

KT&G Corporation

**Separate Financial Statements
December 31, 2013 and 2012**

KT&G Corporation
Index
December 31, 2013 and 2012

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Report of Independent Auditors

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

We have audited the accompanying separate statements of financial position of KT&G Corporation (the "Company") as of December 31, 2013 and 2012, and the related separate statements of comprehensive income, changes in equity and cash flows for the years then ended, expressed in Korean won. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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 provides a reasonable basis for our opinion.

In our opinion, the separate financial statements, referred to above, present fairly, in all material respects, the financial position of KT&G Corporation as of December 31, 2013 and 2012, and its financial performance and cash flows for the year then ended, in accordance with International Financial Reporting Standards as adopted by the Republic of Korea ("Korean IFRS").

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The accompanying separate financial statements as of and for the years ended December 31, 2013 and 2012, have been translated into US dollars solely for the convenience of the reader and have been translated on the basis set forth in Note 33 to the separate financial statements.

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

Seoul, Korea
February 12, 2014

Samil pricewaterhouse Coopers

This report is effective as of February 12, 2014, the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying separate financial statements and notes thereto. Accordingly, the readers of the audit report should understand that there is a possibility that the above audit report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

KT&G Corporation
Separate Statements of Financial Position
December 31, 2013 and 2012

(in millions of Korean won
and thousands of U.S. dollars)

	Notes	December 31, 2013 Korean won	December 31, 2013 U.S. dollars (Note 33)	December 31, 2012 Korean won
Assets				
Non-current assets				
Property, plant and equipment	9	₩ 1,182,763	\$ 1,120,783	₩ 1,163,220
Intangible assets	10	21,191	20,080	19,937
Investment property	11,13	146,034	138,382	153,907
Investments in associates	14	60,225	57,069	57,725
Investments in subsidiaries	14	1,166,478	1,105,352	1,178,590
Available-for-sale financial assets	4,5,6	296,391	280,860	263,544
Long-term deposits in MSA Escrow Fund	4,5,8,31	219,760	208,245	168,667
Long-term prepaid expenses		4,797	4,546	4,163
Long-term trade and other receivables	4,5,7,32	134,498	127,450	146,174
		<u>3,232,137</u>	<u>3,062,767</u>	<u>3,155,927</u>
Current assets				
Inventories	15	939,744	890,499	872,833
Available-for-sale financial assets	4,5,6	-	-	1,000
Other financial assets	4,5,16	660,000	625,415	620,000
Prepaid tobacco excise and other taxes		262,770	249,000	254,562
Trade and other receivables	4,5,7,32	721,468	683,661	726,397
Advance payments		16,474	15,610	13,964
Prepaid expenses		3,878	3,675	5,757
Cash and cash equivalents	4,5,16	245,838	232,956	266,720
		<u>2,850,172</u>	<u>2,700,816</u>	<u>2,761,233</u>
Assets held for sale	12	<u>3</u>	<u>3</u>	<u>762</u>
Total assets		<u>₩ 6,082,312</u>	<u>\$ 5,763,586</u>	<u>₩ 5,917,922</u>
Equity				
Capital stock	1,17	₩ 954,959	\$ 904,918	₩ 954,959
Other Capital surplus	17	3,582	3,394	3,582
Treasury shares	18	(339,059)	(321,291)	(339,059)
Gain on reissuance of treasury shares	18	492,032	466,249	492,032
Reserve	19	3,411,099	3,232,350	3,039,034
Retained earnings	20	509,821	483,105	752,766
Total equity		<u>5,032,434</u>	<u>4,768,725</u>	<u>4,903,314</u>
Liabilities				
Non-current liabilities				
Long-term trade and other payables	4,5,21,32	28,269	26,787	27,325
Long-term advance receipts		3,676	3,483	4,953
Defined benefit liability	23	60,273	57,114	66,211
Deferred income tax liabilities	27	53,823	51,003	80,948
		<u>146,041</u>	<u>138,387</u>	<u>179,437</u>
Current liabilities				
Borrowings	4,5,22	4,920	4,662	5,477
Trade and other payables	4,5,21,32	402,389	381,303	266,844
Advance receipts		17,230	16,327	25,639
Income taxes payable		136,285	129,144	137,828
Tobacco excise and other taxes payable		343,013	325,038	399,383
		<u>903,837</u>	<u>856,474</u>	<u>835,171</u>
Total liabilities		<u>1,049,878</u>	<u>994,861</u>	<u>1,014,608</u>
Total liabilities and equity		<u>₩ 6,082,312</u>	<u>\$ 5,763,586</u>	<u>₩ 5,917,922</u>

