination benefits

Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits when it is demonstrably committed to a termination when the entity has a detailed formal plan to terminate the employment of current employees without possibility of withdrawal and in the case of an offer made to encourage voluntary redundancy.

2.24 Share Capital

Where the Parent Company purchases its own equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued. Where such ordinary shares are subsequently reissued, any consideration received is included in equity attributable to the Company's equity holders.

2.25 Revenue Recognition

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

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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 Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company 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 Company 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 the nine-month periods ended September 30, 2014 and 2013, were ₩ 2,615,628 million and ₩ 2,606,373 million, respectively.

Revenue from the construction of real estate includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognized in profit or loss in proportion to the stage of completion of the contract. The stage of completion is assessed by reference to surveys of work performed. Meanwhile, profits from an apartment house for self-installment sales is recognized on percentage-of-completion method according to Q&A of Korea Accounting Institute, called 2011-I-KQA. This accounting standard is effective upon Korean Corporation Financial Reporting Standards of Laws on External Audit of Corporation (Article 13, Section 1, Paragraph 1)

Revenue from 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 Company, 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 from the use by others of the Company's assets yielding interest, royalties and dividends is recognized when it is probable that the economic benefits associated with the transaction will flow to the Company 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 the dividend is established.

2.26 Lease

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of income on a straight-line basis over the period of the lease.

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2.27 Dividend Distribution

A dividend liability is recognized in the financial statements when the dividends are approved by the shareholders.

3. Critical Accounting Estimates and Judgments

The Company makes estimates and assumptions concerning the future. The estimates and assumptions are continuously evaluated with consideration to factors such as events reasonably predictable in the foreseeable future within the present circumstance according to historical experience. The resulting accounting estimates will, by definition, seldom equal the related actual results.

Significant accounting estimates and assumptions made in preparing interim financial statements are the same those made in preparing the prior financial statements, except for the estimating method used in deriving income tax expenses.

4. Financial Risk Management

4.1 Financial Risk Factors

The Company's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. The Company uses derivative financial instruments to hedge certain risk exposures.

Risk management is carried out by a central treasury department (Company treasury) under policies approved by the board of directors. The Company treasury identifies, evaluates and hedges financial risks in close co-operation with the Company's operating units. The board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity. The Company applied the same financial risk management strategy that was applied in the previous period.

(a) Market Risk

i) Foreign exchange risk

The Company 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 Company'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.

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The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014				December 31, 2013			
	USD	EUR	RUB	THB and Others	USD	EUR	RUB	THB and Others
Assets								
Cash and cash equivalents	₩ 11,824	₩ 3	₩ -	₩ -	₩ 10,926	₩ 27	₩ -	₩ -
Trade and other receivables	497,445	27,751	1,874	48,169	439,194	27,932	1,873	47,073
Long-term deposits	270,794	-	-	-	219,760	-	-	-
	<u>780,063</u>	<u>27,754</u>	<u>1,874</u>	<u>48,169</u>	<u>₩ 669,880</u>	<u>₩ 27,959</u>	<u>₩ 1,873</u>	<u>₩ 47,073</u>
Liabilities								
Trade and other payables	6,982	8,809	-	-	₩ 30,655	₩ 10,993	₩ -	₩ -

As of September 30, 2014 and December 31, 2013, the effects of a 10% strengthening or weakening of functional currency against the US dollar other than functional currency on profit before tax were as follows:

<i>(in millions of Korean won)</i>	September 30, 2014		December 31, 2013	
	10% strengthening	10% weakening	10% strengthening	10% weakening
US dollar	₩ 77,308	₩ (77,308)	₩ 63,923	₩ (63,923)

ii) Price risk

The Company 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 Company'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 Company's management.

As of September 30, 2014 and December 31, 2013, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014		December 31, 2013	
	5% increase	5% decrease	5% increase	5% decrease
Other comprehensive income before tax	₩ 8,441	₩ (8,441)	₩ 6,811	₩ (6,811)
Tax effect	(2,043)	2,043	(1,648)	1,648
Other comprehensive income after tax	<u>₩ 6,398</u>	<u>₩ (6,398)</u>	<u>₩ 5,163</u>	<u>₩ (5,163)</u>

iii) Interest rate risk

The Company 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 Company's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation.

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(b) Credit Risk

The Company is exposed to credit risk which arises from counterparty's non-performance of obligation. The Company 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 Company has been provided with 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 Company's assets.

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of September 30, 2014 and December 31, 2013, is as follows:

<i>(in millions of Korean won)</i>	September 30, 2014	December 31, 2013
Available-for-sale financial assets	₩ 2,500	₩ 2,500
Long-term deposits in MSA Escrow Fund	270,794	219,760
Trade and other receivables	983,179	855,966
Other financial assets	640,000	660,000
Cash and cash equivalents	333,761	245,838
Financial guarantee contracts	152,263	152,263

(c) Liquidity Risk

The Company has exposure to the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Company'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 Company's management determines whether or not the financial liabilities are repayable with the operating cash flows and cash inflows from financial assets.

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The maturity analysis by a residual contractual maturity of financial liabilities as of September 30, 2014 and December 31, 2013, is as follows:

(in millions of Korean won)

	September 30, 2014					
	Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
Trade and other payables	₩ 246,743	₩ 247,911	₩ 220,180	₩ -	₩ 27,731	₩ -
Short-term borrowings	4,794	4,794	4,794	-	-	-
Financial guarantee contracts ¹	-	152,263	-	152,263	-	-

(in millions of Korean won)

	December 31, 2013					
	Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
Trade and other payables	₩ 307,074	₩ 308,297	₩ 278,805	₩ -	₩ 29,492	₩ -
Short-term borrowings	4,920	4,920	4,920	-	-	-
Financial guarantee contracts ¹	-	152,263	-	-	152,263	-

¹ The maximum guaranteed amount of financial guarantee contracts (Note 31)

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

4.2 Capital Management

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 Company consists of equity and net debt deducting cash and cash equivalents and current financial instruments from borrowings. The Company applied the same financial risk management strategy that was applied in the previous period.

As of September 30, 2014 and December 31, 2013, the Company defines net debt and equity attributable to owners of the Parent as follows:

(in millions of Korean won)

	September 30, 2014	December 31, 2013
Total borrowings	₩ 4,794	₩ 4,920
Less:		
-Cash and cash equivalents	(333,761)	(245,838)
-Other financial assets, current	(640,000)	(660,000)
Net debt(Net asset)	(968,967)	(900,918)
Equity attributable to owners of the parent	₩ 5,261,193	₩ 5,032,435

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4.3 Fair Value

There are no significant changes in business and economic circumstances which impact the fair value of financial assets and liabilities of the Company for the nine-month period ended September 30, 2014.

(a) Fair Value by Financial Instruments

Book value and fair value by financial instruments consists of the following:

(in millions of Korean won)

	September 30, 2014		December 31, 2013	
	Book value	Fair value	Book value	Fair value
Financial assets				
Available-for-sale assets ¹	₩ 284,581	₩ 284,581	₩ 279,797	₩ 279,797
Long-term deposits	270,794	270,794	219,760	219,760
Long-term trade and other receivables	122,718	122,718	134,498	134,498
Other financial assets	640,000	640,000	660,000	660,000
Trade and other receivables	860,462	860,462	721,468	721,468
Cash and cash equivalents	333,761	333,761	245,838	245,838
	<u>₩ 2,512,316</u>	<u>₩ 2,512,316</u>	<u>₩ 2,261,361</u>	<u>₩ 2,261,361</u>
Financial liabilities				
Long-term trade and other payables	₩ 26,563	₩ 26,563	₩ 28,269	₩ 28,269
Short-term borrowings	4,794	4,794	4,920	4,920
Trade and other payables	220,180	220,180	278,805	278,805
	<u>₩ 251,537</u>	<u>₩ 251,537</u>	<u>₩ 311,994</u>	<u>₩ 311,994</u>

¹ Equity instruments that do not have a quoted price in an active market are measured at cost because their fair value cannot be measured reliably and excluded from the fair value disclosures.

