Korea Tomorrow & Global

KT&G CORPORATION

Non-Consolidated Financial Statements

December 31, 2009, December 31, 2008 and January 1, 2008

(With Independent Auditors' Report Thereon)

Contents

SAMJONG

KPMG SAMJONG Accounting Corp.
10th Floor, Gangnam Finance Center,
737 Yeoksam-dong,
Gangnam-gu, Seoul 135-984,
Republic of Korea

Tel +82 (2) 2112 0100
Fax +82 (2) 2112 0101
www.kr.kpmg.com

Independent Auditors' Report

The Board of Directors and Shareholders
KT&G Corporation:

We have audited the accompanying non-consolidated financial statements of KT&G Corporation (the "Company"), which comprise the non-consolidated statements of financial position as of December 31, 2009, December 31, 2008 and January 1, 2008, and the non-consolidated statements of comprehensive income, changes in equity and cash flows for the years all of which ended December 31, 2009 and 2008.

Management's responsibility
Management is responsible for the preparation and fair presentation of these non-consolidated financial statements in accordance with Korean International Financial Reporting Standards.

Our responsibility
Our responsibility is to express an opinion on these non-consolidated financial statements based on our audits.

Scope of Audit
We conducted our audits 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 audits provide a reasonable basis for our opinion.

Audit Opinion
In our opinion, the non-consolidated financial statements referred to above present fairly, in all material respects, the financial position of KT&G Corporation as of December 31, 2009, December 31, 2008 and January 1, 2008 and the results of its operations, the changes in its equity and its cash flows for the years all of which ended December 31, 2009 and 2008 in conformity with Korean International Financial Reporting Standards.

The accompanying non-consolidated financial statements as of and for the year ended December 31, 2009 have been translated into United States dollars solely for the convenience of the reader. We have reviewed the translation and, in our opinion, the non-consolidated financial statements expressed in Korean Won have been translated into dollars on the basis set forth in note 3 to the non-consolidated financial statements.

Without qualifying our opinion, we draw attention to the following:

As discussed in note 28 to the non-consolidated financial statements, the Company and the Korean government are defendants in lawsuits claiming damages of ₩584 million for the effects of smoking. The final outcome of these lawsuits cannot be predicted. Accordingly, no provisions have been made in accompanying non-consolidated financial statements.

As discussed in notes 2 and 33 to the non-consolidated financial statements, the Company has early-adopted Korean International Financial Reporting Standards as prescribed in the Act on External Audit of Corporation from 2009. Accordingly, the prior period non-consolidated financial statements presented for comparative purposes have been restated in accordance with Korean International Financial Reporting Standards No.1101 *First-time Adoption of Korean International Financial Reporting Standards*.

KPMG Samjong Accounting Corp.

KPMG Samjong Accounting Corp.
Seoul, Korea
February 11, 2010

This report is effective as of February 11, 2010, 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 non-consolidated 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
Non-Consolidated Statements of Financial Position

As of December 31, 2009, December 31, 2008 and January 1, 2008

In millions of Won and thousands of U.S. dollars	Note	2009 Korean Won	2009 U.S. dollars (note 3)	2008 Korean Won	January 1 2008 Korean Won
Assets					
Property, plant and equipment	4	₩ 1,210,426	$ 1,036,679	₩ 1,275,536	₩ 1,282,939
Intangible assets	5	45,041	38,576	41,260	37,284
Investment property	6	101,900	87,273	105,075	108,262
Investments in associates	7	2,830	2,424	7,277	6,777
Investments in subsidiaries	8	720,330	616,932	662,668	660,372
Available-for-sale financial assets	9, 27	441,843	378,420	301,956	252,663
Long-term deposits in MSA Escrow Fund	10, 27, 28	118,121	101,166	110,261	66,633
Long-term prepaid expenses		4,927	4,218	5,342	2,579
Long-term trade and other receivables	11, 27	106,567	91,270	122,122	128,185
Total non-current assets		2,751,985	2,356,958	2,631,497	2,545,694
Inventories	12	1,054,321	902,981	1,147,096	996,860
Trade and other receivables	11, 27	505,731	433,137	517,644	371,052
Prepaid tobacco excise and other taxes		169,440	145,118	201,774	164,376
Advance payments		10,776	9,229	21,297	243
Prepaid expenses		1,395	1,196	2,575	5,123
Current available-for-sale financial assets	9, 27	1,957	1,676	2,149	92
Other financial assets	27	-	-	1,000	1,000
Cash and cash equivalents	13, 27	268,954	230,348	88,352	115,126
		2,012,574	1,723,685	1,981,887	1,653,872
Asset held for sale	29	23,246	19,909	-	-
Total current assets		2,035,820	1,743,594	1,981,887	1,653,872
Total assets		₩ 4,787,805	$ 4,100,552	₩ 4,613,384	₩ 4,199,566

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION
Non-Consolidated Statements of Financial Position (Continued)

As of December 31, 2009, December 31, 2008 and January 1, 2008

In millions of Won and thousands of U.S. dollars	*Note*	2009 Korean Won	2009 U.S. dollars (note 3)	2008 Korean Won	January 1 2008 Korean Won
Equity					
Ordinary shares	*14*	₩ 954,959	$ 817,882	₩ 954,959	₩ 954,959
Other capital surplus	*14*	2,632	2,254	337	337
Treasury shares	*15*	(226,945)	(194,369)	(226,945)	(414,947)
Gain on reissuance of treasury shares	*15*	468,274	401,057	468,274	463,900
Reserve	*16*	2,074,108	1,776,386	1,821,348	1,738,415
Retained earnings	*17, 18*	579,963	496,714	436,453	393,213
Total equity		3,852,991	3,299,924	3,454,426	3,135,877
Liabilities					
Long-term trade and other payables	*20, 27*	24,042	20,591	24,323	26,861
Long-term advance receipts		535	458	622	-
Defined benefit liabilities	*21*	18,295	15,669	48,336	47,005
Deferred income tax liabilities	*24*	122,372	104,806	81,691	91,786
Total non-current liabilities		165,244	141,524	154,972	165,652
Short-term borrowings	*19, 27*	19,338	16,562	13,344	14,955
Trade and other payables	*20, 27*	277,616	237,766	392,964	329,262
Advance receipts		22,528	19,295	71,296	24,202
Other financial liabilities	*27*	-	-	2,699	25
Income taxes payable	*24*	100,038	85,678	153,486	183,482
Tobacco excise and other taxes payable		350,050	299,803	370,197	346,111
Total current liabilities		769,570	659,104	1,003,986	898,037
Total liabilities		934,814	800,628	1,158,958	1,063,689
Total equity and liabilities		₩ 4,787,805	$ 4,100,552	₩ 4,613,384	₩ 4,199,566

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION
Non-Consolidated Statements of Comprehensive Income

For the years ended December 31, 2009 and 2008

In millions of Won and thousands of U.S. dollars, except earnings per share	*Note*		2009 Korean Won		2009 U.S. dollars (note 3)		2008 Korean Won
Sales:	*26*						
Manufacture of tobacco		₩	2,472,054	$	2,117,210	₩	2,514,164
Real estate			258,033		220,994		21,738
Exports of leaf tobacco and others			46,316		39,668		37,240
			2,776,403		2,377,872		2,573,142
Cost of sales:	*22, 26*						
Manufacture of tobacco			(960,187)		(822,360)		(938,790)
Real estate			(165,811)		(142,010)		(3,409)
Exports of leaf tobacco and others			(28,946)		(24,791)		(23,119)
			(1,154,944)		(989,161)		(965,318)
Gross profit			1,621,459		1,388,711		1,607,824
Other income	*22*		51,395		44,018		108,361
Selling expenses	*22*		(460,792)		(394,649)		(475,044)
General and administrative expenses	*22*		(150,432)		(128,839)		(142,974)
Employee welfare fund			(10,000)		(8,565)		(15,000)
Other expense	*22*		(100,137)		(85,763)		(36,748)
Profit from operations	*26*		951,493		814,913		1,046,419
Finance income	*23*		41,607		35,635		78,393
Finance costs	*23*		(7,752)		(6,639)		(10,093)
Net finance income	*23*		33,855		28,996		68,300
Profit before income taxes			985,348		843,909		1,114,719
Income tax expense	*24*		(240,406)		(205,898)		(265,233)
Profit for the period		₩	744,942	$	638,011	₩	849,486
Other comprehensive income:							
Available-for-sale financial assets, net of tax	*9*		101,055		86,549		25,637
Actuarial gains (losses), net of tax	*21*		16,924		14,495		(31,044)
Other comprehensive income (expense) for the period, net of tax			117,979		101,044		(5,407)
Total comprehensive income for the period		₩	862,921	$	739,055	₩	844,079
Earnings per share in Won:							
Basic and Diluted	*25*	₩	5,803	$	4.97	₩	6,527

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION
Non-Consolidated Statements of Changes in Equity

For the year ended December 31, 2009

In millions of Won		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
Balance at January 1, 2009	₩	954,959	337	(226,945)	468,274	1,821,348	436,453	3,454,426
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	744,942	744,942
Other comprehensive income:								
Available-for-sale financial assets, net of tax		-	-	-	-	101,055	-	101,055
Actuarial gains, net of tax		-	-	-	-	-	16,924	16,924
Total other comprehensive income		-	-	-	-	101,055	16,924	117,979
Total comprehensive income for the period		-	-	-	-	101,055	761,866	862,921
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(360,357)	(360,357)
Reacquisition of treasury shares		-	-	(103,999)	-	-	-	(103,999)
Retirement of treasury shares		-	-	103,999	-	-	(103,999)	-
Transfer to unconditional reserve		-	-	-	-	169,000	(169,000)	-
Transfer from reserve for research and human resource development		-	-	-	-	(15,000)	15,000	-
Expiration of employee share options		-	2,295	-	-	(2,295)	-	-
Total transactions with owners		-	2,295	-	-	151,705	(618,356)	(464,356)
Balance at December 31, 2009	₩	954,959	2,632	(226,945)	468,274	2,074,108	579,963	3,852,991

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION
Non-Consolidated Statements of Changes in Equity (Continued)

For the year ended December 31, 2009

In thousands of U.S. dollars		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
Balance at January 1, 2009	$	817,882	289	(194,369)	401,057	1,559,908	373,804	2,958,571
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	638,011	638,011
Other comprehensive income:								
Available-for-sale financial assets, net of tax		-	-	-	-	86,549	-	86,549
Actuarial gains, net of tax		-	-	-	-	-	14,495	14,495
Total other comprehensive income		-	-	-	-	86,549	14,495	101,044
Total comprehensive income for the period		-	-	-	-	86,549	652,506	739,055
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(308,631)	(308,631)
Reacquisition of treasury shares		-	-	(89,071)	-	-	-	(89,071)
Retirement of treasury shares		-	-	89,071	-	-	(89,071)	-
Transfer to unconditional reserve		-	-	-	-	144,741	(144,741)	-
Transfer from reserve for research and human resource development		-	-	-	-	(12,847)	12,847	-
Expiration of employee share options		-	1,965	-	-	(1,965)	-	-
Total transactions with owners		-	1,965	-	-	129,929	(529,596)	(397,702)
Balance at December 31, 2009	$	817,882	2,254	(194,369)	401,057	1,776,386	496,714	3,299,924

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION
Non-Consolidated Statements of Changes in Equity (Continued)

For the year ended December 31, 2008

In millions of Won		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
Balance at January 1, 2008	₩	954,959	337	(414,947)	463,900	1,738,415	393,213	3,135,877
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	849,486	849,486
Other comprehensive income:								
Available-for-sale financial assets, net of tax		-	-	-	-	25,637	-	25,637
Actuarial losses, net of tax		-	-	-	-	-	(31,044)	(31,044)
Total other comprehensive income		-	-	-	-	25,637	(31,044)	(5,407)
Total comprehensive income for the period		-	-	-	-	25,637	818,442	844,079
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(340,449)	(340,449)
Reacquisition of treasury shares		-	-	(194,128)	-	-	-	(194,128)
Retirement of treasury shares		-	-	379,753	-	-	(379,753)	-
Share-based payment transaction		-	-	-	-	2,296	-	2,296
Employee benefits by treasury shares		-	-	2,377	4,374	-	-	6,751
Transfer to unconditional reserve		-	-	-	-	70,000	(70,000)	-
Transfer from reserve for research and human resource development		-	-	-	-	(15,000)	15,000	-
Total transactions with owners		-	-	188,002	4,374	57,296	(775,202)	(525,530)
Balance at December 31, 2008	₩	954,959	337	(226,945)	468,274	1,821,348	436,453	3,454,426

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION
Non-Consolidated Statements of Cash Flows

For the years ended December 31, 2009 and 2008

In millions of Won and thousands of U.S. dollars	*Note*	2009 Korean Won	2009 U.S. dollars (note 3)	2008 Korean Won
Cash flows from operating activities				
Cash generated from operations	30	₩ 1,034,124	$ 885,683	₩ 907,711
Income tax paid		(286,450)	(245,332)	(305,254)
Net cash from operating activities		747,674	640,351	602,457
Cash flows from investing activities				
Interest received		9,468	8,109	14,851
Dividends received		30,215	25,878	63,458
Proceeds from investments in associates		1	1	-
Proceeds from investments in subsidiaries		-	-	282
Proceeds from sale of available-for-sale financial assets		1,648	1,411	249
Collection of loans		23,967	20,527	7,643
Proceeds from sale of property, plant and equipment		17,972	15,392	21,867
Proceeds from sale of intangible assets		64	55	-
Purchases of investments in associates		(500)	(428)	(500)
Purchases of investments in subsidiaries		(34,233)	(29,319)	(2,498)
Purchases of available-for-sale financial assets		(11,222)	(9,611)	(18,931)
Increase in loans		(15,461)	(13,242)	(10,360)
Payments long-term deposits in MSA Escrow Fund		(18,055)	(15,463)	(17,895)
Purchases of property, plant and equipment		(96,400)	(82,563)	(136,727)
Acquisition of intangible assets		(4,769)	(4,084)	(4,507)
Acquisition of investment property		(323)	(277)	(222)
Settlement of financial derivatives		(4,410)	(3,777)	(6,320)
Cash flows from other investing activities		284	243	(2,440)
Net cash used in investing activities		(101,754)	(87,148)	(92,050)
Cash flows from financing activities				
Interest paid		(585)	(501)	(647)
Reacquisition of treasury shares		(103,999)	(89,071)	(194,128)
Dividends paid		(360,357)	(308,631)	(340,449)
Cash flows from other financing activities		(347)	(296)	(1,908)
Net cash used in financing activities		(465,288)	(398,499)	(537,132)
Net increase (decrease) in cash and cash equivalents		180,632	154,704	(26,725)
Cash and cash equivalents at beginning of year		88,352	75,670	115,126
Effect of exchange rate fluctuation on cash held		(30)	(26)	(49)
Cash and cash equivalents at end of year		₩ 268,954	$ 230,348	₩ 88,352

See accompanying notes to non-consolidated financial statements.

