

KT&G Corporation
Separate Financial Statements
December 31, 2012

KT&G Corporation
Index
December 31, 2012

	Page(s)
Report of Independent Auditors	1 - 2
Separate Financial Statements	
Separate Statements of Financial Position	3
Separate Statements of Comprehensive Income	4
Separate Statement of Changes in Equity	5 - 6
Separate Statements of Cash Flows	7
Notes to Separate Financial Statements	8 - 56
Report of Independent Accountants' Review of Internal Accounting Control System	57 - 58



RESPECTED
TRUSTED
PROFESSIONAL
SAMIL

Report of Independent Auditors

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

We have audited the accompanying separate statements of financial position of KT&G Corporation (the "Company") as of December 31, 2012, and the related separate statements of comprehensive income, changes in equity and cash flows for the year then ended, expressed in Korean won. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The separate financial statements of the Company as of and for the year ended December 31, 2011, presented herein for comparative purposes, were audited by other auditors whose report dated February 16, 2012, expressed an unqualified opinion on those statements. The separate financial statements as of Dec 31, 2011, with unqualified opinion by KPMG Samjong Accounting Corporation do not reflect adjustments due to the change of accounting policy, stated in Note 2.1.1. However, the comparable separate financial statements on appendix reflect these adjustments.

We conducted our audit in accordance with auditing standards generally accepted in the Republic of Korea. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the separate financial statements, referred to above, present fairly, in all material respects, the financial position of KT&G Corporation as of December 31, 2012, and its financial performance and cash flows for the year then ended, in accordance with International Financial Reporting Standards as adopted by the Republic of Korea ("Korean IFRS").

*Samil PricewaterhouseCoopers, TS Yongsan Tower, 191, Hangeul-ro 2-gu, Yongsan-gu,
Seoul 140-702, Korea (Yongsan P.O Box 266, 140-600), www.samil.com*

Samil PricewaterhouseCoopers is the Korean network firm of PricewaterhouseCoopers International Limited (PwCIL). "PricewaterhouseCoopers" and "PwC" refer to the network of member firms of PwCIL. Each member firm is a separate legal entity and does not act as an agent of PwCIL or any other member firm.

The accompanying separate financial statements as of and for the years ended December 31, 2012 and 2011, have been translated into US dollars solely for the convenience of the reader and have been translated on the basis set forth in Note 33 to the separate financial statements.

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

Samil PriceWaterhouseCoopers

Seoul, Korea
February 5, 2013

This report is effective as of February 5, 2013, 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 separate financial statements and notes thereto. Accordingly, the readers of the audit report should understand that there is a possibility that the above audit report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

KT&G Corporation
Separate Statements of Financial Position
December 31, 2012 and 2011

<i>(in millions of Korean won and thousands of U.S. dollars)</i>				
	Notes	December 31, 2012 Korean won	December 31, 2012 U.S. dollars (Note 33)	December 31, 2011 Korean won
Assets				
Non-current assets				
Property, plant and equipment	9	₩ 1,163,220	\$ 1,086,005	₩ 1,163,361
Intangible assets	10	19,937	18,613	18,972
Investment property	11,13	153,907	143,691	165,053
Investments in associates	14	57,725	53,893	36,725
Investments in subsidiaries	14	1,178,590	1,100,355	1,054,767
Available-for-sale financial assets	4,5,6	263,544	246,050	247,018
Long-term deposits in MSA Escrow Fund	4,5,8,31	168,667	157,471	147,290
Long-term prepaid expenses		4,163	3,887	4,084
Long-term trade and other receivables	4,5,7,32	146,174	136,471	199,031
		₩ 3,155,927	\$ 2,946,436	₩ 3,036,301
Current assets				
Inventories	15	872,833	814,894	904,112
Available-for-sale financial assets	4,5,6	1,000	934	1,044
Other financial assets	4,5,16	620,000	578,844	-
Prepaid tobacco excise and other taxes		254,562	237,664	198,222
Trade and other receivables	4,5,7,32	726,397	678,179	625,756
Advance payments		13,964	13,037	9,358
Prepaid expenses		5,757	5,374	403
Cash and cash equivalents	4,5,16	266,720	249,015	639,097
		₩ 2,761,233	\$ 2,577,941	₩ 2,377,992
	12	762	711	3,196
Assets held for sale				
		₩ 5,917,922	\$ 5,525,088	₩ 5,417,489
Total assets				
Equity				
Capital stock	1,17	₩ 954,959	\$ 891,569	₩ 954,959
Other Capital surplus	17	3,582	3,344	3,582
Treasury shares	18	(339,059)	(316,552)	(343,522)
Gain on reissuance of treasury shares	18	492,032	459,371	485,922
Reserve	19	3,039,034	2,837,302	2,678,814
Retained earnings	20	752,766	702,797	763,738
Total equity		₩ 4,903,314	\$ 4,577,831	₩ 4,543,493
Liabilities				
Non-current liabilities				
Long-term trade and other payables	4,5,21,32	₩ 27,325	\$ 25,511	₩ 26,628
Long-term advance receipts		4,953	4,624	12,375
Defined benefit liability	23	66,211	61,816	47,640
Deferred income tax liabilities	27	80,948	75,575	82,923
		₩ 179,437	\$ 167,526	₩ 169,566
Current liabilities				
Borrowings	4,5,22	₩ 5,477	\$ 5,114	₩ 6,975
Trade and other payables	4,5,21,32	266,844	249,130	248,976
Advance receipts		25,639	23,936	3,936
Income taxes payable		137,828	128,679	138,846
Tobacco excise and other taxes payable		399,383	372,872	305,697
		₩ 835,171	\$ 779,731	₩ 704,430
Total liabilities		₩ 1,014,608	\$ 947,257	₩ 873,996
Total liabilities and equity		₩ 5,917,922	\$ 5,525,088	₩ 5,417,489

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

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

KT&G Corporation
Separate Statements of Comprehensive Income
Years Ended December 31, 2012 and 2011

	Notes	2012	2012	2011
		Korean won	U.S. dollars (Note 33)	Korean won
<i>(in millions of Korean won and thousands of U.S. dollars, except per share amounts)</i>				
Sales				
Manufacture of tobacco		₩ 2,523,880	\$ 2,356,344	₩ 2,390,076
Real estate		43,509	40,621	41,208
Exports of leaf tobacco and others		70,223	65,561	59,547
	31.32	2,637,612	2,462,526	2,490,831
Cost of sales				
Manufacture of tobacco		(926,007)	(864,538)	(911,423)
Real estate		(7,265)	(6,783)	(14,741)
Exports of leaf tobacco and others		(48,824)	(45,583)	(40,790)
	15,25.32	(982,096)	(916,904)	(966,954)
Gross profit		1,655,516	1,545,622	1,523,877
Selling and administrative expenses	24, 25	(682,836)	(637,509)	(625,908)
Operating income	24	972,680	908,113	897,969
Other income	24, 32	92,651	86,500	97,497
Other expenses	24, 25, 32	(91,014)	(84,972)	(92,217)
Net other income		1,637	1,528	35,280
Finance income	26	45,346	42,336	94,067
Finance expense	26	(1,185)	(1,105)	(4,915)
Net finance income		44,161	41,230	89,152
Profit before income tax		1,018,478	950,871	1,022,401
Income tax expense	27	(250,040)	(233,442)	(246,464)
Profit for the year		₩ 768,438	\$ 717,429	₩ 775,937
Other comprehensive income				
Change in value of available-for-sale financial assets		₩ 1,220	\$ 1,139	₩ (49,889)
Actuarial gain(loss) on defined benefit liability		(18,014)	(16,818)	(14,392)
Other comprehensive income (loss) for the year, net of tax		(16,794)	(15,679)	(64,281)
Total comprehensive income for the year		₩ 751,644	\$ 701,750	₩ 711,656
Earnings per share attributable to the equity holders of the Company during the year (in won)				
Basic and diluted earnings per share	28	₩ 6,111	\$ 5,71	₩ 6,134

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

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

KT&G Corporation
Separate Statements of Changes in Equity
Years Ended December 31, 2012 and 2011

(in millions of Korean won)

Notes	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
Balance at January 1, 2011	₩ 954,959	₩ 3,582	₩ (216,827)	₩ 482,129	₩ 2,164,703	₩ 929,140	₩ 4,337,686
Comprehensive income							
Profit for the year	-	-	-	-	-	775,937	775,937
Other comprehensive income(loss)							
Change in value of available-for-sale financial assets	-	-	-	-	(49,889)	-	(49,889)
Actuarial gain(loss) on defined benefit liability	-	-	-	-	-	(14,392)	(14,392)
Total other comprehensive income (loss)	-	-	-	-	(49,889)	(14,392)	(64,281)
Total comprehensive income (loss)	-	-	-	-	(49,889)	761,545	711,656
Transactions with equity holders of the Company							
Cash dividends	-	-	-	-	-	(382,946)	(382,946)
Acquisition of treasury shares	-	-	(129,671)	-	-	-	(129,671)
Reissuance of treasury shares	-	-	2,976	3,793	-	-	6,769
Other reserve	-	-	-	-	544,000	(544,000)	-
Total transactions with equity holders of the Company	-	-	(126,695)	3,793	544,000	(926,946)	(505,848)
Balance at December 31, 2011	₩ 954,959	₩ 3,582	₩ (343,522)	₩ 485,922	₩ 2,678,814	₩ 763,739	₩ 4,543,494
Balance at January 1, 2012	₩ 954,959	₩ 3,582	₩ (343,522)	₩ 485,922	₩ 2,678,814	₩ 763,739	₩ 4,543,494
Comprehensive income							
Profit for the year	-	-	-	-	-	768,437	768,437
Other comprehensive income(loss)							
Change in value of available-for-sale financial assets	-	-	-	-	1,220	-	1,220
Actuarial gain(loss) on defined benefit liability	-	-	-	-	-	(18,014)	(18,014)
Total other comprehensive income (loss)	-	-	-	-	1,220	(18,014)	(16,794)
Total comprehensive income (loss)	-	-	-	-	1,220	750,423	751,643
Transactions with equity holders of the Company							
Cash dividends	-	-	-	-	-	(402,396)	(402,396)
Reissuance of treasury shares	-	-	4,463	6,110	-	-	10,573
Other reserve	-	-	-	-	359,000	(359,000)	-
Total transactions with equity holders of the Company	-	-	4,463	6,110	359,000	(761,396)	(391,823)
Balance at December 31, 2012	₩ 954,959	₩ 3,582	₩ (339,059)	₩ 492,032	₩ 3,039,034	₩ 752,766	₩ 4,903,314

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

KT&G Corporation
Separate Statements of Changes in Equity
Years Ended December 31, 2012 and 2011