(b) Financial Instruments Measured at Cost

Details of financial instruments measured at cost consist of the following:

(in millions of Korean won)

	September 30, 2014	December 31, 2013
Available-for-sale financial assets		
MASTERN 2 Co., Ltd.	₩ 10,000	₩ 10,000
U&i Corp.	3,000	3,000
SJ BIOMED Inc.	1,000	1,000
Ktoto Co.,Ltd	3,000	-
Others	2,593	2,594
	<u>₩ 19,593</u>	<u>₩ 16,594</u>

MASTERN 2 REIT equity and others are non-listed equity investments and are measured using cost method as their fair value cannot be reliably estimated.

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(c) Fair Value Hierarchy

Assets measured at fair value or for which the fair value is disclosed are categorized within the fair value hierarchy, and the defined levels are as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

Fair value hierarchy classifications of the financial assets and financial liabilities that are measured at fair value or its fair value is disclosed as of September 30, 2014, are as follows:

<i>(in millions of Korean won)</i>	Level 1	Level 2	Level 3	Total
Recurring fair value measurements				
Available-for-sale financial assets	₩ 201,317	₩ 83,264	₩ -	₩ 284,581
Disclosed fair value				
Investment property	-	-	461,378	461,378

The fair value of financial instruments traded in active markets is based on quoted market prices at the statement of financial position date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, an entity in the same industry, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Company is the current bid price. These instruments are included in Level 1. Instruments included in Level 1 consist primarily of KOSPI and KOSDAQ equity investments classified as trading securities or available for sale.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the statement of financial position date, with the resulting value

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discounted back to present value.

- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

(d) Valuation Technique and the Inputs

Valuation techniques and inputs used in the recurring, non-recurring fair value measurements and disclosed fair values categorized within Level 2 and Level 3 of the fair value hierarchy as of September 30, 2014, are as follows:

<i>(in millions of Korean won)</i>	Fair value	level	Valuation techniques
Available-for-sale financial assets			
Real estate investment trusts	₩ 83,264	2	Market approach
Investment property			
Investment property	461,378	3	Yield capitalization method and other method

5. Financial Instruments by Category

Categorizations of financial assets as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014		
	Loans and receivables	Assets classified as available-for-sale	Total
Available-for-sale financial assets, non-current	₩ -	₩ 304,174	₩ 304,174
Long-term deposits in MSA Escrow Fund	270,794	-	270,794
Long-term trade and other receivables	122,718	-	122,718
Other financial assets, current	640,000	-	640,000
Trade and other receivables	860,462	-	860,462
Cash and cash equivalents	333,761	-	333,761
	<u>₩ 2,227,735</u>	<u>₩ 304,174</u>	<u>₩ 2,531,909</u>

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	December 31, 2013		
	Loans and receivables	Assets classified as available-for-sale	Total
Available-for-sale financial assets, non-current	₩ -	₩ 296,391	₩ 296,391
Long-term deposits in MSA Escrow Fund	219,760	-	219,760
Long-term trade and other receivables	134,498	-	134,498
Other financial assets, current	660,000	-	660,000
Trade and other receivables	721,468	-	721,468
Cash and cash equivalents	245,838	-	245,838
	<u>₩ 1,981,564</u>	<u>₩ 296,391</u>	<u>₩ 2,277,955</u>

Categorizations of financial liabilities as of September 30, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

	September 30, 2014		
	Other financial liabilities at amortized cost	Other financial liabilities	Total
Long-term trade and other payables	₩ 26,563	₩ -	₩ 26,563
Short-term borrowings	-	4,794	4,794
Trade and other payables	220,180	-	220,180
	<u>₩ 246,743</u>	<u>₩ 4,794</u>	<u>₩ 251,537</u>

(in millions of Korean won)

	December 31, 2013		
	Other financial liabilities at amortized cost	Other financial liabilities	Total
Long-term trade and other payables	₩ 28,269	₩ -	₩ 28,269
Short-term borrowings	-	4,920	4,920
Trade and other payables	278,805	-	278,805
	<u>₩ 307,074</u>	<u>₩ 4,920</u>	<u>₩ 311,994</u>

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Income and loss of financial instruments by category for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014		2013	
	Three months	Nine months	Three months	Nine months
Available-for-sale financial assets				
Gain(Loss) on valuation (Other comprehensive income)	₩ (9,473)	₩ (5,166)	₩ 18,730	₩ 13,674
Profit on disposal (Profit or loss)	20,121	20,121	-	-
Interest income	13	38	7	22
Dividend income	631	7,796	683	6,889
Impairment loss	-	-	-	(15,000)
Cash and cash equivalents				
Interest income	7,211	20,049	6,167	18,204
Gain(loss) on foreign currency translation	104	63	(63)	(67)
Gain(Loss) on foreign currency transaction	374	(169)	(848)	(25)
Trade and other receivables				
Interest income	2,464	6,942	2,306	6,975
Gain(loss) on foreign currency translation	28,471	225	(58,137)	(17,745)
Gain(Loss) on foreign currency transaction	(2,144)	(4,702)	1,323	7,327
Other financial liabilities at amortized cost				
Interest costs	(170)	(648)	(177)	(562)
Gain on foreign currency translation	(334)	(160)	415	83
Gain(Loss) on foreign currency transaction	115	874	512	(1,173)

6. Available-for-sale Financial Assets

The changes in available-for-sale financial assets for the nine-month periods ended September 30, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014	2013
Beginning	₩ 296,391	₩ 264,544
Additions	19,700	-
Gain on valuation	13,014	15,253
Net gains transfer from equity	-	2,787
Impairment loss	-	(15,000)
Disposal	(24,931)	-
Ending	304,174	267,584
Less: current portion	-	(1,000)
Non-current portion	₩ 304,174	₩ 266,584

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Available-for-sale financial assets as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014	December 31, 2013
Available-for-sale debt instruments:		
Corporate bonds	₩ 2,500	₩ 2,500
Total available-for-sale debt instruments	<u>2,500</u>	<u>2,500</u>
Available-for-sale equity instruments:		
Listed		
Yonhap Television News(YTN)	-	23,380
Oscotech, Inc.	1,072	916
Shinhan Financial Group Co., Ltd.	194,806	189,595
Rexahn Pharmaceuticals, Inc.	5,439	3,440
	<u>201,317</u>	<u>217,331</u>
Unlisted	<u>100,357</u>	<u>76,560</u>
	<u>100,357</u>	<u>76,560</u>
Total available-for-sale equity instruments	<u>301,674</u>	<u>293,891</u>
Total available-for-sale financial assets	<u>₩ 304,174</u>	<u>₩ 296,391</u>

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

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.

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7. Trade and Other Receivables

Trade and other receivables as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014		December 31, 2013	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 8,344	₩ 21,703	₩ 8,680	₩ 29,884
Loans	7,185	53,719	2,205	58,609
Other receivables	74,679	9,545	82,129	9,567
Guarantee deposits	-	37,751	-	36,437
Accrued income	6,810	-	5,495	-
Trade receivables	763,444	-	622,958	-
	<u>₩ 860,462</u>	<u>₩ 122,718</u>	<u>₩ 721,467</u>	<u>₩ 134,497</u>

Trade and other receivables as of September 30, 2014 and December 31, 2013, reported in the separate statements of financial position, net of allowances, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014		December 31, 2013	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 913,284	₩ 132,824	₩ 780,542	₩ 140,779
Allowance account				
- Other receivables	(7,339)	-	(7,711)	-
- Trade receivables	(42,399)	-	(44,395)	-
- Accrued income	(2,033)	-	(2,044)	-
- Loans to subsidiaries	(1,051)	(10,106)	(4,925)	(6,282)
	<u>(52,822)</u>	<u>(10,106)</u>	<u>(59,075)</u>	<u>(6,282)</u>
Net amount	<u>₩ 860,462</u>	<u>₩ 122,718</u>	<u>₩ 721,467</u>	<u>₩ 134,497</u>

Changes in the allowance account for the nine-month periods ended September 30, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014		2013	
Beginning	₩	65,357	₩	19,714
Impairment loss		(1,997)		22,413
Reversal of impairment loss		(432)		-
Ending	<u>₩</u>	<u>62,928</u>	<u>₩</u>	<u>42,127</u>

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The aging schedule of trade and other receivables as of September 30, 2014 and December 31, 2013, is as follows:

<i>(in millions of Korean won)</i>	September 30, 2014		December 31, 2013	
Not past due	₩	497,728	₩	404,941
Past due but not impaired				
Within 1 month		23,703		37,487
Between 1 and 2 months		24,763		20,590
Between 2 and 3 months		14,491		20,148
Beyond 3 months		245,158		184,187
	₩	<u>805,843</u>	₩	<u>667,353</u>

