

KT&G CORPORATION

Separate Interim Financial Statements

**September 30, 2015 and 2014**

(Unaudited)

(With Independent Auditors' Review Report Thereon)

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## Independent Auditors' Review Report

Based on a report originally issued in Korean

The Board of Directors and Shareholders  
KT&G Corporation:

### Reviewed financial statements

We have reviewed the accompanying separate interim financial statements of KT&G Corporation (the "Company"), expressed in Korean won, which comprise the separate interim statement of financial position as of September 30, 2015, and the separate interim statements of comprehensive income for the three- and nine-month periods ended September 30, 2015 and the separate interim statements of changes in equity and cash flows for the nine-month period ended September 30, 2015 and notes to the separate interim financial statements.

### Management's responsibility

Management is responsible for the preparation and fair presentation of these separate interim financial statements in accordance with Korean International Financial Reporting Standards ("K-IFRS") No.1034 *Interim Financial Reporting*, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' review responsibility

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

We conducted our review in accordance with the Review Standards for Quarterly and Semiannual Financial Statements established by the Securities and Futures Commission of the Republic of Korea. A review of separate interim financial statements 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 review, nothing has come to our attention that causes us to believe that the accompanying separate interim financial statements referred to above are not prepared, in all material respects, in accordance with K-IFRS No.1034.

The accompanying separate interim financial statements as of September 30, 2015 and for the three- and nine-month periods ended September 30, 2015 have been translated into United States dollars solely for the convenience of the reader and such translation does not comply with K-IFRS. We have reviewed the translation and nothing came to our attention that causes us to believe that the separate interim financial statements expressed in Korean won have not been translated into dollars on the basis set forth in note 4 to the separate interim financial statements.



### Other matters

The procedures and practices utilized in the Republic of Korea to review such separate interim financial statements may differ from those generally accepted and applied in other countries.

The separate interim statements of comprehensive income for the three- and nine-month periods ended September 30, 2014 and the separate interim statements of changes in equity and cash flows for the nine-month period ended September 30, 2014 were reviewed by other auditors whose review report thereon dated November 13, 2014, expressed that nothing came to their attention that caused them to believe that the separate interim financial statements referred to above were not prepared, in all material respects, in accordance with K-IFRS No.1034.

The separate statement of financial position as of December 31, 2014, and the related separate statements of comprehensive income, changes in equity and cash flows for the year then ended, which are not accompanying this report, were audited by other auditors, whose report thereon dated February 5, 2015, expressed an unqualified opinion. The accompanying separate statement of financial position of the Company as of December 31, 2014, presented for comparative purposes, is not different from that audited by other auditors in all material respects.

*KPMG Samjong Accounting Corp.*

KPMG Samjong Accounting Corp.  
Seoul, Korea  
November 16, 2015

This report is effective as of November 16, 2015, 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 the above review report has not been updated to reflect the impact of such subsequent events or circumstances, if any.

KT&G CORPORATION  
 Separate Interim Statements of Financial Position  
 (Unaudited)

**As of September 30, 2015 and December 31, 2014**

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	September 30 2015 Korean won	September 30 2015 U.S. dollars (note 4)	December 31 2014 Korean won
<b>Assets</b>				
Property, plant and equipment	5	₩ 1,301,926	\$ 1,089,934	₩ 1,279,660
Intangible assets	6	20,704	17,333	19,636
Investment property	7,16	138,336	115,811	140,141
Investments in associates	8	60,225	50,419	60,225
Investments in subsidiaries	9	1,136,691	951,604	1,081,840
Available-for-sale financial assets	10,30	322,558	270,036	303,438
Long-term deposits in MSA Escrow Fund	11,30,32	394,577	330,328	301,808
Long-term prepaid expenses		3,674	3,075	4,160
Long-term trade and other receivables	12,29,30	113,943	95,390	120,702
<b>Total non-current assets</b>		<b>3,492,634</b>	<b>2,923,930</b>	<b>3,311,610</b>
Inventories	13	798,406	668,402	910,438
Current available-for-sale financial assets	10,30	-	-	1,000
Other financial assets	14,30,31	1,011,291	846,623	640,000
Prepaid tobacco excise and other taxes		406,091	339,968	260,773
Trade and other receivables	12,29,30	1,041,418	871,844	824,948
Advance payments		46,558	38,977	20,233
Prepaid expenses		3,187	2,667	3,922
Cash and cash equivalents	14,30,31	342,225	286,501	321,562
<b>Total current assets</b>		<b>3,649,176</b>	<b>3,054,982</b>	<b>2,982,876</b>
Not-current assets held for sale	15	1,542	1,291	426
<b>Total assets</b>		<b>₩ 7,143,352</b>	<b>\$ 5,980,203</b>	<b>₩ 6,294,912</b>

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Financial Position, Continued

(Unaudited)

As of September 30, 2015 and December 31, 2014

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	September 30 2015 Korean won	September 30 2015 U.S. dollars (note 4)	December 31 2014 Korean won
<b>Equity</b>				
Ordinary shares	1,17	₩ 954,959	\$ 799,464	₩ 954,959
Other capital surplus	17	3,582	2,999	3,582
Treasury shares	18	(337,062)	(282,179)	(339,059)
Gain on reissuance of treasury shares	18	494,648	414,105	492,032
Reserves	19	3,794,593	3,176,721	3,493,758
Retained earnings	20	813,200	680,786	736,461
<b>Total equity</b>		<b>5,723,920</b>	<b>4,791,896</b>	<b>5,341,733</b>
<b>Liabilities</b>				
Long-term trade and other payables	16,21,29,30	27,025	22,625	28,310
Long-term advance receipts		1,093	915	2,344
Net defined benefit liability	23	88,065	73,726	67,260
Deferred income tax liabilities		62,797	52,571	69,195
<b>Total non-current liabilities</b>		<b>178,980</b>	<b>149,837</b>	<b>167,109</b>
Short-term borrowings	22,30,31	5,595	4,684	5,552
Trade and other payables	21,29,30	416,583	348,751	347,240
Advance receipts		29,945	25,069	26,245
Income tax payable		142,064	118,932	157,545
Tobacco excise and other taxes payable		646,265	541,034	249,488
<b>Total current liabilities</b>		<b>1,240,452</b>	<b>1,038,470</b>	<b>786,070</b>
<b>Total liabilities</b>		<b>1,419,432</b>	<b>1,188,307</b>	<b>953,179</b>
<b>Total equity and liabilities</b>		<b>₩ 7,143,352</b>	<b>\$ 5,980,203</b>	<b>₩ 6,294,912</b>

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION  
 Separate Interim Statements of Comprehensive Income  
 (Unaudited)

**For the nine-month periods ended September 30, 2015 and 2014**

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

	Note	2015 Korean won	2015 U.S. dollars (note 4)	2014 Korean won
<b>Sales:</b>	29,32			
Manufacture of tobacco		₩ 1,999,179	\$ 1,673,653	₩ 1,853,414
Real estate		99,241	83,082	110,987
Exports of leaf tobacco and others		50,443	42,230	60,460
		2,148,863	1,798,965	2,024,861
<b>Cost of sales:</b>	24,29			
Manufacture of tobacco		(609,699)	(510,422)	(668,803)
Real estate		(57,650)	(48,263)	(64,770)
Exports of leaf tobacco and others		(34,669)	(29,024)	(39,276)
		(702,018)	(587,709)	(772,849)
<b>Gross profit</b>		1,446,845	1,211,256	1,252,012
Selling, general and administrative expenses	24,29	(479,820)	(401,691)	(467,925)
<b>Operating profit</b>		967,025	809,565	784,087
Other income	25,29	108,920	91,184	27,890
Other expenses	25,29	(38,084)	(31,883)	(24,117)
Finance income	26,30	38,364	32,117	55,505
Finance costs	26,30	(703)	(588)	(648)
Net finance income	26	37,661	31,529	54,857
<b>Profit before income tax</b>		1,075,522	900,395	842,717
Income tax expense	27	(262,257)	(219,553)	(205,322)
<b>Profit for the period</b>		₩ 813,265	\$ 680,842	₩ 637,395
<b>Other comprehensive loss:</b>				
<b>Items that will not be reclassified to profit or loss</b>				
Remeasurements of net defined benefit liability, net of tax		₩ (66)	\$ (56)	₩ (595)
<b>Items that are or may be reclassified subsequently to profit or loss</b>				
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		(7,569)	(6,336)	(5,166)
<b>Other comprehensive loss for the period, net of tax</b>		(7,635)	(6,392)	(5,761)
<b>Total comprehensive income for the period</b>		₩ 805,630	\$ 674,450	₩ 631,634
<b>Earnings per share in won and U.S. dollars:</b>				
Basic and diluted	28	₩ 6,457	\$ 5.41	₩ 5,063

See accompanying notes to the separate interim financial statements.

# KT&G CORPORATION

## Separate Interim Statements of Comprehensive Income, Continued

(Unaudited)

### For the three-month periods ended September 30, 2015 and 2014

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

	Note	2015 Korean won	2015 U.S. dollars (note 4)	2014 Korean won
<b>Sales:</b>	29,32			
Manufacture of tobacco		₩ 663,603	\$ 555,548	₩ 669,567
Real estate		19,888	16,650	29,725
Exports of leaf tobacco and others		19,310	16,166	23,094
		702,801	588,364	722,386
<b>Cost of sales:</b>	24,29			
Manufacture of tobacco		(218,406)	(182,843)	(235,423)
Real estate		(8,740)	(7,317)	(16,099)
Exports of leaf tobacco and others		(12,699)	(10,631)	(14,938)
		(239,845)	(200,791)	(266,460)
<b>Gross profit</b>		462,956	387,573	455,926
Selling, general and administrative expenses	24,29	(146,585)	(122,716)	(157,829)
<b>Operating profit</b>		316,371	264,857	298,097
Other income	25,29	61,641	51,604	39,895
Other expenses	25,29	(6,035)	(5,052)	(5,985)
Finance income	26,30	10,808	9,048	30,674
Finance costs	26,30	(284)	(238)	(170)
Net finance income	26	10,524	8,810	30,504
<b>Profit before income tax</b>		382,501	320,219	362,511
Income tax expense	27	(93,620)	(78,376)	(88,061)
<b>Profit for the period</b>		₩ 288,881	\$ 241,843	₩ 274,450
<b>Other comprehensive income (loss):</b>				
<b>Items that will not be reclassified to profit or loss</b>				
Remeasurements of net defined benefit liability, net of tax		₩ 54	\$ 45	₩ (93)
<b>Items that are or may be reclassified subsequently to profit or loss</b>				
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		(159)	(133)	(9,473)
<b>Other comprehensive loss for the period, net of tax</b>		(105)	(88)	(9,566)
<b>Total comprehensive income for the period</b>		₩ 288,776	\$ 241,755	₩ 264,884
<b>Earnings per share in won and U.S. dollars:</b>				
Basic and diluted	28	₩ 2,293	\$ 1.92	₩ 2,180

See accompanying notes to the separate interim financial statements.