<i>(in thousands of U.S. dollars) (Note 33)</i>	Notes	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
Balance at January 1, 2012		\$ 891,569	\$ 3,344	\$ (320,719)	\$ 453,666	\$ 2,500,993	\$ 713,040	\$ 4,241,893
Comprehensive Income								
Profit for the year		-	-	-	-	-	717,429	717,429
Other comprehensive income(loss)								
Change in value of available-for-sale financial assets		-	-	-	-	1,140	-	1,140
Actuarial gain(loss) on defined benefit liability		-	-	-	-	-	(16,818)	(16,818)
Total other comprehensive income (loss)		-	-	-	-	1,140	(16,818)	(15,678)
Total comprehensive income (loss)		-	-	-	-	1,140	700,611	701,751
Transactions with equity holders of the Company								
Cash dividends		-	-	-	-	-	(375,685)	(375,685)
Reissuance of treasury shares		-	-	4,167	5,705	-	-	9,872
Other reserve		-	-	-	-	335,169	(335,169)	-
Total transactions with equity holders of the Company		-	-	4,167	5,705	335,169	(710,854)	(365,813)
Balance at December 31, 2012		\$ 891,569	\$ 3,344	\$ (316,552)	\$ 459,371	\$ 2,837,302	\$ 702,797	\$ 4,577,831

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

KT&G Corporation
Separate Statements of Cash Flows
Years Ended December 31, 2012 and 2011

	Notes	2012 Korean won	2012 U.S. dollars (Note 33)	2011 Korean won
<i>(in millions of Korean won and thousands of U.S. dollars)</i>				
Cash flows from operating activities				
Cash generated from operations	30	₩ 1,050,604	\$ 980,864	₩ 952,067
Income tax paid		(249,623)	(233,053)	(290,179)
Net cash generated from operating activities		<u>800,981</u>	<u>747,811</u>	<u>661,888</u>
Cash flows from investing activities				
Interest received		29,280	27,336	28,130
Investment income received from long-term deposits in MSA Escrow Fund		407	380	10,582
Dividends received		8,903	8,312	57,116
Proceeds from sale of property, plant and equipment		30,922	28,870	31,650
Proceeds from sale of intangible assets		401	375	24,253
Proceeds from sale of assets held for sale		35,566	33,205	977
Proceeds from sale of available-for-sale financial assets		296	276	2,570
Proceeds from sale of investments in subsidiaries		900	840	873
Decrease in loans		36,797	34,355	17,208
Decrease in guarantee deposits		52,744	49,243	29,722
Acquisition of property, plant and equipment		(155,205)	(144,903)	(165,737)
Acquisition of intangible assets		(1,727)	(1,612)	(4,133)
Acquisition of investment property		(51)	(49)	(2,136)
Acquisition of investments in associates		(21,000)	(19,606)	(16,595)
Acquisition of investments in subsidiaries		(77,389)	(72,251)	(214,813)
Acquisition of available-for-sale financial assets		(16,500)	(15,405)	(22,220)
Increase in loans		-	-	(82,225)
Increase in guarantee deposits		(54,547)	(50,926)	(31,390)
Increase in long-term deposits in MSA Escrow Fund		(34,096)	(31,833)	(15,150)
Increase in other financial assets		(620,000)	(578,844)	-
Net cash used in investing activities		<u>(784,298)</u>	<u>(732,236)</u>	<u>(351,318)</u>
Cash flows from financing activities				
Dividends paid	29	(402,396)	(375,685)	(382,946)
Acquisition of treasury shares		-	-	(129,671)
Increase in deposits received		5,651	5,276	10,631
Decrease in deposits received		(4,819)	(4,499)	(6,340)
Reissuance of treasury shares		12,525	11,694	7,980
Net cash used in financing activities		<u>(389,039)</u>	<u>(363,214)</u>	<u>(500,346)</u>
Net decrease in cash and cash equivalents		(372,356)	(347,639)	(189,776)
Cash and cash equivalents at the beginning of year		639,097	596,674	828,951
Exchange gains/(losses) on cash and cash equivalents		(21)	(20)	(78)
Cash and cash equivalents at the end of year		<u>₩ 266,720</u>	<u>\$ 249,015</u>	<u>₩ 639,097</u>

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

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

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

1. General Information

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

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

As of December 31, 2012, the Company has two manufacturing plants, including the Shintanjaen plant, and 14 local headquarters and 135 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Company is located in Pyeongchon-dong, Daedeok-gu, Daejeon.

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

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

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

The ownership of the Company's issued ordinary shares as of December 31, 2012, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee share ownership association	2,706,848	1.97%
Others	113,681,467	82.80%
Treasury shares	125,898,800	91.70%
	11,393,697	8.30%
	137,292,497	100.00%

2. Significant Accounting Policies

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

2.1 Basis of Preparation

The Company maintains its accounting records in Korean won and prepares statutory financial statements in the Korean language (Hangul) in accordance with the International Financial Reporting Standards as adopted by the Republic of Korea ("Korean IFRS"). The accompanying separate financial statements have been condensed, restructured and translated into English from the Korean language financial statements.

Certain information attached to the Korean language financial statements, but not required for a fair presentation of the Company's financial position, financial performance or cash flows, is not presented in the accompanying separate financial statements.

The Company's financial statements for the annual period beginning on January 1, 2009, have been prepared in accordance with Korean IFRS. These are the standards, subsequent amendments and related interpretations issued by the International Accounting Standards Board ("IASB") that have been adopted by the Republic of Korea.

The preparation of the separate financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the separate financial statements are disclosed in Note 3.

2.1.1 Changes in Accounting Policy and Disclosures

(a) New and amended standards adopted by the Company

The Company changed its accounting policy to present the operating income after deducting cost of sales, and selling and administrative expenses from revenue, in accordance with the amendment of Korean IFRS 1001, *Presentation of Financial Statements*.

The Company applies the accounting policy retroactively in accordance with the amended standards and the comparative statement of the comprehensive income is restated by reflecting adjustments resulting from the retrospective application. As a result of the changes in the accounting policy, other income and expenses of ₩92,651 million and ₩91,014 million,

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

respectively, for the year ended December 31, 2012 (2011: ₩97,497 million and ₩62,217 million, respectively), which include gain or loss on disposal of property, plant and equipment, gain or loss on disposal of investments in associates and others, classified as operating income under the previous standard, were excluded from operating income. Consequently, operating income for the years ended December 31, 2012 and 2011, decreased by ₩1,637 million and ₩35,280 million, respectively, as compared to the amounts under the previous standard. However, there is no material impact on net income and earnings per share for the years ended December 31, 2012 and 2011.

(b) New standards and interpretations not yet adopted

New standards, amendments and interpretations issued but not effective for the financial year beginning January 1, 2012, and not early adopted by the Company are as follows:

- Amendment of Korean IFRS 1001, Presentation of Financial Statements

Korean-IFRS 1001, *Presentation of Financial Statements*, was amended to require other comprehensive income items to be presented into two groups on the basis of whether they are potentially reclassifiable to profit or loss subsequently. This is effective for annual periods beginning on or after July 1, 2012, with early adoption permitted. The Company expects that the application of this amendment would not have a material impact on its separate financial statements.

- Amendments to Korean IFRS 1019, Employee Benefits

According to the amendments to Korean IFRS 1019, *Employee Benefits*, the use of a 'corridor' approach is no longer permitted, and therefore all actuarial gains and losses incurred are immediately recognized in other comprehensive income. All past service costs incurred from changes in pension plan are immediately recognized, and expected returns on interest costs and plan assets that used to be separately calculated are now changed to calculating net interest expense (income) by applying discount rate used in measuring defined benefit obligation in net defined benefit liabilities (assets). This amendment will be effective for annual periods beginning on or after January 1, 2013, and the Company is assessing the impact of application of the amended Korean IFRS 1019 on its separate financial statements as of the report date.

- Enactment of Korean IFRS 1113, Fair Value Measurement

Korean IFRS 1113, *Fair value measurement*, aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across Korean IFRSs. Korean IFRS 1113 does not extend the use of fair value accounting but provides guidance on how it should be applied where its use is already required or permitted by other standards within the Korean IFRSs. This amendment will be effective for annual periods beginning on or after January 1, 2013, and the Company expects that the application of this enactment would not have a material impact on its separate financial statements.

2.2 Subsidiaries and associates

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

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

2.3 Segment Reporting

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

2.4 Foreign Currency Translation

(a) Functional and presentation currency

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

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of comprehensive income, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the statement of comprehensive income within 'financial income or expenses'. All other foreign exchange gains and losses are presented in the statement of comprehensive income within 'other gains and losses, net'.

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analyzed between translation differences resulting from changes in the amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortized cost are recognized in profit or loss, and other changes in carrying amount are recognized in other comprehensive income.

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognized in profit or loss as part of the fair value gain or loss.

Translation differences on non-monetary financial assets, such as equities classified as available-for-sale, are included in other comprehensive income.

2.5 Cash and Cash Equivalents

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

2.6 Financial Assets

2.6.1 Classification

The Company classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, available-for-sale, and held-to-maturity. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

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

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives or embedded derivatives are also categorized as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. The Company's loans and receivables comprise 'cash and cash equivalents', 'trade and other receivables', and 'other financial assets' in the statement of financial position.

(c) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of them within 12 months after the end of the reporting period.

(d) Financial liabilities carried at amortized cost

The Company classifies non-derivative financial liabilities, except for financial liabilities at fair value through profit or loss, financial guarantee contracts and financial assets that arise when a transfer of financial liabilities at fair value through profit or loss, financial guarantee contracts and financial assets does not qualify for derecognition, as financial liabilities carried at amortized cost. Financial liabilities carried at amortized cost are included in non-current liabilities, except for liabilities with maturities within 12 months after the end of the reporting period, which are classified as current liabilities.

2.6.2 Recognition and Measurement

Regular purchases and sales of financial assets are recognized on the trade date. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the statement of comprehensive income. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are subsequently carried at amortized cost using the effective interest rate method.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the statement of comprehensive income as 'financial gains and losses, net'.

Interest on available-for-sale and held-to-maturity securities calculated using the effective interest method is recognized in the statement of comprehensive income as part of 'financial income'. Dividends on available-for-sale equity instruments are recognized in the statement of comprehensive income as part of 'financial income' when the Company's right to receive dividend payments is established.

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

2.6.3 Offsetting financial instruments

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

2.7 Impairment of Financial Assets

(a) Assets carried at amortized cost

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

The criteria that the Company uses to determine that there is objective evidence of an impairment loss include:

- Significant financial difficulty of the issuer or obligor;
- Delinquency in interest or principal payments for more than three months;
- For economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- It becomes probable that the borrower will enter bankruptcy or other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties; or
- Observable data suggesting that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, even though the decrease cannot be identified with respect to individual financial assets in the portfolio, such as:
 - (i) adverse changes in the payment status of borrowers in the portfolio;
 - (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

Impairment loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted using the initial effective interest rate. The carrying amount of the asset is reduced by the impairment loss amount and the amount of the loss is recognized in the statement of comprehensive income. In practice, the Company may measure impairment loss based on the fair value of financial asset using an observable market price.

If, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (for example, an improvement in debtor's credit rating), the reversal of the previously recognized impairment loss is recognized in the statement of comprehensive income.

(b) Assets classified as available-for-sale

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. For debt securities, the Company uses the criteria refer to in (a) above. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost, for example decrease in fair value of the investments by more than 30% from its cost for more than six months, is also evidence that the asset is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

profit or loss – is removed from equity and recognized in the statement of comprehensive income. Impairment losses recognized in the separate statement of comprehensive income on equity instruments are not reversed through the statement of comprehensive income. 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 through the statement of comprehensive income.