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

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

KT&G Corporation
Separate Statements of Comprehensive Income
Years Ended December 31, 2013 and 2012

<i>(in millions of Korean won and thousands of U.S. dollars, except per share amounts)</i>		Notes	2013 Korean won	2013 U.S. dollars (Note 33)	2012 Korean won
Sales					
Manufacture of tobacco		₩	2,342,229	\$ 2,219,491	₩ 2,523,880
Real estate			109,201	103,479	43,509
Exports of leaf tobacco and others			59,202	56,100	70,223
	31,32		<u>2,510,632</u>	<u>2,379,070</u>	<u>2,637,612</u>
Cost of sales					
Manufacture of tobacco			(841,434)	(797,342)	(926,007)
Real estate			(57,285)	(54,283)	(7,265)
Exports of leaf tobacco and others			(37,336)	(35,379)	(48,824)
	15,25,32		<u>(936,055)</u>	<u>(887,004)</u>	<u>(982,096)</u>
			1,574,577	1,492,066	1,655,516
Gross profit					
Selling and administrative expenses	24,25		(651,073)	(616,956)	(682,836)
Operating income	24		<u>923,504</u>	<u>875,110</u>	<u>972,680</u>
Other income	24,32		47,914	45,403	92,651
Other expenses	24,25,32		(246,352)	(233,443)	(91,014)
Net other income			<u>(198,438)</u>	<u>(188,040)</u>	<u>1,637</u>
Finance income	26		47,490	45,002	45,346
Finance costs	26		(15,753)	(14,928)	(1,185)
Net finance income	26		<u>31,737</u>	<u>30,074</u>	<u>44,161</u>
Profit before income tax			756,803	717,145	1,018,478
Income tax expense	27		(255,488)	(242,100)	(250,040)
Profit for the year			<u>₩ 501,315</u>	<u>\$ 475,045</u>	<u>₩ 768,438</u>
Other comprehensive income					
Items that will not be reclassified subsequently to profit or loss:					
Remeasurements of the net defined benefit liability		₩	5,616	\$ 5,322	₩ (18,014)
Items that will be reclassified subsequently to profit or loss:					
Change in value of available-for-sale financial assets			25,065	23,751	1,220
Other comprehensive income (loss) for the year, net of tax			<u>30,681</u>	<u>29,073</u>	<u>(16,794)</u>
Total comprehensive income for the year			<u>₩ 531,996</u>	<u>\$ 504,118</u>	<u>₩ 751,644</u>
Earnings per share attributable to the equity holders of the Company during the year (in won)					
Basic and diluted earnings per share	28	₩	<u>3,982</u>	<u>\$ 4</u>	<u>₩ 6,111</u>

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

KT&G Corporation
Separate Statements of Changes in Equity
Years Ended December 31, 2013 and 2012

(in millions of Korean won)

	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
Balance at January 1, 2012	₩ 954,959	₩ 3,582	₩ (343,522)	₩ 485,922	₩ 2,678,814	₩ 763,739	₩ 4,543,494
Comprehensive income							
Profit for the year	-	-	-	-	-	768,438	768,438
Other comprehensive income(loss)	-	-	-	-	1,220	-	1,220
Change in value of available-for-sale financial assets	-	-	-	-	-	(18,014)	(18,014)
Remeasurements of the net defined benefit liability	-	-	-	-	1,220	(16,794)	(16,794)
Total other comprehensive income (loss)	-	-	-	-	1,220	750,424	751,644
Total comprehensive income (loss)	-	-	-	-	-	-	-
Transactions with equity holders of the Company							
Cash dividends	-	-	-	-	-	(402,396)	(402,396)
Sale of treasury shares	-	-	4,463	6,110	-	-	10,573
Other reserve	-	-	-	-	359,000	(359,000)	-
Total transactions with equity holders of the Company	-	-	4,463	6,110	359,000	(761,396)	(391,823)
Balance at December 31, 2012	₩ 954,959	₩ 3,582	₩ (339,059)	₩ 492,032	₩ 3,039,034	₩ 752,767	₩ 4,903,315
Balance at January 1, 2013	₩ 954,959	₩ 3,582	₩ (339,059)	₩ 492,032	₩ 3,039,034	₩ 752,767	₩ 4,903,315
Comprehensive income							
Profit for the year	-	-	-	-	-	501,315	501,315
Other comprehensive income(loss)	-	-	-	-	25,065	-	25,065
Change in value of available-for-sale financial assets	-	-	-	-	-	5,616	5,616
Remeasurements of the net defined benefit liability	-	-	-	-	25,065	5,616	30,681
Total other comprehensive income (loss)	-	-	-	-	25,065	506,931	531,996
Total comprehensive income (loss)	-	-	-	-	-	-	-
Transactions with equity holders of the Company							
Cash dividends	-	-	-	-	-	(402,876)	(402,876)
Other reserve	-	-	-	-	317,000	(317,000)	-
Reserve for research and human resource development	-	-	-	-	30,000	(30,000)	-
Total transactions with equity holders of the Company	-	-	-	-	347,000	(749,876)	(402,876)
Balance at December 31, 2013	₩ 954,959	₩ 3,582	₩ (339,059)	₩ 492,032	₩ 3,411,099	₩ 509,822	₩ 5,032,435

