

KT&G CORPORATION

Separate Interim Financial Statements

June 30, 2016 and 2015

(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 June 30, 2016, the separate interim statements of comprehensive income for the three- and six-month periods ended June 30, 2016 and 2015 and the separate interim statements of changes in equity and cash flows for the six-month periods ended June 30, 2016 and 2015 and notes, comprising a summary of significant accounting policies and other explanatory information.

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 reviews.

We conducted our reviews 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 Korean Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our reviews, nothing has come to our attention that causes us to believe 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 and for the three- and six-month periods ended June 30, 2016 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 statement of financial position of the Company as of December 31, 2015, 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 us in accordance with Korean Standards on Auditing and our report thereon dated February 25, 2016, expressed an unqualified opinion. The accompanying separate statement of financial position of the Company as of December 31, 2015, presented for comparative purposes, is consistent, in all material respects, with the audited separate financial statements from which it has been derived.

KPMG Samjong Accounting Corp.

KPMG Samjong Accounting Corp.
Seoul, Korea
August 16, 2016

This report is effective as of August 16, 2016, 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 June 30, 2016 and December 31, 2015

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	June 30 2016 Korean won	June 30 2016 U.S. dollars (note 4)	December 31 2015 Korean won
Assets				
Property, plant and equipment	5	₩ 1,190,036	\$ 1,021,753	₩ 1,309,632
Intangible assets	6	28,102	24,128	22,494
Investment property	7,16	256,560	220,280	136,801
Investments in associates	8	39,230	33,683	46,230
Investments in subsidiaries	9	1,153,361	990,264	1,124,446
Available-for-sale financial assets	10,31	332,608	285,574	340,149
Long-term deposits in MSA Escrow Fund	11,31,33	449,730	386,134	403,966
Long-term prepaid expenses		6,076	5,217	6,706
Long-term trade and other receivables	12,30,31	72,559	62,298	78,600
Total non-current assets		3,528,262	3,029,331	3,469,024
Inventories	13	849,524	729,393	889,035
Current available-for-sale financial assets	10,31	1,500	1,288	-
Other financial assets	14,31,32	920,000	789,903	1,091,976
Prepaid tobacco excise and other taxes		480,733	412,753	447,771
Trade and other receivables	12,30,31	1,154,305	991,075	1,074,862
Advance payments		46,350	39,796	26,489
Prepaid expenses		3,938	3,381	4,152
Cash and cash equivalents	14,31,32	442,881	380,253	444,376
Total current assets		3,899,231	3,347,842	3,978,661
Not-current assets held for sale	15	-	-	1,542
Total assets		₩ 7,427,493	\$ 6,377,173	₩ 7,449,227

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Financial Position, Continued

(Unaudited)

As of June 30, 2016 and December 31, 2015

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	June 30 2016 Korean won	June 30 2016 U.S. dollars (note 4)	December 31 2015 Korean won
Equity				
Ordinary shares	1,17	₩ 954,959	\$ 819,919	₩ 954,959
Other capital surplus	17	3,582	3,076	3,582
Treasury shares	18	(331,772)	(284,856)	(337,062)
Gain on reissuance of treasury shares	18	505,192	433,753	494,648
Reserves	19	4,347,490	3,732,712	3,784,467
Retained earnings	20	529,936	454,999	995,886
Total equity		6,009,387	5,159,603	5,896,480
Liabilities				
Long-term trade and other payables	16,21,30,31	3,618	3,106	8,147
Long-term advance receipts		200	172	491
Net defined benefit liability	23	53,745	46,145	42,174
Deferred income tax liabilities		70,465	60,500	72,179
Total non-current liabilities		128,028	109,923	122,991
Short-term borrowings	22,31,32	4,483	3,849	5,031
Trade and other payables	16,21,30,31	435,937	374,291	433,824
Advance receipts	24	6,345	5,448	26,024
Income tax payable		168,925	145,037	199,767
Tobacco excise and other taxes payable		674,388	579,022	765,110
Total current liabilities		1,290,078	1,107,647	1,429,756
Total liabilities		1,418,106	1,217,570	1,552,747
Total equity and liabilities		₩ 7,427,493	\$ 6,377,173	₩ 7,449,227

See accompanying notes to the separate interim financial statements.

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

For the six-month periods ended June 30, 2016 and 2015

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

	Note	2016 Korean won	2016 U.S. dollars (note 4)	2015 Korean won
Sales:	24,30,33			
Manufacture of tobacco		₩ 1,317,753	\$ 1,131,409	₩ 1,335,576
Real estate		74,243	63,744	79,354
Exports of leaf tobacco and others		54,739	46,999	31,132
		1,446,735	1,242,152	1,446,062
Cost of sales:	24,25,30			
Manufacture of tobacco		(423,239)	(363,389)	(391,294)
Real estate		(43,890)	(37,683)	(48,911)
Exports of leaf tobacco and others		(33,001)	(28,333)	(21,968)
		(500,130)	(429,405)	(462,173)
Gross profit		946,605	812,747	983,889
Selling, general and administrative expenses	25,30	(296,508)	(254,579)	(333,236)
Operating profit		650,097	558,168	650,653
Other income	26,30	39,798	34,170	48,939
Other expenses	26,30	(25,509)	(21,902)	(33,710)
Finance income	27,31	34,262	29,417	27,555
Finance costs	27,31	(346)	(297)	(418)
Net finance income	27	33,916	29,120	27,137
Profit before income tax		698,302	599,556	693,019
Income tax expense	28	(168,286)	(144,489)	(168,636)
Profit for the period		₩ 530,016	\$ 455,067	₩ 524,383
Other comprehensive loss:				
Items that will never be reclassified to profit or loss				
Remeasurements of net defined benefit liability, net of tax		₩ (79)	\$ (68)	₩ (120)
Items that are or may be reclassified subsequently to profit or loss				
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		(4,580)	(3,932)	(7,410)
Other comprehensive loss for the period, net of tax		(4,659)	(4,000)	(7,530)
Total comprehensive income for the period		₩ 525,357	\$ 451,067	₩ 516,853
Earnings per share in won and U.S. dollars:				
Basic and diluted	29	₩ 4,202	\$ 3.61	₩ 4,163

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 June 30, 2016 and 2015

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

	Note	2016 Korean won	2016 U.S. dollars (note 4)	2015 Korean won
Sales:	24,30,33			
Manufacture of tobacco		₩ 661,477	\$ 567,937	₩ 630,361
Real estate		54,286	46,609	27,457
Exports of leaf tobacco and others		29,740	25,535	18,443
		745,503	640,081	676,261
Cost of sales:	24,25,30			
Manufacture of tobacco		(210,514)	(180,745)	(223,135)
Real estate		(35,766)	(30,708)	(13,575)
Exports of leaf tobacco and others		(18,706)	(16,060)	(11,839)
		(264,986)	(227,513)	(248,549)
Gross profit		480,517	412,568	427,712
Selling, general and administrative expenses	25,30	(157,775)	(135,464)	(157,013)
Operating profit		322,742	277,104	270,699
Other income	26,30	33,809	29,028	29,237
Other expenses	26,30	(7,688)	(6,601)	(6,983)
Finance income	27,31	15,605	13,398	12,194
Finance costs	27,31	(171)	(147)	(180)
Net finance income	27	15,434	13,251	12,014
Profit before income tax		364,297	312,782	304,967
Income tax expense	28	(88,050)	(75,599)	(74,989)
Profit for the period		₩ 276,247	\$ 237,183	₩ 229,978
Other comprehensive income (loss):				
Items that will never be reclassified to profit or loss				
Remeasurements of net defined benefit liability, net of tax		₩ (15)	\$ (12)	₩ 74
Items that are or may be reclassified subsequently to profit or loss				
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		(8,915)	(7,654)	(1,520)
Other comprehensive loss for the period, net of tax		(8,930)	(7,666)	(1,446)
Total comprehensive income for the period		₩ 267,317	\$ 229,517	₩ 228,532
Earnings per share in won and U.S. dollars:				
Basic and diluted	29	₩ 2,190	\$ 1.88	₩ 1,826