December 31, 2009, December 31, 2008 and January 1, 2008

1 Organization and Description of Business

KT&G Corporation (the "Company"), which is engaged in manufacturing and selling tobacco, 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 share 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, 2009, the Company has four manufacturing plants, including the Shin Tan Jin plant, and 14 local headquarters and 168 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Chunahn printing plant for the manufacturing of packaging, and has its head office 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 ordinary share of the Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program. Also, on June 25, 2009, the market of the Company's GDR was changed from the BdL Market to the Euro MTF in the Luxembourg Stock Exchange.

The ownership of the Company's issued ordinary share at December 31, 2009 is held as follows:

Shareholder	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee Share Ownership Association	5,660,022	4.12%
Treasury shares	10,093,697	7.35%
Others	112,028,293	81.60%
	137,292,497	100.00%

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies

(a) Basis of Preparation

The non-consolidated financial statements have been prepared in accordance with Korean International Financial Reporting Standards ("K-IFRS"), as prescribed in the Act on External Audit of Corporations. K-IFRS is effective from the fiscal year beginning on or after January 1, 2011 and the Company early-adopted K-IFRS from 2009.

These non-consolidated financial statements are separate financial statements which are those presented by a parent or an investor in an associate, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investee in accordance with K-IFRS No.1027 *Consolidated and Separate Financial Statements*.

The non-consolidated financial statements are the Company's first K-IFRS financial statements, with a transition date of January 1, 2008. The prior period non-consolidated financial statements presented for comparative purposes have been restated in accordance with the accounting policies described below. The effect of the transition from the Generally Accepted Accounting Principles in the Republic of Korea to K-IFRS, affecting the Company's reported financial position, financial performance and cash flows is described in note 33 to non-consolidated financial statements.

Certain information included in the Korean language non-consolidated financial statements, but not required for a fair presentation of the Company's financial position, results of operations, changes in equity or cash flows, is not presented in the accompanying non-consolidated financial statements.

(b) Basis of Measurement

The non-consolidated financial statements have been prepared under the historical cost basis except as described in the accounting policy below on financial instruments and share-based payments.

(c) Investments in Subsidiaries and Associates in the Separate Financial Statement

These non-consolidated financial statements are separate financial statements which are those presented by a parent or an investor in an associate in accordance with K-IFRS No.1027, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees. The Company accounts for investments in subsidiaries and associates at cost. The Company measures an investment in Korea Ginseng Corporation at the deemed cost which is previous GAAP carrying amount at the date of transition in accordance with K-IFRS No.1101 *First-time Adoption of Korean International Financial Reporting Standards*. Dividends on investments in subsidiaries and associates are recognized in profit or loss when the Company's right to receive payment is established.

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

(d) Foreign Currencies

These non-consolidated financial statements are presented in Korean Won, which is the Company's functional currency that is the currency of the primary economic environment in which the Company operates.

Foreign currency transactions are initially recorded using the spot exchange rate between the functional currency and the foreign currency at the date of the transaction. At the end of each reporting period, foreign currency monetary items are translated using the closing rate. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements are recognized in profit or loss in the period in which they arise. When gains or losses on non-monetary items are recognized in other comprehensive income, exchange components of that gains or losses are recognized in other comprehensive income. Conversely, when gains or losses on non-monetary items are recognized in profit or loss, exchange components of that gains or losses are recognised in profit or loss.

(e) Property, Plant and Equipment

Property, plant and equipment are measured initially at cost and after initial recognition, are carried at cost less accumulated depreciation and accumulated impairment losses. The cost of property, plant and equipment includes expenditure arising directly from the construction or acquisition of the asset, any costs directly attributable to bringing the asset to the location and condition necessary for them to be capable of operating in the manner intended by management and the initial estimate of the costs of dismantling and removing the item and restoring the site on which they are located.

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

Property, plant and equipment, except for land and other tangible fixed assets, are depreciated on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives are as follows:

	Useful lives (years)
Buildings and structures	10 ~ 60
Machinery and vehicles	4 ~ 12
Tools, furniture and fixtures	4

Each part of property, plant and equipment with a cost that is significant in relation to the total cost are depreciated separately.

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

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

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

The estimated useful lives are as follows:

	Useful lives (years)
Industrial property rights	10 ~ 20 or indefinite
Rights to facility usage	indefinite
Other intangible assets	15

The amortization period and the amortization method for intangible assets with a finite useful life are reviewed at each financial year-end. The useful lives of intangible assets that is not being amortized are reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for those assets. If it is appropriate to change, such a change is accounted for as a change in an accounting estimate.

(g) Investment Property

Properties held to earn rentals or for capital appreciation are classified as investment properties. Investment properties are measured initially at its cost including transaction costs and after initial recognition, are carried at cost less accumulated depreciation and accumulated impairment losses.

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

Investment properties, except for land, are depreciated on a straight-line basis over 10 ~ 60 years, the estimated useful lives. Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate. The change is accounted for as a change in an accounting estimate.

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

(h) Inventories

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

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

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 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 ₩145,064 million, ₩304,969 million and ₩319,217 million, respectively, as of December 31, 2009, December 31, 2008 and January 1, 2008.

(i) Non-Derivative Financial Assets

The Company classifies a non-derivative financial asset into the following four categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables or available-for-sale financial assets, relating to recognition and measurement of financial assets. The Company recognizes financial assets in the non-consolidated statement of financial position when the Company becomes a party to the contractual provisions of the financial asset. The Company derecognizes financial assets from the non-consolidated statement of financial position when the contractual rights to the cash flows from the financial asset expire or the Company transfers the contractual rights to receive the cash flows on the financial asset in a transaction in which all the risks and rewards of ownership of the financial asset are substantially transferred. If the Company retains substantially all the risks and rewards of ownership of the transferred financial assets, the Company continues to recognize the transferred financial asset and recognizes financial liabilities for the consideration received.

Non-derivative financial assets comprise investments in equity and debt securities, long-term deposits in MSA Escrow Fund, trade and other receivables and cash and cash equivalents. When non-derivative financial assets are recognized initially, the Company measures it at its fair value plus, in the case of financial assets not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset.

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

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

(i) Non-Derivative Financial Assets, Continued

Held-to-maturity Investments
Non-derivative financial assets with fixed or determinable payments and fixed maturity that the Company has the positive intention and ability to hold to maturity are classified as held-to-maturity investments. After initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method.

Loans and Receivables
Loans and receivables are trade receivables, loans and other receivables with fixed or determinable payments that are not quoted in an active market. After initial recognition, loans and receivables are measured at amortized cost using the effective interest method except for short-term receivables of which the effect of discounting is immaterial.

Available-for-sale Financial Assets
Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables. Subsequent to initial recognition, they are measured at fair value and changes therein are recognized directly in other comprehensive income, except for impairment losses and foreign exchange gains and losses on monetary available-for-sale financial asset. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost. When the financial asset is derecognized or impairment losses is recognized, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss. Dividends on an available-for-sale equity instrument are recognized in profit or loss when the Company's right to receive payment is established

Cash and Cash Equivalents
Cash and cash equivalents comprise cash on hand, demand deposits and short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date. Bank overdrafts are included as a component of cash and cash equivalents for the purpose of the non-consolidated statement of cash flows.

(j) Non-Derivative Financial liabilities

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

Non-derivative financial liabilities comprise borrowings and trade and other payables. When non-derivative financial liabilities are recognized initially, the Company measures it at its fair value minus, in the case of financial liabilities not at fair value through profit or loss, transaction costs that are directly attributable to the issue of the financial liability.

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

(j) Non-Derivative Financial liabilities, Continued

Financial Liabilities at Fair Value through Profit or Loss
Financial liabilities are classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition transaction costs are recognized in profit or loss when incurred. Financial liabilities at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

Other Financial Liabilities
Other financial liabilities are those non-derivative financial liabilities that are not classified as financial liabilities at fair value through profit or loss. After initial recognition, other financial liabilities are measured at amortized cost using the effective interest method except for short-term liabilities of which the effect of discounting is immaterial.

(k) Derivative Financial Instruments

Derivatives are recognized initially at fair value. Attributable transaction costs are recognized in profit or loss when incurred.

A hedge of the exposure to changes in fair value of a recognized asset or liability or an unrecognized firm commitment that is attributable to a particular risk is accounted for as a fair value hedge. A hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction is accounted for cash flow hedge.

At the inception of the hedge, the Company formally designates the hedging relationship and the Company's risk management objective and strategy for undertaking the hedge and documents identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Company will assess the hedging instrument's effectiveness. The Company assesses the hedge effectiveness on an ongoing basis throughout the financial reporting periods for which the hedge was designated.

Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

Fair value hedges
The gain or loss from remeasuring the hedging instrument designated as a fair value hedge at fair value and the gain or loss on the hedged item attributable to the hedged risk is recognized in profit or loss.

Cash flow hedges
The portion of the gain or loss on the hedging instrument designated as a cash value hedge that is determined to be an effective hedge is recognized in other comprehensive income and the ineffective portion of the gain or loss on the hedging instrument is recognized in profit or loss. The associated gains or losses that were recognized in other comprehensive income is reclassified from equity to profit or loss in the same period or periods during which the hedged forecast transaction affects profit or loss. If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, the associated gains and losses that were recognized in other comprehensive income are removed and included in the initial cost or other carrying amount of the asset or liability.

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

(k) Derivative Financial Instruments, Continued

If the hedging instrument expires or is sold, terminated or exercised or the hedge no longer meets the criteria for hedge accounting or the Company revokes the designation, the hedge accounting is discontinued prospectively. The cumulative gain or loss on the hedging instrument that has been recognized in other comprehensive income is reclassified from equity to profit or loss when the forecast transaction occurs. If the transaction is no longer expected to occur, the cumulative gain or loss that had been recognized in other comprehensive income is immediately reclassified from equity to profit or loss.

Changes in the fair value of derivatives that are not designated as hedging instrument or do not meet the criteria for hedge accounting are recognized immediately in profit or loss.

Derivative financial instruments, which were designed as exchange rate hedging instruments in the year ended December 31, 2008 were settled in the year ended December 31, 2009. Therefore as of December 31, 2009 the Company does not have derivative financial instruments.

(l) Non-current Assets Held for Sale

The Company classifies a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use, and measures it at the lower of its carrying amount and fair value less costs to sell.

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

The Company recognizes an impairment loss for write-down of the asset (or disposal group) to fair value less costs to sell and a gain for increase in fair value less costs to sell of an asset, but not in excess of the cumulative impairment loss that has been recognized previously in accordance with K-IFRS No.1036 *Impairment of Assets*.

(m) 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, 2009 and 2008 were ₩3,772,203 million and ₩4,000,850 million, respectively.

Revenue from the building lotting-out construction contracts is recognized upon delivery when the significant risks and rewards of ownership of the goods are transferred to the buyer.

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

(m) Revenue Recognition, Continued

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

In addition, interest is recognized using the effective interest method, royalties are recognized on an accrual basis in accordance with the substance of the relevant agreement and dividends are recognized when the shareholder's right to receive is established.

(n) Impairment of Non-financial Assets

The Company assesses at the end of each reporting period whether there is any indication that an asset may be impaired except for inventories, deferred tax assets, assets arising from employee benefits and non-current assets (or disposal groups) classified as held for sale. If any such indication exists, the Company estimates the recoverable amount of the asset. Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, irrespective of whether there is any indication that it may be impaired. If there is any indication that an asset may be impaired, recoverable amount is estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, the Company determines the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

The recoverable amount is measured as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. If the recoverable amount of an asset or cash-generating unit is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. That reduction is recognized in profit or loss.

