KT&G CORPORATION AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2016 and 2015

(With Independent Auditors' Report Thereon)

Contents

KPMG SAMJONG

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Independent Auditors' Report

Based on a report originally issued in Korean

The Board of Directors and Shareholders
KT&G Corporation:

We have audited the accompanying consolidated financial statements of KT&G Corporation (the "Parent Company") and its subsidiaries (collectively the "Group"), which comprise the consolidated statements of financial position as of December 31, 2016 and 2015, the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Korean International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Korean Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2016 and 2015 and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with Korea International Financial Reporting Standards.

Other Matters

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

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

KPMG Samjong Accounting Corp.

KPMG Samjong Accounting Corp.
Seoul, Korea
February 24, 2017

This report is effective as of February 24, 2017, the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying financial statements and notes thereto. Accordingly, the readers of the audit report should understand that the above audit report has not been updated to reflect the impact of such subsequent events or circumstances, if any.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Statements of Financial Position

As of December 31, 2016 and 2015

In millions of won and thousands of U.S. dollars	*Note*	2016 Korean won	2016 U.S. dollars (note 4)	2015 Korean won
Assets				
Property, plant and equipment	*6,16*	₩ 1,601,877	$ 1,325,508	₩ 1,789,779
Intangible assets	*7*	104,929	86,826	105,428
Investment property	*8,16*	341,580	282,648	164,489
Investments in associates and joint ventures	*5,9*	56,476	46,732	51,521
Available-for-sale financial assets	*10,32*	385,096	318,656	364,681
Other financial assets	*14,16,32*	11	9	12
Long-term deposits in MSA Escrow Fund	*11,32,34*	503,592	416,708	403,966
Long-term advance payments	*34*	86,592	71,652	107,723
Long-term prepaid expenses		6,091	5,042	7,128
Long-term trade and other receivables	*12,32*	69,942	57,875	75,071
Deferred income tax assets	*29*	35,757	29,588	32,696
Total non-current assets		3,191,943	2,641,244	3,102,494
Inventories	*13*	2,265,355	1,874,518	2,119,114
Current available-for-sale financial assets	*10,32*	1,500	1,241	-
Current other financial assets	*14,16,32,33*	1,657,338	1,371,401	1,136,906
Prepaid tobacco excise and other taxes		439,413	363,602	447,771
Trade and other receivables	*12,25,32*	1,283,647	1,062,182	1,217,938
Advance payments	*34*	69,364	57,397	75,710
Prepaid expenses		26,924	22,278	20,519
Cash and cash equivalents	*14,32,33*	850,786	704,002	546,213
Total current assets		6,594,327	5,456,621	5,564,171
Non-current assets held for sale	*5,15*	26,315	21,775	6,692
Total assets		₩ 9,812,585	$ 8,119,640	₩ 8,673,357

See accompanying notes to the consolidated financial statements.

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

As of December 31, 2016 and 2015

In millions of won and thousands of U.S. dollars	*Note*	2016 Korean won	2016 U.S. dollars (note 4)	2015 Korean won
Equity				
Ordinary shares	*1,17*	₩ 954,959	$ 790,202	₩ 954,959
Other capital surplus	*17*	(3,430)	(2,838)	(9,928)
Treasury shares	*18*	(328,157)	(271,541)	(337,062)
Gain on reissuance of treasury shares	*18*	513,776	425,136	494,648
Reserve	*19*	4,296,523	3,555,253	3,704,315
Retained earnings	*20*	1,612,032	1,333,911	1,401,975
Equity attributable to owners of the parent		7,045,703	5,830,123	6,208,907
Non-controlling interests		72,554	60,035	66,592
Total equity		7,118,257	5,890,158	6,275,499
Liabilities				
Long-term borrowings	*16,23,32,33*	115,953	95,948	102,242
Long-term trade and other payables	*16,22,32*	14,700	12,164	13,647
Long-term advance receipts		9,877	8,173	10,390
Net defined benefit liability	*24*	123,610	102,284	120,648
Provision		4,703	3,892	2,765
Deferred income tax liabilities	*29*	272,106	225,160	276,472
Total non-current liabilities		540,949	447,621	526,164
Short-term borrowings	*16,23,32,33*	136,599	113,032	206,373
Current portion of long-term borrowings	*16,23,32,33*	9,597	7,941	27,659
Trade and other payables	*22,32*	622,208	514,859	606,355
Advance receipts		9,573	7,923	28,650
Income tax payable	*29*	210,213	173,945	224,836
Tobacco excise and other taxes payable		1,165,189	964,161	777,821
Total current liabilities		2,153,379	1,781,861	1,871,694
Total liabilities		2,694,328	2,229,482	2,397,858
Total equity and liabilities		₩ 9,812,585	$ 8,119,640	₩ 8,673,357

See accompanying notes to the consolidated financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income

For the years ended December 31, 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	*5,25,34*	₩ 4,503,280	$ 3,726,338	₩ 4,169,839
Cost of sales	*25,26*	(1,796,725)	(1,486,740)	(1,630,601)
Gross profit		2,706,555	2,239,598	2,539,238
Selling, general and administrative expenses	*26*	(1,236,453)	(1,023,131)	(1,173,334)
Operating profit	*5*	1,470,102	1,216,467	1,365,904
Other income	*27*	165,270	136,757	118,752
Other expenses	*27*	(102,159)	(84,534)	(160,161)
Net finance income	*28,32*	52,551	43,485	74,762
Share of gain of associates and joint ventures	*9*	2,546	2,107	15,137
Share of loss of associates and joint ventures	*9*	(479)	(397)	-
Profit before income tax		1,587,831	1,313,885	1,414,394
Income tax expense	*29*	(361,801)	(299,380)	(382,174)
Profit for the year		₩ 1,226,030	$ 1,014,505	₩ 1,032,220
Other comprehensive income (loss):				
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		₩ 11,436	$ 9,463	₩ (16,076)
Exchange differences on translating foreign operations, net of tax		13,700	11,336	(14,770)
Items that will never be reclassified to profit or loss				
Remeasurements of net defined benefit liability, net of tax	*24*	(24,611)	(20,365)	38
Other comprehensive income (loss) for the year, net of tax		525	434	(30,808)
Total comprehensive income for the year		₩ 1,226,555	$ 1,014,939	₩ 1,001,412
Profit attributable to:				
Owners of the Parent Company		₩ 1,231,274	$ 1,018,845	₩ 1,035,717
Non-controlling interests		(5,244)	(4,340)	(3,497)
		₩ 1,226,030	$ 1,014,505	₩ 1,032,220
Total comprehensive income attributable to:				
Owners of the Parent Company		₩ 1,230,549	$ 1,018,245	₩ 1,007,103
Non-controlling interests		(3,994)	(3,306)	(5,691)
		₩ 1,226,555	$ 1,014,939	₩ 1,001,412
Earnings per share in won and U.S. dollars:				
Basic and diluted	*30*	₩ 9,759	$ 8.08	₩ 8,222

See accompanying notes to the consolidated financial statements.

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

For the year ended December 31, 2016

In millions of won		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non-controlling interests	Total equity
Balance at January 1, 2016	₩	954,959	(9,928)	(337,062)	494,648	3,704,315	1,401,975	6,208,907	66,592	6,275,499
Total comprehensive income for the year:										
Profit (loss) for the year		-	-	-	-	-	1,231,274	1,231,274	(5,244)	1,226,030
Other comprehensive income (loss):										
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	11,436	-	11,436	-	11,436
Exchange differences on translating foreign operations, net of tax		-	-	-	-	13,170	-	13,170	530	13,700
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	(25,331)	(25,331)	720	(24,611)
Total other comprehensive income (loss)		-	-	-	-	24,606	(25,331)	(725)	1,250	525
Total comprehensive income (loss) for the year		-	-	-	-	24,606	1,205,943	1,230,549	(3,994)	1,226,555
Transactions with owners, recorded directly in equity:										
Dividends		-	-	-	-	-	(428,284)	(428,284)	-	(428,284)
In-kind donation of treasury shares		-	-	8,905	19,128	-	-	28,033	-	28,033
Transfer from reserve for research and human resource development		-	-	-	-	(10,000)	10,000	-	-	-
Transfer to unconditional reserve		-	-	-	-	577,602	(577,602)	-	-	-
Extinguishment of equity conversion option		-	7,780	-	-	-	-	7,780	10,220	18,000
Acquisition of non-controlling interests		-	(1,282)	-	-	-	-	(1,282)	(283)	(1,565)
Others		-	-	-	-	-	-	-	19	19
Total transactions with owners		-	6,498	8,905	19,128	567,602	(995,886)	(393,753)	9,956	(383,797)
Balance at December 31, 2016	₩	954,959	(3,430)	(328,157)	513,776	4,296,523	1,612,032	7,045,703	72,554	7,118,257

See accompanying notes to the consolidated financial statements.

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

For the year ended December 31, 2016

In thousands of U.S. dollars (note 4)	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non-controlling interests	Total equity
Balance at January 1, 2016	$ 790,202	(8,215)	(278,909)	409,308	3,065,217	1,160,095	5,137,698	55,103	5,192,801
Total comprehensive income for the year:									
Profit (loss) for the year	-	-	-	-	-	1,018,845	1,018,845	(4,340)	1,014,505
Other comprehensive income (loss):									
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	9,463	-	9,463	-	9,463
Exchange differences on translating foreign operations, net of tax	-	-	-	-	10,898	-	10,898	438	11,336
Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	(20,961)	(20,961)	596	(20,365)
Total other comprehensive income (loss)	-	-	-	-	20,361	(20,961)	(600)	1,034	434
Total comprehensive income (loss) for the year	-	-	-	-	20,361	997,884	1,018,245	(3,306)	1,014,939
Transactions with owners, recorded directly in equity:									
Dividends	-	-	-	-	-	(354,393)	(354,393)	-	(354,393)
In-kind donation of treasury shares	-	-	7,368	15,828	-	-	23,196	-	23,196
Transfer from reserve for research and human resource development	-	-	-	-	(8,275)	8,275	-	-	-
Transfer to unconditional reserve	-	-	-	-	477,950	(477,950)	-	-	-
Extinguishment of equity conversion option	-	6,438	-	-	-	-	6,438	8,456	14,894
Acquisition of non-controlling interests	-	(1,061)	-	-	-	-	(1,061)	(234)	(1,295)
Others	-	-	-	-	-	-	-	16	16
Total transactions with owners	-	5,377	7,368	15,828	469,675	(824,068)	(325,820)	8,238	(317,582)
Balance at December 31, 2016	$ 790,202	(2,838)	(271,541)	425,136	3,555,253	1,333,911	5,830,123	60,035	5,890,158

See accompanying notes to the consolidated financial statements.

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

For the year ended December 31, 2015

In millions of won		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non-controlling interests	Total equity
Balance at January 1, 2015	₩	954,959	(4,573)	(339,059)	492,032	3,426,367	1,100,876	5,630,602	77,478	5,708,080
Total comprehensive income for the year:										
Profit (loss) for the year		-	-	-	-	-	1,035,717	1,035,717	(3,497)	1,032,220
Other comprehensive income (loss):										
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	(16,076)	-	(16,076)	-	(16,076)
Exchange differences on translating foreign operations, net of tax		-	-	-	-	(14,380)	-	(14,380)	(390)	(14,770)
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	1,842	1,842	(1,804)	38
Total other comprehensive income (loss)		-	-	-	-	(30,456)	1,842	(28,614)	(2,194)	(30,808)
Total comprehensive income (loss) for the year		-	-	-	-	(30,456)	1,037,559	1,007,103	(5,691)	1,001,412
Transactions with owners, recorded directly in equity:										
Dividends		-	-	-	-	-	(428,056)	(428,056)	-	(428,056)
In-kind donation of treasury shares		-	-	1,997	2,616	-	-	4,613	-	4,613
Transfer from reserve for research and human resource development		-	-	-	-	(12,522)	12,522	-	-	-
Transfer to unconditional reserve		-	-	-	-	320,926	(320,926)	-	-	-
Extinguishment of equity conversion option		-	(5,483)	-	-	-	-	(5,483)	(5,390)	(10,873)
Paid-in capital increase of subsidiary		-	128	-	-	-	-	128	117	245
Others		-	-	-	-	-	-	-	78	78
Total transactions with owners		-	(5,355)	1,997	2,616	308,404	(736,460)	(428,798)	(5,195)	(433,993)
Balance at December 31, 2015	₩	954,959	(9,928)	(337,062)	494,648	3,704,315	1,401,975	6,208,907	66,592	6,275,499

See accompanying notes to the consolidated financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows