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 Company holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

Details of trade and other receivables that are measured at amortized cost using effective interest rate method as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014			December 31, 2013		
	Effective interest rate(%)	Current	Non-current	Effective interest rate(%)	Current	Non-current
Loans to employees	3.00~5.68	₩ 8,343	₩ 21,703	3.00~5.68	₩ 8,680	₩ 29,884
Other receivables	3.79	-	7,923	3.79	7,997	7,705
Guarantee deposits	3.00~5.68	-	37,751	3.00~5.68	-	36,437
		<u>₩ 8,343</u>	<u>₩ 67,377</u>		<u>₩ 16,677</u>	<u>₩ 74,026</u>

Transferred trade receivables

The Company has sold its trade receivables through trade receivable factoring agreements with National Agricultural Cooperative Federation and other financial institutions in relation with the collecting sales payments with tobacco card. In case the customers default, the Company has an obligation to pay the related amount to the bank. As a result, this transaction treated as a transaction with recourse, has been accounted for as collateralized borrowings. The borrowings recognized in relation to the said transaction as of September 30, 2014 and December 31, 2013, are ₩4,794 million and ₩4,920 million, respectively (Notes 13 and 22).

8. Long-term Deposits

Long-term deposits as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014		December 31, 2013	
MMF	₩	416	₩	15,080
T-Note		269,872		204,680
Cash		506		-
	₩	<u>270,794</u>	₩	<u>219,760</u>

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As discussed in Note 31 to the separate 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 nine-month periods ended September 30, 2014 and 2013, are ₩ 52,036 million and ₩ 41,772 million, respectively.

Long-term deposits are operated as a way of buying T-Note or MMF. Investment income on long-term deposits in MSA Escrow Fund for the nine-month periods ended September 30, 2014 and 2013, are ₩ 559 million and ₩ 959 million, respectively.

9. Property, Plant and Equipment

Changes in property, plant and equipment for the nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 432,365	₩ -	₩ 432,365
Buildings	686,317	(287,758)	398,559
Structures	44,866	(27,311)	17,555
Machinery	956,490	(742,731)	213,759
Vehicles	2,415	(2,099)	316
Tools	36,284	(32,118)	4,166
Furniture and fixture	153,821	(119,977)	33,844
Others	1,312	-	1,312
Construction-in-progress	89,580	-	89,580
	<u>₩ 2,403,450</u>	<u>₩ (1,211,994)</u>	<u>₩ 1,191,456</u>

(in millions of Korean won)

	2013		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 410,918	₩ -	₩ 410,918
Buildings	653,724	(261,853)	391,871
Structures	41,770	(25,282)	16,488
Machinery	932,610	(692,718)	239,892
Vehicles	2,609	(2,210)	399
Tools	34,240	(30,705)	3,535
Furniture and fixture	170,451	(137,399)	33,052
Others	1,127	-	1,127
Construction-in-progress	71,086	-	71,086
	<u>₩ 2,318,535</u>	<u>₩ (1,150,167)</u>	<u>₩ 1,168,368</u>

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<i>(in millions of Korean won)</i>	2014							Net book amount
	Opening net book value	Additions	Disposal	Depreciation	Transfer	Other changes ¹		
Land	₩ 410,763	₩ 1,491	₩ (200)	₩ -	₩ 20,301	₩ 10	₩ 432,365	
Buildings	400,314	11,711	(5)	(19,625)	6,088	76	398,559	
Structures	16,973	1,802	-	(1,568)	348	-	17,555	
Machinery	234,926	3,815	(56)	(37,949)	18,925	(5,902)	213,759	
Vehicles	362	105	-	(151)	-	-	316	
Tools	3,135	1,335	(85)	(1,145)	926	-	4,166	
Furniture and fixture	34,524	8,910	(4)	(12,826)	3,240	-	33,844	
Others	1,162	150	-	-	-	-	1,312	
Construction-in-progress	80,604	58,857	(53)	-	(49,828)	-	89,580	
	<u>₩1,182,763</u>	<u>₩ 88,176</u>	<u>₩ (403)</u>	<u>₩ (73,264)</u>	<u>₩ -</u>	<u>₩ (5,816)</u>	<u>₩1,191,456</u>	

¹ Land and buildings in other changes represent the reclassified amount from investment property to property, plant and equipment. Machinery in other changes represent the decrease due to KGC Yebon's investment in kind (Notes 11 and 14).

<i>(in millions of Korean won)</i>	2013							Net book amount
	Opening net book value	Additions	Disposal	Depreciation	Transfer	Other changes ²		
Land	₩ 397,900	₩ 22	₩ (798)	₩ -	₩ 13,630	₩ 164	₩ 410,918	
Buildings	394,889	2,893	(87)	(18,838)	10,272	2,742	391,871	
Structures	16,716	570	(2)	(1,435)	602	37	16,488	
Machinery	261,847	7,273	(1,722)	(45,927)	18,421	-	239,892	
Vehicles	529	75	-	(205)	-	-	399	
Tools	2,733	2,067	(272)	(993)	-	-	3,535	
Furniture and fixture	36,807	7,330	(72)	(13,221)	2,208	-	33,052	
Others	1,115	-	-	-	12	-	1,127	
Construction-in-progress	50,684	65,697	-	-	(45,145)	(150)	71,086	
	<u>₩1,163,220</u>	<u>₩ 85,927</u>	<u>₩ (2,953)</u>	<u>₩ (80,619)</u>	<u>₩ -</u>	<u>₩ 2,793</u>	<u>₩1,168,368</u>	

² Other changes represent the reclassified amount of ₩520 million from investment property to assets held for sale and the amount of ₩ 3,463 million from investment property to property, plant and equipment and the amount of ₩ 150 million from property, plant and equipment to investment property.

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10. Intangible Assets

Changes in intangible assets for the nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014			
	Industrial property rights	Facility usage rights	Intangible assets under development	Total
At January 1, 2014	₩ 1,625	₩ 17,357	₩ 2,209	₩ 21,191
Additions	-	348	525	873
Disposals	-	(3)	-	(3)
Amortization	(43)	-	-	(43)
Acquisition cost	7,163	17,702	2,734	27,599
Accumulated amortization cost	(5,581)	-	-	(5,581)
Net book amount	₩ 1,582	₩ 17,702	₩ 2,734	₩ 22,018

(in millions of Korean won)

	2013			
	Industrial property rights	Facility usage rights	Intangible assets under development	Total
At January 1, 2013	₩ 1,632	₩ 16,585	₩ 1,720	₩ 19,937
Additions	-	773	470	1,243
Disposals	-	(1)	-	(1)
Amortization	(45)	-	-	(45)
Transfer-in(out)	53	-	(53)	-
Other changes	-	-	(3)	(3)
Acquisition cost	7,163	17,357	2,134	26,654
Accumulated amortization cost	(5,523)	-	-	(5,523)
Net book amount	₩ 1,640	₩ 17,357	₩ 2,134	₩ 21,131

Research and development expenses for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		2013	
	Three months	Nine months	Three months	Nine months
Cost of goods sold	₩ -	₩ 210	₩ 80	₩ 225
Selling and administrative expenses	3,632	11,032	3,268	8,677
	₩ 3,632	₩ 11,242	₩ 3,348	₩ 8,902

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11. Investment Property

Changes in investment property for the nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		
	Land	Building	Total
Beginning net book value	₩ 22,246	₩ 123,788	₩ 146,034
Additions	-	77	77
Other changes ¹	(10)	(76)	(86)
Depreciation	-	(4,521)	(4,521)
Acquisition cost	22,236	169,979	192,215
Accumulated depreciation and impairment cost	-	(50,711)	(50,711)
Net book amount	₩ 22,236	₩ 119,268	₩ 141,504

¹ The amount of other changes is the transfer from investment property to property, plant and equipment (Note 9).

(in millions of Korean won)

	2013		
	Land	Building	Total
Beginning net book value	₩ 22,121	₩ 131,786	₩ 153,907
Additions	559	863	1,422
Other changes ²	(434)	(2,879)	(3,313)
Depreciation	-	(4,510)	(4,510)
Acquisition cost	22,246	169,989	192,235
Accumulated depreciation and impairment cost	-	(44,729)	(44,729)
Net book amount	₩ 22,246	₩ 125,260	₩ 147,506

² The amount of ₩3,463 million from investment property to property, plant and equipment and the amount of ₩ 150 million from property, plant and equipment to investment property.