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Changes in Equity

(Unaudited)

For the six-month period ended June 30, 2016

<i>In millions of won</i>		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
Balance at January 1, 2016	₩	954,959	3,582	(337,062)	494,648	3,784,467	995,886	5,896,480
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	530,016	530,016
Other comprehensive loss:								
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	(79)	(79)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	(4,580)	-	(4,580)
Total other comprehensive loss		-	-	-	-	(4,580)	(79)	(4,659)
Total comprehensive income (loss) for the period		-	-	-	-	(4,580)	529,937	525,357
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(428,284)	(428,284)
In-kind donation of treasury shares		-	-	5,290	10,544	-	-	15,834
Transfer from reserve for research and human resource development		-	-	-	-	(10,000)	10,000	-
Transfer to unconditional reserve		-	-	-	-	577,603	(577,603)	-
Total transactions with owners		-	-	5,290	10,544	567,603	(995,887)	(412,450)
Balance at June 30, 2016	₩	954,959	3,582	(331,772)	505,192	4,347,490	529,936	6,009,387

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Changes in Equity, Continued

(Unaudited)

For the six-month period ended June 30, 2016

In thousands of U.S. dollars

	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
Balance at January 1, 2016	\$ 819,919	3,076	(289,398)	424,700	3,249,306	855,058	5,062,661
Total comprehensive income for the period:							
Profit for the period	-	-	-	-	-	455,067	455,067
Other comprehensive loss:							
Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	(68)	(68)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	(3,932)	-	(3,932)
Total other comprehensive loss	-	-	-	-	(3,932)	(68)	(4,000)
Total comprehensive income (loss) for the period	-	-	-	-	(3,932)	454,999	451,067
Transactions with owners, recorded directly in equity:							
Dividends	-	-	-	-	-	(367,720)	(367,720)
In-kind donation of treasury shares	-	-	4,542	9,053	-	-	13,595
Transfer from reserve for research and human resource development	-	-	-	-	(8,586)	8,586	-
Transfer to unconditional reserve	-	-	-	-	495,924	(495,924)	-
Total transactions with owners	-	-	4,542	9,053	487,338	(855,058)	(354,125)
Balance at June 30, 2016	\$ 819,919	3,076	(284,856)	433,753	3,732,712	454,999	5,159,603

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Changes in Equity, Continued

(Unaudited)

For the six-month period ended June 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
Balance at January 1, 2015	₩	954,959	3,582	(339,059)	492,032	3,493,758	736,461	5,341,733
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	524,383	524,383
Other comprehensive loss:								
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	(120)	(120)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	(7,410)	-	(7,410)
Total other comprehensive loss		-	-	-	-	(7,410)	(120)	(7,530)
Total comprehensive income (loss) for the period		-	-	-	-	(7,410)	524,263	516,853
Transactions with owners, recorded directly in equity:								
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)	-
Total transactions with owners		-	-	1,997	2,616	308,404	(736,460)	(423,443)
Balance at June 30, 2015	₩	954,959	3,582	(337,062)	494,648	3,794,752	524,264	5,435,143

See accompanying notes to the separate interim financial statements.

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

For the six-month periods ended June 30, 2016 and 2015

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2016 Korean won	2016 U.S. dollars (note 4)	2015 Korean won
Cash flows from operating activities				
Cash generated from operations	34	₩ 520,204	\$ 446,642	₩ 818,406
Income tax paid		(202,723)	(174,056)	(160,492)
Net cash provided by operating activities				
		317,481	272,586	657,914
Cash flows from investing activities				
	34			
Interest received		20,523	17,621	16,414
Dividends received		11,620	9,977	10,060
Proceeds from sale of property, plant and equipment		10,002	8,588	3,694
Proceeds from sale of intangible assets		42	36	892
Proceeds from sale of non-current assets held for sale		5,800	4,980	4,630
Proceeds from investments in associates		13,095	11,243	-
Collection of loans		7,296	6,264	5,912
Withdrawal of guarantee deposits		7,739	6,646	11,105
Acquisition of property, plant and equipment		(58,686)	(50,387)	(65,757)
Acquisition of intangible assets		(5,628)	(4,832)	(1,774)
Acquisition of investment property		-	-	(8)
Acquisition of investments in subsidiaries		(1,500)	(1,288)	-
Acquisition of available-for-sale financial assets		-	-	(1,200)
Increase in loans		-	-	(5,804)
Payments of guarantee deposits		(14,054)	(12,068)	(11,415)
Payments of long-term deposits in MSA Escrow Fund		(46,228)	(39,691)	(40,379)
Decrease (increase) in other financial assets		160,000	137,374	(130,000)
Acquisition of redeemable convertible preferred shares		-	-	(26,000)
Net cash provided by (used in) investing activities				
		110,021	94,463	(229,630)
Cash flows from financing activities				
	34			
Dividends paid		(428,284)	(367,720)	(428,056)
Increase in deposits received		1,198	1,029	1,564
Decrease in deposits received		(1,871)	(1,608)	(2,933)
Net cash used in financing activities				
		(428,957)	(368,299)	(429,425)
Effect of exchange rate fluctuation on cash held				
		(40)	(34)	138
Net decrease in cash and cash equivalents				
		(1,495)	(1,284)	(1,003)
Cash and cash equivalents at January 1		444,376	381,537	321,562
Cash and cash equivalents at June 30				
		₩ 442,881	\$ 380,253	₩ 320,559

See accompanying notes to the separate interim financial statements.

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

For the six-month periods ended June 30, 2016 and 2015

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 June 30, 2016, 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 at 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 Depository 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 June 30, 2016 is held as follows:

Shareholder	Number of shares	Percentage of ownership
National Pension Service	11,793,134	8.59%
Industrial Bank of Korea	9,510,485	6.93%
Employee Share Ownership Association	2,851,103	2.08%
Treasury shares	11,148,827	8.12%
Others	101,988,948	74.28%
	137,292,497	100.00%

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

For the six-month periods ended June 30, 2016 and 2015

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 July 21, 2016.

(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, 2015.

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

For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies

The significant accounting policies applied by the Company in preparation of its separate interim financial statements are included below. The accounting policies set out below have been applied consistently to all periods presented in these separate interim financial statements.

(a) 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.

(b) 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 attributable 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

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.

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

For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies, Continued

(c) 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.

(d) 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.

(e) 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.

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.

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3. Significant Accounting Policies, Continued

(f) 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 period and adjusted, if appropriate. The change is accounted for as a change in an accounting estimate.