For the years ended December 31, 2016 and 2015

In millions of won and thousands of U.S. dollars	*Note*	2016 Korean won	2016 U.S. dollars (note 4)	2015 Korean won
Cash flows from operating activities				
Cash generated from operations	*35*	₩ 1,882,242	$ 1,557,503	₩ 1,585,600
Income tax paid		(384,480)	(318,147)	(326,365)
Net cash provided by operating activities		1,497,762	1,239,356	1,259,235
Cash flows from investing activities	*35*			
Interest received		35,885	29,694	31,659
Dividends received		18,395	15,222	19,196
Proceeds from sale of property, plant and equipment		11,980	9,913	10,314
Proceeds from sale of intangible assets		1,545	1,279	2,878
Proceeds from sale of non-current assets held for sale		7,945	6,574	4,260
Proceeds from sale of available-for-sale financial assets		34,099	28,216	233
Proceeds from sale of equity accounted investments		13,095	10,836	13,625
Collection of loans		15,328	12,683	11,866
Withdrawal of guarantee deposits		20,317	16,812	28,425
Settlement of derivatives, net		-	-	4
Acquisition of property, plant and equipment		(161,745)	(133,840)	(210,247)
Acquisition of intangible assets		(9,222)	(7,631)	(6,076)
Acquisition of investment property		-	-	(64)
Acquisition of available-for-sale financial assets		(31,000)	(25,652)	(34,200)
Acquisition of equity accounted investments		(19,000)	(15,722)	-
Increase in loans		(471)	(389)	(51,336)
Payments of guarantee deposits		(29,668)	(24,550)	(21,437)
Payments of long-term deposits in MSA Escrow Fund		(89,663)	(74,193)	(78,492)
Increase in other financial assets, net		(520,385)	(430,603)	(468,183)
Net cash used in investing activities		(702,565)	(581,351)	(747,575)
Cash flows from financing activities				
Interest paid		(4,693)	(3,883)	(6,946)
Paid-in capital increase of subsidiaries		-	-	245
Payments of capital share issue cost		(128)	(106)	(249)
Dividends paid		(428,284)	(354,393)	(428,056)
Proceeds from borrowings		637,914	527,856	702,040
Increase in leasehold deposits received		3,803	3,146	3,191
Redemption of borrowings		(692,814)	(573,284)	(646,030)
Decrease in leasehold deposits received		(4,225)	(3,496)	(5,157)
Net cash used in financing activities		(488,427)	(404,160)	(380,962)
Effect of exchange rate fluctuation on cash held		(2,197)	(1,819)	(879)
Net increase in cash and cash equivalents		304,573	252,026	129,819
Cash and cash equivalents at January 1		546,213	451,976	416,394
Cash and cash equivalents at December 31		₩ 850,786	$ 704,002	₩ 546,213

See accompanying notes to the consolidated financial statements.

1. Reporting Entity

(a) Description of the Controlling Company

KT&G Corporation (the "Parent 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 Parent Company changed its name to Korea Tobacco and Ginseng Corporation pursuant to the Korea Tobacco and Ginseng Corporation Act. Also, pursuant to the Act on Management Reform and Privatization of Public Enterprises, proclaimed on August 28, 1997 and enforced on October 1, 1997, the Parent Company was excluded from the application of the Act for the Management of Government Invested Enterprises. Accordingly, the Parent Company became an entity existing and operating under the Commercial Act of Korea. The Korean government sold 28,650,000 shares of the Parent Company to the public during 1999 and the Parent Company listed its shares on the Korea Exchange (formerly, the Korea Stock Exchange) on October 8, 1999. On December 27, 2002, the Parent Company changed its name again to KT&G Corporation from Korea Tobacco and Ginseng Corporation.

As of December 31, 2016, the Parent 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 Parent Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Parent Company is located in 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 Parent Company into two companies by setting up a subsidiary for its red ginseng business segment effective January 1, 1999. The separation was accomplished by the Parent Company's contribution of the assets and liabilities in the red ginseng business segment into a wholly-owned subsidiary, Korea Ginseng Corporation.

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

The ownership of the Parent Company's issued ordinary shares as of December 31, 2016 is held as follows:

Shareholder	Number of shares	Percentage of ownership
National Pension Service	11,958,664	8.71%
Industrial Bank of Korea	9,510,485	6.93%
Employee Share Ownership Association	2,809,669	2.05%
Treasury shares	11,027,370	8.03%
Others	101,986,309	74.28%
	137,292,497	100.00%

1. Reporting Entity, Continued

(b) Consolidated Subsidiaries

(i) List of consolidated subsidiaries

Next most senior parent	Subsidiary	Principal operation	Percentage of ownership	Reporting date	Location
KT&G Corporation	Korea Ginseng Corporation	Manufacturing and selling ginseng	100.00%	Dec. 31	Korea
	Yungjin Pharm. Ind. Co., Ltd.	Manufacturing and selling pharmaceuticals	53.00%	Dec. 31	Korea
	Tae-a Industry Co., Ltd.	Manufacturing tobacco materials	100.00%	Dec. 31	Korea
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Manufacturing and selling tobaccos	99.99%	Dec. 31	Turkey
	Korea Tabacos do Brasil Ltda.	Processing leaf tobaccos	99.99%	Dec. 31	Brazil
	KT&G Pars	Manufacturing and selling tobaccos	99.99%	Dec. 31	Iran
	KT&G Rus L.L.C.	Manufacturing and selling tobaccos	100.00%	Dec. 31	Russia
	KT&G USA Corporation (former, Global Trading, Inc.)	Selling tobaccos	100.00%	Dec. 31	USA
	Cosmocos Co., Ltd. (former, Somang Cosmetics Co., Ltd.)	Manufacturing and selling cosmetics	98.49%	Dec. 31	Korea
	Renzoluc Pte., Ltd.(*)	Manufacturing and selling tobaccos	100.00%	Dec. 31	Singapore
	KT&G Life Sciences Corporation	Research and development medicine	34.03%	Dec. 31	Korea
	KGC Yebon Corporation	Manufacturing and selling medical herbs	100.00%	Dec. 31	Korea
	K-Q HongKong I, Limited(*)	Manufacturing and selling ginseng	100.00%	Dec. 31	Hong Kong
	PT KT&G Indonesia	Manufacturing and selling tobaccos	99.99%	Dec. 31	Indonesia
	K&I HK Co., Ltd.	Selling cosmetics	100.00%	Dec. 31	Hong Kong
	K&I China Co., Ltd.	Selling cosmetics	100.00%	Dec. 31	China
	SangSang Stay, Inc.	Hotel	100.00%	Dec. 31	Korea
	KT&G Global Rus L.L.C.	Selling tobaccos	100.00%	Dec. 31	Russia
Renzoluc Pte., Ltd.	PT Trisakti Purwosari Makmur	Manufacturing and selling tobaccos	60.17%	Dec. 31	Indonesia
	PT Mandiri Maha Mulia	Manufacturing and selling tobaccos	66.47%	Dec. 31	Indonesia
PT Trisakti Purwosari Makmur	PT Sentosa Ababi Purwosari	Manufacturing and selling tobaccos	99.80%	Dec. 31	Indonesia
	PT Purindo Ilufa	Manufacturing and selling tobaccos	100.00%	Dec. 31	Indonesia
Korea Ginseng Corporation	KGC Life & Gin Co., Ltd.	Selling ginseng door-to-door	100.00%	Dec. 31	Korea
	Cheong Kwan Jang Taiwan Corporation	Manufacturing and selling ginseng	100.00%	Dec. 31	Taiwan
	Korean Red Ginseng Corp., Inc.	Manufacturing and selling ginseng	100.00%	Dec. 31	USA
	Korea Ginseng (China) Corp.	Manufacturing and selling ginseng	100.00%	Dec. 31	China
	Korea Ginseng Corporation Japan	Manufacturing and selling ginseng	100.00%	Dec. 31	Japan
	PT CKJ INDONESIA	Manufacturing and selling ginseng	99.88%	Dec. 31	Indonesia
	Jilin Hanzheng Ginseng Co., Ltd.	Manufacturing and selling ginseng	100.00%	Dec. 31	China

(*) The Group's percentage of ownership, shown above, excludes preferred shares. As of December 31, 2016, the Group's percentage of ownership would be 68.91% and 50.00%, respectively, if preferred shares are included.

1. Reporting Entity, Continued

(b) Consolidated Subsidiaries, Continued

For the year ended December 31, 2016, the Parent Company's ownership interest in Cosmocos Co., Ltd. has increased to 98.49% from 97.73% as a result of the conversion of its redeemable convertible preferred shares.

For the year ended December 31, 2016, 6,149,639 redeemable convertible preferred shares of KT&G Life Sciences Corporation were converted and the Parent Company acquired additional 301,841 shares of the investee for ₩1,565 million, decreasing its ownership interest to 34.03% from 73.94%. As of January 13, 2017, KT&G Life Sciences Corporation was merged into Yungjin Pharm. Ind. Co., Ltd.

For the year ended December 31, 2016, the Parent Company made an in-kind capital contribution of its entire interest in KGC Life & Gin Co., Ltd. to Korea Ginseng Corporation.

(ii) Financial information of subsidiaries

In millions of won

Subsidiary		Total assets	Total liabilities	Revenue	Net profit (loss)	Total comprehensive income (loss)
Korea Ginseng Corporation	₩	1,867,855	310,993	1,107,646	85,209	75,857
Yungjin Pharm. Ind. Co., Ltd.		199,354	93,186	193,134	4,202	5,744
Tae-a Industry Co., Ltd.		15,668	4,393	13,857	652	512
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		46,667	39,256	14,700	(1,156)	(2,465)
Korea Tabacos do Brasil Ltda.		2,615	6	-	-	-
KT&G Pars		24,820	50,999	883	(8,236)	(8,236)
KT&G Rus L.L.C.		157,332	84,304	32,126	6,716	20,879
KT&G USA Corporation		50,367	30,020	134,898	1,061	1,686
Cosmocos Co., Ltd.		76,557	21,161	82,336	(6,757)	(7,307)
Renzoluc Pte., Ltd.		45,479	81,075	-	(4,729)	(6,512)
KT&G Life Sciences Corporation		10,829	508	120	(8,612)	(8,599)
KGC Yebon Corporation		58,511	11,239	8,458	258	210
K-Q HongKong I, Limited		41,379	-	-	(1,646)	(413)
PT KT&G Indonesia		16,731	42,128	19,955	(3,625)	(4,887)
K&I HK Co., Ltd.		1,280	699	2,269	386	408
K&I China Co., Ltd.		4,047	1,550	928	(2,160)	(2,286)
SangSang Stay, Inc.		14,082	2,605	9,591	(8,097)	(8,097)
KT&G Global Rus L.L.C.		20,145	18,483	-	(23)	165
PT Trisakti Purwosari Makmur, etc.		92,646	72,799	38,203	(358)	712
PT Mandiri Maha Mulia		23,244	15,950	18,142	3,231	3,540
KGC Life & Gin Co., Ltd.		24,200	7,611	51,771	(2,574)	(2,537)
Cheong Kwan Jang Taiwan Corporation		13,004	11,795	16,975	(264)	(199)
Korean Red Ginseng Corp., Inc.		11,841	7,532	18,595	243	731
Korea Ginseng (China) Corp.		29,428	13,953	27,717	(7,026)	(7,447)
Korea Ginseng Corporation Japan		4,947	3,680	13,112	264	320
PT CKJ INDONESIA		1,042	1,127	-	-	(5)
Jilin Hanzheng Ginseng Co., Ltd.		73,310	7,054	3,816	(6,025)	(7,311)

(c) Change in Consolidated Group

For the year ended December 31, 2016, the Parent Company established KT&G Global Rus L.L.C.

2. Basis of Preparation

(a) Statement of Compliance

The consolidated financial statements have been prepared in accordance with Korean International Financial Reporting Standards ("K-IFRS"), as prescribed in *the Act on External Audits of Corporations* in the Republic of Korea.

The consolidated financial statements were authorized for issue by the Board of Directors on January 19, 2017, which will be submitted for approval to the shareholders' meeting to be held on March 17, 2017.

(b) Basis of Measurement

The consolidated financial statements have been prepared on the historical cost basis, except for the following material items in the consolidated 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 consolidated financial statements are presented in Korean won, which is the Parent Company's functional currency and the currency of the primary economic environment in which the Group operates.

(d) Use of Estimates and Judgments

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

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

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

- Note 3 – classification of financial instruments;
- Note 9 – classification of joint arrangements.

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

- Note 7 – impairment test: key assumptions underlying recoverable amounts;
- Note 24 – measurement of defined benefit obligations: key actuarial assumptions;
- Note 29 – recognition of deferred tax assets: availability of future taxable profit against which temporary differences can be utilized; and
- Notes 34 – recognition and measurement of contingencies: key assumptions about likelihood and magnitude of an outflow of resources.