The amounts recognized in profit or loss from investment property for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		2013	
	Three months	Nine months	Three months	Nine months
Rental income	₩ 8,258	₩ 24,913	₩ 8,153	₩ 24,669
Direct operating expense	(1,507)	(4,521)	(1,504)	(4,510)
	₩ 6,751	₩ 20,392	₩ 6,649	₩ 20,159

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Fair values and book values of investment property as of September 30, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

	September 30, 2014		December 31, 2013	
	Fair value	Book value	Fair value	Book value
Land	₩ 281,106	₩ 22,236	₩ 281,311	₩ 22,246
Building	180,272	119,268	180,361	123,788
	<u>₩ 461,378</u>	<u>₩ 141,504</u>	<u>₩ 461,672</u>	<u>₩ 146,034</u>

12. Non-current Assets Held for Sale

The Company recognizes non-current assets held for sale as the lower of net fair value and book value. Non-current assets held for sale recognized as of December 31, 2013, were completely disposed during the current period.

13. Pledged Assets

The following assets are pledged as collateral for the Company's long-term and short-term borrowings and others as of September 30, 2014:

(in millions of Korean won)

Asset	Book amount	Reason	Borrowings	Collateralized amount	Lender /Leaseholder
Investment property	₩ 71,773	Leasehold deposits received	₩ 8,746	₩ 8,838	Metlife Insurance Korea Co., Ltd. and 25 others
Trade receivables	4,794	Short-term borrowings	4,794	4,794	National Agricultural Cooperative Federation and 1 other

The following assets are pledged as collateral for the Company's long-term and short-term borrowings and others as of December 31, 2013:

(in millions of Korean won)

Asset	Book amount	Reason	Borrowings	Collateralized amount	Lender /Leaseholder
Investment property	₩ 74,555	Leasehold deposits received	₩ 9,020	₩ 9,123	Metlife Insurance Korea Co., Ltd. and 26 others
Trade receivables	4,920	Short-term borrowings	4,920	4,920	National Agricultural Cooperative Federation and 1 other

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14. Investments in Associates and Subsidiaries

Investments in associates and subsidiaries as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>			September 30, 2014		December 31, 2013	
	Location	Principal operation	Interest (%)	Carrying Amount	Interest (%)	Carrying Amount
Associates						
Lite Pharm Tech, Inc	Korea	Manufacturing Medical supplies	25.34	₩ 1,830	25.34	₩ 1,830
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	13,995	49.02	13,995
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	7,300	29.67	7,300
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	7,000	22.06	7,000
JR REIT V Co., Ltd.	Korea	Selling and renting of real estate	34.63	5,600	34.63	5,600
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	10,000	21.74	10,000
LSK Global Pharma Services Co., Ltd.	Korea	Research and developing new drug	23.15	-	23.15	-
JR REIT X Co., Ltd.	Korea	Selling and renting of real estate	28.78	9,500	28.78	9,500
JR REIT XIII Co., Ltd.		Selling and renting of real estate	27.03	5,000	27.03	5,000
				<u>60,225</u>		<u>60,225</u>
Subsidiaries						
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00	672,408	100.00	599,023
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceuticals	53.00	66,355	53.00	66,355
Tae-a Industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00	15,698	100.00	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	Manufacturing and selling tobaccos	99.99	54,049	99.99	54,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf Tobaccos	99.90	535	99.90	535
KT&G Pars	Iran	Manufacturing and selling tobaccos	99.99	-	99.99	-
KT&G Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00	110,297	100.00	110,297
KGC Life & Gin Co., Ltd.	Korea	Selling ginseng	100.00	44,100	100.00	44,100
Global Trading, Inc.	USA	Selling tobaccos	100.00	4,913	100.00	4,913
Jilin Hanzheng Ginseng Co., Ltd.	China	Manufacturing and selling ginseng	-	-	100.00	47,675
Somang Cosmetics Co., Ltd. ¹	Korea	Manufacturing and selling cosmetics	60.00	60,721	60.00	60,721
Renzoluc Pte., Ltd. ²	Singapore	Manufacturing and selling tobaccos	100.00	66,356	100.00	66,356
KT&G Life Science ³	Korea	Medical researching and developing	73.94	31,232	73.94	31,232
Yebon Nongwon Agriculture Co., Ltd.	Korea	Corporate agriculture	-	-	90.00	90
KGC Yebon	Korea	Manufacturing and selling medicinal herbs	100.00	49,828	100.00	43,927
K-Q HongKong I, Limited ⁴	Hong Kong	Manufacturing and selling ginseng	100.00	17,761	100.00	17,761
PT KT&G Indonesia	Indonesia	Manufacturing and selling tobaccos	99.98	6,948	99.96	3,746
K&I HK Co., Ltd	Hong Kong	Selling cosmetics	100.00	11	-	-
K&I China Co., Ltd	China	Selling cosmetics	100.00	31	-	-
				<u>1,200,883</u>		<u>1,166,478</u>
				<u>₩ 1,261,108</u>		<u>₩ 1,226,703</u>

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¹ The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of September 30, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

² The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of September 30, 2014, the Company's percentage of ownership would be 68.91% if convertible preferred shares are included.

³ The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of September 30, 2014, the Company's percentage of ownership would be 59.48% if convertible preferred shares are included.

⁴ The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of September 30, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

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Changes in investments in associates and subsidiaries for the nine-month periods ended September 30, 2014 and 2013, are as follows:

	2014				
	Beginning balance	Acquisition	Disposals	Others	Ending balance
<i>(in millions of Korean won)</i>					
Associates					
Lite Pharm Tech, Inc	₩ 1,830	₩ -	₩ -	₩ -	₩ 1,830
JR CR-REIT IV Co., Ltd.	13,995	-	-	-	13,995
KVG REIT 1 Co., Ltd.	7,300	-	-	-	7,300
KOCREF REIT 17 Co., Ltd.	7,000	-	-	-	7,000
JR REIT V Co., Ltd.	5,600	-	-	-	5,600
JR REIT VIII Co., Ltd.	10,000	-	-	-	10,000
LSK Global Pharma Services Co., Ltd.	-	-	-	-	-
JR REIT X Co., Ltd.	9,500	-	-	-	9,500
JR REIT XIII Co., Ltd.	5,000	-	-	-	5,000
	<u>60,225</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>60,225</u>
Subsidiaries					
Korea Ginseng Corporation ¹	599,023	73,025	-	-	672,048
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	66,355
Tae-a Industry Co., Ltd.	15,698	-	-	-	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	535	-	-	-	535
KT&G Pars	-	-	-	-	-
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KGC Life & Gin Co., Ltd.	44,100	-	-	-	44,100
Global Trading, Inc.	4,913	-	-	-	4,913
Jilin Hanzheng Ginseng Co., Ltd. ¹	47,675	-	(47,675)	-	-
Somang Cosmetics Co., Ltd.	60,721	-	-	-	60,721
Renzoluc Pte., Ltd.	66,356	-	-	-	66,356
KT&G Life Science	31,232	-	-	-	31,232
Yebon Nongwon Agriculture Co., Ltd.	90	-	(90)	-	-
KGC Yebon ²	43,927	5,901	-	-	49,828
K-Q HongKong I,Limited	17,761	-	-	-	17,761
PT KT&G Indonesia	3,746	3,202	-	-	6,948
K&I HK Co., Ltd	-	11	-	-	11
K&I China Co., Ltd	-	31	-	-	31
	<u>1,166,478</u>	<u>82,170</u>	<u>(47,765)</u>	<u>-</u>	<u>1,200,883</u>
	<u>₩ 1,226,703</u>	<u>₩ 82,170</u>	<u>₩ (47,765)</u>	<u>₩ -</u>	<u>₩ 1,261,108</u>

¹ During the current period, the Company acquired ₩ 47,675 million through investment in kind of the entire amount of shares of Jilin Hanzheng Ginseng Co, Ltd., and ₩ 25,350 million through investment in kind of available-for-sale financial assets, respectively.

² The amount of acquisition represents the Company's investment in kind (Note 9).