(g) 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).

(h) 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.

KT&G CORPORATION
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3. Significant Accounting Policies, Continued

(h) Inventories, Continued

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 ₩291,449 million and ₩310,043 million, respectively, as of June 30, 2016 and December 31, 2015.

(i) 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.

(j) 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.

KT&G CORPORATION
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For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies, Continued

(j) Non-derivative Financial Assets, Continued

(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.

(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.

KT&G CORPORATION
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For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies, Continued

(j) Non-derivative Financial Assets, Continued

- (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.

(k) 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.

(l) 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.

- (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.

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For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies, Continued

(l) Impairment of Financial Assets, Continued

- (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.

(m) 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.

(n) 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.

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3. Significant Accounting Policies, Continued

(n) Non-derivative Financial Liabilities, Continued

(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).

(o) 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.

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3. Significant Accounting Policies, Continued

(o) Employee Benefits, Continued

(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 year 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.

(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.

(p) 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.

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3. Significant Accounting Policies, Continued

(q) 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.

(r) Revenue Recognition

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

Revenue from sales 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 six-month periods ended June 30, 2016 and 2015 were ₩2,991,671 million and ₩2,062,653million, respectively.

Revenue from sales of real estate where the Company transfers to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses is recognized by reference to the stage of completion using the percentage of completion method, according to the Q&A of Korea Accounting Institute, called 2011-I-KQA, when it is probable that they will result in revenue and can be measured reliably. The stage of completion is determined as the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs.

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.

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3. Significant Accounting Policies, Continued

(s) Finance Income and Finance Costs

Finance income comprises interest income on funds invested (including available-for-sale financial assets), dividend income and interest 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.

(t) 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 year 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

(u) 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.

(v) 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.

(w) Operating Segment

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 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 ₩1,164.70 to \$1, the basic exchange rate on June 30, 2016 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 June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016			December 31 2015		
	Cost	Accumulated depreciation	Carrying amount	Cost	Accumulated depreciation	Carrying amount
Land	₩ 471,875	-	471,875	467,590	-	467,590
Buildings	696,371	(323,191)	373,180	696,569	(311,151)	385,418
Structures	45,004	(30,042)	14,962	44,962	(29,061)	15,901
Machinery	1,000,864	(794,393)	206,471	991,848	(775,864)	215,984
Vehicles	2,280	(1,906)	374	2,211	(1,855)	356
Tools	38,055	(32,987)	5,068	37,753	(32,199)	5,554
Furniture and fixtures	175,898	(144,119)	31,779	169,422	(135,913)	33,509
Others	1,656	-	1,656	1,366	-	1,366
Construction-in-progress	84,671	-	84,671	183,954	-	183,954
	₩ 2,516,674	(1,326,638)	1,190,036	2,595,675	(1,286,043)	1,309,632

(b) Changes in property, plant and equipment for the six-month period ended June 30, 2016 were as follows:

<i>In millions of won</i>	January 1 2016	Acquisition	Disposal	Depreciation	Transfer of construction- in-progress	Other changes	June 30 2016
Land	₩ 467,590	37	(955)	-	52,028	(46,825)	471,875
Buildings	385,418	368	(1,111)	(13,525)	78,684	(76,654)	373,180
Structures	15,901	44	(5)	(1,076)	90	8	14,962
Machinery	215,984	518	(248)	(24,211)	14,428	-	206,471
Vehicles	356	191	(90)	(91)	-	8	374
Tools	5,554	729	-	(1,207)	-	(8)	5,068
Furniture and fixtures	33,509	6,466	(4,920)	(8,222)	4,946	-	31,779
Others	1,366	-	-	-	290	-	1,656
Construction-in-progress	183,954	51,219	-	-	(150,466)	(36)	84,671
	₩ 1,309,632	59,572	(7,329)	(48,332)	-	(123,507)	1,190,036

For the six-month period ended June 30, 2016, the Company received ₩289 million of government grant related with acquisition of buildings and furniture and fixtures.

For the six-month period ended June 30, 2016, land, buildings and structures with a carrying amount of ₩123,471 million were transferred to investment property and construction-in-progress with a carrying amount of ₩36 million were transferred to intangible assets.

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5. Property, Plant and Equipment, Continued

(c) Changes in property, plant and equipment for the year ended December 31, 2015 were as follows:

<i>In millions of won</i>	January 1 2015	Acquisition	Disposal	Depreciation	Transfer of construction- in-progress	Other changes	December 31 2015
Land	₩ 457,890	7,158	(773)	-	5,293	(1,978)	467,590
Buildings	404,503	1,238	(398)	(26,812)	9,124	(2,237)	385,418
Structures	17,150	836	(41)	(2,159)	174	(59)	15,901
Machinery	236,848	4,649	(411)	(50,716)	25,614	-	215,984
Vehicles	271	263	(14)	(193)	29	-	356
Tools	4,447	3,005	(144)	(2,101)	347	-	5,554
Furniture and fixtures	35,447	15,276	(6)	(17,236)	28	-	33,509
Others	1,312	54	-	-	-	-	1,366
Construction-in-progress	121,792	102,771	-	-	(40,609)	-	183,954
	₩ 1,279,660	135,250	(1,787)	(99,217)	-	(4,274)	1,309,632

For the year ended December 31, 2015, land and buildings with a carrying amount of ₩2,732 million were transferred to investment property and land, buildings, structures and machinery with a carrying amount of ₩1,542 million were transferred to non-current assets held for sale.

6. Intangible Assets

(a) Details of intangible assets as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016			December 31 2015		
	Cost	Accumulated amortization	Carrying amount	Cost	Accumulated amortization	Carrying amount
Industrial property rights	₩ 7,311	(5,545)	1,766	6,997	(5,535)	1,462
Facility usage rights	24,485	(1,709)	22,776	19,180	(1,708)	17,472
Intangible assets under development	3,560	-	3,560	3,560	-	3,560
	₩ 35,356	(7,254)	28,102	29,737	(7,243)	22,494

(b) Changes in intangible assets for the six-month period ended June 30, 2016 were as follows:

<i>In millions of won</i>	January 1 2016	Acquisition	Disposal	Transfer from property, plant and equipment	Amortization	June 30 2016
Industrial property rights	₩ 1,462	314	-	-	(10)	1,766
Facility usage rights	17,472	5,314	(46)	36	-	22,776
Intangible assets under development	3,560	-	-	-	-	3,560
	₩ 22,494	5,628	(46)	36	(10)	28,102

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6. Intangible Assets, Continued

(c) Changes in intangible assets for the year ended December 31, 2015 were as follows:

<i>In millions of won</i>		January 1 2015	Acquisition	Disposal	Amortization	December 31 2015
Industrial property rights	₩	1,567	23	(104)	(24)	1,462
Facility usage rights		15,043	3,195	(766)	-	17,472
Intangible assets under development		3,026	534	-	-	3,560
	₩	19,636	3,752	(870)	(24)	22,494

(d) Expenditures not capitalized for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016		2015	
		Three-month	Six-month	Three-month	Six-month
Cost of sales	₩	60	196	73	104
Selling, general and administrative expenses		2,855	4,681	2,571	5,484
	₩	2,915	4,877	2,644	5,588