(o) Impairment of Financial Assets

The Company assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired, except a financial asset at fair value through profit or loss. A financial asset or group of financial assets is considered to be impaired if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset. For specific financial assets such as trade receivables, if the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, it collectively assesses them for impairment. The objective evidence that the group of loans and receivables is impaired includes an increased number of delayed payments and an adverse change in national or local economic conditions that correlate with defaults on the assets in the group.

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

(o) Impairment of Financial Instruments, Continued

The amount of the impairment loss on financial assets carried at amortized cost is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognized in profit or loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. The reversal does not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal is recognized in profit or loss.

The amount of the impairment loss on financial assets carried at cost is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

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

(p) Income Taxes

Income tax expense comprises current tax expense and deferred tax expense. Current and deferred taxes are recognized as an expense included in profit or loss for the period, except to the extent that the tax arises from a transaction which is recognized in other comprehensive income or directly in equity.

Current tax expense is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period. Current tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and liabilities are recognized for temporary differences which are differences between the carrying amount of an asset or liability in the non-consolidated statement of financial position and its tax base, the carryforward of unused tax losses and unused tax credits. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted by the end of the reporting period.

The Company recognizes a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries and associates, except to the extent that the parent or investor is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future.

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

(p) Income Taxes, Continued

The Company recognizes a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries and associates, to the extent that, and only to the extent that it is probable that the temporary difference will reverse in the foreseeable future; and taxable profit will be available against which the temporary difference can be utilized.

The carrying amount of a deferred tax asset is reviewed at the end of each reporting period. The Company reduces the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of these deferred tax assets to be utilised. Such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

(q) Dividends

The dividends declared to holders of equity instruments after the reporting period are not recognized as a liability at the end of the reporting period.

(r) Equity Capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the equity transaction are recognized as a deduction from equity, net of any tax effects.

If the Company reacquires its own equity instruments, those instruments ("treasury shares") are presented as a deduction from total equity. The gain or loss on the purchase, sale, issue or cancellation of treasury shares is not recognized in profit or loss but recognized directly in equity.

(s) Provisions, Contingent Assets and Contingent Liabilities

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

The amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The risks and uncertainties that inevitably surround many events and circumstances are taken into account in reaching the best estimate of a provision. Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

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

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

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

(t) Employee Benefits

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

The Company recognizes the expected cost of profit-sharing and bonus payments if the Company has a present legal or constructive obligation to make such payments as a result of past events; and a reliable estimate of the obligation can be made.

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

Retirement Benefits: Defined Benefit Plans
The Company classifies retirement benefits plans other than defined contribution plans as defined benefit plans. The defined benefit liabilities are calculated the present value of the defined benefit obligations less the fair value of the plan assets at the end of the reporting period.

In determining the present value of its defined benefit obligations and the related current service cost, the Company uses the projected unit credit method.

With regard to actuarial gains and losses which arise from application of actuarial assumptions, the Company recognizes all actuarial gains and losses in other comprehensive income. Actuarial gains and losses recognized in other comprehensive income are recognized immediately in retained earnings and are not reclassified to profit or loss in a subsequent period.

(u) Share-based Payment

For equity-settled share-based payment transactions, the Company measures the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the Company cannot estimate reliably the fair value of the goods or services received, the Company measures their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

For cash-settled share-based payment transactions, the Company measures the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the Company remeasures the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognized in profit or loss for the period.

2 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies, Continued

(u) Share-based Payment, Continued

For share-based payment transactions in which the terms of the arrangement provide either the Company or the counterparty with the choice of whether the Company settles the transaction in cash or by issuing equity instruments, the Company accounts for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the Company has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.

(v) Earning per Share

The Company presents basic and diluted earnings per share data for its ordinary shares. Basic earnings per share are calculated by dividing the profit or loss for the period attributable to owners of the Company by the weighted-average number of shares outstanding during the period.

Diluted earnings per share are determined by adjusting the profit or loss for the period attributable to owners of the Company and the weighted-average number of shares outstanding for the effects of all dilutive potential shares, which comprise employee share options.

(w) Use of Estimates and Judgments

The preparation of non-consolidated financial statements in conformity with K-IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. These include estimates about carrying amount of property, plant and equipment, financial instruments, defined benefit obligations and deferred tax assets and liabilities. Actual results may differ from these estimates.

(x) New Standards and Interpretations Not Yet Adopted

The new and amended standards and interpretations that have been issued but are not yet effective as of December 31, 2009 have not applied in preparing the non-consolidated financial statements. These standards and interpretations will be applied for annual periods beginning on or after January 1, 2010 and are not expected to have significant impact on the non-consolidated financial statements.

3 Basis of Translating Financial Statements

The non-consolidated financial statements are expressed in Korean Won and have been translated into U.S. dollars at the rate of ₩1,167.60 to $1, the basic exchange rate on December 31, 2009, 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 United States dollars at this or any other rate.

4 Property, Plant and Equipment

(a) Changes in property, plant and equipment for the year ended December 31, 2009 were as follows:

In millions of Won		Land, buildings and structures	Machinery and vehicles	Tools, furniture, fixtures and other	Construction-in-progress	Total
Cost:						
Balance at January 1, 2009	₩	1,022,851	837,278	212,724	41,380	2,114,233
Additions		12,100	13,349	17,464	53,487	96,400
Disposals		(13,579)	(17,402)	(2,242)	-	(33,223)
Other		975	2,529	4,823	(49,420)	(41,093)
Balance at December 31, 2009	₩	1,022,347	835,754	232,769	45,447	2,136,317
Accumulated depreciation and impairment:						
Balance at January 1, 2009	₩	(206,967)	(492,017)	(139,713)	-	(838,697)
Disposals		2,918	14,756	2,151	-	19,825
Depreciation		(25,177)	(61,811)	(35,535)	-	(122,523)
Other		-	15,503	1	-	15,504
Balance at December 31, 2009	₩	(229,226)	(523,569)	(173,096)	-	(925,891)
Carrying amount:						
Balance at January 1, 2009	₩	815,884	345,261	73,011	41,380	1,275,536
Balance at December 31, 2009	₩	793,121	312,185	59,673	45,447	1,210,426

Other changes for the year ended December 31, 2009 include the carrying amount of machinery, furniture and fixtures provided as an investment in kind in KT&G Pars amounting to ₩2,343 million and the amount transferred to non-current asset held for sale amounting to ₩23,246 million.

4 Property, Plant and Equipment, Continued

(b) Changes in property, plant and equipment for the year ended December 31, 2008 were as follows:

In millions of Won		Land, buildings and structures	Machinery and vehicles	Tools, furniture, fixtures and other	Construction-in-progress	Total
Cost:						
Balance at January 1, 2008	₩	979,362	812,718	227,020	57,893	2,076,993
Additions		10,802	11,748	21,463	92,714	136,727
Disposals		(7,818)	(44,528)	(40,801)	-	(93,147)
Other		40,505	57,340	5,042	(109,227)	(6,340)
Balance at December 31, 2008	₩	1,022,851	837,278	212,724	41,380	2,114,233
Accumulated depreciation and impairment:						
Balance at January 1, 2008	₩	(187,196)	(467,409)	(139,449)	-	(794,054)
Disposals		2,133	40,003	40,335	-	82,471
Impairment		-	(429)	-	-	(429)
Depreciation		(21,904)	(64,354)	(40,599)	-	(126,857)
Other		-	172	-	-	172
Balance at December 31, 2008	₩	(206,967)	(492,017)	(139,713)	-	(838,697)
Carrying amount:						
Balance at January 1, 2008	₩	792,166	345,309	87,571	57,893	1,282,939
Balance at December 31, 2008	₩	815,884	345,261	73,011	41,380	1,275,536

Other changes for the year ended December 31, 2008 include the amount transferred to inventories and intangible assets amounting to ₩5,970 million and ₩198 million, respectively. The Company recognized ₩ 429 million of impairment loss on the machinery relating to the closure of the Namwon plant for fabrication of leaf tobacco for the year ended December 31, 2008.

5 Intangible Assets

(a) Changes in intangible assets for the year ended December 31, 2009 were as follows:

In millions of Won		Industrial property rights	Rights to facility usage	Other intangible assets	Intangible assets under development	Total
Cost:						
Balance at January 1, 2009	₩	6,133	14,616	658	25,456	46,863
Additions		42	764	-	3,963	4,769
Disposals		-	(64)	-	-	(64)
Balance at December 31, 2009	₩	6,175	15,316	658	29,419	51,568
Accumulated amortization and impairment:						
Balance at January 1, 2009	₩	(5,028)	-	(575)	-	(5,603)
Amortization		(205)	-	(72)	-	(277)
Impairment		-	-	-	(647)	(647)
Balance at December 31, 2009	₩	(5,233)	-	(647)	(647)	(6,527)
Carrying amount:						
Balance at January 1, 2009	₩	1,105	14,616	83	25,456	41,260
Balance at December 31, 2009	₩	942	15,316	11	28,772	45,041

The Company recognized ₩647 million of impairment loss on the intangible assets under development due to the relinquishment of the industrial property rights for the year ended December 31, 2009.

(b) Changes in intangible assets for the year ended December 31, 2008 were as follows:

In millions of Won		Industrial property rights	Rights to facility usage	Other intangible assets	Intangible assets under development	Total
Cost:						
Balance at January 1, 2008	₩	5,935	14,246	681	21,319	42,181
Additions		-	370	-	4,137	4,507
Other		198	-	(23)	-	175
Balance at December 31, 2008	₩	6,133	14,616	658	25,456	46,863
Accumulated amortization and impairment:						
Balance at January 1, 2008	₩	(4,415)	-	(482)	-	(4,897)
Amortization		(613)	-	(93)	-	(706)
Balance at December 31, 2008	₩	(5,028)	-	(575)	-	(5,603)
Carrying amount:						
Balance at January 1, 2008	₩	1,520	14,246	199	21,319	37,284
Balance at December 31, 2008	₩	1,105	14,616	83	25,456	41,260

5 Intangible Assets, Continued

(c) Expenditures not capitalized for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Cost of sales	₩	182	196
Selling expenses		403	2,951
General and administrative expenses		12,815	12,364
	₩	13,400	15,511

6 Investment Property

(a) Changes in investment property for the year ended December 31, 2009 were as follows:

In millions of Won		Land	Buildings	Total
Cost:				
Balance at January 1, 2009	₩	13,919	116,687	130,606
Subsequent expenditure		-	323	323
Balance at December 31, 2009	₩	13,919	117,010	130,929
Accumulated depreciation and impairment:				
Balance at January 1, 2009	₩	-	(25,531)	(25,531)
Depreciation		-	(3,498)	(3,498)
Balance at December 31, 2009	₩	-	(29,029)	(29,029)
Carrying amount:				
Balance at January 1, 2009	₩	13,919	91,156	105,075
Balance at December 31, 2009	₩	13,919	87,981	101,900

(b) Changes in investment property for the year ended December 31, 2008 were as follows:

In millions of Won		Land	Buildings	Total
Cost:				
Balance at January 1, 2008	₩	13,919	116,465	130,384
Subsequent expenditure		-	222	222
Balance at December 31, 2008	₩	13,919	116,687	130,606
Accumulated depreciation and impairment:				
Balance at January 1, 2008	₩	-	(22,122)	(22,122)
Depreciation		-	(3,409)	(3,409)
Balance at December 31, 2008	₩	-	(25,531)	(25,531)
Carrying amount:				
Balance at January 1, 2008	₩	13,919	94,343	108,262
Balance at December 31, 2008	₩	13,919	91,156	105,075

6 Investment Property, Continued

(c) The amounts recognized in profit or loss from investment property for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Rental income	₩	16,739	16,462
Direct operating expense		(3,498)	(3,409)
	₩	13,241	13,053

(d) The carrying amount and the fair value of investment property as of December 31, 2009 are as follows:

In millions of Won		Fair value	Carrying amount
Land	₩	204,383	13,919
Buildings		109,235	87,981
	₩	313,618	101,900

7 Investments in Associates

Investments in associates as of December 31, 2009, December 31, 2008 and January 1, 2008 are summarized as follows:

In millions of Won, except percentage of ownership			2009		2008		January 1 2008	
Associate	Location	Principal operation	Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Cosmo Tabacco Co., Ltd.	Mongolia	Manufacturing and selling tobacco	40.00%	₩ -	40.00%	₩ 2,947	40.00%	₩ 2,947
Korea Islet Transplantation, Inc.	Korea	Research and development medicine	-	-	48.25%	2,000	48.25%	2,000
Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	29.46%	1,830	29.46%	1,830	29.46%	1,830
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00%	1,000	20.00%	500	-	-
				₩ 2,830		₩ 7,277		₩ 6,777

The Company recognized ₩2,947 million of impairment loss on the investment in Cosmo Tabacco Co., Ltd. for the year ended December 31, 2009 and this impairment loss is recognized as finance costs in the non-consolidated statements of comprehensive income.

.