2. Basis of Preparation, Continued

(e) Measurement of Fair Value

A number of the Group's accounting policies and disclosures require the measurement of fair values, for both financial and non-financial assets and liabilities. The Group has an established control framework with respect to the measurement of fair values. This includes a valuation team that has overall responsibility for overseeing all significant fair value measurements, including Level 3 fair values, and reports directly to the CFO.

The valuation team regularly reviews significant unobservable inputs and valuation adjustments. If third party information, such as broker quotes or pricing services, is used to measure fair values, then the valuation team assesses the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of K-IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

Significant valuation issues are reported to the Group's Audit Committee.

When measuring the fair value of an asset or a liability, the Group uses market observable data as far as possible. Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows.

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

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. The Group recognizes transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

Further information about the assumptions made in measuring fair values is included in the following notes:

- Note 8 – investment property
- Note 32 – financial instruments

3. Significant Accounting Policies

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

(a) Basis of Consolidation

(i) Non-controlling interests

Non-controlling interests are measured at their proportionate share of the acquiree's identifiable net assets at the acquisition date.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

(ii) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

(iii) Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related non-controlling interests and other components of equity. Any resulting gain or loss is recognized in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

(iv) Interests in equity-accounted investees

The Group's interests in equity-accounted investees comprise interests in associates and joint ventures.

Associates are those entities in which the Group has significant influence, but not control or joint control, over the financial and operating policies. A joint venture is an arrangement in which the Group has joint control, whereby the Group has rights to the net assets of the arrangement, rather than rights to its assets and obligations for its liabilities.

Interests in associates and joint venture are accounted for using the equity method. They are initially recognized at cost, which includes transaction costs. Subsequent to initial recognition, the consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of equity-accounted investees, until the date on which significant influence or joint control ceases.

(v) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated. Unrealised gains arising from transactions with equity-accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

3. Significant Accounting Policies, Continued

(a) Basis of Consolidation, Continued

(vi) Acquisitions from entities under common control

The assets and liabilities acquired under business combinations under common control are recognized at the carrying amounts recognized previously in the consolidated financial statements of the ultimate parent. The difference between consideration transferred and carrying amounts of net assets acquired is recognized as part of share premium.

(b) Joint Arrangements

A joint arrangement is an arrangement of which two or more parties have joint control. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. Joint arrangements are classified into two types - joint operations and joint ventures. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (i.e. joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (i.e. joint ventures) have rights to the net assets of the arrangement.

The Group determines the type of joint arrangement in which it is involved by considering its rights and obligations arising from the arrangement. The Group assesses its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties in the contractual arrangement and, when relevant, other facts and circumstances.

If the Group is a joint operator, the Group recognizes and measures the assets and liabilities (and recognize the related revenues and expenses) in relation to its interest in the arrangement in accordance with relevant K-IFRSs applicable to the particular assets, liabilities, revenues and expenses.

If the Group is a joint venturer, the Group recognizes its interest in a joint venture as an investment and accounts for that investment using the equity method in accordance with K-IFRS No. 1028 *Investments in Associates and Joint Ventures* unless an investment, or a portion of an investment in the joint venture meets the criteria to be classified as held for sale.

(c) Property, Plant and Equipment

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

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group 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.

3. Significant Accounting Policies, Continued

(c) Property, Plant and Equipment, Continued

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

	Useful lives (years)		Useful lives (years)
Buildings	10 ~ 60	Vehicles	4 ~ 10
Structures	5 ~ 40	Tools	4 ~ 5
Machinery	5 ~ 20	Furniture and fixtures	2 ~ 5

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

(d) Borrowing Costs

The Group 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 Group borrows funds specifically for the purpose of obtaining a qualifying asset, the Group 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 Group immediately recognizes other borrowing costs as an expense. To the extent that the Group borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the Group 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 Group 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 Group capitalizes during a period does not exceed the amount of borrowing costs incurred during that period.

(e) Government Grants

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

3. Significant Accounting Policies, Continued

(f) Intangible Assets except for Goodwill

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 were as follows:

	Useful lives (years)
Industrial property rights	5 ~ 20 or indefinite
Facility usage rights	indefinite
Other intangible assets	3 ~ 5 or indefinite

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

(g) Investment Property

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

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

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

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

3. Significant Accounting Policies, Continued

(h) Non-current Assets Held for Sale

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

The Group 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).

(i) Inventories

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

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

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

Tobacco leaf inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognized industry practice. The estimated amounts of inventories in current assets which are not expected to be realized within 12 months are ₩314,457 million and ₩310,043 million, respectively, as of December 31, 2016 and 2015.

(j) Impairment of Non-financial Assets

The carrying amounts of the Group'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.

3. Significant Accounting Policies, Continued

(j) Impairment of Non-financial Assets, Continued

The Group estimates the recoverable amount of an individual asset. If it is impossible to measure the individual recoverable amount of an asset, then the Group 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.

Except for impairment losses in respect of goodwill which are never reversed, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(k) Non-derivative Financial Assets

The Group 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 Group recognizes financial assets in the statement of financial position when the Group becomes a party to the contractual provisions of the instrument.

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

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

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

(ii) Held-to-maturity investments

A non-derivative financial asset with a fixed or determinable payment and fixed maturity, for which the Group 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.

3. Significant Accounting Policies, Continued

(k) Non-derivative Financial Assets, Continued

(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 Group 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 Group is recognized as a separate asset or liability.

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

(vi) Offsetting between financial assets and financial liabilities

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

(l) Derivative financial instruments

Derivatives are initially recognized at fair value. Subsequent to initial recognition, derivatives are measured at fair value, and changes in the fair value of derivative financial instrumnets 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.

3. Significant Accounting Policies, Continued

(m) Impairment of Financial Assets

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

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

(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 Group can recognize impairment losses directly or establish a provision to cover impairment losses. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed either directly or by adjusting an allowance account.

(ii) Financial assets carried at cost

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

(iii) Available-for-sale financial assets

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

3. Significant Accounting Policies, Continued

(n) Cash and Cash Equivalents

Cash and cash equivalents comprise cash balances and call deposits with maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Group 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.

(o) Non-derivative Financial Liabilities

The Group 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 Group recognizes financial liabilities in the statement of financial position when the Group becomes a party to the contractual provisions of the financial liability.

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

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

(ii) Financial guarantee liabilities

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

3. Significant Accounting Policies, Continued

(p) Employee Benefits

(i) Short-term employee benefits

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

(ii) Retirement benefits: defined contribution plans

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

(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 Group, 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 Group determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in profit or loss.

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

(iv) Termination benefits

Termination benefits are expensed at the earlier of when the Group can no longer withdraw the offer of those benefits and when the Group 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.

3. Significant Accounting Policies, Continued

(q) Provisions

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

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

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

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

(r) Equity Capital

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

When the Group 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 Group acquires and retains treasury shares, the consideration paid or received is directly recognized in equity.

(s) Revenue Recognition

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

Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods, the Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Group and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the years ended December 31, 2016 and 2015 were ₩6,479,257 million and ₩5,514,613 million, respectively.

3. Significant Accounting Policies, Continued

(s) Revenue Recognition, Continued

Revenue from the construction of real estate includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognized in profit or loss in proportion to the stage of completion of the contract. The stage of completions is assessed by reference to surveys of work performed. Meanwhile, profits from an apartment house for self-instalment sales is recognized on percentage-of-completion method according to Q&A of Korea Accounting Institute, called 2011-I-KQA, which is effective under K-IFRS.

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 Group, the stage of completion of the transaction at the end of the reporting period can be measured reliably and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably. When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue is recognized only to the extent of the expenses recognized that are recoverable.

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

(t) Finance Income and Finance Costs

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

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

(u) Income Taxes

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

(i) Current tax

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

3. Significant Accounting Policies, Continued

(u) Income Taxes, Continued

(ii) Deferred tax

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 Group expects, at the end of the reporting period to recover or settle the carrying amount of its assets and liabilities.

The Group 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 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.

(v) Foreign Currencies

(i) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of the Group 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.

(ii) Foreign operations

If the presentation currency of the Group is different from a foreign operation's functional currency, the financial statements of the foreign operation are translated into the presentation currency using the following methods:

The assets and liabilities of foreign operations, whose functional currency is not the currency of a hyperinflationary economy, are translated to presentation currency at exchange rates at the reporting date. The income and expenses of foreign operations are translated to functional currency at exchange rates at the dates of the transactions. Foreign currency differences are recognized in other comprehensive income.

3. Significant Accounting Policies, Continued

(v) Foreign Currencies, Continued

Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation is treated as assets and liabilities of the foreign operation. Thus they are expressed in the functional currency of the foreign operation and translated at the closing rate.

When a foreign operation is disposed of, the relevant amount in the translation is transferred to profit or loss as part of the profit or loss on disposal.

Foreign exchange gains or losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely to occur in the foreseeable future and which in substance is considered to form part of the net investment in the foreign operation, are recognized in other comprehensive income in the translation reserve. On the partial disposal of a subsidiary that includes a foreign operation, the entity re-attribute the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the non-controlling interests in that foreign operation. In any other partial disposal of a foreign operation the entity reclassify to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

(w) Earnings per Share

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

(x) New Standards and Interpretations Not Yet Adopted

The following new standards are issued for annual periods beginning after January 1, 2016 and earlier application is permitted; however, the Group has not early adopted the following new standards in preparing these consolidated financial statements.

K-IFRS No. 1109 *Financial Instruments*
K-IFRS 1109 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. It replaces the existing guidance in K-IFRS No. 1039 *Financial Instruments: Recognition and Measurement*. K-IFRS 1109 includes revised guidance on the classification and measurement of financial instruments, a new expected credit loss model for calculating impairment on financial assets, and new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from K-IFRS No. 1039.

3. Significant Accounting Policies, Continued

(x) New Standards and Interpretations Not Yet Adopted, Continued

K-IFRS No. 1115 *Revenue from Contracts with Customers*
K-IFRS 1115 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. It replaces existing revenue recognition guidance, including K-IFRS No. 1018 *Revenue*, K-IFRS No. 1011 *Construction Contracts*, K-IFRS No. 2031 *Revenue—Barter Transactions Involving Advertising Services*, K-IFRS No. 2113 *Customer Loyalty Programmes,* K-IFRS No. 2115 *Agreements for the Construction of Real Estate* and K-IFRS No. 2118 *Transfers of Assets from Customers*. K-IFRS 1115 establishes a comprehensive framework for determining whether, how much and when revenue is recognized.

The Group currently plans to apply K-IFRS No. 1109 and K-IFRS No. 1115 initially for the year beginning January 1, 2018. The actual impact of adopting those new standards will be dependent on the financial instruments that the Group holds and economic conditions at that time as well as accounting elections and judgements that it will make in the future. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of those new standards and expects to disclose additional quantitative information in the consolidated financial statements for the year ended December 31, 2017.

4. Basis of Translating Financial Statements

The consolidated financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩1,208.50 to $1, the basic exchange rate on December 31, 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.

5. Operating Segments

(a) The Group's operating segments are summarized as follows:

Operating segments	Principal operation
Tobacco	Manufacturing and selling tobaccos
Ginseng	Manufacturing and selling red ginseng
Real estate	Selling and renting real estate
Others	Manufacturing and selling pharmaceuticals, cosmetics and others

5. Operating Segments

(b) Segment information on sales and operating profit for the year ended December 31, 2016 was as follows:

In millions of won		Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Sales:								
Total segment sales	₩	2,937,751	1,183,617	185,590	470,450	4,777,408	(274,128)	4,503,280
Less: Inter-segment sales		163,441	49,994	10,065	50,628	274,128	(274,128)	-
External sales	₩	2,774,310	1,133,623	175,525	419,822	4,503,280	-	4,503,280
Depreciation and amortization:								
Depreciation	₩	104,275	30,309	8,998	8,716	152,298	-	152,298
Amortization		53	793	-	5,045	5,891	-	5,891
Segment profit:								
Operating profit	₩	1,220,222	164,508	41,951	29,219	1,455,900	14,202	1,470,102
Other expense, net								63,111
Net finance income								52,551
Share of gain of associates and joint ventures, net								2,067
Income tax expense								(361,801)
Profit for the year	₩							1,226,030

(c) Segment information on sales and operating profit for the year ended December 31, 2015 was as follows:

In millions of won		Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Sales:								
Total segment sales	₩	2,879,091	1,007,593	143,619	391,242	4,421,545	(251,706)	4,169,839
Less: Inter-segment sales		127,575	65,263	6,864	52,004	251,706	(251,706)	-
External sales	₩	2,751,516	942,330	136,755	339,238	4,169,839	-	4,169,839
Depreciation and amortization:								
Depreciation	₩	107,388	29,202	6,277	8,226	151,093	-	151,093
Amortization		4,012	1,548	-	5,199	10,759	-	10,759
Segment profit:								
Operating profit	₩	1,202,798	114,952	30,481	24,054	1,372,285	(6,381)	1,365,904
Other expense, net								(41,409)
Net finance income								74,762
Share of gain of associates and joint ventures								15,137
Income tax expense								(382,174)
Profit for the year	₩							1,032,220