7. Investment Property

(a) Details of investment property as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>		June 30 2016			December 31 2015		
		Cost	Accumulated depreciation	Carrying amount	Cost	Accumulated depreciation	Carrying amount
Land	₩	69,891	-	69,891	23,066	-	23,066
Buildings		250,126	(63,457)	186,669	172,757	(59,022)	113,735
	₩	320,017	(63,457)	256,560	195,823	(59,022)	136,801

(b) Changes in investment property for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>		2016			2015		
		Land	Buildings	Total	Land	Buildings	Total
Beginning balance	₩	23,066	113,735	136,801	22,236	117,905	140,141
Acquisition		-	-	-	-	64	64
Depreciation		-	(3,712)	(3,712)	-	(6,136)	(6,136)
Transfer from property, plant and equipment		46,825	76,646	123,471	830	1,902	2,732
Ending balance	₩	69,891	186,669	256,560	23,066	113,735	136,801

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7. Investment Property, Continued

- (c) The amounts recognized in profit or loss from investment property for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Rental income	₩ 8,209	17,116	8,094	17,207
Direct operating expense	(2,189)	(3,712)	(1,534)	(3,067)
	₩ 6,020	13,404	6,560	14,140

- (d) The carrying amount and the fair value of investment property as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>	June 30 2016		December 31 2015	
	Fair value	Carrying amount	Fair value	Carrying amount
Land	₩ 532,420	69,891	406,600	23,066
Buildings	227,030	186,669	171,979	113,735
	₩ 759,450	256,560	578,579	136,801

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 June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	Company	Location	Principal operation	June 30 2016		December 31 2015	
				Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
	Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	20.24%	₩ 1,830	20.24%	₩ 1,830
	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
	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
					₩39,230		₩46,230

For the six-month period ended June 30, 2016, the Company recognized ₩6,095 million of gain on disposal of investments in associates as KOCREF REIT 17 Co., Ltd. was liquidated.

In 2015, the Company's ownership in Lite Pharm Tech, Inc. has decreased to 20.24% due to their paid-in capital increase.

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9. Investments in Subsidiaries

Investments in subsidiaries as of June 30, 2016 and December 31, 2015 are summarized as follows:

In millions of won

Company	Location	Principal operation	June 30 2016		December 31 2015	
			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	99.99%	2,891	99.99%	2,891
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.	Korea	Manufacturing and selling cosmetics	98.49%	98,094	97.73%	70,676
Renzoluc Pte., Ltd. ^(*)	Singapore	Manufacturing and selling tobaccos	100.00%	-	100.00%	-
KT&G Life Sciences Corporation ^(*)	Korea	Researching and developing medicine	73.94%	14,287	73.94%	14,287
KGC Yebon Corporation	Korea	Manufacturing and selling medical herbs	100.00%	49,828	100.00%	49,828
K-Q HongKong I, Limited ^(*)	HongKong	Manufacturing and selling ginseng	100.00%	17,761	100.00%	17,761
PT KT&G Indonesia	Indonesia	Manufacturing and selling tobaccos	99.99%	-	99.99%	-
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%	5,532
SangSang Stay, Inc.	Korea	Hotel	100.00%	20,000	100.00%	20,000
KT&G Global Rus L.L.C.	Russia	Selling tobaccos	100.00%	1,497	-	-
				₩1,153,361		₩1,124,446

^(*) The Company's percentage of ownership, shown above, excludes preferred shares. As of June 30, 2016, the Company's percentage of ownership would be 68.91%, 59.48% and 50.00%, respectively, if preferred shares are included.

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9. Investments in Subsidiaries, Continued

For the six-month period ended June 30, 2016, the Company acquired ₩27,418 million of additional shares of Somang Cosmetics Co., Ltd. as a result of the exercise of conversion options embedded in its redeemable convertible preferred shares, increasing its ownership from 97.73% to 98.49%.

For the six-month period ended June 30, 2016, the Company established KT&G Global Rus L.L.C.

For the year ended December 31, 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 year ended December 31, 2015, the Company made an additional investment of ₩2,356 million and ₩5,096 million in Korea Tobacos do Brasil Ltda. and K&I China Co., Ltd, respectively, and established SangSang Stay, Inc.

For the year ended December 31, 2015, the Company recognized ₩34,601 million of impairment losses on investments in Renzoluc Pte., Ltd., KT&G Life Sciences Corporation and PT KT&G Indonesia since the carrying amounts exceeded their recoverable amounts.

10. Available-for-sale Financial Assets

- (a) Changes in available-for-sale financial assets for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>	2016	2015
Beginning balance	₩ 340,149	304,438
Acquisitions	-	63,190
Net changes in fair value	(6,041)	1,744
Disposals or exercise of conversion options	-	(29,223)
Ending balance	₩ 334,108	340,149
Statement of financial position:		
Current	₩ 1,500	-
Non-current	332,608	340,149
	₩ 334,108	340,149

In 2015, the Company acquired ₩28,990 million of ordinary shares of U&I Corporation by exercising conversion options embedded in their convertible bonds and redeemable convertible preferred shares. The Company recognized ₩24,990 million of difference between the fair value of ordinary shares acquired and the carrying amount of bonds and preferred shares converted as gain on sale of available-for-sale financial assets for the year ended December 31, 2015.

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10. Available-for-sale Financial Assets, Continued

(b) Available-for-sale financial assets as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Available-for-sale debt instruments:		
Corporate bonds	₩ 1,500	1,500
Available-for-sale equity instruments:		
Listed		
– Shinhan Financial Group Co., Ltd.	152,317	158,530
– Oscotech, Inc.	5,280	3,696
– Rexahn Pharmaceuticals, Inc.	1,861	2,696
– U&I Corporation	21,549	22,564
	181,007	187,486
Unlisted	151,601	151,163
Total available-for-sale equity instruments	332,608	338,649
Total available-for-sale financial assets	₩ 334,108	340,149

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

As of June 30, 2016 and December 31, 2015, ₩37,555 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.

11. Long-term Deposits in MSA Escrow Fund

Long-term deposits in MSA Escrow Fund as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
MMF	₩ 5,940	43,309
Treasury note	443,790	360,657
	₩ 449,730	403,966

As discussed in note 33 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 six-month periods ended June 30, 2016 and 2015, ₩46,228 million and ₩40,379 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. Interest income on long-term deposits in MSA Escrow Fund for the six-month periods ended June 30, 2016 and 2015 are ₩4,089 million and ₩1,066 million, respectively.

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12. Trade and Other Receivables

(a) Trade and other receivables as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>		June 30 2016		December 31 2015	
		Current	Non-current	Current	Non-current
Loans to employees	₩	14,313	46,664	15,767	51,976
Loans		76,843	2,912	69,813	8,204
Other receivables		106,407	4,068	142,130	1,551
Guarantee deposits		23,220	18,915	19,070	16,869
Accrued income		6,560	-	8,912	-
Trade receivables		926,962	-	819,170	-
	₩	1,154,305	72,559	1,074,862	78,600

(b) Trade and other receivables as of June 30, 2016 and December 31, 2015 have been reported in the separate statements of financial position net of allowances as follows:

<i>In millions of won</i>		June 30 2016		December 31 2015	
		Current	Non-current	Current	Non-current
Gross trade and other receivables	₩	1,200,424	73,141	1,121,048	78,600
Allowance:					
Loans		(11,787)	(582)	(12,447)	-
Other receivables		(8,181)	-	(7,570)	-
Accrued income		(2,250)	-	(2,264)	-
Trade receivables		(23,901)	-	(23,905)	-
		(46,119)	(582)	(46,186)	-
Net trade and other receivables	₩	1,154,305	72,559	1,074,862	78,600

(c) Changes in the allowance account for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>		2016	2015
Beginning balance	₩	46,186	55,083
Impairment loss		519	2,569
Reversal of impairment loss		(4)	(11,466)
Ending balance	₩	46,701	46,186

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 statements of comprehensive income.