8 Investments in Subsidiaries

Investments in subsidiaries as of December 31, 2009, December 31, 2008 and January 1, 2008 are summarized as follows:

In millions of Won, except percentage of ownership

Associate	Location	Principal operation	2009 Percentage of ownership	2009 Carrying amount	2008 Percentage of ownership	2008 Carrying amount	January 1 2008 Percentage of ownership	January 1 2008 Carrying amount
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00%	₩ 559,882	100.00%	₩ 559,882	100.00%	₩ 559,882
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceutical	55.50%	50,691	55.50%	50,691	55.50%	50,691
Tae-a Industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00%	14,198	100.00%	14,198	100.00%	14,198
KT&G Tutun MamulleriSanayi ve Ticaret A.S. (*1)	Turkey	Manufacturing and selling tobacco	99.99%	54,049	99.99%	35,005	99.99%	35,005
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf tobacco	99.90%	394	99.90%	394	99.90%	394
KT&G Pars (*2)	Iran	Manufacturing and selling tobacco	99.99%	5,733	99.99%	1,696	-	-
KT&G Rus L.L.C. (*3)	Russia	Manufacturing and selling tobacco	100.00%	34,483	100.00%	802	-	-
KT&G Bio Corp. (*4)	Korea	Manufacturing and selling pharmaceutical	100.00%	900	-	-	-	-
KT&G Mongolia LLC (*5)	Mongolia	Manufacturing and selling tobacco	-	-	-	-	100.00%	202
				₩ 720,330		₩ 662,668		₩ 660,372

(*1) KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. increased paid-in capital by way of shareholder allocation and the Company's investments in subsidiaries increased by ₩19,044 million for the year ended December 31, 2009.

(*2) The Company established KT&G Pars by way of investment in cash for the year ended December 31, 2008. In addition, KT&G Pars increased paid-in capital by way of investment in kind and the Company's investments in subsidiaries increased by ₩4,037 million for the year ended December 31, 2009.

(*3) The Company established KT&G Rus L.L.C. for the year ended December 31, 2008. In addition, KT&G Rus L.L.C. increased paid-in capital by way of shareholder allocation and the Company's investments in subsidiaries increased by ₩33,681 million for the year ended December 31, 2009.

(*4) The Company established KT&G Bio Corp. and the Company's investments in subsidiaries increased by ₩900 million for the year ended December 31, 2009.

(*5) The liquidation process was completed in the year ended December 31, 2008, the Company recognized ₩80 million of gain on sale of investments in subsidiaries as finance income in the non-consolidated statements of comprehensive income.

8 Investments in Subsidiaries, Continued

The Company measures its investment in Korea Ginseng Corporation at the deemed cost which is the previous K-GAAP carrying amount at the date of transition in accordance with K-IFRS No.1101.

9 Available-for-sale Financial Assets

(a) Changes in available-for-sale financial assets for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won		2009	2008
Balance at beginning of year	₩	304,105	252,755
Acquisitions		11,222	18,931
Net changes in fair value before tax		129,558	32,664
Disposals		(1,085)	(245)
Balance at end of year	₩	443,800	304,105
Current	₩	1,957	2,149
Non-current		441,843	301,956
	₩	443,800	304,105

(b) Available-for-sale financial assets as of December 31, 2009, December 31, 2008 and January 1, 2008 are summarized as follows:

In millions of Won		2009	2008	January 1 2008
Available-for-sale debt instruments:				
- Government and municipal bonds	₩	2,001	2,150	2,221
- Corporate bonds		2,000	2,000	2,000
Total available-for-sale debt instruments		4,001	4,150	4,221
Available-for-sale equity instruments:				
Listed				
- Yonhap Television News (YTN)		38,967	37,249	28,366
- Crystal Genomics Co., Ltd.		1,748	1,722	1,791
- Oscotech, Inc.		780	748	1,396
- Shinhan Financial Group Co., Ltd.		173,161	103,950	187,250
- Rexahn Pharmaceuticals, Inc.		4,878	5,196	-
- Celltrion, Inc.		195,462	129,005	-
- Genematrix, Inc.		708	-	-
		415,704	277,870	218,803
Unlisted				
- Rexahn Pharmaceuticals, Inc.		-	-	5,158
- Celltrion, Inc.		-	-	21,245
- Dream Hub PFV Co., Ltd.		15,975	15,000	75
- Migami, Inc.		3,365	2,831	-
- Genematrix, Inc.		-	1,500	1,500
- Other unlisted available-for-sale equity instruments		4,755	2,754	1,753
		24,095	22,085	29,731
Total available-for-sale equity instruments		439,799	299,955	248,534
Total available-for-sale financial assets	₩	443,800	304,105	252,755

9 Available-for-sale Financial Assets, Continued

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

The fair value of Dream Hub PFV Co., Ltd. that does not have market price in an active market is established by the independent rating agency using a valuation method. The fair value of Dream Hub PFV Co., Ltd. is established on the basis of the value per share determined by using discounted cash flow model and net asset valuation model and estimation of probability distribution of the value per share.

The other unlisted available-for-sale equity instruments that do not have 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.

10 Long-term Deposits in MSA Escrow Fund

(a) Long-term deposits in MSA Escrow Fund as of December 31, 2009, December 31, 2008 and January 1, 2008 are summarized as follows:

In millions of Won		2009	2008	January 1 2008
MMF	₩	4,874	110,261	66,633
T-Bill		57,287	-	-
T-Note		55,960	-	-
	₩	118,121	110,261	66,633

(b) As discussed in notes 28 to non-consolidated financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the years ended December 31, 2009 and 2008 are ₩18,055 million and ₩17,895 million, respectively.

(c) Investment income on long-term deposits in MSA Escrow Fund for the years ended December 31, 2009 and 2008 are ₩23 million and ₩1,335 million, respectively.

(d) Long-term deposits in MSA Escrow Fund are measured at quoted prices in an active market.

December 31, 2009, December 31, 2008 and January 1, 2008

11 Trade and Other Receivables

(a) Trade and other receivables as of December 31, 2009, December 31, 2008 and January 1, 2008 are summarized as follows:

		2009		2008		January 1 2008	
In millions of Won		Current	Non-current	Current	Non-current	Current	Non-current
Loans to employees	₩	23,985	68,067	27,994	78,437	19,442	95,939
Loans		9,870	5,861	-	11,049	-	915
Other receivables		53,775	-	51,813	561	31,003	1,028
Guarantee deposits		-	32,639	-	32,075	-	30,303
Accrued income		981	-	287	-	237	-
Trade receivables		417,120	-	437,550	-	320,370	-
	₩	505,731	106,567	517,644	122,122	371,052	128,185

(b) Trade and other receivables as of December 31, 2009, December 31, 2008 and January 1, 2008 have been reported in the non-consolidated statements of financial position net of allowances as follows:

		2009		2008		January 1 2008	
In millions of Won		Current	Non-current	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩	511,138	106,567	522,511	122,122	375,366	128,185
Allowance account:							
- Other receivables		(2,161)	-	(1,636)	-	(1,321)	-
- Trade receivables		(3,246)	-	(3,231)	-	(2,993)	-
		(5,407)	-	(4,867)	-	(4,314)	-
Net trade and other receivables	₩	505,731	106,567	517,644	122,122	371,052	128,185

(c) Changes in the allowance account for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won		2009	2008
Balance at beginning of year	₩	4,867	4,314
Impairment loss		540	553
Balance at end of year	₩	5,407	4,867

Impairment loss on trade and other receivables are included as part of other expense and income in the non-consolidated statements of comprehensive income.

(d) The age schedule of trade and other receivables which were past due but not impaired as of December 31, 2009, December 31, 2008 and January 1, 2008 are as follows:

In millions of Won		2009	2008	January 1 2008
Within 1 month	₩	58,419	57,002	35,188
Between 1 and 2 months		71,366	60,654	28,995
Beyond 2 months		15,243	43,580	27,599
	₩	145,028	161,236	91,782

11 Trade and Other Receivables, Continued

There is no significant concentration of credit risk with respect to trade receivables as the Company has a large number widely dispersed of customers, except for export trade receivables, and the Company holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

(e) Details of trade and other receivables that are measured at amortized cost as of December 31, 2009 and 2008 are as follows:

In millions of Won	2009 Effective interest rate		2009 Current	2009 Non-current	2008 Effective interest rate		2008 Current	2008 Non-current
Loans to employees	3.00~5.68%	₩	23,985	68,067	5.38~5.68%	₩	27,994	78,437
Guarantee deposits	3.00~5.68%		-	32,639	5.38~5.68%		-	32,075
		₩	23,985	100,706		₩	27,994	110,512

There is no material difference between the carrying amount and their fair value except the above trade and other receivables, due to the short-term duration of the majority of trade and other receivables.

12 Inventories

(a) Inventories as of December 31, 2009, December 31, 2008 and January 1, 2008 were summarized as follows:

In millions of Won		2009	2008	January 1 2008
Finished goods, net of loss on the write-down of inventories	₩	86,318	78,473	80,680
Work-in-progress		12,633	10,039	10,100
Raw materials		858,373	822,964	794,210
Supplies		23,895	22,978	21,507
By-products		5,547	3,242	2,641
Completed buildings		53,816	-	-
Buildings under construction		-	182,059	66,837
Sites for building lotting-out construction		-	17,613	14,215
Goods-in-transit		13,739	9,728	6,670
	₩	1,054,321	1,147,096	996,860

(b) The amount of inventories recognized as an expense for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Cost of sales:			
- Loss on the write-down of inventories	₩	-	4,413
- Reversal of loss on the write-down of inventories		(189)	(18,439)
Other expense		2,473	3,763
	₩	2,284	(10,263)

13 Cash and Cash Equivalents

Cash and cash equivalents as of December 31, 2009, December 31, 2008 and January 1, 2008 were summarized as follows:

In millions of Won		2009	2008	January 1 2008
Cash on hand	₩	6,681	5,941	1,657
Demand deposits		62,273	72,411	66,469
Short-term investment assets		200,000	10,000	47,000
	₩	268,954	88,352	115,126

Cash equivalents mainly include short-term deposits with an original maturity of three months or less. The carrying amount of cash and cash equivalents approximates their fair value.

14 Share Capital

(a) Details of share capital as of December 31, 2009, December 31, 2008 and January 1, 2008 are as follows:

In Won, except number of shares		2009	2008	January 1 2008
Number of ordinary shares:				
- Authorized		800,000,000	800,000,000	800,000,000
- Issued		137,292,497	138,792,497	143,442,497
- Outstanding		127,198,800	128,698,800	130,839,907
Par value	₩	5,000	5,000	5,000

The Company has, thus far, reacquired and retired 53,699,400 shares of treasury share. Accordingly, as of December 31, 2009, the Company's ordinary share differs from the aggregate par value of issued shares by ₩268,497 million.

(b) Changes in the number of shares for the years ended December 31, 2009 and 2008 were as follows:

	2009			2008		
Number of shares	Ordinary share	Treasury share	Total	Ordinary share	Treasury share	Total
Beginning of year	138,792,497	(10,093,697)	128,698,800	143,442,497	(12,602,590)	130,839,907
Reacquisition	-	(1,500,000)	(1,500,000)	-	(2,254,082)	(2,254,082)
Employee benefits	-	-	-	-	112,975	112,975
Retirement	(1,500,000)	1,500,000	-	(4,650,000)	4,650,000	-
End of year	137,292,497	(10,093,697)	127,198,800	138,792,497	(10,093,697)	128,698,800

(c) Changes in the other capital surplus for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won		2009	2008
Balance at beginning of year	₩	337	337
Expiration of employee share options		2,295	-
Balance at end of year	₩	2,632	337

The employee share options were settled in cash and terminated for the year ended December 31, 2009. Consequently, the employee share option reserve was reclassified to the other capital surplus.

December 31, 2009, December 31, 2008 and January 1, 2008

15 Treasury Share

(a) Changes in the treasury shares for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won, except number of shares	2009 Number of share	2009 Carrying amount	2008 Number of share	2008 Carrying amount
Balance at beginning of year	10,093,697	₩ 226,945	12,602,590	₩ 414,947
Reacquisition of treasury shares	1,500,000	103,999	2,254,082	194,128
Employee benefits by treasury shares	-	-	(112,975)	(2,377)
Retirement of treasury shares	(1,500,000)	(103,999)	(4,650,000)	(379,753)
Balance at end of year	10,093,697	₩ 226,945	10,093,697	₩ 226,945

(b) Changes in gain on reissuance of treasury shares for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won		2009	2008
Balance at beginning of year	₩	468,274	463,900
Gain on reissuance of treasury shares before tax		-	6,033
Less: Tax at 27.5%		-	(1,659)
Gain on reissuance of treasury shares, net of tax		-	4,374
Balance at end of year	₩	468,274	468,274

16 Reserves

(a) Details of reserves as of December 31, 2009, December 31, 2008 and January 1, 2008 are as follows:

In millions of Won		2009	2008	January 1 2008
Available-for-sale financial assets reserve	₩	128,793	27,737	2,100
Employee share option reserve		-	2,296	-
Legal reserve		602,937	602,937	602,937
Voluntary reserve		1,342,378	1,188,378	1,133,378
	₩	2,074,108	1,821,348	1,738,415

(b) Available-for-sale financial assets reserve as of December 31, 2009, December 31, 2008 and January 1, 2008 were summarized as follows:

In millions of Won		2009	2008	January 1 2008
Available-for-sale financial assets reserve before tax	₩	165,119	35,561	2,897
Tax effect		(36,326)	(7,824)	(797)
	₩	128,793	27,737	2,100

(c) Legal Reserve

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 share in connection with a free issue of shares.