For the years ended December 31, 2016 and 2015

5. Operating Segments, Continued

(d) Segment information on assets and liabilities as of December 31, 2016 was as follows:

In millions of won		Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Assets:								
Segment assets	₩	3,993,355	1,847,372	296,699	286,075	6,423,501	(247,874)	6,175,627
Investments in associates and joint ventures		-	-	53,475	3,001	56,476	-	56,476
Non-current assets held for sale		-	5,150	21,165	-	26,315	-	26,315
		3,993,355	1,852,522	371,339	289,076	6,506,292	(247,874)	6,258,418
Unallocated assets								3,554,167
Total assets	₩							9,812,585
Acquisition of non-current assets	₩	130,104	32,727	-	14,109	176,940	(5,973)	170,967
Liabilities:								
Segment liabilities	₩	1,875,081	167,383	-	96,254	2,138,718	(216,457)	1,922,261
Unallocated liabilities								772,067
Total liabilities	₩							2,694,328

(e) Segment information on assets and liabilities as of December 31, 2015 was as follows:

In millions of won		Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Assets:								
Segment assets	₩	3,990,313	1,831,157	149,522	365,152	6,336,144	(319,032)	6,017,112
Investments in associates and joint ventures		-	-	48,801	2,720	51,521	-	51,521
Non-current assets held for sale		1,542	-	-	5,150	6,692	-	6,692
		3,991,855	1,831,157	198,323	373,022	6,394,357	(319,032)	6,075,325
Unallocated assets								2,598,032
Total assets	₩							8,673,357
Acquisition of non-current assets	₩	144,008	55,708	-	16,671	216,387	-	216,387
Liabilities:								
Segment liabilities	₩	1,443,132	161,563	-	84,536	1,689,231	(155,384)	1,533,847
Unallocated liabilities								864,011
Total liabilities	₩							2,397,858

(f) Geographical information determined by customer's and branch's location as of and for the years ended December 31, 2016 and 2015 were as follows:

		2016			2015		
In millions of won		Korea	Foreign country	Total	Korea	Foreign country	Total
Sales	₩	3,356,997	1,146,283	4,503,280	3,138,878	1,030,961	4,169,839
Non-current assets		2,101,214	96,331	2,197,545	2,125,865	100,203	2,226,068

5. Operating Segments, Continued

(g) Revenues from major customers which amount to more than 10 percent of the details of the Group's consolidated total revenues for the years ended December 31, 2016 and 2015 were as follows:

In millions of won

Segment	Customer		2016	2015
Tobacco	Alokozay International Limited	₩	503,676	443,183

6. Property, Plant and Equipment

(a) Details of property, plant and equipment as of December 31, 2016 and 2015 are summarized as follows:

		2016			2015		
In millions of won		Cost	Accumulated depreciation and impairment	Carrying amount	Cost	Accumulated depreciation and impairment	Carrying amount
Land	₩	541,980	-	541,980	583,481	-	583,481
Buildings		962,633	(423,925)	538,708	963,700	(389,526)	574,174
Structures		72,551	(42,153)	30,398	72,949	(39,770)	33,179
Machinery		1,324,784	(998,291)	326,493	1,278,124	(933,159)	344,965
Vehicles		11,771	(9,356)	2,415	12,907	(10,572)	2,335
Tools		67,597	(56,227)	11,370	63,467	(52,664)	10,803
Furniture and fixtures		241,915	(179,217)	62,698	245,349	(195,912)	49,437
Others		1,907	-	1,907	1,508	-	1,508
Construction-in-progress		85,908	-	85,908	189,897	-	189,897
	₩	3,311,046	(1,709,169)	1,601,877	3,411,382	(1,621,603)	1,789,779

(b) Changes in property, plant and equipment for the year ended December 31, 2016 were as follows:

In millions of won		January 1 2016	Acquisition	Disposal	Depreciation	Transfer of construction -in-progress	Net exchange difference and others	December 31 2016
Land	₩	583,481	300	(2,633)	-	62,207	(101,375)	541,980
Buildings		574,174	3,933	(1,423)	(37,014)	101,215	(102,177)	538,708
Structures		33,179	1,020	(809)	(3,416)	745	(321)	30,398
Machinery		344,965	7,585	(994)	(72,810)	47,264	483	326,493
Vehicles		2,335	621	(425)	(747)	554	77	2,415
Tools		10,803	4,569	(26)	(4,789)	823	(10)	11,370
Furniture and fixtures		49,437	32,839	(1,468)	(24,523)	6,398	15	62,698
Others		1,508	93	-	-	306	-	1,907
Construction-in-progress		189,897	112,438	-	-	(219,512)	3,085	85,908
	₩	1,789,779	163,398	(7,778)	(143,299)	-	(200,223)	1,601,877

For the year ended December 31, 2016, the Group received ₩3,777 million of government grant related with acquisition of buildings, furniture and fixtures and machinery.

For the year ended December 31, 2016, land, buildings and structures with a carrying amount of ₩207,255 million were transferred to investment property and construction-in-progress with a carrying amount of ₩137 million were transferred to intangible assets.

6. Property, Plant and Equipment, Continued

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

In millions of won		January 1 2015	Acquisition	Disposal	Depreciation	Transfer of construction -in-progress	Net exchange difference and others	December 31 2015
Land	₩	574,429	7,271	(823)	-	5,293	(2,689)	583,481
Buildings		520,515	19,685	(398)	(34,617)	76,931	(7,942)	574,174
Structures		28,568	3,722	(86)	(3,455)	4,588	(158)	33,179
Machinery		348,806	29,847	(740)	(74,567)	48,891	(7,272)	344,965
Vehicles		2,850	481	(107)	(982)	156	(63)	2,335
Tools		9,656	5,502	(144)	(4,568)	351	6	10,803
Furniture and fixtures		53,836	22,493	(384)	(26,629)	108	13	49,437
Others		1,454	54	-	-	-	-	1,508
Construction-in-progress		213,298	112,914	-	-	(136,318)	3	189,897
	₩	1,753,412	201,969	(2,682)	(144,818)	-	(18,102)	1,789,779

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 ₩6,692 million were transferred to non-current assets held for sale.

For the year ended December 31, 2015, borrowing costs of ₩82 million were capitalized as part of the cost of machinery and others with the capitalization rate of 3.75%.

7. Intangible Assets

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

		2016			2015		
In millions of won		Cost	Accumulated amortization and impairment	Carrying amount	Cost	Accumulated amortization and impairment	Carrying amount
Goodwill	₩	87,902	(72,841)	15,061	87,902	(72,841)	15,061
Industrial property rights		47,759	(36,078)	11,681	46,806	(32,015)	14,791
Facility usage rights		35,080	(2,731)	32,349	28,282	(2,731)	25,551
Other intangible assets		115,256	(73,508)	41,748	116,349	(70,150)	46,199
Intangible assets under development		6,460	(2,370)	4,090	6,180	(2,354)	3,826
	₩	292,457	(187,528)	104,929	285,519	(180,091)	105,428

7. Intangible Assets, Continued

(b) Changes in intangible assets for the year ended December 31, 2016 were as follows:

In millions of won		January 1 2016	Acquisition	Disposal	Transfer of intangible assets under development	Amortization	Impairment	Net exchange difference and others	December 31 2016
Goodwill	₩	15,061	-	-	-	-	-	-	15,061
Industrial property rights		14,791	1,961	(30)	5	(1,148)	(3,898)	-	11,681
Facility usage rights		25,551	8,280	(1,518)	36	-	-	-	32,349
Other intangible assets		46,199	326	-	101	(4,743)	-	(135)	41,748
Intangible assets under development		3,826	284	-	(5)	-	(15)	-	4,090
	₩	105,428	10,851	(1,548)	137	(5,891)	(3,913)	(135)	104,929

For the year ended December 31, 2016, the Group recognized ₩3,913 million of impairment losses on industrial property rights and intangible assets under development since the carrying amounts exceeded their recoverable amounts.

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

In millions of won		January 1 2015	Acquisition	Disposal	Transfer of intangible assets under development	Amortization	Impairment	Net exchange difference and others	December 31 2015
Goodwill	₩	32,161	-	-	-	-	(17,941)	841	15,061
Industrial property rights		17,000	1,030	(104)	82	(1,330)	(1,575)	(312)	14,791
Facility usage rights		23,550	4,042	(2,041)	-	-	-	-	25,551
Other intangible assets		79,086	221	-	-	(9,429)	(23,694)	15	46,199
Intangible assets under development		3,140	783	-	(82)	-	(14)	(1)	3,826
	₩	154,937	6,076	(2,145)	-	(10,759)	(43,224)	543	105,428

For the year ended December 31, 2015, the Group recognized ₩43,224 million of impairment losses on goodwill, industrial property rights, other intangible assets and intangible assets under development since the carrying amounts exceeded their recoverable amounts.

(d) Expenditures not capitalized for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Cost of sales	₩	1,385	1,972
Selling, general and administrative expenses		37,468	36,032
	₩	38,853	38,004

7. Intangible Assets, Continued

(e) Impairment reviews for goodwill are undertaken annually. As of December 31, 2016 and 2015, goodwill is allocated to each segment as follows:

In millions of won		2016	2015
Others	₩	15,061	15,061

The recoverable amounts of all CGUs have been determined based on value-in-use calculations, and the key assumptions used for value-in-use calculations for the year ended December 31, 2016 are as follows:

	2016
Gross margin	5.4 ~ 28.7%
Perpetual growth rate	0.0 ~ 2.0%
Discount rate (weighted average cost of capital)	8.8 ~ 12.1%

As a result of the impairment test, the Group recognized ₩17,941 million of impairment loss on goodwill for the year ended December 31, 2015.

8. Investment Property

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

				2016			2015
In millions of won		Cost	Accumulated depreciation and impairment	Carrying amount	Cost	Accumulated depreciation and impairment	Carrying amount
Land	₩	129,655	-	129,655	49,123	-	49,123
Buildings		282,357	(70,432)	211,925	179,949	(64,583)	115,366
	₩	412,012	(70,432)	341,580	229,072	(64,583)	164,489

(b) Changes in investment property for the years ended December 31, 2016 and 2015 were as follows:

				2016			2015
In millions of won		Land	Buildings	Total	Land	Buildings	Total
Beginning balance	₩	49,123	115,366	164,489	48,293	119,675	167,968
Acquisition		-	-	-	-	64	64
Depreciation		-	(8,999)	(8,999)	-	(6,275)	(6,275)
Transfer from property, plant and equipment		101,697	105,558	207,255	830	1,902	2,732
Transfer to non-current assets held for sale		(21,165)	-	(21,165)	-	-	-
Ending balance	₩	129,655	211,925	341,580	49,123	115,366	164,489

8. Investment Property, Continued

(c) The amounts recognized in profit or loss from investment property for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Rental income	₩	39,120	34,764
Direct operating expense		(9,056)	(6,377)
	₩	30,064	28,387

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

		2016		2015	
In millions of won		Fair value	Carrying amount	Fair value	Carrying amount
Land	₩	539,689	129,655	435,034	49,123
Buildings		232,806	211,925	177,756	115,366
	₩	772,495	341,580	612,790	164,489

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.

9. Investments in Associates and Joint Ventures

(a) Investments in associates and joint ventures as of December 31, 2016 and 2015 are summarized as follows:

In millions of won, except percentage of ownership

Company	Location	Principal operation	2016 Percentage of ownership	2016 Carrying amount	2015 Percentage of ownership	2015 Carrying amount
Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	20.24%	₩ 3,001	20.24%	₩ 2,720
KVG REIT 1 Co., Ltd.	Korea	Renting of real estate	29.67%	6,426	29.67%	6,635
KOCREF REIT 17 Co., Ltd.	Korea	Renting of real estate	-	-	22.06%	13,208
JR REIT V Co., Ltd.	Korea	Renting of real estate	34.63%	5,420	34.63%	5,470
JR REIT VIII Co., Ltd.	Korea	Renting of real estate	21.74%	9,555	21.74%	9,693
LSK Global Pharma Services Co., Ltd.	Korea	Researching and developing medicine	23.15%	-	23.15%	-
JR REIT X Co., Ltd.	Korea	Renting of real estate	28.79%	8,697	28.79%	8,907
JR REIT XIII Co., Ltd.	Korea	Renting of real estate	27.03%	4,742	27.03%	4,888
KB Gimpo Logistics CR REIT Co., Ltd.(*1)	Korea	Renting of real estate	12.00%	2,943	-	-
KORAMCO Private REIT 50 Fund(*2)	Korea	Renting of real estate	84.21%	15,692	-	-
				₩ 56,476		₩ 51,521

(*1) KB Gimpo Logistics CR REIT Co., Ltd is classified as a joint venture since decisions about the significant financial and operating policy of the investee cannot be made without unanimous consent of the Group and another party, holding 12% shares each, as the remaining equity interest of 76% held by a collective investment business entity is not entitled to have any impact on resolutions of the investee in accordance with the *Financial Investment Services and Capital Markets Act.*

(*2) KORAMCO Private REIT 50 Fund is classified as a joint venture since decisions about the significant financial and operating policy of the investee cannot be made without unanimous consent of the parties that control the arrangement collectively.