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12. Trade and Other Receivables, Continued

- (d) The aging schedule of trade and other receivables which were past due but not impaired as of June 30, 2016 and December 31, 2015 is as follows:

<i>In millions of won</i>		June 30 2016	December 31 2015
Within 1 month	₩	52,325	48,107
Between 1 and 2 months		47,072	39,921
Beyond 2 months		248,335	245,788
	₩	347,732	333,816

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.

- (e) Details of trade and other receivables that are measured at amortized cost as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>			June 30 2016				December 31 2015	
	Effective interest rate		Current	Non-current	Effective interest rate		Current	Non-current
Loans to employees	1.89~5.68%	₩	14,313	46,664	1.89~5.68%	₩	15,767	51,976
Guarantee deposits	1.89~5.68%		23,220	18,915	1.89~5.68%		19,070	16,869
		₩	37,533	65,579		₩	34,837	68,845

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13. Inventories

(a) Inventories as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>		June 30 2016	December 31 2015
Finished goods, net of loss on write-down of inventories	₩	82,527	72,394
Work-in-progress		16,996	15,294
Raw materials		662,451	685,101
Supplies		27,669	25,959
By-products		6,701	5,515
Buildings under construction		6,196	3,618
Sites for lotting-out construction		20,935	25,815
Goods-in-transit		26,049	55,339
	₩	849,524	889,035

(b) The amount of inventories recognized as an expense for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016		2015	
		Three-month	Six-month	Three-month	Six-month
Cost of sales:					
Write-down (reversal of write-down) of inventories	₩	26	45	(189)	(153)
Loss on retirement of inventories		505	809	189	303
Other expense:					
Loss on retirement of inventories		216	219	49	117
	₩	747	1,073	49	267

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14. Cash and Cash Equivalents and Other Financial Assets

(a) Cash and cash equivalents as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>		June 30 2016	December 31 2015
Cash on hand	₩	1,864	2,623
Demand deposits		91,017	71,753
Short-term investment assets		350,000	370,000
	₩	442,881	444,376

(b) Other financial assets as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>		June 30 2016	December 31 2015
Time deposits	₩	100,000	100,000
Money trust		780,000	950,000
Certificates of deposit		40,000	30,000
Derivative financial instruments		-	11,976
	₩	920,000	1,091,976

During the year ended December 31, 2015, the Company acquired redeemable convertible preferred shares of Somang Cosmetics Co., Ltd. and recognized embedded derivatives as other financial assets separately from the host contract. The Company exercised those conversion options and recognized ₩311 million of gain on conversion of redeemable convertible preferred shares for the six-month period ended June 30, 2016.

15. Non-current Assets Held for Sale

Changes in non-current assets held for sale for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>		2016	2015
Beginning balance	₩	1,542	426
Transfer from property, plant and equipment		-	1,542
Disposal		(1,542)	(426)
Ending balance	₩	-	1,542

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16. Pledged Assets

(a) Investment property pledged as collateral as of June 30, 2016 was as follows:

In millions of won

Asset	Carrying amount	Type	Received amount	Collateralized amount	Leaseholder
Investment property	₩ 67,013	Leasehold deposits received	₩ 8,975	9,225	Metlife Insurance Korea Co., Ltd. and others

(b) Investment property pledged as collateral as of December 31, 2015 was as follows:

In millions of won

Asset	Carrying amount	Type	Received amount	Collateralized amount	Leaseholder
Investment property	₩ 70,769	Leasehold deposits received	₩ 8,975	9,225	Metlife Insurance Korea Co., Ltd. and others

17. Share Capital and Other Capital Surplus

(a) Details of share capital as of June 30, 2016 and December 31, 2015 were as follows:

	June 30 2016	December 31 2015
Number of ordinary shares:		
Authorized	800,000,000	800,000,000
Issued	137,292,497	137,292,497
Outstanding	126,143,670	125,965,892
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 June 30, 2016, 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 six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

	2016			2015		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning balance	137,292,497	(11,326,605)	125,965,892	137,292,497	(11,393,697)	125,898,800
In-kind donation of treasury shares	-	177,778	177,778	-	67,092	67,092
Ending balance	137,292,497	(11,148,827)	126,143,670	137,292,497	(11,326,605)	125,965,892

(c) There was no change in other capital surplus for the six-month period ended June 30, 2016 and the year ended December 31, 2015.

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18. Treasury Shares

- (a) Changes in treasury shares for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won, except number of shares</i>	2016		2015	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Beginning balance	11,326,605	₩ 337,062	11,393,697	₩ 339,059
In-kind donation of treasury shares	(177,778)	(5,290)	(67,092)	(1,997)
Ending balance	11,148,827	₩ 331,772	11,326,605	₩ 337,062

- (b) Changes in gain on reissuance of treasury shares for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>	2016	2015
Beginning balance	₩ 494,648	492,032
In-kind donation of treasury shares, net of tax	10,544	2,616
Ending balance	₩ 505,192	494,648

19. Reserves

- (a) Details of reserves as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Available-for-sale financial assets - net change in fair value	₩ (49,708)	(45,128)
Legal reserve	602,937	602,937
Voluntary reserve	3,794,261	3,226,658
	₩ 4,347,490	3,784,467

- (b) Available-for-sale financial assets - net change in fair value as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Available-for-sale financial assets - net change in fair value before tax	₩ (65,578)	(59,536)
Tax effect	15,870	14,408
	₩ (49,708)	(45,128)

- (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.

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19. Reserves, Continued

(d) Details of voluntary reserve as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Reserve for business rationalization	₩ 12,851	12,851
Reserve for research and human resource development	20,000	30,000
Reserve for business expansion	698,881	698,881
Unconditional reserve	3,062,529	2,484,926
	₩ 3,794,261	3,226,658

Reserve for business rationalization

Until December 10, 2002 under *the Restriction of Special Taxation 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

According to *the Restriction of Special Taxation Act*, certain taxable deductions are required to be transferred from retained earnings to reserve for research and human resource development. This reserve may be used for each purpose and their remaining amounts could be reclassified as a voluntary reserve.

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.