# KT&G CORPORATION

## Separate Interim Statements of Changes in Equity

(Unaudited)

**For the nine-month period ended September 30, 2015**

<i>In millions of won</i>		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
<b>Balance at January 1, 2015</b>	₩	954,959	3,582	(339,059)	492,032	3,493,758	736,461	5,341,733
<b>Total comprehensive income for the period:</b>								
Profit for the period		-	-	-	-	-	813,265	813,265
<b>Other comprehensive loss:</b>								
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	(66)	(66)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	(7,569)	-	(7,569)
<b>Total other comprehensive loss</b>		-	-	-	-	(7,569)	(66)	(7,635)
<b>Total comprehensive income for the period</b>		-	-	-	-	(7,569)	813,199	805,630
<b>Transactions with owners, recorded directly in equity:</b>								
Dividends		-	-	-	-	-	(428,056)	(428,056)
In-kind donation of treasury shares		-	-	1,997	2,616	-	-	4,613
Transfer from reserve for research and human resource development		-	-	-	-	(12,522)	12,522	-
Transfer to unconditional reserve		-	-	-	-	320,926	(320,926)	-
<b>Total transactions with owners</b>		-	-	1,997	2,616	308,404	(736,460)	(423,443)
<b>Balance at September 30, 2015</b>	₩	954,959	3,582	(337,062)	494,648	3,794,593	813,200	5,723,920

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Changes in Equity, Continued

(Unaudited)

For the nine-month period ended September 30, 2015

*In thousands of U.S. dollars (note 4)*

	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
<b>Balance at January 1, 2015</b>	\$ 799,464	2,999	(283,850)	411,915	2,924,870	616,543	4,471,941
<b>Total comprehensive income for the period:</b>							
Profit for the period	-	-	-	-	-	680,842	680,842
<b>Other comprehensive loss:</b>							
Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	(56)	(56)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	(6,336)	-	(6,336)
<b>Total other comprehensive loss</b>	-	-	-	-	(6,336)	(56)	(6,392)
<b>Total comprehensive income for the period</b>	-	-	-	-	(6,336)	680,786	674,450
<b>Transactions with owners, recorded directly in equity:</b>							
Dividends	-	-	-	-	-	(358,356)	(358,356)
In-kind donation of treasury shares	-	-	1,671	2,190	-	-	3,861
Transfer from reserve for research and human resource development	-	-	-	-	(10,483)	10,483	-
Transfer to unconditional reserve	-	-	-	-	268,670	(268,670)	-
<b>Total transactions with owners</b>	-	-	1,671	2,190	258,187	(616,543)	(354,495)
<b>Balance at September 30, 2015</b>	\$ 799,464	2,999	(282,179)	414,105	3,176,721	680,786	4,791,896

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Changes in Equity, Continued

(Unaudited)

**For the nine-month period ended September 30, 2014**

<i>In millions of won</i>		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
<b>Balance at January 1, 2014</b>	₩	954,959	3,582	(339,059)	492,032	3,411,099	509,821	5,032,434
<b>Total comprehensive income for the period:</b>								
Profit for the period		-	-	-	-	-	637,395	637,395
<b>Other comprehensive loss:</b>								
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	(595)	(595)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	(5,166)	-	(5,166)
<b>Total other comprehensive loss</b>		-	-	-	-	(5,166)	(595)	(5,761)
<b>Total comprehensive income for the period</b>		-	-	-	-	(5,166)	636,800	631,634
<b>Transactions with owners, recorded directly in equity:</b>								
Dividends		-	-	-	-	-	(402,876)	(402,876)
Transfer from reserve for research and human resource development		-	-	-	-	(47,478)	47,478	-
Transfer to unconditional reserve		-	-	-	-	152,000	(152,000)	-
<b>Total transactions with owners</b>		-	-	-	-	104,522	(507,398)	(402,876)
<b>Balance at September 30, 2014</b>	₩	954,959	3,582	(339,059)	492,032	3,510,455	639,223	5,261,192

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION  
 Separate Interim Statements of Cash Flows  
 (Unaudited)

**For the nine-month periods ended September 30, 2015 and 2014**

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2015 Korean won	2015 U.S. dollars (note 4)	2014 Korean won
<b>Cash flows from operating activities</b>				
Cash generated from operations	33	₩ 1,318,153	\$ 1,103,518	₩ 784,096
Income tax paid		(282,533)	(236,528)	(193,362)
<b>Net cash provided by operating activities</b>		<b>1,035,620</b>	<b>866,990</b>	<b>590,734</b>
<b>Cash flows from investing activities</b>				
Interest received		21,486	17,987	22,819
Investment income received				
from long-term deposits in MSA Escrow Fund		1,209	1,012	1,107
Dividends received		11,680	9,778	7,796
Proceeds from sale of property, plant and equipment		6,671	5,585	5,635
Proceeds from sale of intangible assets		1,592	1,333	-
Proceeds from sale of non-current assets held for sale		4,260	3,566	55
Proceeds from sale of investments in subsidiaries		-	-	85
Collection of loans		8,929	7,475	11,148
Withdrawal of guarantee deposits		19,468	16,299	16,389
Acquisition of property, plant and equipment		(105,518)	(88,336)	(88,016)
Acquisition of intangible assets		(1,957)	(1,638)	(873)
Acquisition of investment property		(64)	(54)	(77)
Acquisition of investments in subsidiaries		(54,851)	(45,920)	(3,244)
Acquisition of available-for-sale financial assets		(28,200)	(23,608)	(19,700)
Increase in loans		(4,835)	(4,048)	(2,265)
Payments of guarantee deposits		(17,861)	(14,953)	(17,744)
Payments of long-term deposits in MSA Escrow Fund		(61,325)	(51,340)	(52,036)
Decrease (increase) in other financial assets		(360,000)	(301,381)	20,000
Acquisition of redeemable convertible preference shares		(26,000)	(21,766)	-
<b>Net cash used in investing activities</b>		<b>(585,316)</b>	<b>(490,009)</b>	<b>(98,921)</b>
<b>Cash flows from financing activities</b>				
Dividends paid		(428,056)	(358,356)	(402,876)
Increase in deposits received		1,860	1,557	1,653
Decrease in deposits received		(3,464)	(2,900)	(2,730)
<b>Net cash used in financing activities</b>		<b>(429,660)</b>	<b>(359,699)</b>	<b>(403,953)</b>
<b>Effect of exchange rate fluctuation on cash held</b>		<b>19</b>	<b>16</b>	<b>63</b>
<b>Net increase in cash and cash equivalents</b>		<b>20,663</b>	<b>17,298</b>	<b>87,923</b>
Cash and cash equivalents at January 1		321,562	269,203	245,838
<b>Cash and cash equivalents at September 30</b>		<b>₩ 342,225</b>	<b>\$ 286,501</b>	<b>₩ 333,761</b>

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION  
Notes to the Separate Interim Financial Statements  
(Unaudited)

**For the nine-month periods ended September 30, 2015 and 2014**

**1. Organization and Description of Business**

KT&G Corporation (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 Act 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 30, 2015, the Company has three manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 123 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 71, Beotkkot-gil, 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.

The ownership of the Company's issued ordinary shares as of September 30, 2015 is held as follows:

Shareholder	Number of shares	Percentage of ownership
National Pension Service	11,098,167	8.08%
Industrial Bank of Korea	9,510,485	6.93%
Employee Share Ownership Association	2,473,696	1.80%
Treasury shares	11,326,605	8.25%
Others	102,883,544	74.94%
	137,292,497	100.00%

KT&G CORPORATION  
Notes to the Separate Interim Financial Statements  
(Unaudited)

**For the nine-month periods ended September 30, 2015 and 2014**

**2. Basis of Preparation**

**(a) Statement of Compliance**

The separate interim financial statements have been prepared in accordance with Korean International Financial Reporting Standards ("K-IFRS"). These separate interim financial statements were prepared in accordance with K-IFRS No. 1034 *Interim Financial Reporting* as part of the period covered by the Company's K-IFRS annual separate financial statements.

These separate interim financial statements are separate financial statements prepared in accordance with K-IFRS No.1027 *Separate Financial Statements* presented by a parent, an investor in an associate or a venture in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

The separate interim financial statements were authorized for issue by the Board of Directors on October 22, 2015.

**(b) Basis of Measurement**

The separate interim financial statements have been prepared on the historical cost basis, except for the following material items in the separate interim statements of financial position:

- Derivative financial instruments measured at fair value
- Available-for-sale financial assets measured at fair value
- Liabilities for defined benefit plans recognized at the net of the total present value of defined benefit obligations less the fair value of plan assets

**(c) Functional and Presentation Currency**

These separate interim financial statements are presented in Korean won, which is the Company's functional currency and the currency of the primary economic environment in which the Company operates.

**(d) Use of Estimates and Judgments**

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

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

In preparing these separate interim financial statements, the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the financial statements as of and for the year ended December 31, 2014.

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Notes to the Separate Interim Financial Statements  
(Unaudited)

**For the nine-month periods ended September 30, 2015 and 2014**

**3. Significant Accounting Policies**

**(a) Changes in Accounting Policies**

The accounting policies applied in these separate interim financial statements are the same as those applied in the Company's separate financial statements as of and for the year ended December 31, 2014, except for the adoption of amendments to K-IFRS 1019 *Employee Benefits*.

Amendments to K-IFRS 1019 introduced a practical expedient to accounting for defined benefit plan, when employees or third parties pay contributions if certain criteria are met. According to the amendments, the entity is permitted to recognize those contributions as a reduction of the service cost in the period in which the related service is rendered, instead of forecast future contributions from employees or third parties and attribute them to periods or service as negative benefits.

The Company retrospectively applied the amendments in accordance with the transitional requirements of K-IFRS 1019. The changes in accounting policies are also expected to be reflected in the Company's separate financial statements as of and for the year ending December 31, 2015.

**(b) Subsidiaries and Associates in the Separate Financial Statements**

These separate interim financial statements are prepared and presented in accordance with K-IFRS No.1027. The Company applied the cost method to investments in subsidiaries, associates and joint ventures in accordance with K-IFRS No. 1027. Dividends from a subsidiaries, associates and joint ventures are recognized in profit or loss when the right to receive the dividend is established.