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	2013				
	Beginning balance	Acquisition	Disposals	Others	Ending balance
Associates					
Cosmo Tobacco Co., Ltd.	₩ -	₩ -	₩ -	₩ -	₩ -
Lite Pharm Tech, Inc.	1,830	-	-	-	1,830
Korean Carbon Finance, Inc.	1,000	-	-	-	1,000
JR CR-REIT IV Co., Ltd.	13,995	-	-	-	13,995
KVG REIT 1 Co., Ltd.	7,300	-	-	-	7,300
KOCREF REIT 17 Co., Ltd.	7,000	-	-	-	7,000
JR REIT V Co., Ltd.	5,600	-	-	-	5,600
JR REIT VIII Co., Ltd.	10,000	-	-	-	10,000
LSK Global Pharma Services Co., Ltd.	1,500	-	-	-	1,500
JR REIT X Co., Ltd.	9,500	-	-	-	9,500
	<u>57,725</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>57,725</u>
Subsidiaries					
Korea Ginseng Corporation	599,023	-	-	-	599,023
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	66,355
Tae-a Industry Co., Ltd.	15,698	-	-	-	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	535	-	-	-	535
KT&G Pars	-	-	-	-	-
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KGC Life & Gin Co., Ltd	52,900	22,000	-	-	74,900
KT&G Bio Corp.	-	-	-	-	-
Global Trading, Inc.	4,913	-	-	-	4,913
Jilin Hanzheng Ginseng Co., Ltd.	31,333	-	-	-	31,333
Somang Cosmetics Co., Ltd.	60,721	-	-	-	60,721
Renzoluc Pte., Ltd.	89,756	-	-	-	89,756
KT&G Life Science	31,232	-	-	-	31,232
Yebon Nongwon Agriculture Co., Ltd.	90	-	-	-	90
KGC Yebon	43,927	-	-	-	43,927
K-Q Hong Kong I, Limited	17,761	-	-	-	17,761
PT KT&G Indonesia	-	3,746	-	-	3,746
	<u>1,178,590</u>	<u>25,746</u>	<u>-</u>	<u>-</u>	<u>1,204,336</u>
	<u>₩ 1,236,315</u>	<u>₩ 25,746</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 1,262,061</u>

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15. Inventories

Inventories as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014			December 31, 2013		
	Acquisition Cost	Allowance	Book amount	Acquisition Cost	Allowance	Book amount
Finished goods	₩ 102,188	₩ (1,464)	₩ 100,724	₩ 107,950	₩ (2,135)	₩ 105,815
Work in progress	15,762	-	15,762	11,889	-	11,889
Raw materials	640,165	-	640,165	704,494	-	704,494
Supplies	24,595	-	24,595	24,500	-	24,500
By-products	6,909	-	6,909	6,512	-	6,512
Unfinished housing	754	-	754	840	-	840
Lots	2,942	-	2,942	6,432	-	6,432
Goods-in-transit	23,217	-	23,217	79,262	-	79,262
	<u>₩ 816,532</u>	<u>₩ (1,464)</u>	<u>₩ 815,068</u>	<u>₩ 941,879</u>	<u>₩ (2,135)</u>	<u>₩ 939,744</u>

The costs related inventories for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014		2013	
	Three months	Nine months	Three months	Nine months
Cost of sales				
Loss(gain) on inventory valuation	₩ 228	₩ (671)	₩ 199	₩ 525
Loss on retirement of inventories	605	2,179	724	2,541
Other expenses				
Loss on retirement of inventories	12	413	123	705
	<u>₩ 845</u>	<u>₩ 1,921</u>	<u>₩ 1,046</u>	<u>₩ 3,771</u>

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16. Cash and Cash Equivalents

Cash and cash equivalents as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014		December 31, 2013	
Cash on hand	₩	4,093	₩	3,147
Demand deposits		69,668		82,691
Short-term investment assets		260,000		160,000
	₩	<u>333,761</u>	₩	<u>245,838</u>

Other financial assets as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014		December 31, 2013	
Short-term financial assets				
Time deposits	₩	10,000	₩	20,000
Money trust		600,000		620,000
Certificates of deposit		30,000		20,000
	₩	<u>640,000</u>	₩	<u>660,000</u>

17. Equity and Share Premium

Details of share capital as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in Korean won, except number of shares)</i>	September 30, 2014		December 31, 2013	
Number of ordinary shares				
Authorized		800,000,000		800,000,000
Issued		137,292,497		137,292,497
Par value per share	₩	5,000	₩	5,000
Capital stock	₩	954,959,485,000	₩	954,959,485,000

The Company has reacquired and retired 53,699,400 shares of treasury shares. Accordingly, as of September 30, 2014, the Company's ordinary shares differ from the aggregate par value of issued shares by ₩ 268,497 million.

Changes in the number of shares for the nine-month period ended September 30, 2014 and the year ended December 31, 2013, are as follows:

	2014			2013		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Number of shares	137,292,497	(11,393,697)	125,898,800	137,292,497	(11,393,697)	125,898,800

There are no changes in the other capital surplus for the nine-month period ended September 30, 2014 and the year ended December 31, 2013.

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18. Treasury Shares

There is no change in the treasury shares for the nine-month period ended September 30, 2014 and the year ended December 31, 2013. Details of the number of treasury shares and carrying amount are as follows:

<i>(in millions of Korean Won, except number of shares)</i>	2014		2013	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Issuance of treasury shares	11,393,697	₩ 339,059	11,393,697	₩ 339,059

There is no change in gain on reissuance of the treasury shares for the nine-month period ended September 30, 2014 and the year ended December 31, 2013. The book values are as follows:

<i>(in millions of Korean won)</i>	2014	2013
Gain on reissuance of treasury shares	₩ 492,032	₩ 492,032

19. Reserves

Details of reserves as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014	December 31, 2013
Available-for-sale financial assets reserve	₩ (10,736)	₩ (5,570)
Legal reserve	602,937	602,937
Voluntary reserve	2,918,254	2,813,732
	<u>₩ 3,510,455</u>	<u>₩ 3,411,099</u>

Available-for-sale financial assets reserve as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014	December 31, 2013
Available-for-sale financial assets reserve before tax	₩ (14,163)	₩ (7,348)
Tax effect	3,427	1,778
Available-for-sale financial assets reserve after tax	<u>₩ (10,736)</u>	<u>₩ (5,570)</u>

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.

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Details of the Company's voluntary reserve as of September 30, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2014		December 31, 2013	
Reserve for business rationalization ¹	₩	12,851	₩	12,851
Reserve for research and human resource development ²		42,522		90,000
Reserve for business expansion ³		698,881		698,881
Other reserve ³		2,164,000		2,012,000
	₩	<u>2,918,254</u>	₩	<u>2,813,732</u>

¹*Reserve for Business Rationalization*

Until December 10, 2002, under the Special Tax Treatment Control Law, investment tax credits were allowed for certain investments. The 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 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.

²*Reserve for research and human resource development*

Reserve for research and human resource development was appropriated in order to utilize certain tax deduction benefits through the early recognition of future expenditures. This reserve is restored to retained earnings in accordance with the relevant tax laws. Such reserves are taken back into taxable income in the year of restoration.

³*Reserve for Business Expansion and other reserve*

Reserves without specific purposes are restored to retained earnings and can be used for other purposes afterwards upon a resolution at a general meeting of shareholders.