20. Retained Earnings

Changes in retained earnings for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>	2016	2015
Beginning balance	₩ 995,886	736,460
Dividends	(428,284)	(428,056)
Transfer from reserve for research and human resource development	10,000	12,522
Transfer to unconditional reserve	(577,603)	(320,926)
Profit for the period	530,016	987,924
Remeasurements of net defined benefit liability, net of tax	(79)	7,962
Ending balance	₩ 529,936	995,886

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21. Trade and Other Payables

Trade and other payables as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>		June 30 2016		December 31 2015	
		Current	Non-current	Current	Non-current
Leasehold deposits received	₩	23,466	3,618	19,404	8,147
Trade payables		53,659	-	65,154	-
Withholdings		3,400	-	4,749	-
Withholdings value added tax		204,508	-	184,587	-
Accrued expenses		106,206	-	125,699	-
Other payables		44,698	-	34,231	-
	₩	435,937	3,618	433,824	8,147

22. Short-term Borrowings

Short-term borrowings as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	Annual interest rate	June 30 2016	December 31 2015
Customer credit contracts:			
Nonghyup Bank	6.09%	₩ 3,666	4,099
KEB Hana Card Co., Ltd.	3M CD rate+2.5%	817	932
		₩ 4,483	5,031

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 for 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 six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Defined benefit plans:				
Current service cost	₩ 6,225	12,450	7,096	14,191
Net interest cost	232	464	437	875
	6,457	12,914	7,533	15,066
Defined contribution plans:				
Contributions recognized as expense	910	2,588	667	2,040
	₩ 7,367	15,502	8,200	17,106

The Company recognized termination benefits amounting to ₩6,116 million as an expense for the six-month period ended June 30, 2015.

- (b) Net defined benefit liability as of June 30, 2016 and December 31, 2015 is summarized as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Present value of defined benefit obligations	₩ 248,197	247,774
Fair value of plan assets	(194,452)	(205,600)
Net defined benefit liability	₩ 53,745	42,174

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24. Revenue from Real Estate Sales

(a) Details of agreements for real estate sales under construction as of June 30, 2016 were as follows:

<i>In millions of won</i>	Construction period		Total revenue estimated	Total revenue contracted
Daegu Station Central-Xi	Dec. 2014 ~ Oct. 2017	₩	342,666	318,525

(b) Changes in the balance of contract amount for the six-month period ended June 30, 2016 were as follows:

<i>In millions of won</i>	2016
Beginning balance	₩ 246,340
Revenue recognized	(51,413)
Ending balance	₩ 194,927

(c) Recognized profits and related balances for agreements under construction as of June 30, 2016 were as follows:

<i>In millions of won</i>	Stage of completion		Aggregate revenue recognized	Aggregate expenses recognized	Due to customers for contract work
Daegu Station Central-Xi	38.80%	₩	123,597	96,567	3,830

(d) There was no change in the estimates of total revenue and total costs during the six-month period ended June 30, 2016. The total revenue and the total costs are estimated based on the information and circumstances available at the end of the reporting period and actual results may differ from these estimates.

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25. Result from Operating Activities

- (a) Details of expenses classified by nature for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016		2015	
		Three-month	Six-month	Three-month	Six-month
Changes in inventories	₩	17,340	39,511	56,510	46,031
Raw materials and consumables purchased		199,940	358,438	156,617	313,748
Salaries		84,358	165,307	87,367	181,489
Retirement and termination benefits		7,367	15,502	8,200	23,222
Depreciation		25,975	52,044	26,328	52,538
Amortization		5	10	5	16
Employee welfare		11,630	22,110	10,500	34,906
Advertising		26,432	50,324	26,637	59,178
Commissions		27,174	53,216	23,588	48,275
Other expenses		22,540	40,176	9,810	36,006
	₩	422,761	796,638	405,562	795,409

- (b) Details of selling, general and administrative expenses for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016		2015	
		Three-month	Six-month	Three-month	Six-month
Salaries	₩	57,020	111,752	57,715	122,439
Retirement and termination benefits		5,247	10,835	5,732	16,570
Employee welfare		8,480	16,035	7,581	24,501
Travel		1,746	2,642	1,226	2,106
Communications		863	1,708	845	1,734
Utilities		1,627	4,149	1,764	4,650
Taxes and dues		12,472	13,576	11,931	13,410
Supplies		364	795	566	1,038
Rent		3,266	6,328	3,461	6,909
Depreciation		7,998	16,018	8,189	16,280
Amortization		5	10	5	16
Repairs and maintenance		853	1,588	1,091	1,579
Vehicles		1,016	1,983	1,253	2,394
Insurance		35	176	11	170
Commissions		19,488	38,191	17,580	37,025
Freight and custody		6,004	12,012	6,837	13,821
Conferences		683	1,399	684	1,379
Advertising		26,368	50,244	26,583	59,097
Training		961	1,788	892	1,961
Prizes and rewards		425	602	496	952
Normal research and development		2,855	4,681	2,571	5,484
Reversal of impairment loss on trade receivables		(1)	(4)	-	(279)
	₩	157,775	296,508	157,013	333,236

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26. Other Income and Expenses

(a) Details of other income for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Foreign currency transaction gain	₩ 3,780	11,076	3,175	6,204
Foreign currency translation gain	12,799	2,486	16,009	19,174
Reversal of impairment loss on other receivables	66	-	-	2,011
Gain on sale of property, plant and equipment	11,544	11,553	6,232	6,973
Gain on sale of intangible assets	-	-	638	723
Gain on sale of investments in associates	-	6,095	-	-
Others	5,620	8,588	3,183	13,854
	₩ 33,809	39,798	29,237	48,939

(b) Details of other expenses for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Foreign currency transaction loss	₩ 5,209	9,955	2,781	5,159
Foreign currency translation loss	-	9,459	-	4,058
Impairment loss on other receivables	-	519	2,965	-
Donations	1,383	3,202	670	20,980
Loss on sale of property, plant and equipment	870	870	26	369
Loss on sale of intangible assets	5	5	-	-
Others	221	1,499	541	3,144
	₩ 7,688	25,509	6,983	33,710

27. Net Finance Income

(a) Details of net finance income for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Finance income:				
Interest income	₩ 8,685	18,435	6,836	15,534
Dividend income	4,863	11,427	5,343	10,955
Interest income on long-term deposits in MSA Escrow Fund	2,057	4,089	15	1,066
Gain on conversion of redeemable convertible preferred shares	-	311	-	-
	15,605	34,262	12,194	27,555
Finance costs:				
Interest expense	(171)	(346)	(180)	(418)
Net finance income	₩ 15,434	33,916	12,014	27,137

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27. Net Finance Income, Continued

(b) Details of interest income for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016		2015	
		Three-month	Six-month	Three-month	Six-month
Trade and other payables	₩	171	346	180	418

(c) Details of interest expenses for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016		2015	
		Three-month	Six-month	Three-month	Six-month
Deposits	₩	6,542	14,095	4,754	11,608
Available-for-sale financial assets		8	15	13	25
Trade and other receivables		2,135	4,325	2,069	3,901
	₩	8,685	18,435	6,836	15,534

28. Income Tax

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 24.10% and 24.33% for the six-month periods ended June 30, 2016 and 2015, respectively.

29. Earnings per Share

Basic and diluted earnings per share for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

		2016		2015	
		Three-month	Six-month	Three-month	Six-month
Profit for the period in millions of won	₩	276,247	530,016	229,978	524,383
Weighted-average number of ordinary shares outstanding		126,143,670	126,133,902	125,965,892	125,957,737
Basic and diluted earnings per share in won	₩	2,190	4,202	1,826	4,163

The weighted-average number of ordinary shares outstanding is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time-weighting factor.