2.8 Trade Receivables

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

2.9 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 ₩ 347,489 million and ₩ 385,459 million as of December 31, 2012 and 2011, respectively.

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

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

2.11 Property, Plant and Equipment

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

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

replaced part is derecognized. All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

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

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

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

2.12 Borrowing Costs

General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization. All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

2.13 Government Grants

Grants from a government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions.

Government grants relating to costs are deferred and recognized in the statement of comprehensive income over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to property, plant and equipment are presented as a deduction of related assets and are credited to depreciation over the expected lives of the related assets.

2.14 Intangible Assets

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

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

The estimated useful lives are as follows:

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

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

2.15 Investment Property

Investment property is held to earn rentals or for capital appreciation or both. Investment property also includes property that is being constructed or developed for future use as investment property. Investment property is measured initially at its cost including transaction costs incurred in acquiring the asset. After recognition as an asset, investment property is carried at cost less accumulated depreciation and impairment losses.

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

Land held for investment is not depreciated. Investment property, except for land, is depreciated using straight-line method over their useful lives from ten to 60 years.

The depreciation method, the residual value and the useful life of an asset are reviewed at the end of each financial year and, if management judges that previous estimates should be adjusted, the change is accounted for as a change in an accounting estimate.

2.16 Impairment of Non-financial Assets

Goodwill or intangible assets with indefinite useful lives are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets, other than goodwill, that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.17 Trade Payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

2.18 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of comprehensive income over the period of the borrowings using the effective interest method. The Company recognizes borrowings as current assets unless it has an unconditional right to delay the settlement of the borrowing. Preference shares, which are mandatorily redeemable on a specific date, are classified as liabilities. The dividends on these preference shares are recognized in the statement of comprehensive income as 'finance expense'.

2.19 Compound Financial Instruments

Compound financial instruments issued by the Company comprise convertible notes that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

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

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition except on conversion or expiry.

2.20 Provisions

Provisions are recognized when: the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

2.21 Current and Deferred Income Tax

The tax expense for the period comprises current and deferred tax. Tax is recognized in the statement of comprehensive income, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position date in the countries where the Company operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

between the tax bases of assets and liabilities and their carrying amounts in the separate financial statements. However, deferred tax assets and liabilities are not recognized if they arise from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

2.22 Employee Benefits

(a) Defined benefit liability

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

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

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

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

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

(b) Termination benefits

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

2.23 Share Capital

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

2.24 Revenue Recognition

The Company's revenue categories consist of goods sold, services and other income. Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the years ended December 31, 2012 and 2011, were ₩ 3,508,517 million and ₩ 3,374,958 million, respectively.

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

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

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

In addition, interest is recognized using the effective interest method, royalties are recognized on

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

an accrual basis in accordance with the substance of the relevant agreement and dividends are recognized when the shareholders' right to receive the dividend is established.

2.25 Lease

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

2.26 Dividend Distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

2.27 Dividend Distribution

The issuance of the December 31, 2012 financial statements of the Company was approved by the Board of Directors on 17 January 2013.

3. Critical Accounting Estimates and Judgments

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. Estimations and assumptions are continuously evaluated with consideration to factors such as events reasonably predictable in the foreseeable future within the present circumstance according to historical experience. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Income taxes

The Company recorded, based on its best estimate, current taxes and deferred taxes that the Company will be liable in the future for the operating results as of the financial year end. However, the final tax outcome in the future may be different from the amounts that were initially recorded. Such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

(b) Fair value of financial instruments

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company uses its judgment to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.

(c) Defined benefit liability

The present value of the defined benefit liability depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of the defined benefit liability. The Company determines the appropriate discount rate at the end of each year. This is the interest rate that is used to determine the present value of estimated future cash outflows expected to be required to settle the defined benefit liability. In determining the appropriate discount rate, the Company considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the pension benefits will be paid, and that have terms to maturity approximating to the

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

terms of the related pension liability. Other key assumptions for defined benefit liability are based in part on current market conditions. Additional information is disclosed in Note 23.

4. Financial Risk Management

4.1 Financial Risk Factors

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

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

(a) Market Risk

i) Foreign exchange risk

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

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of December 31, 2012 and 2011, are as follows:

	(in millions of Korean won)									
	December 31, 2012					December 31, 2011				
	USD	EUR	RUB	THBQDR	USD	EUR	RUB	THB		
Assets										
Cash and cash equivalents	₩ 10,695	₩ 1	₩ -	₩ -	₩ 24,198	₩ 37	₩ -	₩ -		
Trade and other receivables	497,705	23,059	2,156	290	419,781	17,078	10,389	60		
Long-term deposits	168,667	-	-	-	147,290	-	-	-		
	₩ 677,067	₩ 23,060	₩ 2,156	₩ 290	₩ 591,269	₩ 17,115	₩ 10,389	₩ 60		
Liabilities										
Trade and other payables	₩ 3,047	₩ 1,896	₩ -	₩ -	₩ 3,194	₩ 4,281	₩ -	₩ -		
	₩ 3,047	₩ 1,896	₩ -	₩ -	₩ 3,194	₩ 4,281	₩ -	₩ -		

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

As of December 31, 2012 and 2011, the effects of a 10% strengthening or weakening of functional currency against the US dollar other than functional currency on profit before tax were as follows:

(in millions of Korean won)	2012		2011	
	10% strengthening	10% weakening	10% strengthening	10% weakening
US dollar	₩ 67,402	(67,402)	₩ 58,808	₩ (58,808)

ii) Price risk

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

As of December 31, 2012 and 2011, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income are as follows:

(in millions of Korean won)	2012				2011			
	5% increase		5% decrease		5% increase		5% decrease	
Other comprehensive income before tax	₩	5,266	₩	(5,266)	₩	8,464	₩	(8,464)
Tax effect		(1,274)		1,274		(2,048)		2,048
Other comprehensive income after tax	₩	3,992	₩	(3,992)	₩	6,416	₩	(6,416)

iii) Interest rate risk

The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation.

(b) Credit Risk

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

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of December 31, 2012 and 2011, is as follows:

(in millions of Korean won)	2012	2011
Available-for-sale financial assets	₩ 2,500	₩ 2,044
Long-term deposits in MSA Escrow Fund		168,667
Trade and other receivables		872,572
Other financial assets		620,000
Cash and cash equivalents	266,720	639,097

Notes to Separate Financial Statements

23

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

4.3 Fair Value Estimation

The table below analyzes financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

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

The following table presents the Company's financial assets and financial liabilities that are measured at fair value as of December 31, 2012:

<i>(in millions of Korean won)</i>	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale financial assets	₩188,297	₩ 47,440	₩ 12,213	₩ 247,950

The following table presents the Company's assets and liabilities that are measured at fair value as of December 31, 2011:

<i>(in millions of Korean won)</i>	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale financial assets	₩ 187,312	₩ 42,604	₩ 12,009	₩ 241,925

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

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

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

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the statement of financial position date, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

5. Financial Instruments by Category

Categorizations of financial assets as of December 31, 2012 and 2011, are as follows:

	2012				
(in millions of Korean won)	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for-sale	Total
Cash and cash equivalents	₩ 266,720	₩ -	₩ -	₩ -	₩ 266,720
Financial assets as available-for-sale, current	-	-	-	1,000	1,000
Trade and other receivables, current	726,397	-	-	-	726,397
Other financial assets, current	620,000	-	-	-	620,000
Long-term deposits	168,667	-	-	-	168,667
Financial assets as available-for-sale, non-current	-	-	-	263,544	263,544
Long-term trade and other receivables	146,174	-	-	-	146,174
	₩ 1,927,958	₩ -	₩ -	₩ 264,544	₩ 2,192,502
2011					
(in millions of Korean won)	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for-sale	Total
Cash and cash equivalents	₩ 639,097	₩ -	₩ -	₩ -	₩ 639,097
Financial assets as available-for-sale, current	-	-	-	1,044	1,044
Trade and other receivables, current	625,756	-	-	-	625,756
Long-term deposits	147,290	-	-	-	147,290
Financial assets as available-for-sale, non-current	-	-	-	247,018	247,018
Long-term trade and other receivables	199,031	-	-	-	199,031
	₩ 1,611,174	₩ -	₩ -	₩ 248,062	₩ 1,859,236

Categorizations of financial liabilities as of December 31, 2012 and 2011, are as follows:

2012						
(in millions of Korean won)	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total	
Borrowings, current	₩ -	₩ -	₩ 5,477	₩ -	₩	5,477
Trade and other payables, current	-	-	145,309	-		145,309
Trade and other payables, non-current	-	-	27,325	-		27,325
	₩ -	₩ -	₩ 178,111	₩ -	₩	178,111

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

	2011				
	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total
(in millions of Korean won)					
Borrowings, current	₩ -	₩ -	₩ 6,975	₩ -	₩ 6,975
Trade and other payables, current	-	-	130,523	-	130,523
Trade and other payables, non-current	-	-	26,628	-	26,628
	₩ -	₩ -	₩ 164,126	₩ -	₩ 164,126

Income and loss of financial instruments by category for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Available-for-sale financial assets		
Gain(Loss) on valuation (Other comprehensive income(loss))	1,220	(49,889)
Gain(Loss) on disposal (Profit or loss)	(287)	643
Interest income	229	69
Dividend income	8,903	56,726
Impairment	-	-
Cash and cash equivalents		
Interest income	26,097	27,904
Gain(Loss) on foreign currency translation	(20)	3,573
Foreign currency transaction gain (loss)	(1,654)	6,588
Trade and other receivables		
Interest income	10,099	2,068
Gain(Loss) on foreign currency translation	(38,222)	7,893
Foreign currency transaction gain(loss)	(12,877)	(3,444)
Other financial liabilities at amortized cost		
Interest costs	(898)	(927)
Gain(Loss) on foreign currency translation	24	71
Foreign currency transaction gain (loss)	1,229	526

6. Available-for-sale Financial Assets

The changes in available-for-sale financial assets as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
At January 1	₩ 248,062	₩ 314,937
Additions	16,500	22,219
Disposals	(1,628)	(1,928)
Net gains(losses) transfer to equity	1,610	(65,145)
Transfer to others	-	(18,033)
Impairment losses	-	(3,988)
At December 31	₩ 264,544	₩ 248,062
Less: current portion	(1,000)	(1,044)
Non-current portion	₩ 263,544	₩ 247,018

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

Available-for-sale financial assets as of December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Available-for-sale debt instruments:		
Government and municipal bonds	₩ -	₩ 44
Corporate bonds	2,500	2,000
Total available-for-sale debt instruments	2,500	2,044
Available-for-sale equity instruments:		
Listed		
Yonhap Television News(NTN)	29,581	23,130
Oscotech, Inc.	869	2,049
Shinhan Financial Group Co., Ltd.	155,725	159,332
Rexahn Pharmaceuticals, Inc.	2,122	2,801
	188,297	187,312
Unlisted		
Dream Hub PFV Co., Ltd.	12,213	12,009
Others	61,534	46,697
	73,747	58,706
	262,044	246,018
Total available-for-sale equity instruments	₩ 264,544	₩ 248,062
Total available-for-sale financial assets		