In 2016, the Group made an investment of ₩3,000 million and ₩16,000 million in KB Gimpo Logistics CR REIT Co., Ltd and KORAMCO Private REIT 50 Fund, respectively.

In 2016, the Group received ₩13,095 million of dividend related with liquidation of KOCREF REIT 17 Co., Ltd.

In 2015, the Group received ₩13,625 million of dividend related with liquidation of JR CR-REIT IV Co., Ltd.

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

9. Investments in Associates and Joint Ventures, Continued

(b) Financial information of associates and joint ventures accounted for using the equity method as of and for the year ended December 31, 2016 are summarized as follows:

(i) Summarized information

In millions of won

Company		Total assets	Total liabilities	Revenue	Total comprehensive income (loss)
Lite Pharm Tech, Inc.	₩	21,629	6,804	11,001	1,272
KVG REIT 1 Co., Ltd.		49,567	27,907	5,995	1,702
JR REIT V Co., Ltd.		30,837	15,187	2,588	1,422
JR REIT VIII Co., Ltd.		106,992	63,040	7,612	3,391
LSK Global Pharma Services Co., Ltd.		12,427	13,592	20,090	326
JR REIT X Co., Ltd.		86,237	56,027	4,328	812
JR REIT XIII Co., Ltd.		47,318	29,776	1,434	(145)
KB Gimpo Logistics CR REIT Co., Ltd.		64,116	39,597	359	129
KORAMCO Private REIT 50 Fund		48,728	30,094	273	98

(ii) Additional information about joint ventures

In millions of won

Company		Cash and cash equivalents	Current financial liabilities	Non-current financial liabilities	Depre-ciation	Amor-tization	Interest income	Interest costs	Income tax expense
KB Gimpo Logistics CR REIT Co., Ltd.	₩	1,258	36,010	3,481	77	-	102	102	-
KORAMCO Private REIT 50 Fund		956	27,367	2,646	58	-	78	78	-

9. Investments in Associates and Joint Ventures, Continued

(c) Financial information of associates and joint ventures accounted for using the equity method as of and for the year ended December 31, 2015 are summarized as follows:

In millions of won

Company		Total assets	Total liabilities	Revenue	Total comprehensive income (loss)
Lite Pharm Tech, Inc.	₩	14,638	1,199	9,405	2,255
JR CR-REIT IV Co., Ltd.		-	-	3,235	8,208
KVG REIT 1 Co., Ltd.		50,386	28,023	5,892	1,678
KOCREF REIT 17 Co., Ltd.		72,473	12,601	5,875	32,677
JR REIT V Co., Ltd.		30,967	15,170	2,508	1,555
JR REIT VIII Co., Ltd.		107,646	63,060	7,167	3,007
LSK Global Pharma Services Co., Ltd.		5,078	7,562	15,703	(251)
JR REIT X Co., Ltd.		87,412	56,473	3,962	272
JR REIT XIII Co., Ltd.		47,178	29,097	2,887	777

(d) Changes in investments in associates and joint ventures for the year ended December 31, 2016 were as follows:

In millions of won

Company		January 1 2016	Acquisition	Disposal	Share of gain (loss)	Dividends	December 31 2016
Lite Pharm Tech, Inc.	₩	2,720	-	-	281	-	3,001
KVG REIT 1 Co., Ltd.		6,635	-	-	526	(735)	6,426
KOCREF REIT 17 Co., Ltd.		13,208	-	(13,095)	(113)	-	-
JR REIT V Co., Ltd.		5,470	-	-	741	(791)	5,420
JR REIT VIII Co., Ltd.		9,693	-	-	733	(871)	9,555
LSK Global Pharma Services Co., Ltd.		-	-	-	-	-	-
JR REIT X Co., Ltd.		8,907	-	-	265	(475)	8,697
JR REIT XIII Co., Ltd.		4,888	-	-	(1)	(145)	4,742
KB Gimpo Logistics CR REIT Co., Ltd.		-	3,000	-	(57)	-	2,943
KORAMCO Private REIT 50 Fund		-	16,000	-	(308)	-	15,692
	₩	51,521	19,000	(13,095)	2,067	(3,017)	56,476

(e) Changes in investments in associates for the year ended December 31, 2015 were as follows:

In millions of won

Company		January 1 2015	Disposal	Share of gain	Dividends	December 31 2015
Lite Pharm Tech, Inc.	₩	2,061	-	659	-	2,720
JR CR-REIT IV Co., Ltd.		12,900	(13,625)	4,955	(4,230)	-
KVG REIT 1 Co., Ltd.		6,848	-	519	(732)	6,635
KOCREF REIT 17 Co., Ltd.		6,619	-	7,208	(619)	13,208
JR REIT V Co., Ltd.		5,524	-	758	(812)	5,470
JR REIT VIII Co., Ltd.		9,858	-	654	(819)	9,693
LSK Global Pharma Services Co., Ltd.		-	-	-	-	-
JR REIT X Co., Ltd.		9,114	-	126	(333)	8,907
JR REIT XIII Co., Ltd.		4,979	-	258	(349)	4,888
	₩	57,903	(13,625)	15,137	(7,894)	51,521

9. Investments in Associates and Joint Ventures, Continued

(f) Reconciliation of the summarized financial information presented to the carrying amount of the Group's interest in associates and joint ventures as of December 31, 2016 are summarized as follows:

In millions of won

Company	Percentage of ownership		Equity attributable to owners of the parent	Share of net assets	Share of loss not recognized	Carrying amount
Lite Pharm Tech, Inc.	20.24%	₩	14,825	3,001	-	3,001
KVG REIT 1 Co., Ltd.	29.67%		21,660	6,426	-	6,426
JR REIT V Co., Ltd.	34.63%		15,650	5,420	-	5,420
JR REIT VIII Co., Ltd.	21.74%		43,952	9,555	-	9,555
LSK Global Pharma Services Co., Ltd.	23.15%		(1,165)	(270)	270	-
JR REIT X Co., Ltd.	28.79%		30,210	8,697	-	8,697
JR REIT XIII Co., Ltd.	27.03%		17,542	4,742	-	4,742
KB Gimpo Logistics CR REIT Co., Ltd.	12.00%		24,519	2,943	-	2,943
KORAMCO Private REIT 50 Fund	84.21%		18,634	15,692	-	15,692
		₩				56,476

(g) Reconciliation of the summarized financial information presented to the carrying amount of the Group's interest in the associates as of December 31, 2015 are summarized as follows:

In millions of won

Company	Percentage of ownership		Equity attributable to owners of the parent	Share of net assets	Share of loss not recognized	Carrying amount
Lite Pharm Tech, Inc.	20.24%	₩	13,439	2,720	-	2,720
KVG REIT 1 Co., Ltd.	29.67%		22,363	6,635	-	6,635
KOCREF REIT 17 Co., Ltd.	22.06%		59,872	13,208	-	13,208
JR REIT V Co., Ltd.	34.63%		15,797	5,470	-	5,470
JR REIT VIII Co., Ltd.	21.74%		44,586	9,693	-	9,693
LSK Global Pharma Services Co., Ltd.	23.15%		(2,484)	(575)	575	-
JR REIT X Co., Ltd.	28.79%		30,939	8,907	-	8,907
JR REIT XIII Co., Ltd.	27.03%		18,081	4,888	-	4,888
		₩				51,521

(h) As of December 31, 2016 and 2015, there is no significant restriction on the Group's ability to access or use the assets and settle the liabilities of the associates and joint ventures.

10. Available-for-sale Financial Assets

(a) Changes in available-for-sale financial assets for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Beginning balance	₩	364,681	326,833
Acquisitions		31,000	63,190
Net changes in fair value		25,013	3,881
Disposals and exercise of conversion options		(34,098)	(29,223)
Ending balance	₩	386,596	364,681
Consolidated statement of financial position:			
Current	₩	1,500	-
Non-current		385,096	364,681
	₩	386,596	364,681

For the year ended December 31, 2016, the Group recognized ₩13,988 million of gain on sale of available-for-sale financial assets as Mastern 2 REIT Co., Ltd. was liquidated.

For the year ended December 31, 2016, the Group recognized ₩4,077 million of impairment loss on its investment in an equity instrument of Rexahn Pharmaceuticals, Inc. as there was a significant and prolonged decline in the fair value below its cost.

In 2015, the Group acquired ₩28,990 million of ordinary shares of U&I Corporation by exercising equity conversion options embedded in their convertible bonds and redeemable convertible preferred shares. The Group 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.

10. Available-for-sale Financial Assets, Continued

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

In millions of won		2016	2015
Available-for-sale debt instruments:			
Government and municipal bonds	₩	-	96
Corporate bonds		1,500	1,500
Total available-for-sale debt instruments		1,500	1,596
Available-for-sale equity instruments:			
Listed			
– YTN Co., Ltd.		20,782	24,428
– Oscotech, Inc.		3,775	3,696
– Shinhan Financial Group Co., Ltd.		181,378	158,530
– Rexahn Pharmaceuticals, Inc.		1,081	2,696
– U&I Corporation		14,060	22,564
		221,076	211,914
Unlisted		164,020	151,171
Total available-for-sale equity instruments		385,096	363,085
Total available-for-sale financial assets	₩	386,596	364,681

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

As of December 31, 2016 and 2015, ₩32,564 million and ₩37,659 million of available-for-sale financial assets that do not have a market price in an active market and whose fair value cannot be reliably measured or is similar to their carrying amount are measured at cost, respectively.

11. Long-term Deposits in MSA Escrow Fund

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

In millions of won		2016	2015
MMF	₩	56,069	43,309
Treasury bill		21,559	-
Treasury note		425,964	360,657
	₩	503,592	403,966

As discussed in note 34 to the consolidated financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the years ended December 31, 2016 and 2015 are ₩89,663 million and ₩78,492 million, respectively.

Long-term deposits in MSA Escrow Fund are invested in demand deposits of financial institutions or government and public bonds. For the years ended December 31, 2016 and 2015, the Group recognized ₩3,721 million of investment loss and ₩1,287 million of investment income on long-term deposits in MSA Escrow Fund, respectively.

12. Trade and Other Receivables

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

In millions of won		2016 Current	2016 Non-current	2015 Current	2015 Non-current
Loans to employees	₩	16,745	38,984	15,774	52,275
Loans		652	325	2,504	315
Other receivables		108,706	240	127,369	323
Guarantee deposits		36,883	30,393	34,730	22,158
Accrued income		7,215	-	5,943	-
Trade receivables		1,113,446	-	1,031,618	-
	₩	1,283,647	69,942	1,217,938	75,071

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

In millions of won		2016 Current	2016 Non-current	2015 Current	2015 Non-current
Gross trade and other receivables	₩	1,315,237	69,942	1,251,180	75,071
Allowance:					
Loans		(197)	-	(197)	-
Other receivables		(2,345)	-	(2,296)	-
Trade receivables		(29,048)	-	(30,749)	-
		(31,590)	-	(33,242)	-
Net trade and other receivables	₩	1,283,647	69,942	1,217,938	75,071

(c) Changes in the allowance account for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Beginning balance	₩	33,242	39,659
Impairment loss		2,858	12
Reversal of impairment loss		(3)	(5,465)
Net exchange difference		(4,507)	(964)
Ending balance	₩	31,590	33,242

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 consolidated statements of comprehensive income.