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30. Transactions and Balances with Related Companies

(a) Details of parent and subsidiary relationships as of June 30, 2016 and December 31, 2015 were as follows:

Subsidiary	Location	Immediate parent company	Percentage of ownership					
			June 30 2016			December 31 2015		
			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	99.99%	-	99.99%	99.99%	-	99.99%
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. ^(*1)	Korea	KT&G Corporation	98.49%	-	98.49%	97.73%	-	97.73%
Renzoluc Pte., Ltd. ^(*2)	Singapore	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Life Sciences Corporation ^(*2)	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 ^(*2)	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.	HongKong	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
K&I China Co., Ltd.	China	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
SangSang Stay, Inc. ^(*3)	Korea	KT&G Corporation	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Global Rus L.L.C. ^(*4)	Russia	KT&G Corporation	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 Ababi Purwosari	Indonesia	PT Trisakti Purwosari Makmur	-	99.24%	99.24%	-	99.24%	99.24%
PT Purindo Ilufa	Indonesia	PT Trisakti Purwosari Makmur	-	100.00%	100.00%	-	100.00%	100.00%

(*1) For the six-month period ended June 30, 2016, the ownership interest in Somang Cosmetics Co., Ltd. has increased to 98.49% from 97.73% as a result of the conversion of its redeemable convertible preferred shares.

(*2) The percentage of ownership, shown above, excludes preferred shares. As of June 30, 2016, the Company's percentage of ownership would be 68.91%, 59.48% and 50.00%, respectively, if preferred shares are included.

(*3) The Company established SangSang Stay, Inc. in 2015.

(*4) The Company established KT&G Global Rus L.L.C. in 2016.

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30. 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 six-month periods ended June 30, 2016 and 2015 are summarized as follows:

(i) Sales and other income

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Korea Ginseng Corporation	₩ 1,843	3,864	2,232	4,333
Yungjin Pharm. Ind. Co., Ltd.	86	170	76	162
Tae-a Industry Co., Ltd.	4	7	4	11
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	653	711	1,859	4,038
KT&G Pars	321	323	-	941
KT&G Rus L.L.C.	6,681	15,352	8,003	11,856
KGC Life & Gin Co., Ltd.	103	207	118	235
Global Trading, Inc.	30,308	64,472	33,316	53,729
Somang Cosmetics Co., Ltd.	73	94	25	49
Renzoluc Pte., Ltd.	880	1,932	796	1,804
KT&G Life Sciences Corporation	5	11	5	22
KGC Yebon Corporation	8	96	270	351
PT KT&G Indonesia	331	833	619	779
K&I China Co., Ltd.	1	1	-	-
SangSang Stay, Inc.	658	758	-	-
PT Trisakti Purwosari Makmur	16	88	83	83
PT Mandiri Maha mulia	1,096	1,929	545	1,604
	₩ 43,067	90,848	47,951	79,997

In addition, the Company disposed of property, plant and equipment with a carrying amount of ₩4,920 million and ₩3,391 million to SangSang Stay, Inc. and PT Mandiri Maha mulia, respectively, during the six-month period ended June 30, 2016.

(ii) Purchase and other expenses

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Korea Ginseng Corporation	₩ 304	1,488	265	833
Yungjin Pharm. Ind. Co., Ltd.	5	8	5	12
Tae-a Industry Co., Ltd.	3,736	7,539	3,368	7,069
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	-	-	9	9
KGC Life & Gin Co., Ltd.	47	249	20	255
Somang Cosmetics Co., Ltd.	29	407	43	67
KGC Yebon Corporation	-	260	22	72
K&I China Co., Ltd.	30	46	5	5
SangSang Stay, Inc.	33	33	-	-
	₩ 4,184	10,030	3,737	8,322

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30. Transactions and Balances with Related Companies, Continued

(c) Account balances with related companies as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>	June 30 2016		December 31 2015	
	Receivables	Payables	Receivables	Payables
Korea Ginseng Corporation	₩ 236	2,046	37	2,044
Yungjin Pharm. Ind. Co., Ltd.	-	413	11	413
Tae-a Industry Co., Ltd.	-	1,241	-	-
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	39,446	-	44,388	-
Korea Tabacos do Brasil Ltda.	100	-	99	-
KT&G Pars ^(*)	43,374	-	42,868	-
KT&G Rus L.L.C. ^(*)	50,494	-	38,425	-
KGC Life & Gin Co., Ltd.	-	166	-	245
Global Trading, Inc.	17,592	-	12,071	-
Somang Cosmetics Co., Ltd.	52	27	28,144	28
Renzoluc Pte., Ltd.	50,011	-	47,884	-
KT&G Life Sciences Corporation	-	1	-	1
PT KT&G Indonesia	29,463	-	29,112	-
K&I China Co., Ltd.	1	-	-	-
SangSang Stay, Inc.	422	-	-	-
PT Trisakti Purwosari Makmur	243	-	156	-
PT Mandiri Maha Mulia	7,214	-	3,698	-
	₩ 238,648	3,894	246,893	2,731

^(*) Above receivables are the gross amounts before ₩20,717 million and ₩20,198 million of allowance for doubtful accounts as of June 30, 2016 and December 31, 2015, respectively.

(d) During the six-month period ended June 30, 2016, the Company acquired ₩27,418 million of additional shares of Somang Cosmetics Co., Ltd. as a result of the conversion of its redeemable convertible preferred shares.

(e) Details of key management personnel compensation for the three- and six-month periods ended June 30, 2016 and 2015 are summarized as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Short-term employee benefits	₩ 3,810	7,555	3,538	9,091
Retirement benefits	273	807	392	904
	₩ 4,083	8,362	3,930	9,995

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31. 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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31. 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 June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>	June 30 2016		December 31 2015	
	Assets	Liabilities	Assets	Liabilities
USD	₩ 1,012,212	8,522	918,070	44,431
IDR	50,330	-	48,190	-
EUR	30,075	2,112	30,375	1,504
Others	3,681	-	2,177	-
	₩ 1,096,298	10,634	998,812	45,935

As of June 30, 2016 and December 31, 2015, 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>	June 30 2016		December 31 2015	
	10% weakening	10% strengthening	10% weakening	10% strengthening
Increase (decrease) in profit before tax	₩ 108,566	(108,566)	95,288	(95,288)

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 June 30, 2016 and December 31, 2015, 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>	June 30 2016		December 31 2015	
	5% increase	5% decrease	5% increase	5% decrease
Comprehensive income before tax	₩ 3,975	(3,975)	1,627	(1,627)

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31. 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 June 30, 2016, 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 June 30, 2016 and December 31, 2015 is as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Available-for-sale debt instruments	₩ 1,500	1,500
Long-term deposits in MSA Escrow Fund	449,730	403,966
Trade and other receivables	1,226,864	1,153,462
Other financial assets (excluding derivatives)	920,000	1,080,000
Cash and cash equivalents (excluding cash on hand)	441,017	441,753
Financial guarantee contracts	114,855	76,566
	₩ 3,153,966	3,157,247