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

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

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

7. Trade and Other Receivables

Trade and other receivables as of December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 7,186	₩ 22,408	₩ 13,421	₩ 32,339
Loans	6,453	71,216	7,123	108,461
Other receivables	82,335	15,128	60,457	22,281
Guarantee deposits	-	37,422	-	35,950
Accrued income	8,291	-	4,051	-
	622,131	-	540,704	-
Trade receivables	₩ 726,396	₩ 146,174	₩ 625,756	₩ 199,031

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

Trade and other receivables as of December 31, 2012 and 2011, reported in the separate statements of financial position, net of allowances, are as follows:

(in millions of Korean won)	2012		2011	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 746,111	₩ 146,174	₩ 631,121	₩ 199,031
Allowance account				
-Other receivables	(2,083)	-	(2,083)	-
-Trade receivables	(17,631)	-	(3,282)	-
	(19,714)	-	(5,365)	-
Net amount	₩ 726,397	₩ 146,174	₩ 625,756	₩ 199,031

Changes in the allowance account for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012		2011	
Beginning	₩	5,365	₩	5,184
Impairment		14,349		181
Reversal of impairment		-		-
Write-off		-		-
Ending	₩	19,714	₩	5,365

The aging schedule of trade and other receivables as of December 31, 2012 and 2011, is as follows:

(in millions of Korean won)	2012		2011	
Not past due	₩	413,203	₩	406,483
Past due but not impaired				
Within 1 month		46,417		26,792
Between 1 and 2 months		34,941		36,245
Beyond 2 months		251,14		71,184
		106,472		134,221
		120,087		3,282
Impaired	₩	639,762	₩	543,986

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

Details of trade and other receivables that are measured at amortized cost as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012		2011	
	Effective interest rate(%)	Current	Non-current	Effective interest rate(%)
Loans to employees	3.00~5.68	₩ 7,186	₩ 22,408	3.00~5.68
Other receivables	3.79	8,300	15,128	3.79
Guarantee deposits	3.00~5.68	-	37,422	3.00~5.68
		₩ 15,486	₩ 74,958	
				₩ 21,418
				₩ 90,570

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

Transferred trade receivables

The Company discounted its trade receivables through trade receivable factoring agreements with National Agricultural Cooperative Federation and other financial institutions in relation with the collecting sales payments with tobacco card.

In case the customers default, the Company has an obligation to pay the related amount to the bank. As a result, this transaction treated as a transaction with recourse, has been accounted for as collateralized borrowings. The borrowings recognized in relation to the said transaction as of December 31, 2012 and 2011, are ₩ 5,477 million and ₩ 6,975 million, respectively (Note 22).

8. Long-term Deposits

Long-term deposits of December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
MMF	₩ 10,496	₩ 147,290
T-note	158,170	-
	₩ 168,666	₩ 147,290

As discussed in Note 31 to the separate financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the years ended December 31, 2012 and 2011, are ₩34,096 million and ₩15,150 million, respectively.

Investment income on long-term deposits in MSA Escrow Fund for the years ended December 31, 2012 and 2011, are ₩18 million and ₩6,658 million, respectively.

9. Property, Plant and Equipment

Changes in property, plant and equipment for the years ended December 31, 2012 and 2011, are as follows:

	2012		
<i>(in millions of Korean won)</i>	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 397,900	-	₩ 397,900
Buildings	637,516	(242,627)	394,889
Structures	40,729	(24,013)	16,716
Machinery	911,778	(649,931)	261,847
Vehicles	2,596	(2,067)	529
Tools	32,768	(30,035)	2,733
Furniture and fixture	179,214	(142,407)	36,807
Others	1,115	-	1,115
Construction-in-progress	50,684	-	50,684
	₩ 2,254,300	₩ (1,091,080)	₩ 1,163,220

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

(in millions of Korean won)	2011		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩	₩	₩
Buildings	397,775	-	397,775
Structures	655,717	(244,500)	411,217
Machinery	45,445	(26,407)	19,038
Vehicles	846,600	(592,116)	254,484
Tools	3,902	(3,199)	703
Furniture and fixture	31,795	(29,175)	2,620
Others	171,630	(135,268)	36,362
Construction-in-progress	1,078	-	1,078
	40,084	-	40,084
	₩ 2,194,026	₩ (1,030,665)	₩ 1,163,361

(in millions of Korean won)	2012					
	Opening net book value	Additions	Disposal	Transfer	Depreciation charge	Net book amount
Land	₩ 397,775	₩ 3,898	₩ (11,808)	₩ 8,035	₩ -	₩ 397,900
Buildings	411,217	5,623	(7,168)	12,122	(26,905)	39,889
Structures	19,038	435	(329)	(216)	(2,212)	16,716
Machinery	254,484	16,671	(1,193)	53,014	(61,129)	264,847
Vehicles	703	240	(121)	-	(293)	529
Tools	2,620	1,468	(8)	153	(1,500)	2,733
Furniture and fixture	36,362	18,741	(126)	449	(18,619)	36,807
Others	1,078	-	-	37	-	1,115
Construction-in-progress	40,084	108,129	-	(97,529)	-	50,684
	₩ 1,163,361	₩ 155,205	₩ (20,753)	₩ (23,935)	₩ (110,658)	₩ 1,163,220

(in millions of Korean won)	2011					
	Opening net book value	Additions	Disposal	Transfer	Depreciation charge	Net book amount
Land	₩ 379,002	₩ 192	₩ (10,796)	₩ 29,377	₩ -	₩ 397,775
Buildings	385,189	43,058	(1,521)	8,066	23,575	411,217
Structures	20,485	492	(183)	15,456	(2,212)	19,038
Machinery	280,371	5,881	(1,891)	29,345	(59,222)	254,484
Vehicles	592	263	-	166	(318)	703
Tools	3,992	378	(1)	393	(21,142)	2,620
Furniture and fixture	43,413	13,384	(3)	1,740	(2,217)	36,362
Others	607	-	(10)	481	-	1,078
Construction-in-progress	82,475	102,089	-	(144,480)	-	40,084
	₩ 1,196,126	₩ 165,737	₩ (14,405)	₩ (74,456)	₩ (109,641)	₩ 1,163,361

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

10. Intangible Assets

Changes in intangible assets for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012				
	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development	Total
At January 1, 2012	₩ 1,323	₩ 15,946	₩ -	₩ 1,703	₩ 18,972
Additions	190	640	-	-	830
Transfer-in(out)	213	-	-	(213)	-
Disposals	(70)	(1)	-	(667)	(738)
Amortization	(24)	-	-	-	(24)
Other Changes	-	-	-	897	897
Acquisition Cost	6,920	16,585	-	1,720	25,225
Accumulated depreciation and impairment cost	(5,288)	-	-	-	(5,288)
Net book amount	₩ 1,632	₩ 16,585	₩ -	₩ 1,720	₩ 19,937

(in millions of Korean won)	2011				
	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development	Total
At January 1, 2011	₩ 1,079	₩ 16,514	₩ 1	₩ 30,970	₩ 48,564
Additions	-	2,757	-	-	2,757
Transfer-in(out)	275	-	-	(275)	-
Disposals	-	(3,325)	(1)	-	(3,626)
Amortization	(31)	-	-	-	(31)
Impairment	-	-	-	(15,914)	(15,914)
Other Changes	-	-	-	(13,078)	(13,078)
Acquisition Cost	6,541	15,946	4,073	18,264	44,824
Accumulated depreciation and impairment cost	(5,218)	-	(4,073)	(16,561)	(25,852)
Net book amount	₩ 1,323	₩ 15,946	₩ -	₩ 1,703	₩ 18,972

Research and development expenses for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012		2011	
Cost of goods sold	₩	372	₩	433
Selling and administrative expenses	₩	15,788	₩	14,014
	₩	16,160	₩	14,447

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

11. Investment Property

Changes in investment property for the years ended December 31, 2012 and 2011, are as follows:

	2012		
	Land	Building	Total
<i>(in millions of Korean won)</i>	₩	₩	₩
Beginning net book value	22,683	142,370	165,053
Subsequent expenditure	-	51	51
Transfers	(562)	(4,482)	(5,044)
Depreciation	-	(6,153)	(6,153)
Acquisition cost	22,121	172,621	194,742
Accumulated depreciation	-	(40,835)	(40,835)
Net book amount	₩ 22,121	₩ 131,786	₩ 150,907

	2011		
	Land	Building	Total
<i>(in millions of Korean won)</i>	₩	₩	₩
Beginning net book value	13,919	84,224	98,143
Subsequent expenditure	-	2,136	2,136
Transfers	8,764	60,981	69,745
Depreciation	-	(4,971)	(4,971)
Acquisition cost	22,683	179,605	202,288
Accumulated depreciation	-	(37,235)	(37,235)
Net book amount	₩ 22,683	₩ 142,370	₩ 165,053

The amounts recognized in profit or loss from investment property for the years ended December 31, 2012 and 2011, are as follows:

	2012		2011	
	₩	₩	₩	₩
<i>(in millions of Korean won)</i>				
Rental income		32,320		21,105
Direct operating expense		(7,265)		(4,971)
		₩ 25,055		₩ 16,134

Fair values and book values of investment property as of December 31, 2012 and 2011, are as follows:

	2012		2011	
	Fair value	Book value	Fair value	Book value
<i>(in millions of Korean won)</i>	₩	₩	₩	₩
Land	284,993	22,120	289,422	22,683
Building	186,671	131,787	196,258	142,370
	₩ 471,664	₩ 153,907	₩ 485,680	₩ 165,053

12. Non-current Assets Held for Sale and Discontinued Operations

The Company entered into sales contracts with Kim Jae Chil and two others on Nam Woosan Cosmo Tower's land, building and others on January 6, 2012, and with HT&D Co., Ltd. to sell the Gyeonggi branch's land, building and others on February 23, 2012.

Also, the Company has sales contracts with the city governments of Gwangju, Samcheok, Chuncheon District Court and Hansol Techno Co., Ltd, respectively on January 11, 2012, etc, regarding Gwangju, Samcheok, Yangyang and Hwasun branch's land, buildings and others. And

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

the Company has decided to invest in Korea Ginseng Corporation and KGC Yebon by contributing the land, buildings and others located in the plants in Wonju and Chungju upon approval of Board of Directors of the Company on July 31, 2012.