20. Retained Earnings

Changes in retained earnings for the nine-month period ended September 30, 2014 and the year ended December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	2014		2013	
Beginning	₩	509,820	₩	752,766
Transfer from reserve for research and human resource development		47,479		-
Transfer to other reserve		(152,000)		(317,000)
Transfer to reserve for research and human resource development		-		(30,000)
Dividends		(402,876)		(402,876)
Profit for the period		637,395		501,315
Remeasurements of the net defined benefit liability (after tax)		(595)		5,615
Ending	₩	<u>639,223</u>	₩	<u>509,820</u>

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21. Trade and Other Payables

Trade and other payables as of September 30, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

	September 30, 2014		December 31, 2013	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	₩ 26,563	₩ -	₩ 27,585
Accounts payable	51,738	-	60,436	-
Withholdings	5,044	-	3,823	-
Value added tax withheld	141,884	-	119,761	-
Accrued expenses	123,676	-	123,419	-
Other payables	44,765	-	94,950	684
	<u>₩ 367,107</u>	<u>₩ 26,563</u>	<u>₩ 402,389</u>	<u>₩ 28,269</u>

22. Borrowings

Details of borrowings as of September 30, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

	September 30, 2014	December 31, 2013
Current		
Bank borrowings	₩ 4,794	₩ 4,920

Details of bank borrowings as of September 30, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

	Creditor	Latest maturity date	Annual interest rate (%) September 30, 2014	September 30, 2014	December 31, 2013
Borrowings in Korean won	National Agricultural Cooperative Federation	Short-term borrowings	7.15%	₩ 3,936	₩ 4,061
Borrowings in Korean won	Korea Exchange Bank	Short-term borrowings	CD(91) + 2.5%	858	859
				<u>₩ 4,794</u>	<u>₩ 4,920</u>

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23. Net Defined Benefit Liability

The amounts recognized on the statements of income for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014		2013	
	Three months	Nine months	Three months	Nine months
Defined benefit plans :				
Current service cost	₩ 7,018	₩ 21,053	₩ 7,244	₩ 21,733
Interest expenses	2,082	6,246	1,716	5,147
Expected return on plan assets	(1,507)	(4,522)	(1,169)	(3,508)
Effect of past service cost or settlement	462	1,386	-	-
	<u>8,055</u>	<u>24,163</u>	<u>7,791</u>	<u>23,372</u>
Defined contribution plans :				
Contributions recognized as current expense	722	1,952	544	1,539
Total	<u>₩ 8,777</u>	<u>₩ 26,115</u>	<u>₩ 8,335</u>	<u>₩ 24,911</u>

Out of total expenses, ₩8,156 million (2013: ₩8,219 million) and ₩17,959 million (2013: ₩16,692 million) are included in 'cost of sales' and 'selling and administrative expenses', respectively. Termination benefits arising from voluntary resignation for the nine-month period ended September 30, 2014, amounts to ₩269 million (2013: ₩1,168 million).

Net defined benefit liability recognized on the statements of financial position as of September 30, 2014 and December 31, 2013, are as follows:

<i>(In millions of Korean won)</i>	September 30, 2014	December 31, 2013
Present value of defined benefit liability	₩ 242,165	₩ 227,259
Fair value of plan assets	<u>(159,888)</u>	<u>(166,986)</u>
Liability in the statement of financial position	<u>₩ 82,277</u>	<u>₩ 60,273</u>

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24. Operating Income and Other Income

Material items of operating income and expense

Operating income is calculated as gross profit net of selling and administrative expenses and other income and expenses were excluded.

Employee benefit costs for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		2013	
	Three months	Nine months	Three months	Nine months
Salaries	₩ 93,733	₩ 255,260	₩ 86,344	₩ 243,449
Retirement benefits	8,777	26,115	8,335	24,911
Termination benefits	-	269	-	1,168
Employee welfare	9,956	28,770	9,951	29,762
	<u>₩ 112,466</u>	<u>₩ 310,414</u>	<u>₩ 104,630</u>	<u>₩ 299,290</u>

Selling and administrative expenses for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		2013	
	Three months	Nine months	Three months	Nine months
Salaries	₩ 62,429	₩ 172,711	₩ 58,474	₩ 163,929
Retirement benefits	6,004	17,959	5,586	16,692
Termination benefits	-	269	-	819
Employee welfare	7,207	20,841	6,940	20,784
Travel	1,056	3,149	1,470	4,004
Communications	882	2,690	860	2,618
Utilities	2,141	6,443	1,998	6,567
Taxes and dues	1,451	13,023	2,828	10,322
Supplies	346	1,316	321	1,221
Rent	3,415	10,264	3,628	10,629
Depreciation	8,192	24,151	8,017	23,942
Amortization	14	43	15	45
Repairs and maintenance	1,386	4,310	1,619	3,700
Vehicles	1,555	4,912	2,298	6,671
Insurance	127	257	134	298
Commissions	20,263	57,028	17,374	50,665
Freight and custody	6,095	19,436	4,392	14,026
Conferences	692	2,132	711	2,405
Advertising	31,701	93,897	34,110	104,164
Training	1,054	2,956	999	2,963
Prizes and rewards	310	1,103	351	1,180
Normal research and development	3,632	11,032	3,268	8,677
Bad debts expense	(2,123)	(1,997)	3,547	3,545
	<u>₩ 157,829</u>	<u>₩ 467,925</u>	<u>₩ 158,940</u>	<u>₩ 459,866</u>

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Details of other income for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		2013	
	Three months	Nine months	Three months	Nine months
Foreign currency transaction gain	₩ 1,342	₩ 4,903	₩ 3,033	₩ 11,226
Foreign currency translation gain	28,241	3,564	-	1,518
Reversal of impairment loss on other receivables	-	432	-	-
Gain on sale of property, plant and equipment	4,321	5,134	5,121	16,576
Miscellaneous revenues	5,991	13,856	3,427	10,236
	<u>₩ 39,895</u>	<u>₩ 27,889</u>	<u>₩ 11,581</u>	<u>₩ 39,556</u>

Details of other expenses for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		2013	
	Three months	Nine months	Three months	Nine months
Foreign currency transaction loss	₩ 2,997	₩ 8,900	₩ 2,046	₩ 5,097
Foreign currency translation loss	-	3,436	57,785	19,247
Other bad debts expense	346	-	18,868	18,868
Loss on sale of investment in subsidiaries	5	5	-	-
Donations	1,600	3,802	916	2,394
Loss on sale of property, plant and equipment	4	85	101	272
Loss on sale of intangible assets	-	2	-	-
Miscellaneous expenses	1,033	7,887	26,523	29,780
	<u>₩ 5,985</u>	<u>₩ 24,117</u>	<u>₩ 106,239</u>	<u>₩ 75,658</u>

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25. Expenses by Nature

Expenses by nature for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		2013	
	Three months	Nine months	Three months	Nine months
Changes in inventories	₩ 49,463	₩ 124,676	₩ 27,398	₩ 11,124
Raw materials used and consumables purchased	142,753	487,428	159,709	514,273
Salary and wage	93,733	255,260	86,344	243,449
Retirement and termination benefits	8,776	26,383	8,334	26,079
Depreciation	25,831	77,785	26,082	85,129
Amortization	14	43	15	45
Employee benefits	9,956	28,770	9,951	29,762
Advertising costs	31,736	94,004	34,143	104,261
Service fees	26,642	75,010	22,613	67,036
Other expenses	35,385	71,415	26,960	49,722
Total cost of sales and administrative expenses ¹	₩ 424,289	₩ 1,240,774	₩ 401,549	₩ 1,130,880

¹ The amount represents the sum of cost of sales and selling and administrative expenses in the separate statements of comprehensive income.

26. Finance Income and Costs

Finance income and costs for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		2013	
	Three months	Nine months	Three months	Nine months
Finance income				
Interest income	₩ 9,688	₩ 27,029	₩ 8,480	₩ 25,201
Dividend income	631	7,796	683	6,889
Investment income on long-term deposits in MSA Escrow Fund	234	559	741	959
Profit on sale of available-for-sale	20,121	20,121	-	-
	30,674	55,505	9,904	33,049
Finance cost				
Interest costs	(170)	(648)	(176)	(562)
Impairment loss on available-for-sale financial assets	-	-	-	(15,000)
	(170)	(648)	(176)	(15,562)
Net financial income	₩ 30,504	₩ 54,857	₩ 9,728	₩ 17,487

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Details of interest costs for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014		2013	
	Three months	Nine months	Three months	Nine months
Trade and other payables	₩ (170)	₩ (648)	₩ (176)	₩ (562)

Details of interest income for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014		2013	
	Three months	Nine months	Three months	Nine months
Deposits	₩ 7,211	₩ 20,049	₩ 6,167	₩ 18,204
Available-for-sale financial assets	12	37	7	22
Trade and other receivables	2,465	6,943	2,306	6,975
	<u>₩ 9,688</u>	<u>₩ 27,029</u>	<u>₩ 8,480</u>	<u>₩ 25,201</u>

27. Income Tax

Income tax expense was calculated based on the best weighted average annual corporate tax rate for the entire fiscal period. Estimated average annual tax rate of the year ending December 31, 2014, is 24.4%. (The estimated tax rate for the nine-month period ended September 30, 2013, was 29.4%).

28. Earnings per Share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year excluding ordinary shares purchased by the Company and held as treasury shares (Note 18).