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

In millions of won		2016	2015
Within 1 month	₩	77,420	67,309
Between 1 and 2 months		78,179	64,851
Beyond 2 months		212,286	198,982
	₩	367,885	331,142

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

12. Trade and Other Receivables, Continued

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

In millions of won	2016 Effective interest rate		2016 Current	2016 Non-current	2015 Effective interest rate		2015 Current	2015 Non-current
Loans to employees	1.89~5.68%	₩	16,745	38,984	1.89~5.68%	₩	15,774	52,275
Loans	1.93~2.71%		330	325	1.70~7.29%		1,863	315
Guarantee deposits	1.30~5.68%		35,917	28,301	1.70~8.47%		33,787	20,260
		₩	52,992	67,610		₩	51,424	72,850

13. Inventories

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

In millions of won		2016	2015
Merchandise, net of loss on write-down of inventories	₩	16,666	7,677
Finished goods, net of loss on write-down of inventories		686,950	610,309
Work-in-progress, net of loss on write-down of inventories		627,863	608,280
Raw materials, net of loss on write-down of inventories		825,315	770,561
Supplies		29,899	27,367
By-products		6,733	7,051
Buildings under construction		699	3,618
Sites for construction of real estate		12,985	25,815
Goods-in-transit		58,245	58,436
	₩	2,265,355	2,119,114

(b) The amount of inventories recognized as an expense for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Cost of sales:			
Reversal of write-down of inventories	₩	(27)	(565)
Loss on retirement of inventories		9,832	4,706
Other expense:			
Loss on retirement of inventories		3,074	3,798
	₩	12,879	7,939

14. Cash and Cash Equivalents and Other Financial Assets

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

In millions of won		2016	2015
Cash on hand	₩	1,243	2,788
Demand deposits		233,697	161,627
Short-term investment assets		615,846	381,798
	₩	850,786	546,213

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

		2016		2015	
In millions of won		Current	Non-current	Current	Non-current
Time deposits	₩	113,450	-	120,141	-
Certificates of deposit		41,450	-	31,406	-
Money trust		1,502,438	-	985,359	-
Security deposits for checking accounts		-	11	-	12
	₩	1,657,338	11	1,136,906	12

(c) Financial assets restricted in use as of December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Long-term other financial assets	₩	11	12
Current other financial assets		1,450	1,406
	₩	1,461	1,418

15. Non-current Assets Held for Sale

Changes in non-current assets held for sale for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Beginning balance	₩	6,692	426
Transfer from property, plant and equipment		-	6,692
Transfer form investment property		21,165	-
Disposal		(1,542)	(426)
Ending balance	₩	26,315	6,692

16. Pledged Assets

(a) The following assets were pledged as collateral for borrowings as of December 31, 2016.

In millions of won

Asset		Carrying amount	Type		Received amount	Collateralized amount	Holder
Investment property	₩	68,810	Leasehold deposits received	₩	9,241	9,467	Metlife Insurance Korea Co., Ltd., etc.
Property, plant and equipment, investment property, etc.		57,748	Short-term borrowings		9,500	48,660	KEB Hana Bank, etc.
			Long-term borrowings		13,075	16,340	KEB Hana Bank, etc.
Property, plant and equipment		128,542	Investment subsidy		-	4,186	Wonju-si
			Investment subsidy		-	660	Chungju-si
			Short-term and long-term borrowings		7,654	14,500	The Korea Development Bank
Other financial assets		1,450	ACH pledged		-	1,450	Bank of Oklahoma
	₩	256,550		₩	39,470	95,263	

(b) The following assets were pledged as collateral for borrowings as of December 31, 2015.

In millions of won

Asset		Carrying amount	Type		Received amount	Collateralized amount	Holder
Investment property	₩	70,769	Leasehold deposits received	₩	8,975	9,225	Metlife Insurance Korea Co., Ltd., etc.
Property, plant and equipment and investment property		81,465	Short-term borrowings		12,000	48,009	KEB Hana Bank
			Long-term borrowings		14,936	16,991	KEB Hana Bank, etc.
Property, plant and equipment		28,780	Investment subsidy		-	660	Chungju-si
			Short-term borrowings		1,500	4,440	KEB Hana Bank
Other financial assets		1,406	ACH pledged		-	1,406	Bank of Oklahoma
	₩	182,420		₩	37,411	80,731	

17. Share Capital and Other Capital Surplus

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

In won, except number of shares		2016	2015
Number of ordinary shares:			
Authorized		800,000,000	800,000,000
Issued		137,292,497	137,292,497
Outstanding		126,265,127	125,965,892
Par value	₩	5,000	5,000

The Parent Company has, thus far, reacquired and retired 53,699,400 shares of treasury share. Accordingly, as of December 31, 2016, the Parent Company's ordinary share differs from the aggregate par value of issued shares by ₩268,497 million.

(b) Changes in the number of shares for the years ended December 31, 2016 and 2015 were as follows:

	2016			2015		
Number of share	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	-	299,235	299,235	-	67,092	67,092
Ending balance	137,292,497	(11,027,370)	126,265,127	137,292,497	(11,326,605)	125,965,892

(c) Changes in other capital surplus for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Beginning balance	₩	(9,928)	(4,573)
Extinguishment of equity conversion options		-	(5,483)
Paid-in capital increase of subsidiary		-	128
Conversion of redeemable convertible preferred shares of subsidiaries		7,780	-
Acquisition of non-controlling interests		(1,282)	-
Ending balance	₩	(3,430)	(9,928)

For the year ended December 31, 2016, changes in the ownership interest in Cosmocos Co., Ltd. resulting from the conversion of redeemable convertible preferred shares were recognized in other capital surplus.

For the year ended December 31, 2016, changes in the ownership interest in KT&G Life Sciences Corporation resulting from the conversion of redeemable convertible preferred shares and acquisition of additional shares of the investee were recognized in other capital surplus.

For the year ended December 31, 2015, the Group early redeemed the redeemable convertible preferred shares issued by Cosmocos Co., Ltd. With regard to the early redemption, the Group recognized the consideration paid for the repurchase of equity conversion options as other capital surplus.

For the year ended December 31, 2015, the Group recognized changes in controlling interests in other surplus due to the paid-in capital increase of Cosmocos Co., Ltd.

18. Treasury Shares and Gain on Reissuance of Treasury Shares

(a) Changes in treasury shares for the years ended December 31, 2016 and 2015 were as follows:

	2016		2015	
In millions of won, except number of shares	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	(299,235)	(8,905)	(67,092)	(1,997)
Ending balance	11,027,370	₩ 328,157	11,326,605	₩ 337,062

(b) Changes in gain on reissuance of treasury shares for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Beginning balance	₩	494,648	492,032
In-kind donation of treasury shares, net of tax		19,128	2,616
Ending balance	₩	513,776	494,648

19. Reserves

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

In millions of won		2016	2015
Available-for-sale financial assets - net change in fair value	₩	(18,942)	(30,378)
Foreign operations - foreign currency translation differences		(81,940)	(95,110)
Legal reserve		603,145	603,145
Voluntary reserve		3,794,260	3,226,658
	₩	4,296,523	3,704,315

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

In millions of won		2016	2015
Available-for-sale financial assets - net change in fair value before tax	₩	(24,990)	(40,077)
Tax effect		6,048	9,699
	₩	(18,942)	(30,378)

(c) Legal Reserve

The *Korean Commercial Act* requires the Parent 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.

19. Reserves, Continued

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

In millions of won		2016	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		3,062,528	2,484,926
	₩	3,794,260	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 Parent Company was, however, required to appropriate from retained earnings, the amount of tax benefits received, and transfer such amount into a reserve for business rationalization.

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

Reserve for 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 Parent Company. Those reserves can be used for other purposes afterwards upon a resolution at a general meeting of shareholders.

20. Retained Earnings

(a) Changes in retained earnings for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Beginning balance	₩	1,401,975	1,100,876
Dividends		(428,284)	(428,056)
Transfer from reserve for research and human resource development		10,000	12,522
Transfer to unconditional reserve		(577,602)	(320,926)
Profit for the year		1,226,030	1,032,220
- Less: non-controlling interests		5,244	3,497
Remeasurements of net defined benefit liability, net of tax		(24,611)	38
- Less: non-controlling interests		(720)	1,804
Ending balance	₩	1,612,032	1,401,975

20. Retained Earnings, Continued

(b) Statements of appropriation of retained earnings of the Parent Company for the years ended December 31, 2016 and 2015 are as follows:

Date of appropriation for 2016: March 17, 2017
Date of appropriation for 2015: March 18, 2016

In millions of won		2016	2015
Unappropriated retained earnings:			
Beginning balance	₩	-	-
Profit for the year		1,087,347	987,924
Remeasurements of net defined benefit liability, net of tax		(18,878)	7,962
		1,068,469	995,886
Transfer from voluntary reserves		10,000	10,000
Unappropriated retained earnings available for appropriation		1,078,469	1,005,886
Appropriation of retained earnings:			
Dividends		(454,554)	(428,284)
Unconditional reserve		(623,915)	(577,602)
		(1,078,469)	(1,005,886)
Unappropriated retained earnings to be carried over to subsequent year	₩	-	-

21. Dividends

Dividends were declared and paid by the Parent Company for the years ended December 31, 2016 and 2015 as follows:

		2016	2015
Dividends in millions of won	₩	428,284	428,056
Dividends per share in won		3,400	3,400
Dividend rate as a percentage of par value		68.00%	68.00%

Dividends of ₩454,554 million (₩3,600 per share) will be proposed at the shareholders' meeting to be held on March 17, 2017. The dividends have not been recognized as liabilities in the consolidated financial statements.

22. Trade and Other Payables

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

		2016		2015	
In millions of won		Current	Non-current	Current	Non-current
Leasehold deposits received	₩	21,418	6,188	19,404	7,030
Trade payables		103,826	-	103,591	-
Withholdings		212,413	85	212,891	171
Accrued expenses		192,629	-	180,172	-
Other payables		91,922	8,427	90,297	6,446
	₩	622,208	14,700	606,355	13,647

23. Borrowings

(a) Short-term borrowings as of December 31, 2016 and 2015 are summarized as follows:

In millions of won	Lender	Annual interest rate		2016	2015
Borrowings	Kookmin Bank, etc.	1.92 ~ 2.40%	₩	58,000	23,469
	KEB Hana Bank	3.00%		8,000	13,500
	KEB Hana Bank	3M LIBOR+1.30%		6,610	44,252
	The Korea Development Bank	2.10 ~ 2.62%		39,239	100,000
	PT Bank Woori Saudara	10.66%		2,694	2,550
Customer credit contracts(*)	Nonghyup Bank, etc.	6.09%, etc.		22,056	22,602
			₩	136,599	206,373

(*) The Group has entered into a customer credit contract with Nonghyup Bank, etc. The financial institutions pay trade receivables on behalf of customers and the Group has provided guarantees to the financial institutions for customers.

23. Borrowings, Continued

(b) Long-term borrowings as of December 31, 2016 and 2015 are summarized as follows:

In millions of won	Lender	Maturity	Annual interest rate		2016	2015
Borrowings	Nonghyup Bank	Mar.2021	0.00%	₩	44,443	34,514
	KEB Hana Bank	Mar.2017	1.62%		75	1,936
	Kookmin Bank	Sep.2023	2.35 ~ 2.90%		13,000	13,000
	The Korea Development Bank	Nov.2021	2.33 ~ 2.88%		5,950	-
Convertible bond					8,980	8,500
Redeemable convertible preferred shares					35,340	53,340
Redeemable preferred shares					17,762	18,611
				₩	125,550	129,901
Consolidated statement of financial position:						
Current				₩	9,597	27,659
Non-current					115,953	102,242
				₩	125,550	129,901

Details of convertible bond and preferred shares as of December 31, 2016 are summarized as follows:

Description	Issuing company	Details
Convertible bond(*)	PT Trisakti Purwosari Makmur	Issue date: Dec.2011 Par value: IDR 100,000 million Issued value: IDR 100,000 million Carrying amount: ₩8,980 million (IDR 100,000 million) Interest rate: 6.5% The bond can be converted into shares at the rate of IDR 9,659 per share before the maturity date.
Redeemable convertible preferred shares	Renzoluc Pte, Ltd.	Issue date: Sep.2012 Issued value: ₩35,340 million Carrying amount: ₩35,340 million The convertible instrument will mature ten years from the date of establishment of QCP 2011 Corporate Partnership Private Equity Fund (the "PEF"). The instrument can be converted into 6,978,948 ordinary shares at any time after five years from the issue date. Payable on demand from 270 days prior to the expiration of the PEF
Redeemable preferred shares	K-Q HongKong I, Limited	Issue date: Aug.2012, Sep.2012, Dec.2012 Issued value: ₩17,762 million Carrying amount: ₩17,762 million The convertible instrument will mature ten years from the date of establishment of the PEF. Payable on demand from 270 days prior to the expiration of the PEF

(*) The fair value of the liability component was calculated using the market interest rate for an equivalent non-convertible bond. The fair value of the equity component was determined by deducting the fair value of the liability component from the fair value of the compound financial instrument as a whole.

For the year ended December 31, 2015, the Group early redeemed the redeemable convertible preferred shares issued by Cosmocos Co., Ltd. With regard to the early redemption, the Group recognized ₩11,962 million of gain on debt redemption and a decrease of ₩5,483 million in other capital surplus.

(c) As discussed in note 16 to the consolidated financial statements, the Group has provided collateral for the above borrowings as of December 31, 2016.

24. Retirement Benefits Plan

(a) The components of retirement benefits recognized in profit or loss for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Defined benefit plans:			
Current service cost	₩	43,822	44,227
Net interest on net defined benefit liability		3,004	3,351
		46,826	47,578
Defined contribution plans:			
Contributions recognized as expense		6,494	4,300
	₩	53,320	51,878

The Group recognized termination benefits amounting to ₩2,801 million and ₩15,332 million as an expense for the years ended December 31, 2016 and 2015, respectively.