Changes in non-current assets held for sale for the year ended December 31, 2012, are as follows:

(in millions of Korean won)	2012					
	Land	Buildings	Structures	Machinery	Total	
At January 1, 2012						
Acquisition cost	₩ 2,273	₩ 1,429	₩ 197	₩ -	₩	3,899
Accumulated depreciation	-	(553)	(150)	-		(703)
Net book amount	₩ 2,273	₩ 876	₩ 47	₩ -	₩	3,196
Changes						
Transfer from property, plant and equipment	₩ 8,773	13,659	1,458	45		23,935
Transfer from Investment property	562	4,288	13	-		4,863
Disposals	(10,983)	(18,704)	(1,500)	(45)		(31,232)
	₩ (1,648)	₩ (757)	₩ (29)	₩ -	₩	(2,434)
At 2012						
Acquisition cost	₩ 625	₩ 215	₩ 64	₩ -	₩	904
Accumulated depreciation	-	(96)	(46)	-		(142)
Net book amount	₩ 625	₩ 119	₩ 18	₩ -	₩	762

13. Pledged Assets

The following assets were pledged as collateral for the Company's borrowings and others as of December 31, 2012:

(in millions of Korean won)				
Asset	Book amount	Borrowings	Collateralized amount	Lender /Leaseholder
Investment property	₩ 80,783	Leasehold deposits received	₩ 8,169	₩ 8,502
				Metlife Insurance Korea Co., Ltd. and 26 others

The following assets were pledged as collateral for the Company's borrowings and others as of December 31, 2011:

(in millions of Korean won)				
Asset	Book amount	Borrowings	Collateralized amount	Lender /Leaseholder
Investment property	₩ 89,705	Leasehold deposits received	₩ 6,576	₩ 7,469
				Metlife Insurance Korea Co., Ltd. and 27 others

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

14. Investments in Associates and Subsidiaries

Investments in associates and subsidiaries as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)						
	Location	Principal operation	2012		2011	
			Interest (%)	Carrying Amount	Interest (%)	Carrying Amount
Associates						
Cosmo Tobacco Co., Ltd.	Mongolia	Manufacturing and selling tobaccos	40.00	₩ -	40.00	₩ -
Lila Pharm Tech, Inc	Korea	Manufacturing and Medical supplies	25.34	1,830	25.34	1,830
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00	1,000	20.00	1,000
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	13,995	49.02	13,995
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	7,300	29.67	7,300
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	7,000	22.06	7,000
JR REIT V Co., Ltd.	China	Selling and renting of real estate	34.63	5,600	34.63	5,600
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	10,000	-	-
LSK Global Pharma Services Co., Ltd.	Korea	Research and developing new drug	23.15	1,500	-	-
JR REIT X Co., Ltd.	Korea	Selling and renting of real estate	28.78	9,500	-	-
				57,725		36,725
Subsidiaries						
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00	599,023	100.00	559,882
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceuticals	53.00	66,355	53.00	66,355
Tae-a Industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00	15,698	100.00	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	Manufacturing and selling tobaccos	99.99	54,049	99.99	54,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf Tobaccos	99.90	535	99.90	394
KT&G Pars	Iran	Manufacturing and selling tobaccos	99.99	-	99.99	5,733
KT&G Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00	110,297	100.00	110,297
KG Life & Gin Co., Ltd.	Korea	Selling ginseng	100.00	52,900	100.00	31,500
KT&G Bio Corp.	Korea	Manufacturing and selling pharmaceuticals	-	-	100.00	900
Global Trading, Inc.	USA	Selling tobaccos	100.00	4,913	100.00	4,913
Jilin Hanzheng Ginseng Co., Ltd.	China	Manufacturing and selling ginseng	100.00	31,333	100.00	23,247
Somang Cosmetics Co., Ltd. ¹	Korea	Manufacturing and selling cosmetics	60.00	60,721	60.00	60,721
Renzoluc Pte., Ltd. ²	Singapore	Manufacturing and selling tobaccos	100.00	89,756	100.00	89,756
KT&G Life Science ³	Korea	Medical researching and developing	73.94	31,232	59.48	31,232
Yebon Nongwon Agriculture Co., Ltd.	Korea	Corporate agriculture	90.00	90	90.00	90
KGC Yebon	Korea	Corporate agriculture	100.00	43,927	-	-
K-Q HongKong I., Limited ⁴	Hong Kong	Manufacturing and selling ginseng	100.00	17,761	-	-
				1,178,590		1,054,767
				₩ 1,236,315		₩ 1,091,492

KT&G Corporation

Notes to Separate Financial Statements December 31, 2012 and 2011

¹ The Company's percentage of ownership includes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership excluding convertible preferred shares, is 50.00%.

² The Company's percentage of ownership includes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership excluding convertible preferred shares, is 68.91%.

³ The Company's percentage of ownership includes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership excluding convertible preferred shares, is 59.48%.

⁴ The Company's percentage of ownership includes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership excluding convertible preferred shares, is 50.00%.

Changes in investments in associates and subsidiaries for the years ended December 31, 2012 and 2011, are as follows:

(In millions of Korean won)	2012				
	Beginning balance	Acquisition	Disposals	Other changes	Ending balance
Associates					
Cosmo Tabacco Co., Ltd.	₩ -	₩ -	₩ -	₩ -	₩ -
Lite Pharm Tech, Inc	1,830	-	-	-	1,830
Korean Carbon Finance, Inc.	1,000	-	-	-	1,000
JR CR-REIT IV Co., Ltd.	13,995	-	-	-	13,995
KVG REIT 1 Co., Ltd.	7,300	-	-	-	7,300
KOCREF REIT 17 Co., Ltd.	7,000	-	-	-	7,000
JR REIT V Co., Ltd.	5,600	-	-	-	5,600
JR REIT VIII Co., Ltd.	-	10,000	-	-	10,000
LSK Global Pharma Services Co., Ltd	-	1,500	-	-	1,500
JR REIT X Co., Ltd.	-	9,500	-	-	9,500
	36,725	21,000	-	-	57,725
Subsidiaries					
Korea Ginseng Corporation ¹	559,882	39,141	-	-	599,023
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	66,355
Tae-a Industry Co., Ltd.	15,698	-	-	-	15,698
KT&G Tulun Mamullen Sanayi ve Ticaret A.S.	54,049	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	394	141	-	-	535
KT&G Paris	5,733	-	-	(5,733)	-
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KG Life & Gin Co., Ltd	31,500	21,400	-	-	52,900
KT&G Bio Corp.	900	-	(900)	-	-
Global Trading, Inc.	4,913	-	-	-	4,913
Jilin Hanzheng Ginseng Co., Ltd.	23,247	8,086	-	-	31,333
Somang Cosmetics Co., Ltd.	60,721	-	-	-	60,721
Renzoluc Pte. Ltd.	89,756	-	-	-	89,756
KT&G Life Science	31,232	-	-	-	31,232
Yebon Nongwon	90	-	-	-	90
Agriculture Co., Ltd	-	43,927	-	-	43,927
KGC Yebon	-	17,761	-	-	17,761
K-Q HongKong I Limited	-	130,456	-	-	1,178,590
	1,054,767	130,456	(900)	(5,733)	1,178,590
	₩ 1,091,492	₩ 151,456	₩ (900)	₩ (5,733)	₩ 1,236,315

¹ The amount of acquisition during the year ended December 31, 2012, represents the

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

Company's investment in kind (Note12).

² ₩13,927 million of acquisition during the year ended December 31, 2012, represents the Company's investment in kind (Note12).

(in millions of Korean won)	2011				
	Beginning balance	Acquisition	Share of profit(loss)	Other ¹ changes	Ending balance
Associates					
Cosmo Tobacco Co., Ltd.	₩ -	-	-	₩ -	-
Lite Pharm Tech, Inc	1,830	-	-	-	1,830
Korean Carbon Finance, Inc.	1,000	-	-	-	1,000
JR CR-REIT IV Co., Ltd.	-	3,995	-	10,000	13,995
KVG REIT 1 Co., Ltd.	-	-	-	7,300	7,300
KOCREF REIT 17 Co., Ltd.	-	7,000	-	-	7,000
JR REIT V Co., Ltd.	-	5,600	-	-	5,600
	2,830	16,595	-	17,300	36,725
Subsidiaries					
Korea Ginseng Corporation	559,882	-	-	-	559,882
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	66,355
Tae-a Industry Co., Ltd.	14,198	1,500	-	-	15,698
KT&G Tutun Marmuləri Sarayı ve Ticaret A.S.	54,049	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	394	-	-	-	394
KT&G Pars	5,733	-	-	-	5,733
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KG Life & Gin Co., Ltd	22,500	9,000	-	-	31,500
KT&G Bio Corp.	900	-	-	-	900
Global Trading, Inc.	4,913	-	-	-	4,913
Purpleland Development Co., Ltd.	900	-	(900)	-	-
Jilin Hanzheng Ginseng Co., Ltd.	-	23,247	-	-	23,247
Somang Cosmetics Co., Ltd.	-	60,721	-	-	60,721
Renzoluc Pte., Ltd.	-	89,756	-	-	89,756
KT&G Life Science	-	31,232	-	-	31,232
KGC Yebon	-	90	-	-	90
	840,121	215,546	(900)	-	1,054,767
	₩ 842,951	₩ 232,141	₩ (900)	₩ 17,300	₩ 1,091,492

¹ The Company reclassified ₩17,300 million of available-for-sale financial assets to investments in associates during the year ended December 31, 2011.

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

15. Inventories

Inventories as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012			2011		
	Acquisition	Allowance	Book amount	Acquisition	Allowance	Book amount
Finished goods	₩ 83,809	₩ (574)	₩ 83,235	₩ 74,115	₩ (472)	₩ 73,643
Work in progress	15,207	-	15,207	15,373	-	15,373
Raw materials	694,871	-	694,871	752,335	-	752,335
Supplies	22,877	-	22,877	23,340	-	23,340
By-products	5,034	-	5,034	6,362	-	6,362
Goods-in-transit	44,831	-	44,831	33,059	-	33,059
Unfinished housing	227	-	227	-	-	-
Lots	6,551	-	6,551	-	-	-
	<u>₩ 873,407</u>	<u>₩ (574)</u>	<u>₩ 872,833</u>	<u>₩ 904,584</u>	<u>₩ (472)</u>	<u>₩ 904,112</u>

The cost related inventories for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Cost of sales		
-Loss(profit) on inventory valuation	₩ 102	₩ 14
-Loss on retirement of inventories	2,350	-
Other expenses		
-Loss on retirement of inventories	1,429	3,765
	<u>₩ 3,881</u>	<u>₩ 3,779</u>

16. Cash and Cash Equivalents

Cash and cash equivalents as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Cash on hand	₩ 3,405	₩ 4,298
Demand deposits	93,315	84,799
Short-term investment assets	170,000	550,000
	<u>₩ 266,720</u>	<u>₩ 639,097</u>

Other financial assets as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Short-term financial assets		
Time deposits	₩ 170,000	₩ -
Money trust	260,000	-
Certificate of deposit	190,000	-

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

₩	620,000	₩	-
---	---------	---	---

17. Equity and Share Premium

Details of share capital as of December 31, 2012 and 2011, are as follows:

<i>(in Korean won, except number of shares)</i>	2012	2011
Number of ordinary shares		
-Authorized	800,000,000	800,000,000
-Issued	137,292,497	137,292,497
Par value per share	₩ 5,000	₩ 5,000
Ordinary shares	₩ 954,959,485,000	₩ 954,959,485,000
The Company has reacquired and retired 53,699,400 shares of treasury shares. Accordingly, as of December 31, 2012, the Company's ordinary shares differ from the aggregate par value of issued shares by ₩ 268,497 million.		