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31. 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 June 30, 2016 and December 31, 2015 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	
As of June 30, 2016:						
Trade and other payables	₩ 231,647	232,149	204,563	23,760	3,826	
Short-term borrowings	4,483	4,483	4,483	-	-	
Financial guarantee contracts	-	114,855	-	-	114,855	
	₩ 236,130	351,487	209,046	23,760	118,681	
As of December 31, 2015:						
Trade and other payables	₩ 252,635	253,343	225,084	19,583	8,676	
Short-term borrowings	5,031	5,031	5,031	-	-	
Financial guarantee contracts	-	76,566	-	-	76,566	
	₩ 257,666	334,940	230,115	19,583	85,242	

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

(d) Fair Value of Financial Instruments

The carrying amounts of each category of financial assets and liabilities as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Financial assets:		
Financial assets at fair value through profit or loss (derivative financial instruments)	₩ -	11,976
Available-for-sale financial assets	334,108	340,149
Loans and receivables		
–Trade and other receivables	1,226,864	1,153,462
–Long-term deposits in MSA Escrow Fund	449,730	403,966
–Other financial assets (excluding derivatives)	920,000	1,080,000
–Cash and cash equivalents	442,881	444,376
	3,039,475	3,081,804
	₩ 3,373,583	3,433,929
Financial liabilities:		
Financial liabilities measured at amortized cost		
–Trade and other payables	₩ 231,647	252,635
–Short-term borrowings	4,483	5,031
	₩ 236,130	257,666

The fair value measurements classified by fair value hierarchy as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>	Carrying amount	Level I	Level II	Fair value Level III
As of June 30, 2016:				
Available-for-sale financial assets	₩ 296,553	181,007	-	115,546
As of December 31, 2015:				
Available-for-sale financial assets	₩ 302,594	187,486	-	115,108
Other financial assets (derivative financial instruments)	11,976	-	-	11,976
	₩ 314,570	187,486	-	127,084

There is no transfer between fair value hierarchy levels of recurring fair value measurements for the six-month period ended June 30, 2016 and the year ended December 31, 2015.

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31. 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 measured using the adjusted net asset method, DCF and option pricing model and 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 six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>		2016	2015
Beginning balance	₩	127,084	90,726
Acquisition		-	33,073
Exercise of conversion options		(11,976)	-
Changes in fair value		438	3,285
Ending balance	₩	115,546	127,084

(e) Finance Income (Costs)

(i) Details of finance income (costs) by categories for the six-month period ended June 30, 2016 were as follows:

<i>In millions of won</i>		Available -for-sale Financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:					
Interest income	₩	15	18,420	-	18,435
Dividend income		9,920	-	-	9,920
Interest income on long-term deposits in MSA Escrow Fund		-	4,089	-	4,089
Gain on conversion of redeemable convertible preferred shares		-	311	-	311
Interest expense		-	-	(346)	(346)
	₩	9,935	22,820	(346)	32,409
Other comprehensive loss before tax					
Net change in fair value	₩	(6,041)	-	-	(6,041)

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

(e) Finance Income (Costs), Continued

(ii) Details of finance income (costs) by categories for the six-month period ended June 30, 2015 were as follows:

<i>In millions of won</i>	Available -for-sale Financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:				
Interest income	₩ 25	15,509	-	15,534
Dividend income	7,764	-	-	7,764
Interest income on long-term deposits in MSA Escrow Fund	-	1,066	-	1,066
Interest expense	-	-	(418)	(418)
	₩ 7,789	16,575	(418)	23,946
Other comprehensive loss before tax				
Net change in fair value	₩ (9,775)	-	-	(9,775)

32. 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 June 30, 2016 and December 31, 2015, the Company's capital structure was as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Debt (borrowings)	₩ 4,483	5,031
Less:		
Cash and cash equivalents	(442,881)	(444,376)
Current other financial assets	(920,000)	(1,091,976)
Net debt (asset)	(1,358,398)	(1,531,321)
Equity	₩ 6,009,387	5,896,480

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33. 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 June 30, 2016, a lawsuit by National Health Insurance Service claiming damages of ₩53,742 million is filed against the Company. Additionally, as of June 30, 2016, the Company is involved in five lawsuits as a plaintiff for alleged damages totalling ₩14,783 million and five lawsuits as a defendant for alleged damages totalling ₩1,779 million. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of June 30, 2016.
- (c) As of June 30, 2016, 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 June 30, 2016, the Company’s trade receivables from the export of cigarettes are insured against non-payment up to USD 21,100 thousand by short-term export insurances with the Korea Trade 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 June 30, 2016, 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	14,222
Bidding guarantee for export of tobacco sheet to Taiwan Tobacco and Liquor Corporation	USD	85
Performance guarantee for export of tobacco sheet to Thailand Tobacco Monopoly	THB	8,142
Payment guarantee for purchase of certificate stamp of PT Mandiri Maha Mulia	IDR	137,524

- (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.

KT&G CORPORATION
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33. Contingent Liabilities and Commitments, Continued

- (g) 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.

- (h) As of June 30, 2016, the Company has provided guarantees up to ~~₩~~225,600 million with an exercised amount of ~~₩~~114,855 million for the buyers of apartments in respect of their borrowings from Shinhan Bank.
- (i) As of June 30, 2016, the Company is insured by performance bond insurance up to ~~₩~~1,284 million with the Seoul Guarantee Insurance.

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34. Cash Flows

(a) Details of cash generated from operations for the six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016	2015
Profit for the period	₩ 530,016	524,383
Adjustments for:		
Income tax expense	168,286	168,636
Finance costs	346	418
Finance income	(34,262)	(27,555)
Depreciation	52,044	52,538
Amortization	10	16
Retirement and termination benefits	15,502	23,222
Foreign currency translations loss	9,459	4,058
Impairment loss on trade and other receivables	519	-
Write-down (reversal of write-down) of inventories	45	(153)
Loss on sale of property, plant and equipment	870	369
Loss on sale of intangible assets	5	-
Other expense	1,028	5,868
Foreign currency translations gain	(2,486)	(19,174)
Reversal of impairment loss on trade and other receivables	(4)	(2,290)
Gain on sale of property, plant and equipment	(11,553)	(6,973)
Gain on sale of intangible assets	-	(723)
Gain on sale of investment in associates	(6,095)	-
	723,730	722,640
Changes in working capital:		
Trade and other receivables	(92,866)	(81,899)
Advance payments	(19,861)	(31,002)
Prepaid expenses	1,494	(338)
Prepaid tobacco excise and other taxes	(32,962)	(184,737)
Inventories	38,439	45,764
Trade and other payables	17,514	66,506
Advance receipts	(19,486)	9,670
Tobacco excise and other taxes payable	(90,721)	281,201
Payment of retirement and termination benefits	(5,077)	(9,399)
Cash generated from operations	₩ 520,204	818,406

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34. Cash Flows, Continued

- (b) Details of material transactions without cash inflow and outflow for the six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016	2015
In-kind donation of treasury shares	₩ 19,200	5,448
Acquisition of investment in subsidiaries		
resulting from the conversion of redeemable convertible preferred shares	27,415	-
Decrease in accrued expenses		
related to payment of retirement and termination benefits	1,042	220
Increase in other payables		
related to acquisition of property, plant and equipment	887	3,229
Increase (decrease) in advance receipts related to disposal of		
property, plant and equipment and non-current assets held for sale	(623)	514
Increase in other receivables related with disposal of		
property, plant and equipment and non-current assets held for sale	3,129	230
Increase in other receivables related with disposal of intangible assets	-	700

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