(b) Changes in net defined benefit liabilities for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Beginning balance	₩	120,648	132,247
Current service cost		43,822	44,227
Net interest on net defined benefit liabilities		3,004	3,351
Remeasurements of net defined benefit liabilities before tax		32,364	(553)
Retirement benefits paid		(6,913)	(9,224)
Payments into plan assets		(69,566)	(49,224)
Net exchange difference		251	(176)
Ending balance	₩	123,610	120,648
Statements of financial position:			
Present value of defined benefit obligations	₩	426,116	373,590
Fair value of plan assets		(302,506)	(252,942)
Net defined benefit liabilities	₩	123,610	120,648

24. Retirement Benefits Plan, Continued

(c) Changes in defined benefit obligations for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Beginning balance	₩	373,590	364,717
Current service cost		43,822	44,227
Interest expense		8,441	9,230
Actuarial losses (gains) before tax		32,088	(1,075)
Retirement benefits paid		(32,076)	(43,333)
Net exchange difference		251	(176)
Ending balance	₩	426,116	373,590

(d) Changes in plan assets for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Beginning balance	₩	252,942	232,470
Interest income		5,437	5,879
Return on plan assets, excluding interest income on plan assets		(276)	(522)
Retirement benefits paid		(25,163)	(34,109)
Contribution to plan assets		69,566	49,224
Ending balance	₩	302,506	252,942

Actual returns on plan assets for the years ended December 31, 2016 and 2015 are ₩5,161 million and ₩ 5,357 million, respectively.

(e) The amount of remeasurements of net defined benefit liabilities for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Actuarial gains (losses) before tax:			
Demographic assumptions	₩	(2)	1,705
Financial assumptions		(24,088)	(9,170)
Experience adjustments		(7,998)	8,540
The return on plan assets, excluding interest income on plan assets		(276)	(522)
Remeasurements of the net defined benefit liabilities before tax		(32,364)	553
Tax effect		7,753	(515)
Remeasurements of the net defined benefit liabilities, net of tax	₩	(24,611)	38

(f) The components of plan assets as of December 31, 2016 and 2015 are as follows:

In millions of won		2016	2015
Deposits	₩	92,156	27,551
Other		210,350	225,391
	₩	302,506	252,942

24. Retirement Benefits Plan, Continued

(g) The principal actuarial assumptions as of December 31, 2016 and 2015 were as follows:

	2016	2015
Discount rate	1.95% ~ 2.59%	1.93 ~ 2.54%
Rate of salary increases	3.00% ~ 5.68%	3.00 ~ 5.00%

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

As of December 31, 2016 and 2015, the weighted average duration of the defined benefit obligations were 9.43 and 9.46 years, respectively.

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

In millions of won		1 % point increase	1 % point decrease
Discount rate	₩	(38,294)	44,647
Rate of salary increase		43,460	(38,082)

The effect on defined benefit obligations is as of December 31, 2016.

25. Result from Real Estate Sales

(a) Details of agreements for real estate sales under construction as of December 31, 2016 was as follows:

In millions of won	Construction period		Total revenue estimated	Total revenue contracted
Daegu Station Central-Xi	Dec. 2014 ~ Oct. 2017	₩	343,958	342,225

(b) Changes in the balance of contract amounts for the year ended December 31, 2016 was as follows:

In millions of won		2016
Beginning Balance	₩	246,340
Contract increase		23,700
Revenue recognition		(136,549)
Ending Balance	₩	133,491

(c) Recognized profits and related balance for agreements under construction as of December 31, 2016 is summarized as follows:

In millions of won	Stage of completion		Aggregate revenue recognized	Aggregate expenses recognized	Due from customers for contract work
Daegu Station Central-Xi	60.99%	₩	208,734	165,958	47,104

Due from customers for contract work is recognized as trade and other receivables in consolidated financial statements.

(d) The effects of current profit (loss), future profit (loss) and due to customers for contract work from changes in total contract revenue and costs for the year ended December 31, 2016 are summarized as follows:

In millions of won		Changes in total contract revenue	Changes in total contract costs	The effects of current profit (loss)	The effects of future profit (loss)	The effects of due from customers for contract work
Daegu Station Central-Xi	₩	1,291	4,690	(2,063)	(1,336)	40

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.

26. Result from Operating Activities

(a) Details of expenses classified by nature for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Changes in inventories	₩	(146,241)	(136,611)
Raw materials and consumables purchased		1,414,179	1,299,921
Salaries		540,635	517,604
Retirement and termination benefits		56,121	67,210
Depreciation		152,298	151,093
Amortization		5,891	10,759
Employee welfare		91,282	94,725
Advertising		267,840	248,137
Commissions		327,908	264,302
Other expenses		323,265	286,795
	₩	3,033,178	2,803,935

(b) Details of selling, general and administrative expenses for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Salaries	₩	360,351	346,393
Retirement and termination benefits		36,310	46,263
Employee welfare		68,537	67,978
Travel		13,905	11,338
Communications		5,156	5,226
Utilities		8,448	9,044
Taxes and dues		20,870	19,293
Supplies		4,329	3,683
Rent		20,128	22,872
Depreciation		39,912	43,609
Amortization		5,697	10,561
Repairs and maintenance		5,584	4,476
Vehicles		5,694	6,606
Insurance		2,019	1,928
Commissions		269,158	228,990
Freight and custody		49,352	52,510
Conferences		3,032	3,493
Advertising		267,690	247,985
Training		6,288	6,465
Prizes and rewards		2,830	3,238
Cooperation		887	813
Normal research and development		37,468	36,032
Impairment loss (reversal of impairment loss) on trade receivables		2,808	(5,462)
	₩	1,236,453	1,173,334

27. Other Income and Expenses

(a) Details of other income for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Foreign currency transaction gain	₩	24,729	32,055
Foreign currency translation gain		65,274	53,337
Reversal of impairment loss on other receivables		3	3
Gain on sale of property, plant and equipment		12,722	12,912
Gain on sale of intangible assets		50	789
Others		62,492	19,656
	₩	165,270	118,752

(b) Details of other expenses for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Foreign currency transaction loss	₩	32,610	14,022
Foreign currency translation loss		16,850	34,087
Impairment loss on other receivables		50	12
Donations		29,997	46,189
Loss on sale of property, plant and equipment		3,082	963
Loss on sale of intangible assets		53	57
Impairment loss on intangible assets		3,913	43,224
Others		15,604	21,607
	₩	102,159	160,161

28. Net Finance Income

(a) Details of net finance income for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Finance income:			
Interest income	₩	37,941	33,803
Dividend income		15,129	12,098
Investment income on long-term deposits in MSA Escrow Fund		-	1,287
Gain on sale of available-for-sale financial assets		14,003	25,184
Gain on settlement of derivative instruments		-	7
Gain on debt redemption		-	11,962
		67,073	84,341
Finance costs:			
Interest expense		(6,724)	(9,482)
Investment loss on long-term deposits in MSA Escrow Fund		(3,721)	-
Impairment loss on available-for-sale financial assets		(4,077)	(95)
Loss on settlement of derivative instruments		-	(2)
		(14,522)	(9,579)
Net finance income	₩	52,551	74,762

(b) Details of interest income for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Deposits	₩	34,115	30,597
Available-for-sale financial assets		30	40
Trade and other receivables		3,796	3,166
	₩	37,941	33,803

(c) Details of interest expense for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Borrowings	₩	3,393	4,261
Trade and other payables		3,329	2,168
Others		2	3,053
	₩	6,724	9,482

29. Income Tax

(a) The components of income tax expense for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Current income tax expense	₩	377,898	368,953
Adjustments recognized in the current year for current tax of prior years		(10,594)	216
Changes in temporary difference		(7,427)	6,219
Cash reserve tax		3,889	2,881
Total income tax expense		363,766	378,269
Less: tax expense (benefit) recognized outside profit or loss		(1,965)	3,905
Income tax expense	₩	361,801	382,174

(b) Current and deferred tax expense (benefit) that were recognized outside profit or loss for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Current:			
Gain on reissuance of treasury shares	₩	6,107	835
Deferred:			
Net changes in fair value of available-for-sale financial assets		3,651	(5,133)
Remeasurements of the net defined benefit liabilities		(7,753)	515
Exchange differences on translating foreign operations		(40)	(122)
		(4,142)	(4,740)
Tax expense (benefit) recognized outside profit or loss	₩	1,965	(3,905)

Income tax related to gain on reissuance of treasury shares was recognized directly in equity and income tax related to remeasurements of net defined benefit liabilities, net changes in fair value of available-for-sale financial assets and exchange differences on translating foreign operations was recognized in other comprehensive income (loss).

(c) Reconciliation of income tax expense based on statutory tax rate to actual income tax expense for the years ended December 31, 2016 and 2015 are as follows:

In millions of won, except tax rate information		2016	2015
Profit before tax	₩	1,587,831	1,414,394
Normal tax rate		23.3%	24.7%
Income taxes at normal tax rate		370,665	349,489
Adjustment:			
Non-taxable income		(6,515)	(353)
Non-deductible expenses		6,027	7,966
Changes in unrecognized deferred tax		231	24,206
Tax credits and deduction		(1,440)	(1,250)
Adjustments recognized in the current year for current tax of prior years		(10,594)	216
Other		3,427	1,900
Income tax expense	₩	361,801	382,174
Effective tax rate		22.8%	27.0%

29. Income Tax, Continued

(d) Changes in deferred tax assets (liabilities) for the years ended December 31, 2016 and 2015 were as follows:

(i) For the year ended December 31, 2016

In millions of won		January 1 2016	Profit (loss)	Other comprehensive income (loss)	December 31 2016
Accumulated depreciation	₩	11,313	8,665	-	19,978
Allowance for bad debts		9,200	6,747	-	15,947
Available-for-sale financial assets		9,752	988	(3,651)	7,089
Accrued expense		32,047	(548)	-	31,499
Defined benefit liability		18,565	(6,376)	7,753	19,942
Treasury shares		(8,756)	231	-	(8,525)
Investments in subsidiaries		(308,340)	(7,823)	40	(316,123)
Provision for advanced depreciation		(19,256)	4,763	-	(14,493)
Reserve		(7,502)	4,195	-	(3,307)
Others		19,201	(7,557)	-	11,644
	₩	(243,776)	3,285	4,142	(236,349)

(ii) For the year ended December 31, 2015

In millions of won		January 1 2015	Profit (loss)	Other comprehensive income (loss)	December 31 2015
Accumulated depreciation	₩	3,140	8,173	-	11,313
Allowance for bad debts		11,481	(2,281)	-	9,200
Available-for-sale financial assets		15,339	(10,720)	5,133	9,752
Accrued expense		28,847	3,200	-	32,047
Defined benefit liability		9,700	9,380	(515)	18,565
Treasury shares		(8,808)	52	-	(8,756)
Investments in subsidiaries		(283,739)	(24,723)	122	(308,340)
Provision for advanced depreciation		(14,493)	(4,763)	-	(19,256)
Reserve		(12,320)	4,818	-	(7,502)
Others		13,296	5,905	-	19,201
	₩	(237,557)	(10,959)	4,740	(243,776)

(e) As of December 31, 2016 and 2015, deferred tax asset of ₩410,116 million and ₩391,655 million for temporary differences arising from investments in subsidiaries, associates and joint ventures was not recognized, respectively, because it is not probable that they will reverse in the foreseeable future.

(f) Details of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognized as of December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Deductible temporary differences	₩	17,325	29,728
Unused tax losses		128,825	118,042
Unused tax credits		4,209	4,826
	₩	150,359	152,596

30. Earnings per Share

Basic and diluted earnings per share for the years ended December 31, 2016 and 2015 were as follows:

		2016	2015
Profit for the year attributable to owners of the Parent Company in millions of won	₩	1,231,274	1,035,717
Weighted-average number of ordinary shares outstanding		126,168,347	125,961,848
Basic and diluted earnings per share in won	₩	9,759	8,222

The weighted average number of ordinary shares outstanding during the period 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.

31. Transactions and Balances with Related Companies

(a) The Group has no significant transactions, receivables and liabilities with related parties, as of and for the years ended December 31, 2016 and 2015.

(b) There is no guarantee being provided by related parties as of December 31, 2016 and 2015.