Changes in the number of shares for the years ended December 31, 2012 and 2011, are as follows:

<i>(Number of shares)</i>	2012		2011	
	Ordinary shares	Treasury shares	Ordinary shares	Treasury shares
Beginning	137,292,497	(11,543,697)	137,292,497	(9,643,697)
Acquisition of treasury shares	-	-	-	(2,000,000)
Issuance of treasury shares	-	150,000	-	100,000
Ending	<u>137,292,497</u>	<u>(11,393,697)</u>	<u>137,292,497</u>	<u>(11,543,697)</u>
		<u>125,898,800</u>		<u>125,748,800</u>

No changes in the other capital surplus for the years ended December 31, 2012 and 2011.

18. Treasury Shares

Changes in the treasury shares for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Beginning	11,543,697	₩ 343,522	9,643,697	₩ 216,827
Acquisition of treasury shares	-	-	2,000,000	129,671
Issuance of treasury shares	(150,000)	(4,463)	(100,000)	(2,976)
Ending	<u>11,393,697</u>	<u>₩ 339,059</u>	<u>11,543,697</u>	<u>₩ 343,522</u>

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

Changes in gain on reissuance of treasury shares for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Beginning	₩ 485,922	₩ 482,129
Gain on reissuance of treasury shares before tax	8,061	5,004
Less: tax at 24.2%	(1,951)	(1,211)
Gain on reissuance of treasury shares, net of tax	6,110	3,793
Ending	₩ 492,032	₩ 485,922

19. Reserves

Details of reserves as of December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Available-for-sale financial assets reserve	₩ (30,635)	₩ (31,855)
Legal reserve	602,937	602,937
Voluntary reserve	2,466,732	2,107,732
	₩ 3,039,034	₩ 2,678,814

Available-for-sale financial assets reserve as of December 31, 2012 and 2011, are summarized as follows:

<i>(in millions of Korean won)</i>	2012	2011
Available-for-sale financial assets reserve before tax	₩ (40,415)	₩ (42,025)
Tax effect	9,780	10,170
Available-for-sale financial assets reserve after tax	₩ (30,635)	₩ (31,855)

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

Details of the Company's voluntary reserve as of December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Reserve for business rationalization	₩ 12,851	₩ 12,851
Reserve for research and human resource development	60,000	60,000
Reserve for business expansion	698,881	698,881
Other reserve	1,695,000	1,336,000
	₩ 2,466,732	₩ 2,107,732

Reserve for Business Rationalization

Until December 10, 2002, under the Special Tax Treatment Control Law, investment tax credits were allowed for certain investments. The Company was, however, required to appropriate from retained earnings, the amount of tax benefits received, and transfer such amount into a reserve for business rationalization. Effective December 11, 2002, the Company was no longer required to

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

establish a reserve for business rationalization despite tax benefits received for certain investments and, consequently, the existing balance is now regarded as a voluntary reserve.
Reserve for Research and Human Resource Development

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

Reserve for Business Expansion and other reserve

Reserves without specific purposes are restored to retained earnings by a resolution at a general meeting of shareholders.

20. Retained Earnings

Changes in retained earnings for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Beginning	₩ 763,738	₩ 929,140
Transfer from other reserve	(359,000)	(544,000)
Dividends	(402,396)	(382,946)
Profit for the year	768,438	775,937
Actuarial losses, net of tax	(18,014)	(14,393)
Ending	₩ 752,766	₩ 763,738

**Dates of appropriation: February 28, 2013 and February 24, 2012
for the years ended December 31, 2012 and 2011, respectively**

The appropriation of retained earnings for the years ended December 31, 2012 and 2011, is as follows:

<i>(in millions of Korean won, in Korean won for common stock)</i>	2012	2011
At January 1		
Unappropriated retained earnings carried over from prior year	₩ 2,342	₩ 2,194
Net income (loss)	768,438	775,937
Actuarial gains and losses	(18,014)	(14,393)
Transfers such as discretionary reserves	-	-
Total	₩ 752,766	₩ 763,738
Dividends		
(Cash dividend (%):	(402,876)	(402,396)
Common stock: ₩ 3,200(64%)(2011: ₩ 3,200(64%))		
Reserve for R&D	(30,000)	-
Discretionary appropriated retained earnings	(317,000)	(359,000)
Appropriation	(749,876)	(761,396)
At December 31	₩ 2,890	₩ 2,342

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

21. Accounts Payable and Other Finance Liabilities

Accounts payable and other finance liabilities as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012		2011	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	₩ 27,325	₩ -	₩ 26,628
Accounts payable	19,037	-	20,588	-
Withholdings	5,540	-	4,206	-
Value added tax withheld	115,995	-	114,247	-
Accrued expenses	105,071	-	92,386	-
Other payables	21,201	-	17,549	-
	<u>₩ 266,844</u>	<u>₩ 27,325</u>	<u>₩ 248,976</u>	<u>₩ 26,628</u>

22. Borrowings

Details of borrowings as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Current		
Bank borrowings ¹	₩ 5,477	₩ 6,975

¹ The borrowings are related to trade receivables factoring contract. In case the customers default, the Company has an obligation to pay the related amounts to the bank. As a result, this transaction, treated as a transaction with recourse, has been accounted for as a collateralized borrowing (Note 7).

Details of bank borrowings as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)					
	Creditor	Latest maturity date	Annual interest rate(%) 2012	2012	2011
Korean won	National Agricultural Cooperative Federation	Short-term Borrowings	8.06	₩ 4,575	₩ 5,468
Korean won	Kookmin Bank, other	Short-term Borrowings	-	-	1,507
Korean won	Korea Exchange Bank	Short-term Borrowings	CD(91) + 2.5%	902	-
				<u>₩ 5,477</u>	<u>₩ 6,975</u>

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

23. Defined Benefit Liability

The amounts recognized on the statements of income for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Defined benefit plans :		
Current service cost	₩ 25,255	₩ 22,931
Interest expenses	6,727	6,096
Expected return on plan assets	(5,050)	(4,473)
Effect of pension system reduction or settlement	87	489
	<u>27,019</u>	<u>25,043</u>
Defined contribution plans :		
Pension costs	1,740	1,164
Total	<u>₩ 28,759</u>	<u>₩ 26,207</u>

Retirement benefits for the year ended December 31, 2012, were ₩1,194 million (2011: ₩2,574 million). Out of total expenses, ₩9,960 million (2011: ₩9,623 million) and ₩19,992 million (2011: ₩19,158 million) were included in 'cost of sales' and 'selling and administrative expenses', respectively.

The defined benefit liability as of December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Present value of funded defined benefit liability	213,387	168,419
Present value of unfunded defined benefit liability	-	-
Fair value of plan assets	<u>(147,176)</u>	<u>(120,779)</u>
Liability in the statement of financial position	<u>₩ 66,211</u>	<u>₩ 47,640</u>

The movements in the defined benefit obligation for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Beginning balance	₩ 168,419	₩ 133,114
Current service cost	25,255	22,931
Interest cost	6,727	6,096
Gains (Losses) on settlement	87	489
Actuarial (gains)/losses (before tax)	23,893	19,028
Payments, including the amount transferred to the defined contribution plan	<u>(10,977)</u>	<u>(13,425)</u>
Changes in accrued expenses	<u>(17)</u>	<u>186</u>
Ending balance	<u>₩ 213,387</u>	<u>₩ 168,419</u>

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

The movements in the fair value of plan assets for the years ended December 31, 2012 and 2011, are as follows:

<i>(In millions of Korean won)</i>	2012	2011
Beginning balance	₩ 120,779	₩ 104,340
Expected return on plan assets	5,050	4,473
Actuarial gains/(losses) (before tax)	128	40
Payment into plan assets	29,100	20,800
Payments, including the amount transferred to the defined contribution plan	(7,345)	(9,109)
Changes in accrued expenses	(536)	235
Ending balance	₩ 147,176	₩ 120,779

Actual return on plan assets for the years ended December 31, 2012 and 2011, are ₩5,178 million and ₩4,513 million, respectively.

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

Actuarial gains and losses recognized as other comprehensive income for the years ended December 31, 2012 and 2011, are as follows:

<i>(In millions of Korean won)</i>	2012	2011
Actuarial gains (losses) before income tax	₩ (23,765)	₩ (18,988)
Income tax effects	5,751	4,595
Actuarial gains (losses) after income tax	(18,014)	(14,393)

The components of plan assets as of December 31, 2012 and 2011, are as follows:

<i>(In millions of Korean won)</i>	2012	2011
Short-term trading financial assets	₩ 83,215	₩ 4,732
Available-for-sale financial assets	63,914	65,206
Others	47	50,841
	₩ 147,176	₩ 120,779

The principal actuarial assumptions as of December 31, 2012 and 2011, are as follows:

	2012	2011
Rate of salary increases	5.00%	5.00%
Discount rate	3.30	4.10
Expected return on plan assets	4.30	4.30

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

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

<i>(In millions of Korean won)</i>			1% Increase	1% Decrease
Rate of salary increases:				
Increase(decrease) in defined benefit obligations		₩	22,045	₩ (19,362)
Increase(decrease) in retirement benefits before tax			3,384	(3,110)
Discount rate:				
Increase(decrease) in defined benefit obligations			(20,886)	24,418
Increase(decrease) in retirement benefits before tax			(1,593)	1,585
Expected rate of return on plan assets:				
Increase(decrease) in retirement benefits before tax			(1,261)	1,088

Adjustments for the differences between initial assumptions and actual figures as of December 31, 2012, 2011 and 2010, 2009, and January 1, 2008, are as follows:

<i>(In millions of Korean won)</i>	December 31, 2012	December 31, 2011	December 31, 2010	December 31, 2009	December 31, 2008	January 1, 2008
Present value of defined benefit liability	₩ 213,387	₩ 168,419	₩ 133,114	₩ 129,813	₩ 133,460	₩ 182,345
Fair value of plan assets	(147,176)	(120,779)	(104,340)	(111,519)	(85,123)	(117,986)
Deficit (Surplus) in the funded plans	66,211	47,640	28,774	18,294	48,337	64,359
Experience adjustments on plan liabilities	(7,674)	(8,432)	4,112	6,438	(24,389)	-
Experience adjustments on plan assets	128	40	(660)	(761)	(762)	-

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

24. Classification of Operating Income

(1) Material items of operating income and expense

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

(2) Employee benefit costs for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Salaries	₩ 335,650	₩ 318,247
Retirement benefits	28,759	26,207
Termination benefits	1,194	2,574
Employee welfare	40,422	35,533
	₩ 406,025	₩ 382,561

(3) Depreciation and amortization for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Depreciation	₩ 116,811	₩ 114,612
Amortization	24	31
	₩ 116,835	₩ 114,643