16 Reserves, Continued

(d) Details of voluntary reserve as of December 31, 2009, December 31, 2008 and January 1, 2008 are as follows:

In millions of Won		2009	2008	January 1 2008
Reserve for business rationalization	₩	12,851	12,851	12,851
Reserve for research and human resource development		15,000	30,000	45,000
Reserve for loss on reissuance of treasury shares		26,646	26,646	26,646
Reserve for business expansion		698,881	698,881	698,881
Unconditional reserve		589,000	420,000	350,000
	₩	1,342,378	1,188,378	1,133,378

Reserve for Business Rationalization
Until December 10, 2002 under the Special Tax Treatment Control Law, investment tax credits were allowed for certain investments. The Company was, however, required to appropriate from retained earnings, the amount of tax benefits received, and transfer such amount into a reserve for business rationalization.

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

Reserve for Business Expansion
Reserve for business expansion was a legal reserve under the Korea Tobacco and Ginseng Corporation Act, which was abrogated on September 1, 1997, consequently, the existing balance has been regarded as a voluntary reserve since then.

Other Reserves
Reserves for research and human resource development and loss on reissuance of treasury shares were appropriated in order to utilize certain tax deduction benefits through the early recognition of future expenditures. These reserves are restored to retained earnings in accordance with the relevant tax laws. Such reserves are taken back into taxable income in the year of restoration. Reserves without specific purposes are restored to retained earnings by a resolution at a general meeting of shareholders.

17 Retained Earnings

Changes in retained earnings for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won		2009	2008
Balance at beginning of year	₩	436,453	393,213
Transfer from reserve for research and human resource development		15,000	15,000
Transfer to unconditional reserve		(169,000)	(70,000)
Dividends		(360,357)	(340,449)
Profit for the period		744,942	849,486
Actuarial gains (losses), net of tax		16,924	(31,044)
Retirement of treasury shares		(103,999)	(379,753)
Balance at end of year	₩	579,963	436,453

18 Statements of Appropriation of Retained Earnings

Statements of Appropriation of Retained Earnings for the years ended December 31, 2009 and 2008 are as follows:

Date of Appropriation for 2009: February 26, 2010
Date of Appropriation for 2008: March 13, 2009

In millions of Won		2009	2008
Unappropriated retained earnings:			
Balance at beginning of year	₩	(77,904)	(2,236)
Retirement of treasury shares		(103,999)	(379,753)
Profit for the period		744,942	849,486
Actuarial gains (losses), net of tax		16,924	(31,044)
Balance at end of year before appropriation		579,963	436,453
Transfer from voluntary reserves:			
Reserve for research and human resource development		15,000	15,000
Reserve for loss on reissuance of treasury shares		26,646	-
		41,646	15,000
Unappropriated retained earnings available for appropriation		621,609	451,453
Appropriation of retained earnings:			
Dividends (note 31)		(356,157)	(360,357)
Reserve for research and human resource development		(60,000)	-
Unconditional reserve		(203,000)	(169,000)
		(619,157)	(529,357)
Unappropriated retained earnings (undisposed accumulated deficit) to be carried over to subsequent year	₩	2,452	(77,904)

19 Short-term Borrowings

Short-term borrowings as of December 31, 2009, December 31, 2008 and January 1, 2008 are summarized as follows:

In millions of Won	Annual interest rate		2009	2008	January 1 2008
Customer credit contracts	8.00~8.50%	₩	19,338	13,344	14,955

The Company has entered into a customer credit contract with the National Agricultural Cooperative Federation ("NACF") and other financial institutions, the financial institutions pay past-due trade receivables for customers and the Company has provided guarantees to the financial institutions for customers. The amount paid by the financial institutions is recognized as short-term borrowings on the non-consolidated statements of financial position.

December 31, 2009, December 31, 2008 and January 1, 2008

20 Trade and Other Payables

(a) Trade and other payables as of December 31, 2009, December 31, 2008 and January 1, 2008 are summarized as follows:

		2009		2008		January 1 2008	
In millions of Won		Current	Non-current	Current	Non-current	Current	Non-current
Leasehold deposits received	₩	-	24,042		24,323		26,861
Trade payables		35,019	-	27,543	-	9,590	-
Withholdings		3,504	-	8,633	-	6,243	-
Withholdings taxes		121,217	-	125,184	-	128,867	-
Accrued expenses		87,024	-	91,829	-	89,130	-
Other payables		30,852	-	139,775	-	95,432	-
	₩	277,616	24,042	392,964	24,323	329,262	26,861

(b) Details of trade and other payables that are measured at amortized cost as of December 31, 2009 and 2008 are as follows:

	2009			2008		
In millions of Won	Effective interest rate		Amortized cost	Effective interest rate		Amortized cost
Leasehold deposits received	3.00~5.68%	₩	24,042	5.38~5.68%	₩	24,323

There is no material difference between the carrying amount and their fair value except the above trade and other payables, due to the short-term duration of the majority of trade and other payables.

21 Defined Benefits Plan

The Company operates both defined benefit and defined contribution plans. According to these plans, the Company pays retirement benefits calculated under the plan's benefit formula at the time employees leave the Company. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method.

(a) The components of retirement benefit costs for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won		2009	2008
Defined benefit costs:			
Current service costs	₩	32,676	22,374
Interest costs		5,550	6,582
Expected returns on plan assets		(5,412)	(5,634)
Gains on the settlement of the plan		(279)	-
		32,535	23,322
Defined contribution costs:			
Contributions recognized as expense		365	-
	₩	32,900	23,322

Some of employees have transferred from the defined benefit plan to the defined contribution plan. The Company recognized ₩279 million of the gains on the settlement of defined benefit plan in profit or loss.

The Company recognized contributions payable amounting to ₩74 million as accrued expenses in the non-consolidated statements of financial position.

(b) Changes in defined benefit liabilities for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won		2009	2008
Balance at beginning of year	₩	48,336	47,005
Retirement benefit costs		32,535	23,322
Actuarial losses (gains) before tax		(21,698)	39,800
Payments into plan assets		(29,127)	-
Payments, including the amount transferred to the defined contribution plan		(11,751)	(61,791)
Balance at end of year	₩	18,295	48,336
Non-consolidated statements of financial position:			
- Present value of retirement benefit obligations	₩	129,813	133,459
- Fair value of plan assets		(111,518)	(85,123)
Defined benefit liabilities	₩	18,295	48,336

21 Defined Benefits Plan, Continued

(c) Changes in defined benefit obligations for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won		2009	2008
Balance at beginning of year	₩	133,459	164,991
Current service costs		32,676	22,374
Interest costs		5,550	6,582
Actuarial losses before tax		(20,937)	40,562
Payments, including the amount transferred to the defined contribution plan		(20,656)	(101,050)
Gains on the settlement of the plan		(279)	-
Balance at end of year	₩	129,813	133,459

(d) Changes in plan assets for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won		2009	2008
Balance at beginning of year	₩	85,123	117,986
Expected return on plan assets		5,412	5,634
Actuarial gains before tax		761	762
Payments into plan assets		29,127	-
Payments, including the amount transferred to the defined contribution plan		(8,905)	(39,259)
Balance at end of year	₩	111,518	85,123

Actual returns on plan assets for the years ended December 31, 2009 and 2008 are ₩6,173 million and ₩6,396 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.

(e) The amount of actuarial gains (losses) for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won		2009	2008
Actuarial gains (losses) before tax	₩	21,698	(39,800)
Tax effect		(4,774)	8,756
	₩	16,924	(31,044)

(f) The components of plan assets as of December 31, 2009, December 31, 2008 and January 1, 2008 are as follows:

In millions of Won		2009	2008	January 1 2008
Short-term trading financial assets	₩	105,630	49,737	117,986
Available-for-sale financial assets		5,888	35,386	-
	₩	111,518	85,123	117,986

As of December 31, 2009, December 31, 2008 and January 1, 2008, short-term trading financial assets include severance insurance of ₩63 million, ₩164 million and ₩117,986 million which continue to be covered by the existing retirement benefits plan.

21 Defined Benefits Plan, Continued

(g) The principal actuarial assumptions as of December 31, 2009, December 31, 2008 and January 1, 2008 are as follows:

	2009	2008	January 1 2008
Rate of salary increases	5.00%	5.00%	5.00%
Expected rate of return on plan assets	6.00%	6.50%	6.25%
Discount rate	5.80%	4.25%	5.75%

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

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

In millions of Won		1 percentage point increase	1 percentage point decrease
Rate of salary increases:			
- Increase (decrease) in defined benefit obligations	₩	11,366	(10,002)
- Increase (decrease) in retirement benefit costs before tax		2,856	(2,496)
Discount rate:			
- Increase (decrease) in defined benefit obligations		(10,593)	12,300
- Increase (decrease) in retirement benefit costs before tax		(1,250)	1,423
Expected rate of return on plan assets:			
- Increase (decrease) in retirement benefit costs before tax		(1,072)	1,072

The effect on retirement benefit costs before tax is for 2009. The effect on defined benefit obligations is as of December 31, 2009.

22 Profit from Operations

(a) Employee benefit costs for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Salaries	₩	316,006	316,062
Retirement benefit costs		32,900	23,322
Employee welfare		32,983	41,315
	₩	381,889	380,699

(b) Depreciation and amortization for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Depreciation	₩	126,021	130,266
Amortization		277	706
	₩	126,298	130,972

22 Profit from Operations, Continued

(c) Details of other income for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Foreign currency transaction gain	₩	26,854	58,879
Foreign currency translation gain		178	26,141
Gain on sale of property, plant and equipment		12,100	14,286
Others		12,263	9,055
	₩	51,395	108,361

(d) Details of selling expenses for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Salaries	₩	146,695	139,782
Retirement benefit costs		12,340	18,590
Employee welfare		15,839	18,526
Travel		3,606	3,692
Communications		1,668	1,791
Utilities		4,641	4,471
Taxes and dues		13,939	21,395
Supplies		1,271	1,352
Rent		3,881	3,628
Depreciation		32,832	40,578
Amortization		41	152
Repairs and maintenance		3,097	2,642
Vehicles		6,630	7,644
Insurance		75	70
Commissions		31,690	31,531
Freight and custody		24,139	29,465
Conferences		2,232	2,230
Advertising		154,337	142,257
Training		912	1,478
Prizes and rewards		524	819
Normal research and development		403	2,951
	₩	460,792	475,044

22 Profit from Operations, Continued

(e) Details of general and administrative expenses for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Salaries	₩	49,175	51,674
Retirement benefit costs		10,221	12
Employee welfare		5,790	5,364
Travel		2,012	2,294
Communications		2,449	2,536
Utilities		1,788	1,627
Taxes and dues		2,274	1,980
Supplies		2,301	3,018
Rent		6,797	5,499
Depreciation		15,172	9,746
Amortization		231	535
Repairs and maintenance		1,525	2,680
Vehicles		1,443	823
Insurance		369	481
Commissions		28,222	30,821
Conferences		1,864	1,216
Training		5,058	6,172
Prizes and rewards		926	4,132
Normal research and development		12,815	12,364
	₩	150,432	142,974

(f) Details of other expenses for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Foreign currency transaction loss	₩	35,784	9,507
Foreign currency translation loss		16,048	812
Impairment loss on trade and other receivables		540	553
Donations		32,557	13,020
Loss on sale of property, plant and equipment		5,831	3,095
Impairment loss on property, plant and equipment		-	429
Impairment loss on intangible assets		647	-
Others		8,730	9,332
	₩	100,137	36,748

23 Net Finance Costs

(a) Details of net finance costs (income) for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Finance cost:			
- Interest costs	₩	1,095	1,099
- Impairment loss on investments in associates		2,947	-
- Loss on sale of investments in associates		1,999	-
- Loss on transaction of financial derivatives		1,711	6,295
- Loss on valuation of financial derivatives		-	2,699
		7,752	10,093
Finance income:			
- Interest income		(10,806)	(13,516)
- Dividend income		(30,215)	(63,458)
- Investment income on long-term deposits in MSA Escrow Fund		(23)	(1,335)
- Gain on sale of available-for-sale financial assets		(563)	(4)
- Gain on sale of investments in subsidiaries		-	(80)
		(41,607)	(78,393)
Net finance costs (income)	₩	(33,855)	(68,300)

(b) Details of interest costs for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Short-term borrowings	₩	561	639
Trade and other payables		510	452
Others		24	8
	₩	1,095	1,099

(c) Details of interest income for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Deposits	₩	6,483	10,488
Available-for-sale financial assets		245	27
Trade and other receivables		4,078	3,001
	₩	10,806	13,516

(d) Details of finance income recognized in other comprehensive income for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Gain on valuation available-for-sale financial assets, before tax	₩	129,558	32,664
Tax effect		(28,503)	(7,027)
Gain on valuation available-for-sale financial assets, net of tax	₩	101,055	25,637

December 31, 2009, December 31, 2008 and January 1, 2008

24 Income Taxes

(a) The Company was subject to income taxes on taxable income at the following normal tax rates.