**(c) 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.

Property, plant and equipment, except for land and other tangible fixed assets, are depreciated on a straight-line basis over estimated useful lives that appropriately reflect the pattern in which the asset's future economic benefits are expected to be consumed.

The estimated useful lives of the Company's assets are as follows:

	Useful lives (years)		Useful lives (years)
Buildings	10 ~ 60	Vehicles	4
Structures	10 ~ 40	Tools	4
Machinery	10 ~ 12	Furniture and fixtures	4

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**For the nine-month periods ended September 30, 2015 and 2014**

**3. Significant Accounting Policies, Continued**

**(c) Property, Plant and Equipment, Continued**

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 in other income and expense in the statement of comprehensive income.

**(d) Borrowing Costs**

The Company capitalizes borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Other borrowing costs are recognized in expense as incurred. A qualifying asset is an asset that requires a substantial period of time to get ready for its intended use or sale. Financial assets and inventories that are manufactured or otherwise produced over a short period of time are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets.

To the extent that the Company borrows funds specifically for the purpose of obtaining a qualifying asset, the Company determines the amount of borrowing costs eligible for capitalization as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings. The Company immediately recognizes other borrowing costs as an expense. To the extent that the Company borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the Company determines the amount of borrowing costs eligible for capitalization by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Company that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that the Company capitalizes during a period does not exceed the amount of borrowing costs incurred during that period.

**(e) Government Grants**

Government grants are not recognized unless there is reasonable assurance that the Company will comply with the grant's conditions and that the grant will be received. Government grants which are intended to compensate the Company for expenses incurred are recognized as other income in profit or loss over the periods in which the Company recognizes the related costs as expenses.

**(f) Intangible Assets**

Intangible assets are measured initially at cost and, subsequently, are carried at cost less accumulated amortization and accumulated impairment losses. Intangible assets consist of industrial property rights, facility usage rights and intangible assets under development. 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 some of industrial property rights and facility usage rights are expected to be available for use, these intangible assets are regarded as having indefinite useful lives and not amortized.



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**3. Significant Accounting Policies, Continued**

**(f) Intangible Assets, Continued**

The estimated useful lives are as follows:

	Useful lives (years)
Industrial property rights	10 ~ 20 or indefinite
Facility usage rights	indefinite

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 estimate.

**(g) Investment Property**

Property held for the purpose of earning rentals or benefiting from capital appreciation is classified as investment property. Investment property is initially measured at its cost. Transaction costs are included in the initial measurement. Subsequently, investment property is carried at depreciated cost less any accumulated impairment losses.

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

Investment property except for land, are depreciated on a straight-line basis over 10 ~ 60 years as estimated useful lives.

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

**(h) Non-current Assets Held for Sale**

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. In order to be classified as held for sale, the asset (or disposal group) must be available for immediate sale in its present condition and its sale must be highly probable. The assets or disposal group that are classified as non-current assets held for sale are measured at the lower of their carrying amount and fair value less cost to sell.

The Company recognizes an impairment loss for any initial or subsequent write-down of an asset (or disposal group) to fair value less costs to sell, and a gain for any subsequent increase in fair value less costs to sell, up to the cumulative impairment loss previously recognized in accordance with K-IFRS No. 1036 *Impairment of Assets*.

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

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Notes to the Separate Interim Financial Statements  
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**3. Significant Accounting Policies, Continued**

**(i) 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 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 ₩257,374 million and ₩272,649 million, respectively, as of September 30, 2015 and December 31, 2014.

**(j) Impairment of Non-financial Assets**

The carrying amounts of the Company's non-financial assets, other than inventories, deferred tax assets, assets arising from employee benefits and non-current assets held for sale, are reviewed at the end of the reporting period to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, irrespective of whether there is any indication of impairment, are tested for impairment annually by comparing their recoverable amount to their carrying amount.

The Company estimates the recoverable amount of an individual asset. If it is impossible to measure the individual recoverable amount of an asset, then the Company estimates the recoverable amount of cash-generating unit ("CGU"). A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. The value in use is estimated by applying a pre-tax discount rate that reflect current market assessments of the time value of money and the risks specific to the asset or CGU for which estimated future cash flows have not been adjusted, to the estimated future cash flows expected to be generated by the asset or CGU.

An impairment loss is recognized if the carrying amount of an asset or a CGU exceeds its recoverable amount. Impairment losses are recognized in profit or loss.

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**For the nine-month periods ended September 30, 2015 and 2014**

**3. Significant Accounting Policies, Continued**

**(k) Non-derivative Financial Assets**

The Company recognizes and measures non-derivative financial assets by the following four categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets. The Company recognizes financial assets in the statement of financial position when the Company becomes a party to the contractual provisions of the instrument.

Upon initial recognition, non-derivative financial assets are measured at their fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the asset's acquisition or issuance.

(i) Financial assets at fair value through profit or loss

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

(ii) Held-to-maturity investments

A non-derivative financial asset with a fixed or determinable payment and fixed maturity, for which the Company has the positive intention and ability to hold to maturity, are classified as held-to-maturity investments. Subsequent to initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method.

(iii) Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method except for loans and receivables of which the effect of discounting is immaterial.

(iv) Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables. Subsequent to initial recognition, they are measured at fair value, which changes in fair value, net of any tax effect, recorded in other comprehensive income in equity. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments are measured at cost.

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**For the nine-month periods ended September 30, 2015 and 2014**

**3. Significant Accounting Policies, Continued**

**(k) Non-derivative Financial Assets, Continued**

(v) De-recognition of financial assets

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

If the Company retains substantially all the risks and rewards of ownership of the transferred financial assets, the Company continues to recognize the transferred financial assets and recognizes financial liabilities for the consideration received.

(vi) Offsetting between financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount is presented in the statement of financial position only when the Company currently has a legally enforceable right to offset the recognized amounts, and there is the intention to settle on a net basis or to realize the asset and settle the liability simultaneously.

**(l) Derivative Financial Instruments**

Derivatives are initially recognized at fair value. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are recognized immediately in profit or loss.

Embedded derivatives are separated from the host contract and accounted for separately only if the following criteria have been met:

- the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative and
- the hybrid instrument is not measured at fair value with changes in fair value recognized in profit or loss.

Changes in the fair value of separable embedded derivatives are recognized immediately in profit or loss.

**(m) Impairment of Financial Assets**

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably. However, losses expected as a result of future events, regardless of likelihood, are not recognized.

If financial assets have objective evidence that they are impaired, impairment losses should be measured and recognized.

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**3. Significant Accounting Policies, Continued**

**(m) Impairment of Financial Assets, Continued**

(i) Financial assets measured at amortized cost

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of its estimated future cash flows discounted at the asset's original effective interest rate. If it is not practicable to obtain the instrument's estimated future cash flows, impairment losses would be measured by using prices from any observable current market transactions. The Company can recognize impairment losses directly or establish a provision to cover impairment losses. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed either directly or by adjusting an allowance account.

(ii) Financial assets carried at cost

If there is objective evidence that an impairment loss has occurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

(iii) Available-for-sale financial assets

When a decline in the fair value of an available-for-sale financial asset has been recognized in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in other comprehensive income is reclassified from other comprehensive income to profit or loss as a reclassification adjustment even though the financial asset has not been derecognized. Impairment losses recognized in profit or loss for an investment in an equity instrument classified as available-for-sale are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in profit or loss. For an investment in an equity security, objective evidence of impairment includes a significant or prolonged decline in its fair value below its cost. The Company considers a decline of 20% to be significant and a period of nine months to be prolonged.

**(n) Cash and Cash Equivalents**

Cash and cash equivalents comprise cash balances and call deposits with maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Company in the management of its short-term commitments. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares when it has a short maturity with a specified redemption date.

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**3. Significant Accounting Policies, Continued**

**(o) Non-derivative Financial Liabilities**

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

(i) Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading or designated as such upon initial recognition. Subsequent to initial recognition, financial liabilities at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss. Upon initial recognition, transaction costs that are directly attributable to the acquisition are recognized in profit or loss as incurred.

(ii) Financial guarantee liabilities

Financial guarantee liability is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified term of a debt instrument. Upon initial recognition, financial guarantee liabilities are measured at their fair value plus, transaction costs that are directly attributable to the acquisition or issue of the financial guarantee liability.

After initial recognition, an issuer of such a contract measures it at the higher of the amount determined in accordance with K-IFRS No. 1037 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognized less, when appropriate, cumulative amortisation recognized in accordance with K-IFRS No. 1018 *Revenue*.

(iii) Other financial liabilities

Non-derivative financial liabilities other than financial liabilities at fair value through profit or loss or financial guarantee liabilities are classified as other financial liabilities. At the date of initial recognition, other financial liabilities are measured at fair value minus transaction costs that are directly attributable to the acquisition. Subsequent to initial recognition, other financial liabilities are measured at amortized cost using the effective interest method.

The Company derecognizes a financial liability from the statement of financial position when it is extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

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**For the nine-month periods ended September 30, 2015 and 2014**

**3. Significant Accounting Policies, Continued**

**(p) Employee Benefits**

(i) Short-term employee benefits

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

(ii) Retirement benefits: defined contribution plans

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

(iii) Retirement benefits: defined benefit plans

The calculation of defined benefit obligations is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a potential asset for the Company, the recognized asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in other comprehensive income. The Company determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in profit or loss. The Company recognizes gains and losses on the settlement of a defined benefit plan when the settlement occurs.

(iv) Termination benefits

Termination benefits are expensed at the earlier of when the Company can no longer withdraw the offer of those benefits and when the Company recognizes costs for a restructuring. If benefits are not expected to be settled wholly within 12 months of the end of the reporting period, then they are discounted.

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**For the nine-month periods ended September 30, 2015 and 2014**

**3. Significant Accounting Policies, Continued**

**(q) Provisions**

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

The risks and uncertainties that inevitably surround many events and circumstances are taken into account in reaching the best estimate of a provision. Where the effect of the time value of money is material, provisions are determined at the present value of the expected future cash flows.

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

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

**(r) Equity Capital**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issuance of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects.

When the Company repurchases its share capital, the amount of the consideration paid is recognized as a deduction from equity and classified as treasury shares. The profits or losses from the purchase, disposal, reissue, or retirement of treasury shares are not recognized as current profit or loss. If the Company acquires and retains treasury shares, the consideration paid or received is directly recognized in equity.