(4) Selling and administrative expenses for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Salaries	₩ 221,050	₩ 206,816
Retirement benefits	19,025	16,720
Termination benefits	968	2,438
Employee welfare	28,076	24,703
Travel	6,756	6,670
Communications	3,636	3,700
Utilities	8,534	7,110
Taxes and dues	14,621	13,884
Supplies	2,308	2,130
Rent	14,421	12,996
Depreciation	33,302	34,347
Amortization	24	31
Repairs and maintenance	10,154	7,893
Vehicles	9,253	8,842
Insurance	461	599
Commissions	70,239	63,677
Freight and custody	25,218	29,500
Conferences	3,997	2,860
Advertising	173,520	158,488
Training	4,560	5,054
Prizes and rewards	2,576	3,421
Normal research and development	15,788	14,014
Bad debts expense	14,349	15
	₩ 682,836	₩ 625,908

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

(5) Details of other income for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Foreign currency transaction gain	₩ 5,623	₩ 21,365
Foreign currency translation gain	44	13,085
Gain on sale of property, plant and equipment	70,781	45,502
Gain on sale of intangible assets	-	6,650
Miscellaneous revenues	16,203	10,895
	<u>₩ 92,651</u>	<u>₩ 97,497</u>

(6) Details of other expenses for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Foreign currency transaction loss	₩ 18,926	₩ 17,695
Foreign currency translation loss	38,263	1,548
Impairment loss on other receivables	-	166
Donations	20,596	17,845
Impairment loss on investments in subsidiaries	5,733	-
Loss on sale of investments in subsidiaries	-	27
Loss on sale of property, plant and equipment	4,255	2,762
Loss on sale of intangible assets	337	177
Impairment loss on intangible assets	-	15,914
Miscellaneous expenses	2,904	6,083
	<u>₩ 91,014</u>	<u>₩ 62,217</u>

25. Expenses by Nature

Expenses by nature for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Changes in inventories	₩ 31,279	₩ 86,221
Raw materials and consumables purchased	756,947	694,168
Salary and wage	335,650	318,247
Retirement and termination benefits	29,953	28,781
Depreciation charges	116,811	109,642
Amortization charges	24	31
Employee benefits	40,422	35,533
Advertising costs	173,688	158,709
Service fees	93,887	83,900
Other expenses	177,285	139,847
Total cost of sales and administrative expenses	<u>₩ 1,755,946</u>	<u>₩ 1,655,079</u>

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

26. Financial Income and Costs

Financial income and costs for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Financial cost		
Interest costs	₩ (898)	₩ (927)
Loss on sale of available-for-sale financial assets	(287)	-
Impairment loss on available-for-sale financial assets	-	(3,988)
	<u>(1,185)</u>	<u>(4,915)</u>
Financial income		
Interest income	36,425	30,041
Dividend income	8,903	56,726
Investment income on long-term deposits in MSA Escrow Fund	18	6,658
Gain on sale of available-for-sale financial assets	-	643
	<u>45,346</u>	<u>94,068</u>
Net financial income	<u>₩ 44,161</u>	<u>₩ 89,153</u>

Details of interest costs for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Trade and other payables	₩ (898)	₩ (927)

Details of interest income for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Deposits	₩ 26,097	₩ 27,904
Available-for-sale financial assets	229	69
Trade and other receivables	10,099	2,068
	<u>₩ 36,425</u>	<u>₩ 30,041</u>

27. Income Tax and Deferred Income Tax

Income tax expense for the years ended December 31, 2012 and 2011, consists of:

<i>(in millions of Korean won)</i>	2012	2011
Current tax expense:		
Current tax on profits for the year	₩ 248,195	₩ 237,986
Adjustments in respect of prior years	410	225
Total current tax	<u>248,605</u>	<u>238,211</u>
Deferred tax:		
Origination and reversal of temporary differences	(1,975)	(10,387)
Gross Income tax expense	246,630	227,824
Current tax charge/ (credited) directly to equity	3,410	18,640
Income tax expense	<u>₩ 250,040</u>	<u>₩ 246,464</u>

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

Reconciliation of net income before tax and income expense for the years ended December 31, 2012 and 2011, follows:

<i>(In millions of Korean won)</i>		2012	2011
Profit before tax		₩ 1,018,478	₩ 1,022,401
Income tax based on statutory rate		₩ 246,010	₩ 247,395
Tax effects of:			
Expenses not deductible for tax purposes		2,958	2,638
Tax credit		(2,360)	(1,752)
Adjustment in respect of prior years		410	225
Re-measurement of deferred tax expense – change in the Korean tax rate		-	8,463
Non-deduction of dividend income		(233)	(12,327)
Others		3,255	1,822
Income tax expense		₩ 250,040	₩ 246,464

The tax (charged) / credited directly to other comprehensive income and equity as of December 31, 2012 and 2011, is as follows:

<i>(In millions of Korean won)</i>		2012		2011	
		Before tax	Tax (charge) / credit	Before tax	Tax (charge) / credit
The tax (charge) / credit relating to components of other comprehensive income:					
Fair value gains(losses) from available-for-sale financial assets	₩ 1,610	₩ (390)	₩ 1,220	₩ (65,145)	₩ 15,256
Actuarial gains(losses) on retirement benefit obligations	(23,765)	5,751	(18,014)	(18,988)	4,595
	(22,155)	5,361	(16,794)	(84,133)	19,851
					(64,282)
The income tax (charged) / credited directly to equity:					
Gains (Losses) on disposal of treasury shares	8,061	(1,951)	6,110	5,004	(1,211)
	₩ (14,094)	₩ 3,410	₩ (10,684)	₩ (79,129)	₩ 18,640
					₩ (60,489)
					3,793

The analysis of deferred tax assets and deferred tax liabilities as of December 31, 2012 and 2011, is as follows:

<i>(In millions of Korean won)</i>		2012	2011
Deferred tax assets			
Deferred tax asset to be recovered after more than 12 months	₩ 73,121	₩ 63,910	
Deferred tax asset to be recovered within 12 months	25,921	21,250	
	99,042	85,160	
Deferred tax liabilities			
Deferred tax liability to be recovered after more than 12 months	(178,637)	(167,706)	
Deferred tax liability to be recovered within 12 months	(1,353)	(377)	
	(179,990)	(168,083)	
Deferred tax assets (liabilities), net	₩ (80,948)	₩ (82,923)	

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

The gross movement on the deferred income tax account for the years ended December 31, 2012 and 2011, is as follows:

<i>(In millions of Korean won)</i>	2012	2011
Beginning balance	₩ (82,923)	₩ (93,310)
Tax charged to the statement of income	(3,386)	(4,869)
Tax charge/(credit) relating to components of other comprehensive income	5,361	15,256
Ending balance	₩ (80,948)	₩ (82,923)

The movements in deferred income tax assets and liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, are as follows:

<i>(In millions of Korean won)</i>	January 1, 2012	Beginning adjustment	Credited to profit/(Charged to loss)	Charged to other comprehensive income	Charged or credited directly to equity	December 31, 2012
Deferred tax assets						
Available-for-sale financial assets	₩ 11,813	₩ (697)	₩ 2	₩ -	₩ -	₩ 11,118
Accrued expense	21,092	-	1,648	-	-	22,740
Defined benefit liabilities	2,687	148	(1,509)	5,751	-	7,077
Depreciation	3,993	-	2,269	-	-	6,262
Change in value of available-for-sale financial assets	10,169	-	-	(390)	-	9,779
Allowance for doubtful accounts	-	-	3,009	-	-	3,009
Other	1,433	-	(1,052)	-	-	381
	₩ 51,187	₩ (549)	₩ 4,367	₩ 5,361	₩ -	₩ 60,366
Deferred tax liabilities						
Investment in subsidiaries	₩ (105,472)	₩ 697	₩ -	₩ -	₩ -	₩ (104,775)
Treasury stock	(8,924)	-	116	-	-	(8,808)
Voluntary reserve	(14,520)	-	1,282	-	-	(13,238)
Provision for advanced depreciation	(5,194)	-	(9,299)	-	-	(14,493)
	₩ (134,110)	₩ 697	₩ (7,901)	₩ -	₩ -	₩ (141,314)

KT&G Corporation

Notes to Separate Financial Statements December 31, 2012 and 2011

(In millions of Korean won)		January 1, 2011	Credited to profit (Charged to loss)	Charged to other comprehensive income	Changes in tax rates	December 31, 2011				
Deferred tax assets										
Available-for-sale financial assets	₩	9,861	₩	878	₩	-	₩	1,074	₩	11,813
Accrued expense		17,863		1,312		-		1,917		21,092
Defined benefit liabilities		179		2,264		-		244		2,687
Depreciation		3,895		(265)		-		363		3,993
Foreign currency translations		1,220		(1,220)		-		-		-
Other		748		555		-		130		1,433
	₩	33,766	₩	3,524	₩	-	₩	3,728	₩	41,018
Deferred tax liabilities										
Investment in subsidiaries	₩	(95,884)	₩	-	₩	-	₩	(9,588)	₩	(105,472)
Treasury stock		(8,183)		70		-		(811)		(8,924)
Change in value of available-for-sale financial assets		(5,087)		-		15,256		-		10,169
Voluntary reserve		(13,200)		-		-		(1,320)		(14,520)
Provision for advanced depreciation		(4,722)		-		-		(472)		(5,194)
	₩	(127,076)	₩	70	₩	15,256	₩	(12,191)	₩	(123,941)

28. Earnings per Share

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

Basic earnings per ordinary share for the years ended December 31, 2012 and 2011, is as follows:

	2012		2011	
<i>(In Korean won, except number of shares)</i>				
Profit for the period	₩	768,438 million	₩	775,937 million
Weighted-average number of ordinary shares outstanding		125,756,587		126,505,112
Basic and diluted earnings per share in won	₩	6,111	₩	6,134

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

29. Dividends

Dividend distribution to the Company's shareholders amounted to ₩ 402,396 million for the year ended December 31, 2011, was paid in March 2012. A dividend in respect of the year ended December 31, 2012, of ₩ 3,200 per share, amounting to a total dividend of ₩ 402,876 million, is to be proposed at the annual general meeting on February 28, 2013. These financial statements do not reflect this dividend payable.

30. Cash Generated from Operations

(1) Cash generated from operations for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Profit	₩ 768,438	₩ 775,937
Adjustments for:		
Income tax expense	250,040	246,464
Finance costs	1,185	4,915
Finance income	(45,346)	(94,067)
Depreciation	116,811	114,612
Amortization	24	31
Retirement and termination benefits	27,019	28,781
Foreign currency translations loss	38,263	1,548
Loss on the write-down of inventories	102	14
Impairment loss on trade and other receivables	14,349	181
Loss on sale of property, plant and equipment	4,255	2,762
Loss on sale of intangible assets	337	177
Impairment loss on intangible assets	-	15,914
Loss on sale of investments in subsidiaries	-	27
Impairment loss on investments in subsidiaries	5,733	-
Other expense	3,780	3,765
Foreign currency translations gain	(44)	(13,085)
Gain on sale of property, plant and equipment	(70,781)	(45,502)
Gain on sale of intangible assets	-	(6,650)
	1,114,165	1,035,824
Changes in working capital		
Trade and other receivables	(130,454)	(97,019)
Advance payments	(4,605)	(3,575)
Prepaid expenses	(3,665)	856
Prepaid tobacco excise and other taxes	(56,340)	(21,179)
Inventories	27,397	78,197
Trade and other payables	18,077	12,531
Advance receipts	24,556	(3,776)
Tobacco excise and other taxes payable	93,686	(19,160)
Payment of retirement benefits	(32,213)	(30,632)
Cash generated from operations	₩ 1,050,604	₩ 952,067

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

(2) Non-cash transactions

<i>(in millions of Korean won)</i>	2012
Transfer to retained earnings in voluntary reserves	₩ 359,000
Reclassification of construction-in-progress to property, plant and equipment	97,529
Reclassification of property, plant and equipment to non-current assets held for sale	23,935

31. Contingencies

Each year, the Company deposits a proportion of sales of tobacco products in the United States in accordance with the Tobacco Master Settlement Agreement (MSA) under the Escrow Statute of the United States government. The MSA Escrow Funds are maintained to pay the medical expenses of tobacco purchasers who have suffered health effects as a result of smoking. The unused portion of this fund will be refunded to the Company 25 years from the date of each annual funding. The Company recorded as long-term deposits the amounts paid into the MSA Escrow Funds of state governments in the United States against potential litigation and damages related to the export of tobacco into the United States.