Taxable income		Tax rate			
Prior to 2008	Thereafter	Prior to 2008	2008	2009~2011	Thereafter
Up to ₩100 million	Up to ₩200 million	14.3%	12.1%	12.1%	11.0%
Over ₩100 million	Over ₩200 million	27.5%	27.5%	24.2%	22.0%

In December 2008, the Korean government reduced the corporate income tax rate (including resident tax) and increased the tax base from ₩100 million to ₩200 million beginning in 2008. Effective January 1, 2008, the income tax rate for those having their taxable income less than ₩200 million was reduced from 14.3 % to 12.1%.

(b) The components of income tax expense (benefit) for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Current income tax expense	₩	219,928	275,545
Adjustments recognized in the period for current tax of prior periods		13,074	(287)
Changes in temporary difference		40,681	(10,095)
Total income tax expense		273,683	265,163
Tax expense (benefit) recognized outside profit or loss		(33,277)	70
Income tax expense	₩	240,406	265,233

(c) Current and deferred tax expense that were recognized outside profit or loss for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Current:			
- Gain on reissuance of treasury shares	₩	-	(1,659)
Deferred:			
- Net changes in fair value of available-for-sale financial assets		(28,503)	(7,027)
- Actuarial gains (losses)		(4,774)	8,756
		(33,277)	1,729
Tax expense (benefit) recognized outside profit or loss	₩	(33,277)	70

The Company recognized current tax expense related to gain on reissuance of treasury shares directly in equity and deferred tax expense related to other comprehensive income in other comprehensive income.

24 Income Taxes, Continued

(d) The income tax expense calculated by applying statutory tax rates to the Company's profit before tax for the period differs from the actual tax expense in the non-consolidated statement of comprehensive income for the years ended December 31, 2009 and 2008 for the following reasons:

In millions of Won, except tax rate information		2009	2008
Profit before tax	₩	985,348	1,114,719
Normal tax rate		24.2%	27.5%
Expense for income taxes at normal tax rate		238,430	306,517
Adjustment:			
- Tax effects of permanent differences		2,928	3,000
- Non-inclusion of proceeds-dividend earned		(7,275)	(15,898)
- Investment tax credits		(1,724)	(5,104)
- Additional income taxes for prior period		8,047	(233)
- Effect of change in tax rate		-	(23,049)
Income tax expense	₩	240,406	265,233
Effective tax rate		24.4%	23.8%

(e) Deferred tax expense (benefit) relating to the origination and reversal of temporary differences for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Deferred tax liabilities at end of year	₩	122,372	81,691
Deferred tax liabilities at beginning of year		81,691	91,786
Deferred tax expense (benefit)	₩	40,681	(10,095)

(f) Deferred tax assets and liabilities are measured using the tax rate to be applied for the period in which temporary differences are expected to be realized.

(g) The net deferred tax liabilities are reflected in the non-consolidated statements of financial position after offsetting assets and liabilities where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred income taxes relate to the same fiscal authority.

24 Income Taxes, Continued

(h) Changes in deferred tax assets and liabilities for the year ended December 31, 2009 were as follows:

In millions of Won		Balance at beginning of year	Credited to profit (charged to loss)	Charged to other comprehensive income	Balance at end of year
Available-for-sale financial assets	₩	8,800	649	-	9,449
Accrued expense		20,101	310	-	20,411
Sales		7,157	(7,157)	-	-
Donations in excess of tax limit		8,606	(8,517)	-	89
Retirement benefit costs		4,986	(2,106)	(4,774)	(1,894)
Depreciation		1,978	2,191	-	4,169
Investments in subsidiaries		(95,884)	-	-	(95,884)
Foreign currency translations		(6,130)	9,971	-	3,841
Treasury shares		(8,565)	-	-	(8,565)
Unrealized gain on valuation of available-for-sale financial assets		(7,823)	-	(28,503)	(36,326)
Voluntary reserve		(10,078)	(3,122)	-	(13,200)
Provision for advanced depreciation		(4,722)	-	-	(4,722)
Others		(117)	377	-	260
	₩	(81,691)	(7,404)	(33,277)	(122,372)

(i) Changes in deferred tax assets and liabilities for the year ended December 31, 2008 were as follows:

In millions of Won		Balance at beginning of year	Credited to profit (charged to loss)	Credited (charged) to other comprehensive income	Effect of changes in the tax rate	Balance at end of year
Available-for-sale financial assets	₩	11,000	-	-	(2,200)	8,800
Accrued expense		22,966	(124)	-	(2,741)	20,101
Sales		1,801	6,332	-	(976)	7,157
Donations in excess of tax limit		18,467	(8,687)	-	(1,174)	8,606
Retirement benefit costs		(4,621)	2,098	8,756	(1,247)	4,986
Depreciation		3,859	(1,387)	-	(494)	1,978
Investments in subsidiaries		(120,350)	-	-	24,466	(95,884)
Foreign currency translations		-	(6,966)	-	836	(6,130)
Treasury shares		(10,781)	75	-	2,141	(8,565)
Unrealized gain on valuation of available-for-sale financial assets		(797)	(1,955)	(7,027)	1,956	(7,823)
Voluntary reserve		(15,578)	4,126	-	1,374	(10,078)
Provision for advanced depreciation		(5,903)	-	-	1,181	(4,722)
Others		8,151	(8,195)	-	(73)	(117)
	₩	(91,786)	(14,683)	1,729	23,049	(81,691)

24 Income Taxes, Continued

(j) The income taxes payable and income taxes refund before offsetting as of December 31, 2009, December 31, 2008 and January 1, 2008 are as follows:

In millions of Won		2009	2008	January 1 2008
Income taxes payable	₩	221,139	275,315	270,220
Income taxes refund		(121,101)	(121,829)	(86,738)
	₩	100,038	153,486	183,482

25 Earnings per Share

Basic and diluted earnings per share for the years ended December 31, 2009 and 2008 were as follows:

In millions of Won, except share information		2009	2008
Profit for the period	₩	744,942	849,486
Weighted-average number of ordinary shares outstanding		128,372,302	130,140,446
Basic and diluted earnings per share in Won	₩	5,803	6,527

26 Transactions and Balances with Related Companies

(a) Details of parent and subsidiary relationships as of December 31, 2009, December 31, 2008 and January 1, 2008 were as follows:

			Percentage of ownership								
			2009			2008			January 1 2008		
Subsidiary	Location	Next most senior parent	Parent	Sub-sidiary	Total	Parent	Sub-sidiary	Total	Parent	Sub-sidiary	Total
Korea Ginseng Corporation	Korea	The Company	100.00%	-	100.00%	100.00%	-	100.00%	100.00%	-	100.00%
Yungjin Pharm. Ind. Co., Ltd.	Korea	The Company	55.50%	-	55.50%	55.50%	-	55.50%	55.50%	-	55.50%
Tae-a Industry Co., Ltd.	Korea	The Company	100.00%	-	100.00%	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	The Company	99.99%	-	99.99%	99.99%	-	99.99%	99.99%	-	99.99%
Korea Tabacos do Brasil Ltda.	Brazil	The Company	99.90%	-	99.90%	99.90%	-	99.90%	99.90%	-	99.90%
KT&G Pars	Iran	The Company	99.99%	-	99.99%	99.99%	-	99.99%	99.99%	-	99.99%
KT&G Rus L.L.C.	Russia	The Company	100.00%	-	100.00%	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Bio Corp.	Korea	The Company	100.00%	-	100.00%	-	-	-	-	-	-
KT&G Mongolia LLC	Mongolia	The Company	-	-	-	-	-	-	100.00%	-	100.00%
Korea Ginseng HK, Ltd.	Hong Kong	Korea Ginseng Corporation	-	99.99%	99.99%	-	99.99%	99.99%	-	99.99%	99.99%
KGC Sales Co., Ltd.	Korea	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%	-	100.00%	100.00%
Cheong Kwan Jang Taiwan Corporation	Taiwan	Korea Ginseng Corporation	-	100.00%	100.00%	-	-	-	-	-	-
Korea Red Ginseng Corporation	United States	Korea Ginseng Corporation	-	100.00%	100.00%	-	-	-	-	-	-
Korea Ginseng (China) Corp.	China	Korea Ginseng Corporation	-	100.00%	100.00%	-	-	-	-	-	-

December 31, 2009, December 31, 2008 and January 1, 2008

26 Transactions and Balances with Related Companies, Continued

(b) Significant transactions which occurred in the normal course of business with related companies for the years ended December 31, 2009 and 2008 are summarized as follows:

In millions of Won

Relationship	Related Company		2009	2008
Revenue from sales and other income:				
Subsidiary	Korea Ginseng Corporation	₩	12,790	13,271
	Yungjin Pharm. Ind. Co., Ltd.		174	171
	Tae-a Industry Co., Ltd.		1	-
	KGC Sales Co., Ltd.		2	-
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		7,943	3,194
	KT&G Pars		6,825	1,521
	KT&G Rus L.L.C.		485	-
		₩	28,220	18,157
Purchases and other expenses:				
Subsidiary	Korea Ginseng Corporation	₩	2,096	1,446
	Yungjin Pharm. Ind. Co., Ltd.		43	121
	Tae-a Industry Co., Ltd.		13,616	15,321
	Korea Tabacos do Brasil Ltda.		191	165
		₩	15,946	17,053

The Company recognized dividends from Korea Ginseng Corporation amounting to ₩30,000 million and ₩60,000 million as finance income for the years ended December 31, 2009 and 2008, respectively.

(c) Account balances with related companies as of December 31, 2009, December 31, 2008 and January 1, 2008 were as follows:

In millions of Won

Relationship	Related Company		2009	2008	January 1 2008
Receivables:					
Subsidiary	Korea Ginseng Corporation	₩	-	3,184	-
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		13,437	25,441	1,127
	KT&G Pars		18,883	7,204	-
	KT&G Rus L.L.C.		5,487	347	-
	KT&G Mongolia LLC		-	-	554
		₩	37,807	36,176	1,681
Payables:					
Subsidiary	Korea Ginseng Corporation	₩	2,238	2,595	2,649

26 Transactions and Balances with Related Companies, Continued

(d) Details of guarantees provided for related companies as of December 31, 2009, December 31, 2008 and January 1, 2008 were as follows:

In thousands of Euro				2009		2008		January 1 2008	
Relationship	Type of guarantee	Guarantee recipient		Limit	Exercise	Limit	Exercise	Limit	Exercise
Subsidiary	Guarantee on foreign currency letter of credit opened	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	€	-	-	-	-	10,000	-
		KT&G Rus L.L.C.		7,267	-	-	-	-	-

(e) Details of key management personnel compensation for the years ended December 31, 2009 and 2008 are summarized as follows:

In millions of Won		2009	2008
Short-term employee benefits	₩	6,896	8,698
Post-employment benefits		5,838	9,113
	₩	12,734	17,811

27 Risk Management

(a) Overview

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

- capital risk
- currency risk
- liquidity risk
- credit risk
- interest rate risk
- market price risk

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these non-consolidated financial statements.

27 Risk Management, Continued

(b) Risk Management Framework

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has established the Risk Management Committee, which is responsible for developing and monitoring the Company's risk management policies. The committee reports regularly to the Board of Directors on its activities.

The Company's risk management policies are established to identify and analyse the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities. The Company, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Company Audit Committee oversees how management monitors compliance with the Company's risk management policies and procedures, and reviews the adequacy of the risk management framework in relation to the risks faced by the Company. The Company Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

(c) Management of Capital Risk

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

The fundamental goal of capital management is the maximization of shareholders' value by means of the stable dividend policy and the retirement of treasury shares. The capital structure of the Company consists of equity and net debt deducting cash and cash equivalents and current financial instruments from borrowings. The Company applied the same financial risk management strategy that was applied in the previous period.

27 Risk Management, Continued

As of December 31, 2009, December 31, 2008 and January 1, 2008, the Company defines net debt and equity as follows:

In millions of Won		2009	2008	January 1 2008
Net debt:				
Debts (Short-term borrowings)	₩	19,338	13,344	14,955
Less:				
- Cash and cash equivalents		(268,954)	(88,352)	(115,126)
- Current other financial assets		-	(1,000)	(1,000)
- Current available-for-sale financial assets		(1,957)	(2,149)	(92)
	₩	(251,573)	(78,157)	(101,263)
Equity	₩	3,852,991	3,454,426	3,135,877

(b) Management of Financial Risks

Currency Risk

The Company is exposed to foreign currency risk arising from the export and import of tobacco. The Company's primary exposure is to the US dollar and Euro. The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of December 31, 2009, December 31, 2008 and January 1, 2008 are as follows:

		2009		2008		January 1 2008	
In millions of Won		USD	EUR	USD	EUR	USD	EUR
Assets:							
Cash and cash equivalents	₩	3,887	44	1,116	83	8,544	-
Trade and other receivables		258,943	8,390	281,320	1,325	150,238	1,127
Long-term deposits in MSA Escrow Fund		118,121	-	110,261	-	66,633	-
	₩	380,951	8,434	392,697	1,408	225,415	1,127
Liabilities:							
Trade and other payables	₩	3,624	4,045	335	7,282	649	3,495

The Company measures currency risk of changes in foreign exchange rates regularly. As of December 31, 2009, December 31, 2008 and January 1, 2008, the effect of 10% strengthening or weakening of functional currency against foreign currencies other than functional currency on profit before tax are as follows:

		2009		2008		January 1 2008	
In millions of Won		10% strengthening	10% weakening	10% strengthening	10% weakening	10% strengthening	10% weakening
USD	₩	37,733	(37,733)	39,236	(39,236)	22,477	(22,477)
EUR		439	(439)	(587)	587	(237)	237
	₩	38,172	(38,172)	38,649	(38,649)	22,240	(22,240)

The above sensitivity analysis was applied to monetary assets and liabilities denominated in foreign currencies other than the functional currency at the end of the reporting period.