**(s) Revenue Recognition**

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

Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the 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 for the nine-month periods ended September 30, 2015 and 2014 were ₩4,024,488 million and ₩2,615,628 million, respectively.



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**3. Significant Accounting Policies, Continued**

**(s) Revenue Recognition, Continued**

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 completions 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.

Rental income from investment property, net of lease incentives granted, is recognized in profit or loss on a straight-line basis over the term of the lease.

**(t) Finance Income and Finance Costs**

Finance income comprises interest income on funds invested (including available-for-sale financial assets), dividend income and investment income on long-term deposits in MSA Escrow Fund. Interest income is recognized as it accrues in profit or loss, using the effective interest method. Dividend income is recognized in profit or loss on the date that the Company's right to receive payment is established.

Finance costs is interest expense on unwinding of the discount on trade and other payables which is recognized in profit or loss using the effective interest method.

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**3. Significant Accounting Policies, Continued**

**(u) Income Taxes**

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

(i) Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the end of the reporting period and any adjustment to tax payable in respect of previous years. The taxable profit is different from the accounting profit for the period since the taxable profit is calculated excluding the temporary differences, which will be taxable or deductible in determining taxable profit (tax loss) of future periods, and non-taxable or non-deductible items from the accounting profit.

(ii) Deferred tax

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. The Company recognizes a deferred tax asset for all deductible temporary differences to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset only if there is a legally enforceable right to offset the related current tax liabilities and assets, and they relate to income taxes levied by the same tax authority and they intend to settle current tax liabilities and assets on a net basis

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**3. Significant Accounting Policies, Continued**

**(v) Foreign Currencies**

Transactions in foreign currencies are translated to the respective functional currencies of the Company at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency using the reporting date's exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

Foreign currency differences arising on retranslation are recognized in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation, or qualifying cash flow hedges, which are recognized in other comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

**(w) Earnings per Share**

The Company presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares.

**(x) Operating Segments**

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Company's other components. All operating segments' operating results are reviewed regularly by the Company's chief executive officer to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Operating segment disclosures are included in the consolidated interim financial statements in accordance with K-IFRS No. 1108 *Operating Segments*.

**4. Basis of Translating Financial Statements**

The separate interim financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩1,194.50 to \$1, the basic exchange rate on September 30, 2015 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.

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**5. Property, Plant and Equipment**

- (a) Details of property, plant and equipment as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	September 30 2015			December 31 2014		
	Cost	Accumulated depreciation	Carrying amount	Cost	Accumulated depreciation	Carrying amount
Land	₩ 467,778	-	467,778	457,890	-	457,890
Buildings	687,429	(304,668)	382,761	690,661	(286,158)	404,503
Structures	44,719	(28,636)	16,083	44,422	(27,272)	17,150
Machinery	978,030	(765,427)	212,603	972,679	(735,831)	236,848
Vehicles	2,246	(1,849)	397	2,304	(2,033)	271
Tools	37,423	(31,799)	5,624	36,425	(31,978)	4,447
Furniture and fixtures	167,264	(133,524)	33,740	158,793	(123,346)	35,447
Others	1,366	-	1,366	1,312	-	1,312
Construction-in-progress	181,574	-	181,574	121,792	-	121,792
	₩ 2,567,829	(1,265,903)	1,301,926	2,486,278	(1,206,618)	1,279,660

- (b) Changes in property, plant and equipment for the nine-month period ended September 30, 2015 were as follows:

<i>In millions of won</i>	January 1 2015	Acquisition	Disposal	Depreciation	Transfer of construction- in-progress	Other changes	September 30 2015
Land	₩ 457,890	7,141	(568)	-	5,293	(1,978)	467,778
Buildings	404,503	820	(312)	(20,108)	95	(2,237)	382,761
Structures	17,150	617	(21)	(1,620)	16	(59)	16,083
Machinery	236,848	2,737	(319)	(37,992)	11,329	-	212,603
Vehicles	271	263	(14)	(149)	26	-	397
Tools	4,447	2,723	(79)	(1,512)	45	-	5,624
Furniture and fixtures	35,447	11,198	(7)	(12,917)	19	-	33,740
Others	1,312	54	-	-	-	-	1,366
Construction-in-progress	121,792	76,605	-	-	(16,823)	-	181,574
	₩ 1,279,660	102,158	(1,320)	(74,298)	-	(4,274)	1,301,926

For the nine-month period ended September 30, 2015, land and buildings with a carrying amount of ₩2,732 million were transferred to investment property and land, buildings and structures with a carrying amount of ₩1,542 million were transferred to non-current assets held for sale.

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5. Property, Plant and Equipment, Continued

(c) Changes in property, plant and equipment for the year ended December 31, 2014 were as follows:

<i>In millions of won</i>	January 1 2014	Acquisition	Disposal	Depreciation	Transfer of construction- in-progress	Other changes	December 31 2014
Land	₩ 410,763	1,611	(652)	-	75,028	(28,860)	457,890
Buildings	400,314	1,552	(1,182)	(26,351)	30,093	77	404,503
Structures	16,973	1,946	(21)	(2,105)	357	-	17,150
Machinery	234,926	7,410	(60)	(50,666)	51,140	(5,902)	236,848
Vehicles	362	109	-	(200)	-	-	271
Tools	3,135	2,000	(85)	(1,611)	1,008	-	4,447
Furniture and fixtures	34,524	14,220	(5)	(17,151)	3,859	-	35,447
Others	1,162	150	-	-	-	-	1,312
Construction-in-progress	80,604	207,079	(58)	-	(161,485)	(4,348)	121,792
	₩ 1,182,763	236,077	(2,063)	(98,084)	-	(39,033)	1,279,660

For the year ended December 31, 2014, land and construction-in-progress with a carrying amount of ₩32,682 million were transferred to inventories and machinery with a carrying amount of ₩5,902 million was contributed to KGC Yebon Corporation as in-kind capital contribution.

6. Intangible Assets

(a) Details of intangible assets as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	September 30 2015			December 31 2014		
	Cost	Accumulated amortization	Carrying amount	Cost	Accumulated amortization	Carrying amount
Industrial property rights	₩ 6,973	(5,530)	1,443	7,163	(5,596)	1,567
Facility usage rights	17,524	(1,709)	15,815	17,701	(2,658)	15,043
Intangible assets under development	3,446	-	3,446	3,026	-	3,026
	₩ 27,943	(7,239)	20,704	27,890	(8,254)	19,636

(b) Changes in intangible assets for the nine-month period ended September 30, 2015 were as follows:

<i>In millions of won</i>	January 1 2015	Acquisition	Disposal	Amortization	September 30 2015
Industrial property rights	₩ 1,567	-	(104)	(20)	1,443
Facility usage rights	15,043	1,537	(765)	-	15,815
Intangible assets under development	3,026	420	-	-	3,446
	₩ 19,636	1,957	(869)	(20)	20,704

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**6. Intangible Assets, Continued**

(c) Changes in intangible assets for the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		January 1 2014	Acquisition	Disposal	Impairment	Amortization	December 31 2014
Industrial property rights	₩	1,625	-	-	-	(58)	1,567
Facility usage rights		17,357	347	(3)	(2,658)	-	15,043
Intangible assets under development		2,209	817	-	-	-	3,026
	₩	21,191	1,164	(3)	(2,658)	(58)	19,636

(d) Expenditures not capitalized for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015		2014	
		Three-month	Nine-month	Three-month	Nine-month
Cost of sales	₩	82	186	-	210
Selling, general and administrative expenses		2,461	7,945	3,632	11,032
	₩	2,543	8,131	3,632	11,242

**7. Investment Property**

(a) Details of investment property as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		September 30 2015			December 31 2014		
		Cost	Accumulated depreciation	Carrying amount	Cost	Accumulated depreciation	Carrying amount
Land	₩	23,066	-	23,066	22,236	-	22,236
Buildings		172,757	(57,487)	115,270	170,124	(52,219)	117,905
	₩	195,823	(57,487)	138,336	192,360	(52,219)	140,141

(b) Changes in investment property for the nine-month period ended September 30, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		2015			2014		
		Land	Buildings	Total	Land	Buildings	Total
Beginning balance	₩	22,236	117,905	140,141	22,246	123,788	146,034
Acquisition		-	64	64	-	222	222
Depreciation		-	(4,601)	(4,601)	-	(6,028)	(6,028)
Transfer from (to) property, plant and equipment		830	1,902	2,732	(10)	(77)	(87)
Ending balance	₩	23,066	115,270	138,336	22,236	117,905	140,141

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**7. Investment Property, Continued**

(c) The amounts recognized in profit or loss from investment property for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015		2014	
		Three-month	Nine-month	Three-month	Nine-month
Rental income	₩	8,417	25,624	8,258	24,913
Direct operating expense		(1,535)	(4,601)	(1,507)	(4,521)
	₩	6,882	21,023	6,751	20,392

(d) The carrying amount and the fair value of investment property as of September 30, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>		September 30 2015		December 31 2014	
		Fair value	Carrying amount	Fair value	Carrying amount
Land	₩	284,775	23,066	281,106	22,236
Buildings		186,436	115,270	180,272	117,905
	₩	471,211	138,336	461,378	140,141

The fair value of investment property was determined based on the yield capitalization method by external, independent valuers. The fair value measurement for all of the investment properties has been categorized as a level 3 fair value based on the inputs to the valuation techniques used.