Basic earnings per ordinary share for the three-month and nine-month periods ended September 30, 2014 and 2013, are as follows:

<i>(in millions of Korean won, except number of shares)</i>	2014		2013	
	Three months	Nine months	Three months	Nine months
Profit for the period	₩ 274,450	₩ 637,395	₩ 72,034	₩ 463,068
Weighted-average number of ordinary shares outstanding	125,898,800	125,898,800	125,898,800	125,898,800
Basic earnings per share (in won)	<u>₩ 2,180</u>	<u>₩ 5,063</u>	<u>₩ 572</u>	<u>₩ 3,678</u>

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29. Dividends

Dividend distribution to the Company's shareholders amounting to ₩ 402,876 million for the year ended December 31, 2013, was made on April, 2014.

30. Cash Generated from Operations

Cash generated from operations for the nine-month periods ended September 30, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014		2013	
Profit	₩	637,395	₩	463,068
Adjustments for:				
Income tax expense		205,322		216,359
Finance cost		648		15,562
Finance income		(55,505)		(33,049)
Depreciation		77,785		85,129
Amortization		43		45
Retirement and termination benefits		24,163		23,372
Foreign currency translation loss		3,436		19,247
Loss on inventory valuation		-		525
Impairment loss(reversal) on trade and other receivables		(1,997)		22,413
Loss on sale of property, plant and equipment		85		272
Loss on sale of intangible assets		2		-
Loss on sale of investment in subsidiaries		5		-
Other expenses		2,592		8,382
Foreign currency translation gain		(3,564)		(1,518)
Reversal of impairment loss on inventory valuation		(671)		-
Reversal of impairment loss on trade and other receivables		(432)		-
Gain on sale of property, plant and equipment		(5,134)		(16,575)
		<u>884,173</u>		<u>803,232</u>
Changes in working capital				
Increase in trade and other receivables		(130,433)		(17,691)
Increase in advance payments		(7,562)		(29,248)
Decrease in prepaid expenses		3,557		1,614
Decrease in prepaid tobacco excise and other taxes		(115,753)		(13,077)
Decrease in inventories		122,755		7,354
Increase (decrease) in trade and other payables		(52,877)		48,531
Increase (decrease) in advance receipts		(16,155)		2,797
Decrease (Increase) in tobacco excise and other taxes payable		99,334		(46,480)
Payment of retirement benefits		(2,943)		(1,045)
Cash generated from operations	₩	<u>784,096</u>	₩	<u>755,987</u>

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Significant non-cash transactions for the nine-month period ended September 30, 2014, are as follows:

<i>(in millions of Korean won)</i>	2014	
Reclassification of other financial assets to current portion	₩	50,000
Reclassification of construction-in-progress		49,828

31. Contingencies and Commitments

Each year, the Company deposits a proportion of sales of tobacco products in the United States in accordance with the Tobacco Master Settlement Agreement (MSA) under the Escrow Statute of the United States government. 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 Company 25 years from the date of each annual funding. The Company 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.

As of September 30, 2014, the Company is involved in a lawsuit as a plaintiff claiming damages in relation to development of Yongsan area with other companies. The aggregate litigation amount for this case amounts to ₩ 240,000 million, and the litigation amount attributable to the Company is ₩ 5,136 million.

As of September 30, 2014, tobacco lawsuits claiming damages of ₩ 100 million are filed against the Company and the Korean government. The amount of the liability with respect to the litigation cannot be reasonably estimated as of September 30, 2014.

Additionally, as of September 30, 2014, the Company is involved in eight lawsuits as a defendant for alleged damages totalling ₩ 56,768 million.

National Health Insurance Service filed a lawsuit seeking ₩ 53,742 million in damages against the Company on April 14, 2014.

As of September 30, 2014, the Company has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 59,000 thousand.

As of September 30, 2014, the Company's trade receivables from the export of cigarettes are insured against non-payment up to USD 14,900 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of September 30, 2014, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries and also for an opening of L/C up to USD 40,000 thousand by Korea Exchange Bank and others. In addition, the Company provides Customs Bond with limits in the aggregate of USD 12,078 thousand to Korea Exchange Bank, regarding an opening of L/C for import and customs with relation to a subsidiary located in U.S.A (Global Trading Inc.). The Company also provides Performance Bond with limits in the aggregate of THB 4,302 thousand in relation to an opening of L/C for export of tobacco sheet for Thailand

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Tobacco Monopoly, and payment guarantee with limits in the aggregate of IDR 23,657,100 thousand in relation to purchase of certificate stamp of tobacco of MMM, as of September 30, 2014.

As of September 30, 2014, the Company and 28 other companies are guaranteed ₩ 240,000 million by Seoul Guarantee Insurance Co., Ltd. related to the Yongsan International Commercial Development Project. Seoul Guarantee Insurance Co., Ltd. can request amounts for recourse to the Company and 28 other companies based on their ownership rate, if Seoul Guarantee Insurance Co., Ltd. paid the insurance proceeds to KORAIL. As KORAIL requested the corresponding payment to Seoul Guarantee Insurance Co., Ltd. during the reporting period, the Company paid the maximum amount ₩ 5,136 million on July 31, 2013 and recognized the amount as the prior period expenses.

On March 17, 2011, the Company signed the memorandum of understanding (MOU) on global investment partnership with National Pension Service to jointly invest in foreign assets with a limit of ₩ 800,000 million. Following this MOU, the Company entered into a joint investment agreement with Q Capital Partners Co., Ltd., which is a general partner of private equity fund, on November 11, 2011.

In relation to the acquisition of Somang Cosmetics Co., Ltd., the Company entered into a contract with a former owner of the acquiree, Kang Seok-Chang ("the Individual Shareholder"). Details of the contract are as follows:

1) Conditional put option granted to the Individual Shareholder

The Company shall be required to purchase the Individual Shareholder's shares, in whole or in part, at the agreed price if the following conditions are met:

- Somang Cosmetics Co., Ltd. satisfies all the listing requirements.
- Notwithstanding the written request of Individual Shareholder, Somang Cosmetics Co., Ltd. is not able to undertake the necessary procedures for listing, due to the Company's objection, within three years after the Company acquired Somang Cosmetics Co., Ltd.

2) Right of first refusal held by the Company

The individual shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless Individual Shareholder has offered them first to the Company.

3) Tag-along right held by The Individual Shareholder

In the event that the Company proposes to enter into a transaction or a series of related transactions with a third party purchaser to dispose of 50% or more of its shares, then the Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Company.

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In relation to the acquisition of KT&G Life Science (formerly Mazence, Inc.), the Company entered into a contract with a former owner of the acquiree, Gwak Tae-Hwan ("Individual Shareholder"). Details of the contract are as follows:

1) Restriction of disposal

Individual shareholder shall not be permitted to dispose of its shares, in whole or in part, within one year after KT&G Life Science is listed.

2) Right of first refusal held by the Company

The Individual shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless the Individual shareholder has offered them first to the Company.

3) Tag-along right held by the Individual Shareholder

In the event that the Company proposes to enter into a transaction or a series of related transactions with a third party purchaser to dispose of its shares, then the Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Company.

Upon the resolution of the Board of Directors on January 23, 2013, the Parent Company guarantees the principal and the related interest that buyers of Andong Central Xi Apartment have borrowed from the National Agricultural Cooperative Federation, as of September 30, 2014. The amount of guarantee is ₩152,263 million and the guarantee will expire on June 30, 2015.