As of December 31, 2012, tobacco lawsuits claiming damages of ₩ 584 million are filed against the Company and the Korean government. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of December 31, 2012. Additionally, as of December 31, 2012, the company is involved in four lawsuits as a defendant for alleged damages totaling ₩ 1,518 million. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of December 31, 2012.

As of December 31, 2012, the Company has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 57,000 thousand.

As of December 31, 2012, the Company's trade receivables from the export of cigarettes are insured against non-payment up to USD 12,200 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of December 31, 2012, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries and also for an opening of L/C up to USD 40,000 thousand by Korea Exchange Bank and others.

In addition, the Company provides Customs Bond with limits in the aggregate of USD 11,400 thousand to Korea Exchange Bank, regarding an opening of L/C for import and customs with relation to a subsidiary located in U.S.A (Global Trading Inc.).

As of December 31, 2012, the Company and 28 other companies are guaranteed ₩ 240,000 million by Seoul Guarantee Insurance Co., Ltd. related to the Yongsan International Commercial Development Project.

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

KT&G Corporation
Notes to Separate Financial Statements
December 31, 2012 and 2011

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

1) Conditional put option granted to the Individual Shareholder

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

-Somang Cosmetics Co., Ltd. satisfies all the listing requirements.

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

2) Right of first refusal held by the Company

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

3) Tag-along right held by The Individual Shareholder

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

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

1) Restriction of disposal

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

2) Right of first refusal held by the Company

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

3) Tag-along right held by the Individual Shareholder

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

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

32. Related Party Transactions

The subsidiaries and parent companies of subsidiaries as of December 31, 2012 and 2011, are as follows:

Percentage of ownership (%)						
Subsidiaries	Location	Immediate parent companies	2012		2011	
			Parent companies	Subsidiaries	Parent companies	Subsidiaries
Korea Ginseng Corporation	Korea	KT&G	100.00	-	100.00	-
Yungjin Pharm. Ind. Co., Ltd.	Korea	KT&G	53.00	-	53.00	-
Tae-a Industry Co., Ltd.	Korea	KT&G	100.00	-	100.00	-
KT&G Tutun	Turkey	KT&G	99.99	-	99.99	-
Mamullen Sanayi ve Ticaret A.S.	Brazil	KT&G	99.90	-	99.90	-
Korea Tabacos do Brasil Ltda.	Iran	KT&G	99.99	-	99.99	-
KT&G Pars	Russia	KT&G	100.00	-	100.00	-
KT&G Rus L.L.C.	Korea	KT&G	100.00	-	100.00	-
KGC Life & Gin Co., Ltd	Korea	KT&G	-	-	100.00	-
KT&G Bio Corp.	Korea	KT&G	-	-	100.00	-
Global Trading, Inc.	USA	KT&G	100.00	-	100.00	-
Jilin Hanzheng Ginseng Co., Ltd.	China	KT&G	100.00	-	100.00	-
Somang Cosmetics Co., Ltd. ¹	Korea	KT&G	60.00	-	60.00	-
Renzoluc Pte., Ltd. ²	Singapore	KT&G	100.00	-	100.00	-
PT Trisakti Purwosari Makmur	Indonesia	Renzoluc Pte., Ltd.	-	60.17	-	51.00
PT Sentosa Ababi Purwosari	Indonesia	PT Trisakti Purwosari Makmur	-	99.24	-	99.24
PT Purindo Ilufa	Indonesia	PT Trisakti Purwosari Makmur	-	100.00	-	100.00
KT&G Life Science ³	Korea	KT&G	73.94	-	73.94	-
Yebon Nongwon Agriculture Co., Ltd	Korea	KT&G	90.00	-	90.00	-
KGC Yebon ⁵	Korea	KT&G	100.00	-	-	-
K-Q HongKong I, Limited ^{4,6}	HongKong	KT&G	100.00	-	-	-
Cheong Kwan Jang Taiwan Corporation	Taiwan	Korea Ginseng Corporation	-	100.00	-	100.00
Korean Red Ginseng Corp., Inc.	USA	Korea Ginseng Corporation	-	100.00	-	100.00
Korea Ginseng (China) Corp.	China	Korea Ginseng Corporation	-	100.00	-	100.00
Korea Ginseng Corporation Japan	Japan	Korea Ginseng Corporation	-	100.00	-	100.00
PT CKJ INDONESIA	Indonesia	Korea Ginseng Corporation	-	99.88	-	-

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

¹ The Company's percentage of ownership excludes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership including convertible preferred shares is 50.00%.

² The Company's percentage of ownership excludes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership including convertible preferred shares is 68.91%.

³ The Company's percentage of ownership excludes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership including convertible preferred shares is 59.48%.

⁴ The Company's percentage of ownership excludes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership including convertible preferred shares is 50.00%.

⁵ During the year ended December 31, 2012, KGC Yebon was included as a subsidiary.

⁶ During the year ended December 31, 2012, K-Q HongKong I, Limited was included as a subsidiary.

Transactions with related parties for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Sales and other income	₩ 8,680	₩ 4,856
Korea Ginseng Corporation	222	331
Yungjin Pharm. Ind. Co., Ltd.	-	11
Tae-a Industry Co., Ltd.	10,160	6,012
KT&G Tutun Mammuleri Sanayi ve Ticaret A.S.	7,228	8,500
KT&G Pars	29,177	23,420
KT&G Rus L.L.C.	1,651	1,527
KGC Life & Gin Co., Ltd	45,490	33,355
Global Trading, Inc.	325	44
Jilin Hanzheng Ginseng Co., Ltd.	5,372	-
Renzoluc Pte., Ltd.	109	-
KT&G Life Science	437	-
PT Trisakti Purwosari Makmur	-	2
Somang Cosmetics Co., Ltd.	108,851	78,058
Purchases and other expenses		
Korea Ginseng Corporation	1,971	2,286
Yungjin Pharm. Ind. Co., Ltd.	41	30
Tae-a Industry Co., Ltd.	16,221	16,088
KGC Life & Gin Co., Ltd	641	451
Somang Cosmetics Co., Ltd.	199	130
	₩ 19,073	₩ 18,985

The Company has received dividends from subsidiaries. For the year ended December 31, 2012, there were no dividends received from Korea Ginseng Corp.

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2012 and 2011

Dividends received in the year ended December 31, 2011, amounted to ₩50,000 million. These dividends were recognized as financial income.

The Company has decided to invest in Korea Ginseng Corporation and KGC Yebon by contributing property, plant and equipment amounted to ₩13,497 million and ₩1,145 million, respectively. As a result, the Company recognizes the gain on disposal of ₩25,644 million and ₩12,782 million, respectively (Note 12).

Details of related party receivables and liabilities as of December 31, 2012 and 2011, are as follows:

	(in millions of Korean won)	
	2012	2011
Receivables from related parties		
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	₩ 27,203	₩ 23,084
KT&G Pars	36,004	30,499
KT&G Rus L.L.C.	27,135	41,031
Global Trading, Inc.	17,274	14,574
Renzoluc Pte., Ltd.	59,404	64,045
Jilin Hanzheng Ginseng Co., Ltd.	-	9,084
Somang Cosmetics Co., Ltd.	29	2
PT Trisakti Purwosari Makmur	599	-
	<u>167,648</u>	<u>182,319</u>
Payables to related parties		
Yungjin Pharm. Ind. Co., Ltd.	₩ 1,828	₩ 2,414
Korea Ginseng Corporation	413	-
KGC Life & Gin Co., Ltd	212	192
KT&G Life Science	813	-
	<u>₩ 3,266</u>	<u>₩ 2,606</u>

The compensation paid or payable to key management for employee services for the years ended December 31, 2012 and 2011, consists of:

	(in millions of Korean won)	
	2012	2011
Short-term employee benefits	₩ 15,817	₩ 13,176
Retirement benefits	2,431	1,169
	<u>₩ 18,248</u>	<u>₩ 14,345</u>

33. Basis of Translating Financial Statements

The financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩ 1,071.1 to US\$1, the basic exchange rate on December 31, 2012, 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.

Report of Independent Accountants' Review of Internal Accounting Control System

To the President of KT&G Corporation

We have reviewed the accompanying management's report on the operations of the Internal Accounting Control System ("IACS") of KT&G Corporation (the "Company") as of December 31, 2012. The Company's management is responsible for designing and operating IACS and for its assessment of the effectiveness of IACS. Our responsibility is to review the management's report on the operations of the IACS and issue a report based on our review. The management's report on the operations of the IACS of the Company states that "based on its assessment of the operations of the IACS as of December 31, 2012, the Company's IACS has been designed and is operating effectively as of December 31, 2012, in all material respects, in accordance with the IACS standards established by the Internal Accounting Control System Operations Committee (IACSOC) of the Korea Listed Companies Association."

Our review was conducted in accordance with the IACS review standards established by the Korean Institute of Certified Public Accountants. Those standards require that we plan and perform, in all material respects, the review of management's report on the operations of the IACS to obtain a lower level of assurance than an audit. A review is to obtain an understanding of a company's IACS and consists principally of inquiries of management and, when deemed necessary, a limited inspection of underlying documents, which is substantially less in scope than an audit.

A company's IACS is a system to monitor and operate those policies and procedures designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the Republic of Korea. Because of its inherent limitations, IACS may not prevent or detect a material misstatement of the financial statements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on our review, nothing has come to our attention that causes us to believe that management's report on the operations of the IACS, referred to above, is not presented fairly, in all material respects, in accordance with the IACS standards established by IACSOC.

Our review is based on the Company's IACS as of December 31, 2012, and we did not review management's assessment of its IACS subsequent to December 31, 2012. This report has been prepared pursuant to the Acts on External Audit for Stock Companies in Korea and may not be appropriate for other purposes or for other users.

Samil PricewaterhouseCoopers
Seoul, Korea
February 5, 2013

Notice to Readers

This report is annexed in relation to the audit of the financial statements as of December 31, 2012 and the review of internal accounting control system pursuant to Article 2-3 of the Act on External Audit for Stock Companies of the Republic of Korea.