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

KT&G Corporation
Separate Statements of Changes in Equity
Years Ended December 31, 2013 and 2012

(In thousands of U.S. dollars) (Note 33)

	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
Balance at January 1, 2012	\$ 904,918	\$ 3,394	\$ (321,291)	\$ 486,249	\$ 2,879,781	\$ 713,319	\$ 4,646,370
Comprehensive income							
Profit for the year	-	-	-	-	-	475,045	475,045
Other comprehensive income(loss)							
Change in value of available-for-sale financial assets	-	-	-	-	23,751	-	23,751
Actuarial gain(loss) on defined benefit liability	-	-	-	-	-	5,322	5,322
Total other comprehensive income (loss)	-	-	-	-	23,751	5,322	29,073
Total comprehensive income (loss)					23,751	480,367	504,118
Transactions with equity holders of the Company							
Cash dividends	-	-	-	-	-	(381,765)	(381,765)
Reissuance of treasury shares	-	-	-	-	300,389	(300,389)	-
Other reserve	-	-	-	-	28,428	(28,428)	-
Total transactions with equity holders of the Company					328,817	(710,582)	(381,765)
Balance at December 31, 2012	\$ 904,918	\$ 3,394	\$ (321,291)	\$ 486,249	\$ 3,232,349	\$ 483,104	\$ 4,768,723

The accompanying notes are an integral part of these separate financial statements.
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KT&G Corporation
Separate Statements of Cash Flows
Years Ended December 31, 2013 and 2012

(in millions of Korean won
and thousands of U.S. dollars)

	Notes	2013 Korean won	2013 U.S. dollars (Note 33)	2012 Korean won
Cash flows from operating activities				
Cash generated from operations	30	₩ 925,216	\$ 876,732	₩ 1,050,604
Income tax paid		(293,950)	(278,547)	(249,623)
Net cash generated from operating activities		631,266	598,185	800,981
Cash flows from investing activities				
Interest received		32,469	30,767	29,280
Investment income received from long-term deposits in MSA Escrow Fund		845	801	407
Dividends received		12,216	11,576	8,903
Proceeds from sale of property, plant and equipment		8,647	8,194	30,922
Proceeds from sale of intangible assets		1	1	401
Proceeds from sale of assets held for sale		7,471	7,080	35,566
Proceeds from sale of available-for-sale financial assets		-	-	296
Proceeds from sale of investments in associates		612	580	-
Proceeds from sale of investments in subsidiaries		-	-	900
Decrease in loans		13,767	13,046	36,797
Decrease in guarantee deposits		18,431	17,465	52,744
Acquisition of property, plant and equipment		(115,339)	(109,295)	(155,205)
Acquisition of intangible assets		(1,317)	(1,248)	(1,727)
Acquisition of investment property		(1,736)	(1,645)	(51)
Acquisition of investments in associates		(5,000)	(4,738)	(21,000)
Acquisition of investments in subsidiaries		(58,088)	(55,044)	(77,388)
Acquisition of available-for-sale financial assets		(13,781)	(13,058)	(16,500)
Increase in loans		(35,288)	(33,439)	-
Increase in guarantee deposits		(17,337)	(16,429)	(54,547)
Increase in long-term deposits in MSA Escrow Fund		(56,067)	(53,129)	(34,096)
Increase in other financial assets		(40,000)	(37,904)	(620,000)
Net cash used in investing activities		(249,494)	(236,419)	(784,298)
Cash flows from financing activities				
Interest paid		-	-	-
Dividends paid	29	(402,876)	(381,765)	(402,396)
Acquisition of treasury shares		-	-	-
Increase in deposits received		4,182	3,963	5,651
Decrease in deposits received		(3,944)	(3,738)	(4,819)
Reissuance of treasury shares		-	-	12,525
Net cash used in financing activities		(402,638)	(381,540)	(389,039)
Net decrease in cash and cash equivalents		(20,868)	(19,774)	(372,356)
Cash and cash equivalents at the beginning of year		266,720	252,743	639,097
Exchange gains/(losses) on cash and cash equivalents		(14)	(13)	(21)
Cash and cash equivalents at the end of year		₩ 245,838	\$ 232,956	₩ 266,720

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

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

KT&G Corporation

Notes to Separate Financial Statements

December 31, 2013 and 2012

1. General Information

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

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

As of December 31, 2013, the Company has two manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 135 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Company is located in Pyeongchon-dong, Daedeok-gu, Daejeon.