27 Risk Management, Continued

The above sensitivity analysis was applied to monetary assets and liabilities denominated in foreign currencies other than the functional currency at the end of the reporting period.

The Company entered into foreign currency option contracts to hedge foreign currency risk of accounts receivable related to the export of tobacco. Details of the contracts as of December 31, 2008 were as follows:

In Won and in thousands of U.S. dollars	Contracts outstanding	Exchange rate
Call Option Sell	$ 6,000	₩ 988
	4,000	989
Put Option Buy	3,000	988
	2,000	989

The above foreign currency option contracts were not designated as hedging instruments, and were settled in the year ended December 31, 2009. Related gains and losses are charged to the non-consolidated statement of comprehensive income as finance charge.

Liquidity risk
The Company has established short-term and long-term financial management plan to manage the liquidity risk, and analyzed cash outflows occurred and cash outflows budgeted, so as to match the maturity structure of financial assets and financial liabilities. The Company's management determines the financial liabilities are repayable with the operating cash flows and cash inflows from financial assets. The Company entered into an overdraft agreement with the NACF to manage the temporary liquidity risk.

The maturity analysis with a residual contractual maturity of financial liabilities as of December 31, 2009, December 31, 2008 and January 1, 2008 is as follows:

				Residual contractual maturity			
In millions of Won		Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
As of December 31, 2009:							
Derivative financial liabilities	₩	-	-	-	-	-	-
Non-derivative financial liabilities		196,275	196,838	92,772	93,707	8,359	2,000
	₩	196,275	196,838	92,772	93,707	8,359	2,000
As of December 31, 2008:							
Derivative financial liabilities	₩	2,699	2,699	2,699	-	-	-
Non-derivative financial liabilities		296,814	297,444	85,252	204,135	6,057	2,000
	₩	299,513	300,143	87,951	204,135	6,057	2,000
As of January 1, 2008:							
Derivative financial liabilities	₩	25	25	25	-	-	-
Non-derivative financial liabilities		235,968	235,968	90,834	138,023	7,111	-
	₩	235,993	235,993	90,859	138,023	7,111	-

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

27 Risk Management, Continued

Credit Risk
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 collaterals and guarantees. The credit ratings of all counterparties and the level of collaterals 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, 2009, December 31, 2008 and January 1, 2008 is as follows:

In millions of Won		2009	2008	January 1 2008
Available-for-sale financial assets	₩	443,800	304,105	252,755
Long-term deposits in MSA Escrow Fund		118,121	110,261	66,633
Trade and other receivables		612,298	639,766	499,237
Other financial assets		-	1,000	1,000
Cash and cash equivalents		268,954	88,352	115,126

Export trade receivables to overseas clients, including Alokozay International Limited are ₩229,096 million, ₩266,592 million and ₩149,720 million, and equal to 54.9%, 60.9% and 46.7% of the aggregate trade receivables, respectively, as of December 31, 2009, December 31, 2008 and January 1, 2008. The Company's trade receivables mentioned above were insured against non-payment up to USD36,200 thousand, USD34,400 thousand and USD34,900 thousand by export guarantee insurance with the Korea Export Insurance Corporation, respectively, as of December 31, 2009, December 31, 2008 and January 1, 2008. The Company has no significant concentrations of customer credit risk except for the above export trade receivables; on the other hand, there are a large number of widely dispersed customers with trade and other receivables.

The Company has made deposits on cash, cash equivalent and long-term in NACF and several financial institutions with high credit ratings, thus the credit risks from theses financial institutions are very limited.

Interest rate risk
There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation, considering the amounts of interest bearing liabilities.

Market price risk
Market price risk arises from available-for-sale equity instruments held for investments. Management of the Company monitors 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 Risk Management Committee.

As of December 31, 2009, the effect of 5% fluctuation of the price index of stocks on other comprehensive income is as follows:

In millions of Won		5% Increase	5% Decrease
Other comprehensive income before tax	₩	25,536	(25,536)
Tax effect		5,618	(5,618)
	₩	19,918	(19,918)

27 Risk Management, Continued

(c) Fair Value of Financial Instruments

The carrying amount and the fair value of financial instruments as of December 31, 2009, December 31, 2008 and January 1, 2008 are summarized as follows.

In millions of Won		2009 Carrying amount	2009 Fair value	2008 Carrying amount	2008 Fair value	January 1 2008 Carrying amount	January 1 2008 Fair value
Assets:							
Financial assets measured at fair value							
- Available-for-sale financial assets	₩	443,800	443,80	304,10	304,10	252,75	252,75
- Long-term deposits in MSA Escrow Fund		118,121	118,121	110,261	110,261	66,633	66,633
- Other financial assets		-	-	1,000	1,000	1,000	1,000
- Cash and cash equivalents		268,954	268,954	88,352	88,352	115,126	115,126
	₩	830,875	830,875	503,718	503,718	435,514	435,514
Financial assets measured at amortized cost							
- Trade and other receivables	₩	612,298	612,298	639,766	639,766	499,237	499,237
	₩	1,443,173	1,443,173	1,143,484	1,143,484	934,751	934,751
Liabilities:							
Financial liabilities measured at fair value							
- Other financial liabilities	₩	-	-	(2,699)	(2,699)	(25)	(25)
Financial liabilities measured at amortized cost							
- Trade and other payables	₩	(176,937)	(176,937)	(283,470)	(283,470)	(221,013)	(221,013)
- Short-term borrowings		(19,338)	(19,338)	(13,344)	(13,344)	(14,955)	(14,955)
	₩	(196,275)	(196,275)	(296,814)	(296,814)	(235,968)	(235,968)
	₩	(196,275)	(196,275)	(299,513)	(299,513)	(235,993)	(235,993)

27 Risk Management, Continued

The fair value hierarchy
The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The level of fair value hierarchy is as follows:

	the significance of the inputs
Level Ⅰ	The quoted prices in active markets for identical assets or liabilities
Level Ⅱ	The inputs that are observable for the asset or liability, either directly or indirectly
Level Ⅲ	The inputs for the asset or liability that are not based on observable market data

The fair value measurements classified by fair value hierarchy as of December 31, 2009 and December 31, 2008 and January 1, 2008 are as follows.

In millions of Won		Level Ⅰ	Level Ⅱ	Level Ⅲ	Total
As of December 31, 2009:					
Financial assets					
- Available-for-sale financial assets	₩	412,827	6,878	24,095	443,800
- Long-term deposits in MSA Escrow Fund		118,121	-	-	118,121
- Cash and cash equivalents		268,954	-	-	268,954
	₩	799,902	6,878	24,095	830,875
As of December 31, 2008:					
Financial assets					
- Available-for-sale financial assets	₩	274,824	7,196	22,085	304,105
- Long-term deposits in MSA Escrow Fund		110,261	-	-	110,261
- Other financial assets		1,000	-	-	1,000
- Cash and cash equivalents		88,352	-	-	88,352
	₩	474,437	7,196	22,085	503,718
Financial Liabilities					
- Other financial liabilities	₩	-	(2,699)	-	(2,699)
As of January 1, 2008:					
Financial assets					
- Available-for-sale financial assets	₩	221,024	2,000	29,731	252,755
- Long-term deposits in MSA Escrow Fund		66,633	-	-	66,633
- Other financial assets		1,000	-	-	1,000
- Cash and cash equivalents		115,126	-	-	115,126
	₩	403,783	2,000	29,731	435,514
Financial Liabilities					
- Other financial liabilities	₩	-	(25)	-	(25)

As Genematrix, Inc. was listed on KOSDAQ in the year ended December 31, 2009, available-for-sale equity instruments in Genematrix, Inc. was transferred from Level Ⅲ to Level Ⅰ. As Rexahn Pharmaceuticals, Inc. was listed on New York Stock Exchange in the year ended December 31, 2008, available-for-sale equity instruments in Rexahn Pharmaceuticals, Inc. was transferred from Level Ⅲ to Level Ⅱ. As Celltrion, Inc. was listed on KOSDAQ in the year ended December 31, 2008, available-for-sale equity instruments in Celltrion, Inc. was transferred from Level Ⅲ to Level Ⅰ.

28 Contingent Liabilities and Financial Commitments

(a) The Company deposited some proportion of sales in accordance with Tobacco Master Settlement Agreement ("MSA") under the Escrow Statute of the United States government, related to the export of tobacco to the United States. The MSA Escrow Funds is 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 that the fund was established. The Company recorded as long-term deposits the amounts paid into the MSA Escrow Funds of State governments in the United States against potential litigation and damages related to the export of tobacco into the United States.

(b) As of December 31, 2009, tobacco lawsuits claiming damages of ₩584 million were filed against the Company and the Korean government. The plaintiffs have asserted that the Company and the Korean government did not perform their obligations to notify smokers of the potential health hazards of smoking. Additionally, the Company is involved in 6 lawsuits and claims for alleged damages totalling ₩3,910 million as a dependent as of December 31, 2009. The amount of the liability the Company may ultimately have with respect to the litigation cannot be reasonably estimated as of December 31, 2009.

(c) As of December 31, 2009, the Company has entered into Letter of Credit Agreements with the NACF and other banks with a limit set at USD48,000 thousand.

(d) As of December 31, 2009, the Company's trade receivables from the export of cigarettes were insured against non-payment up to USD36,200 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

(e) As of December 31, 2009, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD70,000 thousand by Korea Exchange Bank and others.

(f) As of December 31, 2009, the Company and 28 other companies, which form the Samsung Corporation-National Pension Service Joint Consortium, were guaranteed ₩240,000 million by Seoul Guarantee Insurance Co., Ltd. in relation to the Yongsan International Commercial Development Project.

(g) The Company entered into an overdraft agreement with a limit of ₩10,000 million with the NACF as of December 31, 2009.

(h) The Company has provided KT&G Rus L.L.C. with payment guarantee on foreign currency letter of credit opened in relation with acquisition of tobacco manufacturing machinery up to EUR7,267 thousand to Korea Exchange Bank

29 Non-current Asset Held for Sale

The Company entered into a contract to sell the land for the year ended December 31, 2009 and recognized non-current asset held for sale amounting to ₩23,246 million at the lowers of its carrying amount and fair value less costs to sell.

December 31, 2009, December 31, 2008 and January 1, 2008

30 Cash flows from operating activities

Details of cash generated from operations for the years ended December 31, 2009 and 2008 are as follows:

In millions of Won		2009	2008
Profit for the year	₩	744,942	849,486
Adjustments for:			
- Income tax expense		240,406	265,233
- Finance costs		7,752	10,093
- Finance income		(41,607)	(78,393)
- Depreciation		126,021	130,266
- Amortization		277	706
- Retirement benefit costs		32,900	23,322
- Foreign currency translations loss		16,048	812
- Loss on the write-down of inventories		-	4,413
- Impairment loss on trade and other receivables		540	553
- Loss on sale of property, plant and equipment		5,831	3,095
- Impairment loss on property, plant and equipment		-	429
- Impairment loss on intangible assets		647	-
- Other expense		2,473	3,763
- Reversal of loss on the write-down of inventories		(189)	(18,439)
- Foreign currency translations gain		(178)	(26,141)
- Gain on sale of property, plant and equipment		(12,100)	(14,286)
		1,123,763	1,154,912
Changes in working capital:			
- Trade and other receivables		19,766	(88,411)
- Advance payments		(8,871)	(21,053)
- Prepaid expenses		1,590	2,226
- Prepaid tobacco excise and other taxes		32,333	(37,398)
- Inventories		90,492	(129,298)
- Trade and other payables		(114,865)	65,737
- Advance receipts		(48,768)	(1,299)
- Tobacco excise and other taxes payable		(20,147)	24,086
- Payment of retirement benefits		(41,169)	(61,791)
Cash generated from operations	₩	1,034,124	907,711

31 Dividends

Dividends and dividends per share proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to owners during the years ended December 31, 2009 and 2008 are as follows:

In millions of Won, except share information and dividends per share		2009	2008
Number of shares receivable dividend		127,198,800	128,698,800
Dividends per share in Won	₩	2,800	2,800
Total Dividends		356,157	360,357

32 Date of Authorization for Issue

The 2009 financial statements were authorized for issue on January 20, 2010, at the Board of Directors Meeting.

33 Transition to Korean International Financial Reporting Standards

Prior to 2009, the Company prepared its financial statements under Generally Accepted Accounting Principles in the Republic of Korea ("K-GAAP"). From January 1, 2009, the Company is required to prepare its non-consolidated financial statements in accordance with K-IFRS. As the 2009 financial statements include comparatives for 2008, the Company's date of transition to K-IFRS in accordance with K-IFRS No.1101 on first time adoption of K-IFRS, is January 1, 2008, and the 2008 comparatives are restated to K-IFRS.