**8. Investments in Associates**

Investments in associates as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	Company	Location	Principal operation	September 30 2015		December 31 2014	
				Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
	Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	27.97%	₩ 1,830	25.34%	₩ 1,830
	JR CR-REIT IV Co., Ltd.	Korea	Renting real estate	49.02%	13,995	49.02%	13,995
	KVG REIT 1 Co., Ltd.	Korea	Renting real estate	29.67%	7,300	29.67%	7,300
	KOCREF REIT 17 Co., Ltd.	Korea	Renting real estate	22.06%	7,000	22.06%	7,000
	JR REIT V Co., Ltd.	Korea	Renting real estate	34.63%	5,600	34.63%	5,600
	JR REIT VIII Co., Ltd.	Korea	Renting real estate	21.74%	10,000	21.74%	10,000
	LSK Global Pharma Services Co., Ltd.	Korea	Researching and developing medicine	23.15%	-	23.15%	-
	JR REIT X Co., Ltd.	Korea	Renting real estate	28.79%	9,500	28.79%	9,500
	JR REIT XIII Co., Ltd.	Korea	Renting real estate	27.03%	5,000	27.03%	5,000
					₩ 60,225		₩ 60,225

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9. Investments in Subsidiaries

Investments in subsidiaries as of September 30, 2015 and December 31, 2014 are summarized as follows:

*In millions of won*

Company	Location	Principal operation	September 30 2015		December 31 2014	
			Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00%	₩ 672,048	100.00%	₩ 672,048
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceutical	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%	30,049	99.99%	30,049
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 door-to-door	100.00%	44,100	100.00%	44,100
Global Trading, Inc.	USA	Selling tobaccos	100.00%	4,913	100.00%	4,913
Somang Cosmetics Co., Ltd. <sup>(*)</sup>	Korea	Manufacturing and selling cosmetics	97.73%	70,676	60.00%	20,921
Renzoluc Pte., Ltd. <sup>(*)</sup>	Singapore	Manufacturing and selling tobaccos	100.00%	22,156	100.00%	22,156
KT&G Life Sciences Corporation <sup>(*)</sup>	Korea	Researching and developing medicine	73.94%	15,332	73.94%	15,332
KGC Yebon Corporation	Korea	Manufacturing and selling medical herbs	100.00%	49,828	100.00%	49,828
K-Q HongKong I, Limited <sup>(*)</sup>	HongKong	Manufacturing and selling ginseng	100.00%	17,761	100.00%	17,761
PT KT&G Indonesia	Indonesia	Manufacturing and selling tobaccos	99.99%	11,400	99.99%	11,400
K&I HK Co., Ltd.	HongKong	Selling cosmetics	100.00%	11	100.00%	11
K&I China Co., Ltd.	China	Selling cosmetics	100.00%	5,532	100.00%	436
				₩1,136,691		₩1,081,840

<sup>(\*)</sup> The Company's percentage of ownership, shown above, excludes preferred shares. As of September 30, 2015, the Company's percentage of ownership would be 97.76%, 68.91%, 59.48% and 50.00%, respectively, if preferred shares are included.

For the nine-month period ended September 30, 2015, the Company acquired additional shares of Somang Cosmetics Co., Ltd. for ₩49,775 million, increasing its ownership from 60.00% to 97.73%.

For the nine-month period ended September 30, 2015, the Company made an additional investment of ₩5,096 million in K&I China Co., Ltd.



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9. Investments in Subsidiaries, Continued

For the year ended December 31, 2014, the Company acquired ₩73,025 million of additional interest in Korea Ginseng Corporation through an in-kind capital contribution of its interest in Jilin Hanzheng Ginseng Co., Ltd. and other available-for-sale financial assets with a carrying amount of ₩47,675 million and ₩25,350 million, respectively.

For the year ended December 31, 2014, the Company acquired ₩5,902 million of interest in KGC Yebon through an in-kind capital contribution.

For the year ended December 31, 2014, the Company recognized impairment losses on investments in KT&G Tutun Mamulleri Sanayi ve Ticaret A.S., Somang Cosmetics Co., Ltd., Renzoluc Pte, Ltd. and KT&G Life Science amounting to ₩24,000 million, ₩39,800 million, ₩44,200 million and ₩15,900 million, respectively, since the carrying amounts exceeded their recoverable amounts.

10. Available-for-sale Financial Assets

- (a) Changes in available-for-sale financial assets for the nine-month period ended September 30, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		2015	2014
<b>Beginning balance</b>	₩	304,438	296,391
Acquisitions		28,200	51,992
Net changes in fair value		(10,080)	(28,844)
Reclassification to investments in subsidiaries		-	(24,930)
Net gain reclassified from equity		-	19,829
Disposals		-	(10,000)
<b>Ending balance</b>	₩	322,558	304,438
<b>Statement of financial position:</b>			
Current	₩	-	1,000
Non-current		322,558	303,438
	₩	322,558	304,438

- (b) Available-for-sale financial assets as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		September 30 2015	December 31 2014
<b>Available-for-sale debt instruments:</b>			
Corporate bonds	₩	1,500	2,500
<b>Available-for-sale equity instruments:</b>			
Listed			
– Oscotech, Inc.		2,957	1,030
– Shinhan Financial Group Co., Ltd.		165,946	178,171
– Rexahn Pharmaceuticals, Inc.		3,970	4,917
		172,873	184,118
Unlisted		148,185	117,820
<b>Total available-for-sale equity instruments</b>		321,058	301,938
<b>Total available-for-sale financial assets</b>	₩	322,558	304,438

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**10. Available-for-sale Financial Assets, Continued**

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

As of September 30, 2015 and December 31, 2014, ₩41,594 million and ₩29,594 million of available-for-sale financial assets that do not have a market price in an active market and whose fair value cannot be reliably measured or is similar to their carrying amount are measured at cost, respectively.

**11. Long-term Deposits in MSA Escrow Fund**

Long-term deposits in MSA Escrow Fund as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		September 30 2015	December 31 2014
MMF	₩	26,132	19,269
Treasury note		368,445	282,539
	₩	394,577	301,808

As discussed in note 32 to the separate interim 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. For the nine-month periods ended September 30, 2015 and 2014, ₩61,325 million and ₩52,036 million were paid into long-term deposits in MSA Escrow Fund, respectively.

Long-term deposits in MSA Escrow Fund are invested in demand deposits of financial institutions or government and public bonds. Investment income on long-term deposits in MSA Escrow Fund for the nine-month periods ended September 30, 2015 and 2014 are ₩1,796 million and ₩559 million, respectively.

**12. Trade and Other Receivables**

(a) Trade and other receivables as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		September 30 2015		December 31 2014	
		Current	Non-current	Current	Non-current
Loans to employees	₩	6,722	13,522	7,811	19,885
Loans		10,815	62,832	8,612	61,711
Other receivables		86,441	1,713	72,964	1,697
Guarantee deposits		-	35,876	-	37,409
Accrued income		8,493	-	7,808	-
Trade receivables		928,947	-	727,753	-
	₩	1,041,418	113,943	824,948	120,702

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**12. Trade and Other Receivables, Continued**

- (b) Trade and other receivables as of September 30, 2015 and December 31, 2014 have been reported in the separate interim statements of financial position net of allowances as follows:

<i>In millions of won</i>	September 30 2015		December 31 2014	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 1,092,786	116,959	869,457	131,276
Allowance:				
Loans	(9,669)	(3,016)	(1,099)	(10,574)
Other receivables	(6,059)	-	(7,673)	-
Accrued income	(2,308)	-	(2,126)	-
Trade receivables	(33,332)	-	(33,611)	-
	(51,368)	(3,016)	(44,509)	(10,574)
Net trade and other receivables	₩ 1,041,418	113,943	824,948	120,702

- (c) Changes in the allowance account for the nine-month period ended September 30, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>	2015	2014
<b>Beginning balance</b>	₩ 55,083	65,357
Impairment loss	-	510
Reversal of impairment loss	(699)	(10,784)
<b>Ending balance</b>	₩ 54,384	55,083

Impairment loss (reversal of impairment loss) on trade and other receivables is included as part of selling, general and administrative expenses and other expense (income) in the separate interim statements of comprehensive income.

- (d) The aging schedule of trade and other receivables which were past due but not impaired as of September 30, 2015 and December 31, 2014 is as follows:

<i>In millions of won</i>	September 30 2015	December 31 2014
Within 1 month	₩ 58,273	46,952
Between 1 and 2 months	40,185	35,915
Beyond 2 months	227,950	210,237
	₩ 326,408	293,104

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 pledged assets and guarantees in respect of some of the past due debtor balances.

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**12. Trade and Other Receivables, Continued**

(e) Details of trade and other receivables that are measured at amortized cost as of September 30, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>	Effective interest rate	September 30 2015		Effective interest rate	December 31 2014	
		Current	Non-current		Current	Non-current
Loans to employees	3.00~5.68%	₩ 6,722	13,522	3.00~5.68%	₩ 7,811	19,885
Other receivables	-	-	-	3.79%	8,300	-
Guarantee deposits	2.01~5.68%	-	35,876	3.00~5.68%	-	37,409
		₩ 6,722	49,398		₩ 16,111	57,294

**13. Inventories**

(a) Inventories as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	September 30 2015	December 31 2014
Finished goods, net of loss on the write-down of inventories	₩ 73,099	83,387
Work-in-progress	14,067	7,645
Raw materials	637,228	699,260
Supplies	26,232	25,319
By-products	6,705	7,138
Buildings under construction	1,977	1,185
Sites for lotting-out construction	28,935	31,180
Goods-in-transit	10,163	55,324
	₩ 798,406	910,438

(b) The amount of inventories recognized as an expense for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015		2014	
		Three-month	Nine-month	Three-month	Nine-month
Cost of sales:					
Write-down (reversal of write-down) of inventories	₩	(12)	(165)	228	(671)
Loss on retirement of inventories		335	638	605	2,179
Other expense:					
Loss on retirement of inventories		239	356	12	413
	₩	562	829	845	1,921

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**14. Cash and Cash Equivalents and Other Financial Assets**

(a) Cash and cash equivalents as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	September 30 2015	December 31 2014
Cash on hand	₩ 1,168	883
Demand deposits	71,057	80,679
Short-term investment assets	270,000	240,000
	₩ 342,225	321,562

(b) Other financial assets as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	September 30 2015	December 31 2014
Time deposits	₩ -	10,000
Money trust	970,000	600,000
Certificates of deposit	30,000	30,000
Derivative financial instruments	11,291	-
	₩ 1,011,291	640,000

During the nine-month period ended September 30, 2015, the Company acquired redeemable convertible preference shares of Somang Cosmetics Co., Ltd. and recognized embedded derivatives as other financial assets separately from the host contract. The fair value of derivative financial instruments was determined based on the DCF and option pricing model by external, independent valuers.

**15. Non-current Assets Held for Sale**

Changes in non-current assets held for sale for the nine-month period ended September 30, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>	2015	2014
<b>Beginning balance</b>	₩ 426	3
Transfer from property, plant and equipment	1,542	426
Disposal	(426)	(3)
<b>Ending balance</b>	₩ 1,542	426

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**16. Pledged Assets**

(a) Investment property pledged as collateral as of September 30, 2015 was as follows:

*In millions of won*

Asset	Carrying amount	Type	Received amount	Collateralized amount	Leaseholder
Investment property	₩ 71,043	Leasehold deposits received	₩ 8,668	9,145	Metlife Insurance Korea Co., Ltd. and others

(b) Investment property pledged as collateral as of December 31, 2014 was as follows:

*In millions of won*

Asset	Carrying amount	Type	Received amount	Collateralized amount	Leaseholder
Investment property	₩ 71,677	Leasehold deposits received	₩ 7,901	8,683	Metlife Insurance Korea Co., Ltd. and others

**17. Share Capital and Other Capital Surplus**

(a) Details of share capital as of September 30, 2015 and December 31, 2014 were as follows:

	September 30 2015	December 31 2014
Number of ordinary shares:		
Authorized	800,000,000	800,000,000
Issued	137,292,497	137,292,497
Outstanding	125,965,892	125,898,800
Par value in won	₩ 5,000	5,000

The Company has, thus far, reacquired and retired 53,699,400 shares of treasury share. Accordingly, as of September 30, 2015, the Company's ordinary share differs from the aggregate par value of issued shares by ₩268,497 million.