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32. Related Party Transactions

The subsidiaries and parent companies of subsidiaries as of September 30, 2014 and December 31, 2013, are as follows:

Subsidiaries	Location	Immediate parent companies	Percentage of ownership (%)					
			September 30, 2014			December 31, 2013		
			Parent companies	Subsidiaries	Total	Parent companies	Subsidiaries	Total
Korea Ginseng Corporation	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
Yungjin Pharm. Ind. Co., Ltd.	Korea	KT&G	53.00	-	53.00	53.00	-	53.00
Tae-a industry Co., Ltd.	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	KT&G	99.99	-	99.99	99.99	-	99.99
Korea Tabacos do Brasil Ltda.	Brazil	KT&G	99.90	-	99.90	99.90	-	99.90
KT&G Pars	Iran	KT&G	99.99	-	99.99	99.99	-	99.99
KT&G Rus L.L.C.	Russia	KT&G	100.00	-	100.00	100.00	-	100.00
KGC Life & Gin Co., Ltd	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
Global Trading, Inc.	USA	KT&G	100.00	-	100.00	100.00	-	100.00
Jilin Hanzheng Ginseng Co., Ltd.	China	KT&G	100.00	-	100.00	100.00	-	100.00
Somang Cosmetics Co., Ltd. ¹	Korea	KT&G	60.00	-	60.00	60.00	-	60.00
Renzoluc Pte., Ltd. ²	Singapore	KT&G	100.00	-	100.00	100.00	-	100.00
PT Trisakti Purwosari Makmur	Indonesia	Renzoluc Pte., Ltd.	-	60.17	60.17	-	60.17	60.17
PT Mandiri Maha mulia	Indonesia	Renzoluc Pte., Ltd.	-	66.47	66.47	-	66.47	66.47
PT Sentosa Ababi Purwosari	Indonesia	PT Trisakti Purwosari Makmur	-	99.24	99.24	-	99.24	99.24
PT Purindo Ilufa	Indonesia	PT Trisakti Purwosari Makmur	-	100.00	100.00	-	100.00	100.00
KT&G Life Science ³	Korea	KT&G	73.94	-	73.94	73.94	-	73.94
Yebon Nongwon Agriculture Co., Ltd	Korea	KT&G	-	-	-	90.00	-	90.00
KGC Yebon ⁵	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
K-Q HongKong I,Limited ⁴	HongKong	KT&G	100.00	-	100.00	100.00	-	100.00
PT KT&G Indonesia	Indonesia	KT&G	99.98	-	99.98	99.96	-	99.96
Cheong Kwan Jang Taiwan Corporation	Taiwan	Korea Ginseng Corporation	-	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
Korea Ginseng (China) Corp.	China	Korea Ginseng Corporation	-	100.00	100.00	-	100.00	100.00
Korea Ginseng Corporation Japan	Japan	Korea Ginseng Corporation	-	100.00	100.00	-	100.00	100.00
PT CKJ INDONESIA	Indonesia	Korea Ginseng Corporation	-	99.88	99.88	-	99.88	99.88
K&I HK Co., Ltd ⁶	Hong Kong	KT&G	100.00	-	100.00	-	-	-
K&I China Co., Ltd ⁶	China	KT&G	100.00	-	100.00	-	-	-

¹ The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of September 30, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

² The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of September 30, 2014, the Company's percentage of ownership would be 68.91% if

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convertible preferred shares are included.

³ The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of September 30, 2014, the Company's percentage of ownership would be 59.48% if convertible preferred shares are included.

⁴ The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of September 30, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

⁵ KGC Yebon was liquidated during the current period.

⁶ During the nine-month period ended September 30, 2014, K&I HK Co., Ltd. and K&I China Co., Ltd Have been included as a subsidiary.

Transactions with related parties for the nine-month periods ended September 30, 2014 and 2013, are as follows:

(in millions of Korean won)

		2014		2013	
		Three months	Nine months	Three months	Nine months
Sales and other income					
Subsidiaries	Korea Ginseng Corporation	₩ 2,130	₩ 6,377	₩ 2,307	₩ 6,989
	Yungjin Pharm. Ind. Co., Ltd.	95	262	70	204
	Tae-a industry Co., Ltd.	6	14	6	14
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	2,673	6,071	2,367	8,544
	KT&G Pars	1,072	2,305	386	2,213
	KT&G Rus L.L.C.	10,449	24,386	5,483	14,838
	KGC Life & Gin Co., Ltd	239	539	435	1,215
	Global Trading, Inc.	16,198	48,760	14,076	42,883
	Somang Cosmetics Co., Ltd.	34	151	16	52
	KT&G Life Science	15	50	10	60
	Renzoluc Pte., Ltd.	983	3,015	1,059	3,607
	PT Trisakti Purwosari Makmur	119	119	-	43
	PT KT&G Indonesia	133	546	165	367
	KGC Yebon	152	262	5	15
	PT Mandiri Maha mulia	468	3,747	238	1,011
		<u>₩ 34,766</u>	<u>₩ 96,604</u>	<u>₩ 26,623</u>	<u>₩ 82,055</u>
Purchases and other expenses					
Subsidiaries	Korea Ginseng Corporation	₩ 554	₩ 1,317	₩ 394	₩ 1,192
	Yungjin Pharm. Ind. Co., Ltd.	3	8	4	6
	Tae-a industry Co., Ltd.	3,540	11,406	3,518	10,920
	KGC Life & Gin Co., Ltd	225	497	172	589
	Somang Cosmetics Co., Ltd.	32	92	33	111
	Korea Ginseng (China) Corp.	-	233	-	-
	KGC Yebon	12	12	-	-
		<u>₩ 4,366</u>	<u>₩ 13,565</u>	<u>₩ 4,121</u>	<u>₩ 12,818</u>

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Details of related party receivables and payables as of September 30, 2014 and December 31, 2013 are as follows:

<i>(in millions of Korean won)</i>		September 30, 2014		December 31, 2013	
Receivables from related parties					
Subsidiaries	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	₩	34,299	₩	31,845
	KT&G Pars ¹		40,120		40,149
	KT&G Rus L.L.C.		23,897		26,691
	Global Trading, Inc.		497		2,697
	Renzoluc Pte., Ltd.		48,084		46,989
	PT Mandiri Maha mulia		3,998		3,655
	Somang Cosmetics Co., Ltd.		16		21
	PT Trisakti Purwosari Makmur		121		192
	Korea Ginseng Corporation		544		8
	PT KT&G Indonesia		10,509		7,615
	KGC Life & Gin Co., Ltd.		69		116
	Yungjin Pharm. Ind. Co., Ltd.		10		-
	Korea Tabacos do Brasil Ltda.		94		94
	KGC Yebon		121		-
	KT&G Life Science		5		-
		₩	<u>162,384</u>	₩	<u>160,072</u>
Payables to related parties					
Subsidiaries	Korea Ginseng Corporation	₩	1,811	₩	1,817
	Somang Cosmetics Co., Ltd.		29		37
	Tae-a industry Co., Ltd.		1,285		810
	Yungjin Pharm. Ind. Co., Ltd.		413		413
	KGC Life & Gin Co., Ltd.		183		115
	KT&G Life Science		814		813
	KGC Yebon		12		-
		₩	<u>4,547</u>	₩	<u>4,005</u>

¹ Above receivables are the gross amounts before ₩ 20,572 million of allowance for doubtful accounts.

Fund transactions with related parties for the nine-month period ended September 30, 2014, are as follows:

<i>(in millions of Korean won)</i>		Loan transactions		Equity contributions		Investment			
		Loans	Repayments	in cash		in kind			
Subsidiaries	PT KT&G Indonesia	₩	2,265	₩	-	₩	3,202	₩	-
	K&I HK Co., Ltd.		-		-		11		-
	K&I China Co.,Ltd		-		-		31		-
	Global Trading, Inc.		-		2,035		-		-
	KGC Yebon		-		-		-		5,902
	Korea Ginseng Corporation		-		-		-		73,025

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Fund transactions with related parties for the nine-month period ended September 30, 2013, are as follows:

(in millions of Korean won)

		<u>Loan transactions</u>		<u>Equity</u>
		<u>Loans</u>	<u>Repayments</u>	<u>contributions</u>
				<u>in cash</u>
Subsidiaries	Renzoluc Pte., Ltd.	₩ 2,239	₩ -	₩ -
	PT KT&G Indonesia	7,418	-	3,746
	KGC Life & Gin Co., Ltd.	2,600	2,600	22,000

The compensation paid or payable to key management for employee services for the nine-month periods ended September 30, 2014 and 2013, consists of:

(in millions of Korean won)

	<u>2014</u>		<u>2013</u>	
	<u>Three months</u>	<u>Nine months</u>	<u>Three months</u>	<u>Nine months</u>
Short-term employee benefits	₩ 4,215	₩ 11,768	₩ 4,082	₩ 11,697
Retirement benefits	406	1,463	402	1,264
	<u>₩ 4,621</u>	<u>₩ 13,231</u>	<u>₩ 4,484</u>	<u>₩ 12,961</u>

33. Basis of Translating Financial Statements

The financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩1,050.60 to US\$1, the basic exchange rate on September 30, 2014, posted by Seoul Money Brokerage Services, 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 U.S. dollars at this or any other rate.