(c) Details of key management personnel compensation for the years ended December 31, 2016 and 2015 are summarized as follows:

In millions of won		2016	2015
Short-term employee benefits	₩	24,475	22,550
Retirement benefits		2,585	3,112
	₩	27,060	25,662

32. Risk Management and Fair Value of Financial Instruments

(a) Overview

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

- Market risk
- Credit risk
- Liquidity risk

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

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

(b) Risk Management Framework

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

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

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of December 31, 2016 and 2015 were as follows:

		2016		2015	
In millions of won		Assets	Liabilities	Assets	Liabilities
USD	₩	950,652	69,029	797,656	46,905
EUR		940	3,125	541	1,695
Others		9,727	5,046	7,645	21,151
	₩	961,319	77,200	805,842	69,751

As of December 31, 2016 and 2015, the effects of a 10% weakening or strengthening of functional currency against foreign currencies on profit before tax were as follows:

		2016		2015	
In millions of won		10% weakening	10% strengthening	10% weakening	10% strengthening
Increase (decrease) in profit before tax	₩	88,412	(88,412)	73,609	(73,609)

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

(c) Management of Financial Risks, Continued

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

As of December 31, 2016 and 2015, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income were as follows:

		2016		2015	
In millions of won		5% increase	5% decrease	5% increase	5% decrease
Increase (decrease) in comprehensive income before tax	₩	5,879	(5,879)	1,780	(1,780)

Interest rate risk
The Group has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. As of December 31, 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 Group 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 Group has transacted with customers with high credit ratings to manage credit risk, and has implemented and operated policies and procedures for credit enhancements of the financial assets. Counterparty credit risk is managed by evaluating its credit rating and limiting the aggregate amount and duration of exposure before sales commence, and the Group has been provided collateral and guarantees. The credit ratings of all counterparties and the level of collateral and guarantees are reviewed regularly. Analysis of financial assets past due has been reported quarterly and appropriate measures have been taken to secure the Group's assets.

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of December 31, 2016 and 2015 is as follows:

In millions of won		2016	2015
Available-for-sale debt instruments	₩	1,500	1,596
Long-term deposits in MSA Escrow Fund		503,592	403,966
Trade and other receivables		1,353,589	1,293,009
Other financial assets		1,657,349	1,136,918
Cash and cash equivalents (excluding cash on hand)		849,543	543,425
Financial guarantee contract		153,145	76,566
	₩	4,518,718	3,455,480

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

(c) Management of Financial Risks, Continued

(iii) Liquidity risk

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

The maturity analysis with a residual contractual maturity of financial liabilities as of December 31, 2016 and 2015 is as follows:

				Residual contractual maturity			
In millions of won		Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
As of December 31, 2016:							
Trade and other payables	₩	424,410	425,970	386,382	24,748	11,729	3,111
Long-term borrowings		115,953	117,978	37	111	54,105	63,725
Current portion of long-term borrowings		9,597	9,611	79	9,532	-	-
Short-term borrowings		136,599	137,591	64,221	73,370	-	-
Financial guarantee contract		-	153,145	-	-	153,145	-
	₩	686,559	844,295	450,719	107,761	218,979	66,836
As of December 31, 2015:							
Trade and other payables	₩	406,940	408,593	368,074	27,043	11,042	2,434
Long-term borrowings		102,242	104,044	98	293	43,557	60,096
Current portion of long-term borrowings		27,659	27,676	296	27,380	-	-
Short-term borrowings		206,373	208,593	122,917	85,676	-	-
Financial guarantee contract		-	76,566	-	-	76,566	-
	₩	743,214	825,472	491,385	140,392	131,165	62,530

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

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

(d) Fair Value of Financial Instruments

The carrying amount of each category of financial assets and liabilities as of December 31, 2016 and 2015 are as follows:

In millions of won		2016	2015
Financial assets:			
Available-for-sale financial assets	₩	386,596	364,681
Loans and receivables			
- Long-term deposits in MSA Escrow Fund		503,592	403,966
- Trade and other receivables		1,353,589	1,293,009
- Other financial assets		1,657,349	1,136,918
- Cash and cash equivalents		850,786	546,213
		4,365,316	3,380,106
	₩	4,751,912	3,744,787
Financial liabilities:			
Financial liabilities measured at amortized cost			
- Trade and other payables	₩	424,410	406,940
- Long-term borrowings		115,953	102,242
- Current portion of long-term borrowings		9,597	27,659
- Short-term borrowings		136,599	206,373
	₩	686,559	743,214

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

			Fair value		
In millions of won		Carrying amount	Level I	Level II	Level III
As of December 31, 2016:					
Available-for-sale financial assets	₩	354,032	221,076	-	132,956
As of December 31, 2015:					
Available-for-sale financial assets	₩	327,022	211,914	-	115,108

There is no transfer between fair value hierarchy levels of recurring fair value measurements for the years ended December 31, 2016 and 2015.

The fair value measurements for available-for-sale equity instruments in real estate trust fund have been categorized as a level 3 fair value based on the inputs to the valuation techniques used. Changes in fair value classified as level 3 for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Beginning balance	₩	115,108	90,726
Acquisition		16,000	22,200
Changes in fair value		1,848	2,182
Ending balance	₩	132,956	115,108

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

(e) Finance Income (Costs)

(i) Details of finance income (costs) by categories for the year ended December 31, 2016 were as follows:

In millions of won		Available-for-sale financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:					
Interest income	₩	30	37,911	-	37,941
Dividend income		15,129	-	-	15,129
Gain on sale of available-for-sale financial assets		14,003	-	-	14,003
Interest expense		-	-	(6,724)	(6,724)
Investment loss on long-term deposits in MSA Escrow Fund		-	(3,721)	-	(3,721)
Impairment loss on available-for-sale financial assets		(4,077)	-	-	(4,077)
	₩	25,085	34,190	(6,724)	52,551
Comprehensive income (loss) before tax					
Net change in fair value	₩	25,013	-	-	25,013
Disposal		(14,003)	-	-	(14,003)
Impairment		4,077	-	-	4,077
	₩	15,087	-	-	15,087

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

(e) Finance Income (Costs), Continued

(ii) Details of finance income (costs) by categories for the year ended December 31, 2015 were as follows:

In millions of won		Financial assets at fair value through profit or loss	Available -for-sale financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:						
Interest income	₩	-	40	33,763	-	33,803
Dividend income		-	12,098	-	-	12,098
Investment income on long-term deposits in MSA Escrow Fund		-	-	1,287	-	1,287
Gain on sale of available-for-sale financial assets		-	25,184	-	-	25,184
Gain on transactions of derivative instruments		7	-	-	-	7
Gain on debt redemption		-	-	-	11,962	11,962
Interest expense		-	-	-	(9,482)	(9,482)
Impairment loss on available-for-sale financial assets		-	(95)	-	-	(95)
Loss on transactions of derivative instruments		(2)	-	-	-	(2)
	₩	5	37,227	35,050	2,480	74,762
Comprehensive income (loss) before tax						
Net change in fair value	₩	-	3,881	-	-	3,881
Disposal		-	(25,184)	-	-	(25,184)
Impairment		-	95	-	-	95
	₩	-	(21,208)	-	-	(21,208)

33. Capital Management

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

As of December 31, 2016 and 2015, the Group's capital structure was as follows:

In millions of won		2016	2015
Net debt (asset):			
Debt (borrowings)	₩	262,149	336,274
Less:			
Cash and cash equivalents		(850,786)	(546,213)
Current other financial assets		(1,657,338)	(1,136,906)
		(2,245,975)	(1,346,845)
Equity	₩	7,118,257	6,275,499

34. Contingent Liabilities and Commitments

(a) Each year the Group 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 Group 25 years from the date of each annual funding. The Group recorded as long-term deposits the amounts paid into the MSA Escrow Funds of State governments in the United States against potential litigation and damages related to the export of tobacco into the United States.

(b) As of December 31, 2016, a lawsuit by National Health Insurance Service claiming damages of ₩53,742 million are filed against the Group. Additionally, as of December 31, 2016, the Group is involved in 14 lawsuits as a plaintiff for alleged damages totalling ₩18,276 million and seven lawsuits as a defendant for alleged damages totalling ₩2,247 million. The amount of the liability the Group may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of December 31, 2016.

(c) As of December 31, 2016, the Group has entered into letter of credit agreements with KEB Hana Bank and other banks with limits in the aggregate of USD 64,100 thousand.

(d) As of December 31, 2016, the Group's trade receivables from the export of cigarettes are insured against non-payment up to USD 23,763 thousand by a short-term export insurance with the Korea Trade Insurance Corporation.

34. Contingent Liabilities and Commitments, Continued

(e) The Group has been provided with a foreign currency payment guarantee by KEB Hana Bank up to USD 40,000 thousand for L/C or guarantees related with its foreign exports. Details of guarantees exercised as of December 31, 2016, are summarized as follows:

In thousands of USD, THB and millions of IDR		Exercised amount
Customs bond and L/C opening of KT&G USA Corporation.	USD	15,217
Performance guarantee for export of tobacco sheet to Thailand Tobacco Monopoly	THB	15,191
Payment guarantee for purchase of certificate stamp of PT Mandiri Maha Mulia, etc.	IDR	175,166

(f) The Group has maintained a contract with the farmers who grow six-year old green ginseng for purchase volume guarantees and recorded contractual amounts paid to the farmers as advance payments in the amount of ₩128,633 million and ₩151,783 million as of December 31, 2016 and 2015, respectively.

(g) As of December 31, 2016, the Group has an accounts receivable loan agreement with a limit of ₩107,000 million with KEB Hana Bank and other financial institutions.

(h) As of December 31, 2016, the Group has a trade bill loan agreement with a limit of ₩10,000 million with KEB Hana Bank

(i) As of December 31, 2016, the Group has a loan agreement with a limit of ₩154,600 million with Shinhan Bank and other financial institutions.

(j) As of December 31, 2016, the Group has provided one blank note, five notes amounting to ₩4,000 million and two blank checks to Nara Credit and other financial institutions. Besides, as of December 31, 2016, the Group lost seven blank notes and one blank check and expects to proceed a judgment of nullification.

(k) On March 17, 2011, the Group 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.

(l) With relation to the acquisition of KT&G Life Sciences Corporation, the Parent 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 Parent 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 Parent Company.
Tag-along right held by Individual Shareholder	In the event that the Parent 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 Parent Company.

34. Contingent Liabilities and Commitments, Continued

(m) As of December 31, 2016, the Group has provided guarantees up to ₩225,600 million with an exercised amount of ₩153,145 million for the buyers of apartments in respect of their borrowings from Shinhan Bank.

(n) As of December 31, 2016, the Group is insured by performance guarantee insurance up to ₩4,581 million with the Seoul Guarantee Insurance.

35. Cash Flows

(a) Details of cash generated from operations for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
Profit for the year	₩	1,226,030	1,032,220
Adjustments for:			
Income tax expense		361,801	382,174
Finance costs		14,522	9,579
Finance income		(67,073)	(84,341)
Depreciation		152,298	151,093
Amortization		5,891	10,759
Retirement and termination benefits		56,121	67,210
Foreign currency translations loss		16,850	34,087
Impairment loss on trade and other receivables		2,858	12
Reversal of write-down of inventories		(27)	(565)
Loss on sale of property, plant and equipment		3,082	963
Loss on sale of intangible assets		53	57
Impairment loss on intangible assets		3,913	43,224
Other expenses		10,526	13,952
Share of gain of associates and joint ventures		(2,546)	(15,137)
Share of loss of associates and joint ventures		479	-
Foreign currency translations gain		(65,274)	(53,337)
Reversal of impairment loss on trade and other receivables		(3)	(5,465)
Gain on sale of property, plant and equipment		(12,722)	(12,912)
Gain on sale of intangible assets		(50)	(789)
		1,706,729	1,572,784
Changes in working capital:			
Trade and other receivables		(15,968)	(185,672)
Advance payments		27,432	12,626
Prepaid expenses		(3,350)	(2,522)
Prepaid tobacco excise and other taxes		8,539	(187,086)
Inventories		(153,337)	(145,968)
Trade and other payables		32,059	88,086
Advance receipts		(22,068)	(10,942)
Tobacco excise and other taxes payable		385,705	521,234
Payment of retirement and termination benefits		(83,499)	(76,940)
Cash generated from operations	₩	1,882,242	1,585,600

35. Cash Flows, Continued

(b) Details of material transactions without cash inflow or outflow for the years ended December 31, 2016 and 2015 were as follows:

In millions of won		2016	2015
In-kind donation of treasury shares	₩	34,140	5,448
Acquisition of available-for-sale financial assets by exercise of convertible right		-	28,990
Increase in accrued expenses related with payment of retirement and termination benefits		2,275	1,141
Increase (decrease) in other payables related with acquisition of property, plant and equipment		1,653	(8,360)
Increase (decrease) in advance receipts related with disposal of property, plant and equipment and non-current assets held for sale		1,522	(298)
Increase in other receivables related with disposal of property, plant and equipment		557	184
Increase in other payables related with intangible assets		1,629	-

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

36. Significant Events after the End of Reporting Period

As of January 13, 2017, KT&G Life Sciences Corporation was merged into Yungjin Pharm. Ind. Co., Ltd.