(b) Changes in the number of shares for the nine-month period ended September 30, 2015 and the year ended December 31, 2014 were as follows:

	2015			2014		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
<b>Beginning balance</b>	137,292,497	(11,393,697)	125,898,800	137,292,497	(11,393,697)	125,898,800
In-kind donation of treasury shares	-	67,092	67,092	-	-	-
<b>Ending balance</b>	137,292,497	(11,326,605)	125,965,892	137,292,497	(11,393,697)	125,898,800

(c) There was no change in other capital surplus for the nine-month period ended September 30, 2015 and the year ended December 31, 2014.

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**18. Treasury Shares**

- (a) Changes in the treasury shares for the nine-month period ended September 30, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won, except number of shares</i>	2015		2014	
	Number of shares	Carrying amount	Number of shares	Carrying amount
<b>Beginning balance</b>	11,393,697	₩ 339,059	11,393,697	₩ 339,059
In-kind donation of treasury shares	(67,092)	(1,997)	-	-
<b>Ending balance</b>	11,326,605	₩ 337,062	11,393,697	₩ 339,059

- (b) Changes in gain on reissuance of treasury shares for the nine-month period ended September 30, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>	2015	2014
<b>Beginning balance</b>	₩ 492,032	492,032
In-kind donation of treasury shares, net of tax	2,616	-
<b>Ending balance</b>	₩ 494,648	492,032

**19. Reserves**

- (a) Details of reserves as of September 30, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>	September 30 2015	December 31 2014
Available-for-sale financial assets - net change in fair value	₩ (35,002)	(27,434)
Legal reserve	602,937	602,937
Voluntary reserve	3,226,658	2,918,255
	₩ 3,794,593	3,493,758

- (b) Available-for-sale financial assets - net change in fair value as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	September 30 2015	December 31 2014
Available-for-sale financial assets - net change in fair value before tax	₩ (46,177)	(36,192)
Tax effect	11,175	8,758
	₩ (35,002)	(27,434)

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**19. Reserves, Continued**

(c) Legal Reserve

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

(d) Details of voluntary reserve as of September 30, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>	September 30 2015	December 31 2014
Reserve for business rationalization	₩ 12,851	12,851
Reserve for research and human resource development	30,000	42,523
Reserve for business expansion	698,881	698,881
Unconditional reserve	2,484,926	2,164,000
	₩ 3,226,658	2,918,255

*Reserve for business rationalization*

Until December 10, 2002 under *the Special Tax Treatment Control Act*, 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.

*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.

*Reserve for business expansion and other reserves*

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



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**20. Retained Earnings**

Changes in retained earnings for the nine-month period ended September 30, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		2015	2014
<b>Beginning balance</b>	₩	736,461	509,821
Dividends		(428,056)	(402,876)
Transfer from reserve for research and human resource development		12,522	47,478
Transfer to unconditional reserve		(320,926)	(152,000)
Profit for the period		813,265	747,054
Remeasurements of net defined benefit liability, net of tax		(66)	(13,016)
<b>Ending balance</b>	₩	813,200	736,461

**21. Trade and Other Payables**

Trade and other payables as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		September 30 2015		December 31 2014	
		Current	Non-current	Current	Non-current
Leasehold deposits received	₩	-	27,025	-	28,310
Trade payables		21,297	-	66,448	-
Withholdings		4,760	-	4,031	-
Withholdings value added tax		206,523	-	132,173	-
Accrued expenses		129,726	-	110,155	-
Other payables		54,277	-	34,433	-
	₩	416,583	27,025	347,240	28,310

**22. Short-term Borrowings**

Short-term borrowings as of September 30, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	Annual interest rate		September 30 2015	December 31 2014
<b>Customer credit contracts:</b>				
Nonghyup Bank	6.64%	₩	4,599	4,536
KEB Hana Card Co., Ltd.	3M CD rate+2.5%		996	1,016
		₩	5,595	5,552

The Company has entered into a customer credit contract with the Nonghyup Bank and KEB Hana Card Co., Ltd. The financial institutions pay trade receivables on behalf of customers and the Company has provided guarantees to the financial institutions for customers.

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**23. Retirement Benefits Plan**

- (a) The components of retirement benefits for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>	2015		2014	
	Three-month	Nine-month	Three-month	Nine-month
<b>Defined benefit plans:</b>				
Current service cost	₩ 7,096	21,287	7,018	21,053
Net Interest on the net defined benefit liability	437	1,311	575	1,724
Past service cost and loss on settlement	-	-	462	1,386
	7,533	22,598	8,055	24,163
<b>Defined contribution plans:</b>				
Contributions recognized as expense	990	3,031	722	1,952
	₩ 8,523	25,629	8,777	26,115

The Company recognized termination benefits amounting to ₩6,116 million and ₩269 million as an expense for the nine-month periods ended September 30, 2015 and 2014, respectively.

- (b) Net defined benefit liability as of September 30, 2015 and December 31, 2014 is summarized as follows:

<i>In millions of won</i>	September 30 2015	December 31 2014
Present value of defined benefit obligations	₩ 266,439	258,236
Fair value of plan assets	(178,374)	(190,976)
	₩ 88,065	67,260

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**24. Result from Operating Activities**

- (a) Details of expenses classified by nature for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015		2014	
		Three-month	Nine-month	Three-month	Nine-month
Changes in inventories	₩	66,001	112,032	49,463	124,676
Raw materials and consumables purchased		115,081	428,828	142,753	487,428
Salaries		79,084	260,573	93,733	255,260
Retirement and termination benefits		8,523	31,745	8,776	26,383
Depreciation		26,361	78,899	25,831	77,785
Amortization		4	20	14	43
Employee welfare		14,024	48,930	9,956	28,770
Advertising		27,076	86,254	31,736	94,004
Commissions		25,970	74,245	26,642	75,010
Other expenses		24,306	60,312	35,385	71,415
	₩	386,430	1,181,838	424,289	1,240,774

- (b) Details of selling, general and administrative expenses for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015		2014	
		Three-month	Nine-month	Three-month	Nine-month
Salaries	₩	53,510	175,949	62,429	172,711
Retirement and termination benefits		5,856	22,427	6,004	18,228
Employee welfare		9,896	34,396	7,207	20,841
Travel		1,357	3,463	1,056	3,149
Communications		825	2,558	882	2,690
Utilities		2,219	6,869	2,141	6,443
Taxes and dues		269	13,678	1,451	13,023
Supplies		339	1,378	346	1,316
Rent		3,144	10,053	3,415	10,264
Depreciation		8,214	24,495	8,192	24,151
Amortization		4	20	14	43
Repairs and maintenance		843	2,422	1,386	4,310
Vehicles		1,253	3,646	1,555	4,912
Insurance		73	244	127	257
Commissions		19,225	56,250	20,263	57,028
Freight and custody		8,090	21,911	6,095	19,436
Conferences		608	1,988	692	2,132
Advertising		27,053	86,150	31,701	93,897
Training		974	2,934	1,054	2,956
Prizes and rewards		372	1,323	310	1,103
Normal research and development		2,461	7,945	3,632	11,032
Reversal of impairment loss on trade receivables		-	(279)	(2,123)	(1,997)
	₩	146,585	479,820	157,829	467,925

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**25. Other Income and Expenses**

- (a) Details of other income for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015		2014	
		Three-month	Nine-month	Three-month	Nine-month
Foreign currency transaction gain	₩	12,747	18,952	1,342	4,903
Foreign currency translation gain		42,705	61,810	28,241	3,564
Reversal of impairment loss on other receivables		-	420	-	432
Gain on sale of property, plant and equipment		1,850	8,823	4,321	5,134
Gain on sale of intangible assets		-	723	-	-
Others		4,339	18,192	5,991	13,857
	₩	61,641	108,920	39,895	27,890

- (b) Details of other expenses for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015		2014	
		Three-month	Nine-month	Three-month	Nine-month
Foreign currency transaction loss	₩	1,488	6,647	2,997	8,900
Foreign currency translation loss		-	3,989	-	3,436
Impairment loss on other receivables		1,591	-	346	-
Loss on disposal of investments in subsidiaries		-	-	5	5
Donations		2,138	23,118	1,600	3,802
Loss on sale of property, plant and equipment		27	396	4	85
Loss on sale of intangible assets		-	-	-	2
Others		791	3,934	1,033	7,887
	₩	6,035	38,084	5,985	24,117

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**26. Net Finance Income**

- (a) Details of net finance income for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>	2015		2014	
	Three-month	Nine-month	Three-month	Nine-month
<b>Finance income:</b>				
Interest income	₩ 8,751	24,285	9,688	27,029
Dividend income	909	11,865	631	7,796
Investment income on long-term deposits in MSA Escrow Fund	730	1,796	234	559
Gain on sale of available-for-sale financial assets	-	-	20,121	20,121
Gain on valuation of derivative financial instruments	418	418	-	-
	10,808	38,364	30,674	55,505
<b>Finance costs:</b>				
Interest expense	(189)	(608)	(170)	(648)
Impairment loss on available-for-sale financial assets	(95)	(95)	-	-
	(284)	(703)	(170)	(648)
<b>Net finance income</b>	₩ 10,524	37,661	30,504	54,857

- (b) Details of interest income for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>	2015		2014	
	Three-month	Nine-month	Three-month	Nine-month
Deposits	₩ 6,937	18,545	7,211	20,049
Available-for-sale financial assets	7	32	12	37
Trade and other receivables	1,807	5,708	2,465	6,943
	₩ 8,751	24,285	9,688	27,029

- (c) Details of interest expense for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>	2015		2014	
	Three-month	Nine-month	Three-month	Nine-month
Trade and other payables	₩ 189	608	170	648

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**27. Income Tax**

- (a) Income tax expense comprises as current tax expense adjusted for current adjustments for prior periods, deferred tax expense (income) by origination and reversal of deferred tax assets (liabilities), and income tax recognized in other comprehensive income. The average effective tax rate was 24.38% and 24.36% for the nine-month periods ended September 30, 2015 and 2014, respectively.
- (b) Deferred tax assets have been recognized to the extent the Company has determined it is probable that future profits will be available against which the Company can utilize the related benefit.