The effect of the transition from K-GAAP to K-IFRS, affecting the Company's reported financial position, financial performance and cash flows, is as follows:

(a) K-IFRS No.1101 permits those companies adopting K-IFRS for the first time certain exemptions from the full requirements of K-IFRS in the transition period. The Company has taken the following key exemptions:

(i) Business combinations prior to the date of transition are not restated.

(ii) The Company measures investments in a subsidiary, Korea Ginseng Corporation, at the date of transition to K-IFRS at carrying amounts using a K-GAAP as deemed cost at that date.

(iii) The Company capitalizes borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset after the date of transition to K-IFRS.

(b) The main adjustments in changing to K-IFRS are as follows and the tables of reconciliation are cross-referenced to the notes below where relevant:

(1) Reclassification of Investment Property and Intangible Asset under Development

In accordance with K-GAAP, property held to earn rentals or for capital appreciation or both were classified and accounted for as property, plant and equipment. In accordance with K-IFRS, it is reclassified as investment property. In addition, development costs of new medicines classified as construction-in-progress of property, plant and equipment in accordance with K-GAAP, are reclassified as intangible assets under development in accordance with K-IFRS.

(2) Reclassification of Guarantee Deposits Paid and Guarantee Deposits for Membership

In accordance with K-GAAP, guarantee deposits paid and guarantee deposits for membership recognized as other non-current assets are recorded in intangible assets as rights to facility usage with indefinite useful lives and prepaid expenses, respectively. Prepaid expenses attribute expenses to periods of service.

(3) Revenue Recognition Criteria

In accordance with K-GAAP, revenue from building lotting-out construction contracts is accounted for by the percentage of completion method. In accordance with K-IFRS, it is recognized when the significant risks and rewards of ownership are transferred to a third party.

33 Transition to Korean International Financial Reporting Standards, Continued

(4) Investments in Associates and Subsidiaries

In accordance with K-GAAP, investments in associates such as Cosmo Tabacco Co., Ltd., Korea Islet Transplantation Institute, Inc. and Lite Pharm Tech, Inc. were accounted for under the cost method since the effect of applying the equity method on its financial statements is immaterial. In accordance with K-IFRS, these are reclassified as the investments in associates accounted for under the cost method of accounting.

In accordance with K-GAAP, investments in subsidiaries such as Korea Ginseng Corporation, Youngjin Pharm. Ind. Co., Ltd. and KT&G Tutun Mamulleri Sanayi ve Ticaret A.S were accounted for using the equity method of accounting. In accordance with K-IFRS, these are reclassified as the investments in subsidiaries, and are accounted for under the cost method of accounting.

In addition, in the preparation of the opening K-IFRS statement of financial position on the date of transition to K-IFRS, the Company measures its investment in Korea Ginseng Corporation at the deemed cost which is previous GAAP carrying amount at the date of transition in accordance with K-IFRS No.1101.

(5) Retirement Benefit Obligations

Employees who have been with the Company for more than one year are entitled to lump-sum payments based on current salary rates and length of service when they leave the Company. In accordance with K-GAAP, the Company's estimated liability under the plan which would be payable if all employees left on the end of reporting date is accrued in the statement of financial position. In accordance with K-IFRS, the Company uses the projected unit credit method by way of an actuarial valuation method to determine the present value of its defined benefit obligations.

(6) Employee Benefits: Accumulating Compensated Absence and Bonus

According to the K-IFRS, the Company recognizes the expected cost of short-term employee benefits in the form of compensated absence as a liability, when employees render service that increases their entitlement to future compensated absences. Also, the Company recognizes its legal or constructive obligation under a profit-sharing or bonus plan as a liability when employees render service.

(7) Derecognition of Financial Assets and Financial Liabilities

With regard to trade receivables with customer credit contracts, trade receivables were derecognized at the point of the collection from lenders in accordance with K-GAAP. However, in accordance with K-IFRS, trade receivables with customer credit contracts were derecognized at the point of the collection from borrowers. In addition, in accordance with K-GAAP, tobacco excise and other taxes payable were reflected in the statement of financial position after offsetting by prepaid tobacco excise and other taxes. However, in accordance with K-IFRS, they are reflected in the statement of financial position the aggregate amount in total rather than offset.

(8) Impairment and Uncollectibility of Financial Assets

In accordance with K-GAAP, allowances for the receivables were influenced by tax requirements and practice. However, in accordance with K-IFRS, the Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant.

33 Transition to Korean International Financial Reporting Standards, Continued

(9) Financial Instrument Carried at Amortized Cost

In accordance with K-GAAP, a financial instrument such as loans and receivables was recognized in nominal terms. However, in accordance with K-IFRS, when a financial instrument is recognized initially, it is measured at its fair value. After initial recognition, a financial instrument is measured at amortized cost using the effective interest method.

(10) Review of Depreciation Period or Depreciation Method

The Company reviewed the depreciation method and the useful life of the asset to reflect the pattern and period in which the asset's future economic benefits are expected to be consumed by the Company.

(11) The Effect of Income Tax

In accordance with K-GAAP, it is required that deferred tax assets and liabilities be classified as current or non-current. However, K-IFRS does not specify whether the Company should distinguish current and non-current portions of deferred tax assets and liabilities. In addition, the tax effects of the above adjustments arising from differences between K-GAAP and K-IFRS have been reflected in the financial statements.

33 Transition to Korean International Financial Reporting Standards, Continued

(c) Reconciliation of equity in accordance with K-GAAP to Equity in accordance with K-IFRS

(i) The effect of the change to K-IFRS on the non-consolidated statement of financial position at January 1, 2008 is as follows:

In millions of Won		K-GAAP	Re-classification	Revenue recognition criteria	Investments	Retirement benefit obligations	Employee benefits	Derecognition of financial instruments	Other Changes	K-IFRS
Notes			(1)(2)	(3)	(4)	(5)	(6)	(7)	(8)(9)(10)(11)	
Assets	₩	3,977,800	(942)	12,623	36,058	(2,091)	3,741	179,331	(6,954)	4,199,566
Equity	₩	3,142,003	(942)	(6,549)	36,058	15,262	(73,069)	-	23,114	3,135,877
Liabilities		835,797	-	19,172	-	(17,353)	76,810	179,331	(30,068)	1,063,689
Equity and liabilities	₩	3,977,800	(942)	12,623	36,058	(2,091)	3,741	179,331	(6,954)	4,199,566

(ii) The effect of the change to K-IFRS on the non-consolidated statement of financial position at December 31, 2008 is as follows:

In millions of Won		K-GAAP	Re-classification	Revenue recognition criteria	Investments	Retirement benefit obligations	Employee benefits	Derecognition of financial instruments	Other Changes	K-IFRS
Notes			(1)(2)	(3)	(4)	(5)	(6)	(7)	(8)(9)(10)(11)	
Assets	₩	4,382,573	(1,007)	37,474	(42,563)	2,302	3,890	215,118	15,597	4,613,384
Equity	₩	3,539,831	(1,007)	(29,574)	(42,563)	(7,518)	(74,659)	-	69,916	3,454,426
Liabilities		842,742	-	67,048	-	9,820	78,549	215,118	(54,319)	1,158,958
Equity and liabilities	₩	4,382,573	(1,007)	37,474	(42,563)	2,302	3,890	215,118	15,597	4,613,384

33 Transition to Korean International Financial Reporting Standards, Continued

(d) Reconciliation of total comprehensive income in accordance with K-GAAP to total comprehensive income in accordance with K-IFRS

(i) The effect of the change to K-IFRS on the non-consolidated statement of comprehensive income for the year ended December 31, 2008 is as follows:

In millions of Won, except earnings per share Notes		K-GAAP	Re-classification (1)(2)	Revenue recognition criteria (3)	Investments (4)	Retirement benefit obligations (5)	Employee benefits (6)	Other Changes (8)(9)(10)(11)	K-IFRS
Sales	₩	2,644,656	-	(71,975)	-	-	-	461	2,573,142
Cost of sales		(1,023,034)	(3,409)	48,950	-	8,889	(462)	3,748	(965,318)
Gross profit		1,621,622	(3,409)	(23,025)	-	8,889	(462)	4,209	1,607,824
Other income		108,361	-	-	-	-	-	-	108,361
Selling, general and administrative expenses		(634,754)	3,343	-	-	15,147	(1,128)	(626)	(618,018)
Contribution to employee welfare foundation		(15,000)	-	-	-	-	-	-	(15,000)
Other expense		(48,685)	-	-	-	-	-	11,937	(36,748)
Profit from operations		1,031,544	(66)	(23,025)	-	24,036	(1,590)	15,520	1,046,419
Net finance income (costs)		15,053	-	-	60,000	(7,016)	-	263	68,300
Share of the profit or loss of associates		134,706	-	-	(134,706)	-	-	-	-
Profit before tax		1,181,303	(66)	(23,025)	(74,706)	17,020	(1,590)	15,783	1,114,719
Income tax expense		(287,013)	-	-	-	-	-	21,780	(265,233)
Profit for the period	₩	894,290	(66)	(23,025)	(74,706)	17,020	(1,590)	37,563	849,486
Other comprehensive income, net of tax		29,066	-	-	(3,429)	(31,044)	-	-	(5,407)
Total comprehensive income for the period	₩	923,356	(66)	(23,025)	(78,135)	(14,026)	(1,590)	37,563	844,079
Basic and diluted earnings per share in Won	₩	6,872							6,527

33 Transition to Korean International Financial Reporting Standards, Continued

(e) Explanation of material adjustments to the non-consolidated statement of cash flows

Interest paid, interest received and dividends received were classified as operating cash flows in accordance with K-GAAP. But, in accordance with K-IFRS, interest paid are reclassified as financing cash flows, and interest received and dividends received are reclassified as investing cash flows. The effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is presented separately from cash flows from operating, investing and financing activities.

Bank overdrafts which form an integral part of the Company's cash management are included as a component of cash and cash equivalents rather than financing cash flows.

KPMG SAMJONG

KPMG SAMJONG Accounting Corp.
10th Floor, Gangnam Finance Center,
737 Yeoksam-dong,
Gangnam-gu, Seoul 135-984,
Republic of Korea

Tel +82 (2) 2112 0100
Fax +82 (2) 2112 0101
www.kr.kpmg.com

Independent Accountants' Review Report on Internal Accounting Control System

English Translation of a Report Originally Issued in Korean

To the President of
KT&G Corporation:

We have reviewed the accompanying Report on the Operations of Internal Accounting Control System ("IACS") of KT&G Corporation (the "Company") as of December 31, 2009. The Company's management is responsible for designing and maintaining effective IACS and for its assessment of the effectiveness of IACS. Our responsibility is to review management's assessment and issue a report based on our review. In the accompanying report of management's assessment of IACS, the Company's management stated: "Based on the assessment on the operations of the IACS, the Company's IACS has been effectively designed and is operating as of December 31, 2009, in all material respects, in accordance with the IACS Framework issued by the Internal Accounting Control System Operation Committee."

We conducted our review in accordance with IACS Review Standards, issued by the Korean Institute of Certified Public Accountants. Those Standards require that we plan and perform the review to obtain assurance of a level less than that of an audit as to whether Report on the Operations of Internal Accounting Control System is free of material misstatement. Our review consists principally of obtaining an understanding of the Company's IACS, inquiries of company personnel about the details of the report, and tracing to related documents we considered necessary in the circumstances. We have not performed an audit and, accordingly, we do not express an audit opinion.

A company's IACS is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, however, IACS may not prevent or detect misstatements. 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 Report on the Operations of Internal Accounting Control System as of December 31, 2009 is not prepared in all material respects, in accordance with IACS Framework issued by the Internal Accounting Control System Operation Committee.
This report applies to the Company's IACS in existence as of December 31, 2009. We did not review the Company's IACS subsequent to December 31, 2009. This report has been prepared for Korean regulatory purposes, pursuant to the External Audit Law, and may not be appropriate for other purposes or for other users.

Seoul, Korea
February 11, 2010

Notice to Readers

This report is annexed in relation to the audit of the non-consolidated financial statements as of December 31, 2009 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.

Report on the Operations of Internal Accounting Control System

To the Board of Directors and Internal Audit Committee of
KT&G Corporation:

I, as the Internal Accounting Control Officer ("IACO") of KT&G Corporation (the "Company"), have assessed the status of the design and operations of the Company's internal accounting control system ("IACS") for the year ended December 31, 2009.

The Company's management including IACO is responsible for the design and operations of its IACS. I, as the IACO, have assessed whether the IACS has been effectively designed and is operating to prevent and detect any error or fraud which may cause any misstatement of the financial statements, for the purpose of establishing the reliability of financial reporting and the preparation of financial statements for external purposes. I, as the IACO, applied the IACS Framework for the assessment of design and operations of the IACS.

Based on the assessment of the operations of the IACS, the Company's IACS has been effectively designed and is operating as of December 31, 2009, in all material respects, in accordance with the IACS Framework issued by the Internal Accounting Control System Operation Committee.

January 20, 2010

Kim, San Kyum, Internal Accounting Control Officer

Kwak, Young Kyoon, Chief Executive Officer