**28. Earnings per Share**

Basic and diluted earnings per share for the three- and nine-month periods ended September 30, 2015 and 2014 were as follows:

		2015		2014	
		Three-month	Nine-month	Three-month	Nine-month
Profit for the period in millions of won	₩	288,882	813,265	274,450	637,395
Weighted-average number of ordinary shares outstanding		125,965,892	125,960,485	125,898,800	125,898,800
<b>Basic and diluted earnings per share in won</b>	₩	<b>2,293</b>	<b>6,457</b>	<b>2,180</b>	<b>5,063</b>

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29. Transactions and Balances with Related Companies

(a) Details of parent and subsidiary relationships as of September 30, 2015 and December 31, 2014 were as follows:

Subsidiary	Location	Immediate parent company	Percentage of ownership					
			September 30 2015			December 31 2014		
			Parent	Sub-sidiary	Total	Parent	Sub-sidiary	Total
Korea Ginseng Corporation	Korea	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
Yungjin Pharm. Ind. Co., Ltd.	Korea	KT&G Corporation	53.00%	-	53.00%	53.00%	-	53.00%
Tae-a Industry Co., Ltd.	Korea	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	KT&G Corporation	99.99%	-	99.99%	99.99%	-	99.99%
Korea Tabacos do Brasil Ltda.	Brazil	KT&G Corporation	99.90%	-	99.90%	99.90%	-	99.90%
KT&G Pars	Iran	KT&G Corporation	99.99%	-	99.99%	99.99%	-	99.99%
KT&G Rus L.L.C.	Russia	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
KGC Life & Gin Co., Ltd.	Korea	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
Global Trading, Inc.	USA	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
Somang Cosmetics Co., Ltd. <sup>(*)1</sup>	Korea	KT&G Corporation	97.73%	-	97.73%	60.00%	-	60.00%
Renzoluc Pte., Ltd. <sup>(*)1</sup>	Singapore	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Life Sciences Corporation <sup>(*)1</sup>	Korea	KT&G Corporation	73.94%	-	73.94%	73.94%	-	73.94%
KGC Yebon Corporation	Korea	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
K-Q HongKong I, Limited <sup>(*)1</sup>	HongKong	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
PT KT&G Indonesia	Indonesia	KT&G Corporation	99.99%	-	99.99%	99.99%	-	99.99%
K&I HK Co., Ltd. <sup>(*)2</sup>	HongKong	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
K&I China Co., Ltd. <sup>(*)2</sup>	China	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
Jilin Hanzheng Ginseng Co., Ltd.	China	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
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%
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		PT Trisakti						
Ababi Purwosari	Indonesia	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%

(\*)1 The percentage of ownership, shown above, excludes preferred shares. As of September 30, 2015, the Company's percentage of ownership would be 97.76%, 68.91%, 59.48% and 50.00%, respectively, if preferred shares are included.

(\*)2 The Company established K&I HK Co., Ltd. and K&I China Co., Ltd. in 2014.

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**29. Transactions and Balances with Related Companies, Continued**

(b) Significant transactions which occurred in the normal course of business with related companies for the three- and nine-month periods ended September 30, 2015 and 2014 are summarized as follows:

(i) Sales and other income

<i>In millions of won</i>	2015		2014	
	Three-month	Nine-month	Three-month	Nine-month
Korea Ginseng Corporation	₩ 2,125	6,458	2,130	6,377
Yungjin Pharm. Ind. Co., Ltd.	72	234	95	262
Tae-a Industry Co., Ltd.	3	14	6	14
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	2,291	6,329	2,673	6,071
KT&G Pars	-	941	1,072	2,305
KT&G Rus L.L.C.	8,151	20,007	10,449	24,386
KGC Life & Gin Co., Ltd.	100	335	239	539
Global Trading, Inc.	27,737	81,466	16,198	48,760
Somang Cosmetics Co., Ltd.	27	76	34	151
Renzoluc Pte., Ltd.	1,023	2,827	983	3,015
KT&G Life Sciences Corporation	4	26	15	50
KGC Yebon Corporation	121	472	152	262
PT KT&G Indonesia	385	1,164	133	546
PT Trisakti Purwosari Makmur	4	87	119	119
PT Mandiri Maha mulia	976	2,580	468	3,747
	₩ 43,019	123,016	34,766	96,604

(ii) Purchase and other expenses

<i>In millions of won</i>	2015		2014	
	Three-month	Nine-month	Three-month	Nine-month
Korea Ginseng Corporation	₩ 418	1,251	554	1,317
Yungjin Pharm. Ind. Co., Ltd.	2	14	3	8
Tae-a Industry Co., Ltd.	3,293	10,362	3,540	11,406
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	14	23	-	-
KGC Life & Gin Co., Ltd.	199	454	225	497
Somang Cosmetics Co., Ltd.	26	93	32	92
KGC Yebon Corporation	30	102	12	12
K&I China Co., Ltd.	196	201	-	-
Korea Ginseng (China) Corp.	-	-	-	233
	₩ 4,178	12,500	4,366	13,565



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**29. Transactions and Balances with Related Companies, Continued**

(c) Account balances with related companies as of September 30, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>	September 30 2015		December 31 2014	
	Receivables	Payables	Receivables	Payables
Korea Ginseng Corporation	₩ 1,962	2,049	764	1,795
Yungjin Pharm. Ind. Co., Ltd.	-	413	60	413
Tae-a Industry Co., Ltd.	-	1,281	-	-
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	44,216	-	38,559	-
Korea Tabacos do Brasil Ltda.	98	-	94	-
KT&G Pars <sup>(*)</sup>	44,301	-	41,827	-
KT&G Rus L.L.C.	34,029	-	27,701	-
KGC Life & Gin Co., Ltd.	41	453	109	165
Global Trading, Inc.	11,438	-	509	-
Somang Cosmetics Co., Ltd.	28,151	28	12	29
Renzoluc Pte., Ltd.	46,624	-	48,327	-
KT&G Life Sciences Corporation	-	1	5	814
PT KT&G Indonesia	26,250	-	18,580	-
PT Trisakti Purwosari Makmur	92	-	156	-
PT Mandiri Maha mulia	3,561	-	4,167	-
	₩ 240,763	4,225	180,870	3,216

(\*) Above receivables are the gross amounts before ₩18,969 million and ₩19,668 million of allowance for doubtful accounts.

(d) Details of financial transactions with related parties for the nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>	2015			2014		
	Increase	Loans Collection	Capital increase	Increase	Loans Collection	Capital increase
Korea Ginseng Corporation	₩ -	-	-	-	-	73,025
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	-	1,099	-	-	-	-
Global Trading, Inc.	-	-	-	-	2,035	-
Somang Cosmetics Co., Ltd.	-	-	49,755	-	-	-
Renzoluc Pte., Ltd.	969	-	-	-	-	-
KGC Yebon Corporation	-	-	-	-	-	5,902
PT KT&G Indonesia	4,835	-	-	2,265	-	3,202
K&I HK Co.,Ltd.	-	-	-	-	-	11
K&I China Co.,Ltd.	-	-	5,096	-	-	31

During the nine-month period ended September 30, 2015, the Company acquired 94,079 shares of redeemable convertible preference shares of Somang Cosmetics Co., Ltd. for ₩26,000 million from KOFC QCP IBKC Frontier Champ 2010-2 Private Equity Fund.

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**29. Transactions and Balances with Related Companies, Continued**

(e) Details of key management personnel compensation for the three- and nine-month periods ended September 30, 2015 and 2014 are summarized as follows:

<i>In millions of won</i>		2015		2014	
		Three-month	Nine-month	Three-month	Nine-month
Short-term employee benefits	₩	2,102	11,193	4,215	11,768
Retirement benefits		240	1,144	406	1,463
	₩	2,342	12,337	4,621	13,231

**30. Risk Management and Fair Value of Financial Instruments**

(a) Overview

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

- Market risk
- Credit risk
- Liquidity risk

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

(b) Risk Management Framework

The purpose of managing financial risks is to identify the potential risk factors that may affect the Company's financial performance, and minimize, eliminate and avoid it to the extent that is acceptable. One of the principal responsibilities of the treasury department is to manage the financial risks arising from the Company's underlying operations. The treasury department monitors and manages the financial risk arising from the Company's underlying operations in accordance with the risk management policies and procedures authorized by the board of directors. Also, the treasury department provides an internal report analyzing the nature and exposure level of financial risks to Risk Management Committee of the Company. The Risk Management Committee prepares the overall strategy for financial risk management, and evaluates the effectiveness of the financial risk management strategy. In addition, the Company's audit committee consistently observes the compliance of the risk management policy and procedure, and reviews the risk exposure limit of the Company. The Company applied the same financial risk management strategy that was applied in the previous period.

(c) Management of Financial Risks

(i) Market risk

Market risk is the risk that changes in market prices – such as foreign exchange rates, interest rates and equity prices – will affect the Company's income or the value of its financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

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**30. Risk Management and Fair Value of Financial Instruments, Continued**

(c) Management of Financial Risks, Continued

*Currency 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 forward contracts to hedge foreign currency risk, if necessary.

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of September 30, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>	September 30 2015		December 31 2014	
	Assets	Liabilities	Assets	Liabilities
USD	₩ 921,580	972	785,423	44,293
IDR	46,624	-	48,327	6,785
EUR	31,800	1,811	28,988	-
Others	1,584	-	2,087	-
	₩ 1,001,588	2,783	864,825	51,078

As of September 30, 2015 and December 31, 2014, the effects of a 10% weakening or strengthening of functional currency against foreign currencies on profit before tax were as follows:

<i>In millions of won</i>	September 30 2015		December 31 2014	
	10% weakening	10% strengthening	10% weakening	10% strengthening
Increase (decrease) in profit before tax	₩ 99,881	(99,881)	81,375	(81,375)

*Equity price risk*

The Company has exposure to equity price risk, which arises from listed available-for-sale equity instruments. The Company's management has monitored the proportion of 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, 2015 and December 31, 2014, the effects of a 5% fluctuation in the price index of stocks on comprehensive income before tax were as follows:

<i>In millions of won</i>	September 30 2015		December 31 2014	
	5% increase	5% decrease	5% increase	5% decrease
Increase (decrease) in comprehensive income before tax	₩ (2,338)	2,338	5,252	(5,252)

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**30. Risk Management and Fair Value of Financial Instruments, Continued**

(c) Management of Financial Risks, Continued

*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. As of September 30, 2015, there is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation, considering the amounts of interest bearing liabilities.

(ii) Credit risk

The Company has exposure to the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an 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 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, 2015 and December 31, 2014 is as follows:

<i>In millions of won</i>	September 30 2015	December 31 2014
Available-for-sale debt instruments	₩ 1,500	2,500
Long-term deposits in MSA Escrow Fund	394,577	301,808
Trade and other receivables	1,155,361	945,650
Other financial assets	1,011,291	640,000
Cash and cash equivalents (excluding cash on hand)	341,057	320,679
Financial guarantee contracts	38,276	150,063
	₩ 2,942,062	2,360,700

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**30. Risk Management and Fair Value of Financial Instruments, Continued**

(c) Management of Financial Risks, Continued

(iii) 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.

The maturity analysis with a residual contractual maturity of financial liabilities as of September 30, 2015 and December 31, 2014 is as follows:

<i>In millions of won</i>	Carrying amount	Contractual cash flow	Residual contractual maturity		
			Within 3 months	Between 3 months and 1 year	Between 1 and 5 years
<b>As of September 30, 2015:</b>					
Trade and other payables	₩ 232,325	233,149	205,300	-	27,849
Short-term borrowings	5,595	5,595	5,595	-	-
Financial guarantee liabilities	-	38,276	-	-	38,276
	₩ 237,920	277,020	210,895	-	66,125
<b>As of December 31, 2014:</b>					
Trade and other payables	₩ 239,346	240,489	211,036	-	29,453
Short-term borrowings	5,552	5,552	5,552	-	-
Financial guarantee liabilities	-	150,063	-	150,063	-
	₩ 244,898	396,104	216,588	150,063	29,453

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.

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30. Risk Management and Fair Value of Financial Instruments, Continued

(d) Fair Value of Financial Instruments

The carrying amount of each category of financial assets and liabilities as of September 30, 2015 and December 31, 2014 is summarized as follows:

<i>In millions of won</i>	September 30 2015	December 31 2014
<b>Financial assets:</b>		
Financial assets at fair value through profit or loss (derivative financial instruments)	₩ 11,291	-
Available-for-sale financial assets	322,558	304,438
Loans and receivables		
–Trade and other receivables	1,155,361	945,650
–Long-term deposits in MSA Escrow Fund	394,577	301,808
–Other financial assets	1,000,000	640,000
–Cash and cash equivalents	342,225	321,562
	2,892,163	2,209,020
	₩ 3,226,012	2,513,458
<b>Financial liabilities:</b>		
Financial liabilities measured at amortized cost		
–Trade and other payables	₩ 232,325	239,346
–Short-term borrowings	5,595	5,552
	₩ 237,920	244,898

The fair value measurements classified by fair value hierarchy as of September 30, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>	Carrying amount	Level I	Level II	Fair value Level III
<b>As of September 30, 2015:</b>				
Available-for-sale financial assets	₩ 280,964	172,873	-	108,091
Other financial assets (derivative financial instruments)	11,291	-	-	11,291
	₩ 292,255	172,873	-	119,382
<b>As of December 31, 2014:</b>				
Available-for-sale financial assets	₩ 274,844	184,118	-	90,726

There is no transfer between fair value hierarchy levels of recurring fair value measurements for the nine-month period ended September 30, 2015 and the year ended December 31, 2014.

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30. Risk Management and Fair Value of Financial Instruments, Continued

(d) Fair Value of Financial Instruments, Continued

The fair value measurements for available-for-sale equity instruments in real estate trust fund and derivative financial instruments have been categorized as a level 3 fair value based on the inputs to the valuation techniques used. Changes in fair value classified as level 3 for the nine-month period ended September 30, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		2015	2014
<b>Beginning balance</b>	₩	90,726	62,467
Acquisition		16,200	38,992
Disposal		-	(14,411)
Changes in fair value		1,165	3,678
<b>Ending balance</b>	₩	108,091	90,726

(e) Finance Income (Costs)

(i) Details of finance income (costs) by categories for the nine-month period ended September 30, 2015 were as follows:

<i>In millions of won</i>		Financial assets at fair value through profit or loss	Available-for-sale financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
<b>Profit or loss:</b>						
Interest income	₩	-	32	24,253	-	24,285
Dividend income		-	8,303	-	-	8,303
Investment income on long-term deposits in MSA Escrow Fund		-	-	1,796	-	1,796
Gain on valuation of derivative financial instruments		418	-	-	-	418
Impairment loss on available-for-sale financial assets		-	(95)	-	-	(95)
Interest expense		-	-	-	(608)	(608)
	₩	418	8,240	26,049	(608)	34,099
<b>Other comprehensive loss before tax</b>						
Net change in fair value	₩	-	(10,080)	-	-	(10,080)
Reclassification adjustments upon impairment		-	95	-	-	95
	₩	-	(9,985)	-	-	(9,985)

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**30. Risk Management and Fair Value of Financial Instruments, Continued**

(e) Finance Income (Costs), Continued

(ii) Details of finance income (costs) by categories for the nine-month period ended September 30, 2014 were as follows:

<i>In millions of won</i>		Available -for-sale financial assets	Loans and receivables	Financial Liabilities measured at amortized cost	Total
<b>Profit or loss:</b>					
Interest income	₩	37	26,992	-	27,029
Dividend income		5,466	-	-	5,466
Investment income on long-term deposits in MSA Escrow Fund		-	559	-	559
Gain on sale		20,121	-	-	20,121
Interest expense		-	-	(648)	(648)
	₩	25,624	27,551	(648)	52,527
<b>Other comprehensive income before tax</b>					
Net change in fair value	₩	13,306	-	-	13,306
Reclassification adjustments upon disposal		(20,121)	-	-	(20,121)
	₩	(6,815)	-	-	(6,815)

**31. Capital Management**

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The board of directors seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position.

The Company monitors capital using equity and net debt deducting cash and cash equivalents and current financial instruments from borrowings. The Company applied the same capital management strategy that was applied in the previous year.

As of September 30, 2015 and December 31, 2014, the Company's capital structure was as follows:

<i>In millions of won</i>		September 30 2015	December 31 2014
Debt (borrowings)	₩	5,595	5,552
Less:			
Cash and cash equivalents		(342,225)	(321,562)
Current other financial assets		(1,011,291)	(640,000)
<b>Net debt (asset)</b>		(1,347,921)	(956,010)
<b>Equity</b>	₩	5,723,920	5,341,733



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**32. Contingent Liabilities and Commitments**

- (a) 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.
- (b) As of September 30, 2015, the tobacco lawsuits claiming damages of ₩100 million and a lawsuit by National Health Insurance Service claiming damages of ₩53,742 million are filed against the Company. Additionally, as of September 30, 2015, the Company is involved in three lawsuits as a plaintiff for alleged damages totalling ₩12,304 million and six lawsuits as a defendant for alleged damages totalling ₩2,538 million. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of September 30, 2015.
- (c) As of September 30, 2015, the Company has entered into letter of credit agreements with KEB Hana Bank and other banks with limits in the aggregate of USD 59,000 thousand.
- (d) As of September 30, 2015, the Company’s trade receivables from the export of cigarettes are insured against non-payment up to USD 18,580 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.
- (e) The Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD 40,000 thousand by KEB Hana Bank. Details of guarantees exercised as of September 30, 2015, are summarized as follows:

<i>In thousands of USD, THB and millions of IDR</i>		<i>Exercised amount</i>
Customs bond and L/C opening of Global Trading, Inc.	USD	14,542
Performance guarantee for export of tobacco sheet to Thailand Tobacco Monopoly	THB	12,808
Payment guarantee for purchase of certificate stamp of PT Mandiri Maha Mulia	IDR	88,410

- (f) 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.

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**32. Contingent Liabilities and Commitments, Continued**

- (g) With 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 ("Individual Shareholder"). Details of the contract are as follows:

Description	Details
Right of first refusal held by the Company	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.
Tag-along right held by 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 Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Company.

- (h) With relation to the acquisition of KT&G Life Sciences Corporation, 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:

Description	Details
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 Sciences Corporation is listed.
Right of first refusal held by the Company	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.
Tag-along right held by 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 Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Company.

- (i) As of September 30, 2015, the Company has provided payment guarantees up to ₩225,600 million with an exercised amount of ₩38,276 million for the buyers of apartments in respect of their borrowings from Shinhan Bank.

- (j) As of September 30, 2015, the Company is insured by performance guarantees insurance up to ₩1,357 million with the Seoul Guarantee Insurance.

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33. Cash Flows

- (a) Details of cash generated from operations for the nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>	2015	2014
<b>Profit for the period</b>	₩ 813,265	637,395
<b>Adjustments for:</b>		
Income tax expense	262,257	205,322
Finance costs	703	648
Finance income	(38,364)	(55,505)
Depreciation	78,899	77,785
Amortization	20	43
Retirement and termination benefits	31,745	24,163
Foreign currency translations loss	3,989	3,436
Loss on sale of property, plant and equipment	396	85
Loss on sale of intangible assets	-	2
Loss on disposal of investments in subsidiaries	-	5
Other expense	6,442	2,592
Foreign currency translations gain	(61,810)	(3,564)
Reversal of impairment loss on trade and other receivables	(699)	(2,429)
Reversal of write-down of inventory	(165)	(671)
Gain on sale of property, plant and equipment	(8,823)	(5,134)
Gain on sale of intangible assets	(723)	-
	1,087,132	884,173
<b>Changes in working capital:</b>		
Trade and other receivables	(170,029)	(130,433)
Advance payments	(26,325)	(7,562)
Prepaid expenses	170	3,557
Prepaid tobacco excise and other taxes	(145,318)	(115,753)
Inventories	111,203	122,755
Trade and other payables	72,606	(52,877)
Advance receipts	2,942	(16,155)
Tobacco excise and other taxes payable	396,777	99,334
Payment of retirement and termination benefits	(11,005)	(2,943)
<b>Cash generated from operations</b>	₩ 1,318,153	784,096

- (b) Details of material transactions without cash inflow and outflow for the nine-month periods ended September 30, 2015 and 2014 were as follows:

<i>In millions of won</i>	2015	2014
Increase in accrued expenses		
related with payment of retirement and termination benefits	₩ 1,141	-
Acquisition of available-for-sale financial assets upon exercise of conversion options	28,990	-
Decrease in other payables related with acquisition of property, plant and equipment	3,166	-
Decrease in advance receipts related with disposal of property, plant and equipment and non-current assets held for sale	298	-

- (c) The Company presented cash flows arising from short-term financial instruments on a net basis, respectively.