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

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

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The ownership of the Company's issued ordinary shares as of December 31, 2013, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee share ownership association	2,802,737	2.04%
Others	113,585,578	82.73%
	125,898,800	91.70%
Treasury shares	11,393,697	8.30%
	137,292,497	100.00%

2. Significant Accounting Policies

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

2.1 Basis of Preparation

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

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

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

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Notes to Separate Financial Statements

December 31, 2013 and 2012

2.1.1 Changes in Accounting Policy and Disclosures

(a) New and amended standards adopted by the Company

The Company newly applied the following amended and enacted standards for the annual period beginning on January 1, 2013:

- Amendment to Korean IFRS 1001, *Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income*

The amendment requires entities to group items presented in other comprehensive income based on whether they are potentially reclassifiable to profit or loss subsequently. The Company applies the amendment retroactively and there is no impact of the application of this amendment on its total comprehensive income or loss.

- Amendment to Korean IFRS 1019, *Employee Benefits*

The amendment requires entities to immediately recognize all actuarial gains and losses incurred in other comprehensive income or loss. All past service costs incurred are immediately recognized in accordance with the change of the plan, and the previous separate calculation of the interest cost and the expected returns on plan assets has been revised to calculate net interest expense (income) by applying the discount rate used in the defined benefit obligation measurement in the net defined benefit liabilities (assets). There is no material impact of the application of this amendment on the separate financial statements.

- Korean IFRS 1111, *Joint Arrangements*

Korean IFRS 1111, *Joint Arrangements*, reflects the substance of joint arrangements and focuses on the rights and obligations of the parties to the joint arrangements rather than on the legal forms of the arrangements. Joint arrangements are classified into joint operations or joint ventures. The adoption of this standard does not have an impact on the separate financial statements.

- Korean IFRS 1112, *Disclosures of Interests in Other Entities*

Korean IFRS 1112, *Disclosure of Interests in Other Entities*, provides disclosure requirements for all types of equity investments in other entities including subsidiaries, associates, joint ventures and unseparate structured entities.

- Korean IFRS 1027, *Separate Financial Statements*

Korean IFRS 1027, *Separate Financial Statements*, contains accounting treatments and requirements for investments in subsidiaries, associates and joint ventures relating only to separate financial statements of the Controlling Company.

- Korean IFRS 1113, *Fair Value Measurement*

Korean IFRS 1113, *Fair Value Measurement*, provides a precise definition of fair value, and a single source of fair value measurement and disclosure requirements for use across K-IFRS. The Company has applied this standard prospectively according to the transitional provisions of K-IFRS 1113 and there is no material impact of the application of this standard on the separate

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December 31, 2013 and 2012

financial statements.

(b) New standards and interpretations not yet adopted

New standards, amendments and interpretations issued but not effective for the financial year beginning January 1, 2013, and not early adopted by the Company are as follows:

- Amendment to Korean IFRS 1032, *Financial Instruments: Presentation*

Amendment to Korean IFRS 1032, *Financial Instruments: Presentation*, provides that the right to offset must not be contingent on a future event and must be legally enforceable in all of circumstances; and if an entity can settle amounts in a manner such that outcome is, in effect, equivalent to net settlement, the entity will meet the net settlement criterion. This amendment is effective for annual periods beginning on or after January 1, 2014, and the Company is assessing the impact of application of this amendment on its separate financial statements.

- Amendment to Korean IFRS 1039, *Financial Instruments: Recognition and Measurement*

Amendment to Korean IFRS 1039, *Financial Instruments: Recognition and Measurement*, allows the continuation of hedge accounting for a derivative that has been designated as a hedging instrument in a circumstance in which that derivative is novated to a central counterparty (CCP) as a consequence of laws or regulations. This amendment is effective for annual periods beginning on or after January 1, 2014, with early adoption permitted. The Company is assessing the impact of application of this amendment on its separate financial statements.

- Enactment of IFRIC interpretations 2121, *Levies*

IFRIC interpretations 2121, *Levies*, are applied to a liability to pay a levy imposed by a government in accordance with the legislation. The interpretation requires that the liability to pay a levy is recognized when the activity that triggers the payment of the levy occurs, as identified by the legislation (the obligating event). This interpretation is effective for annual periods beginning on or after January 1, 2014, with early adoption permitted. The Company expects that the application of this interpretation would not have a material impact on its separate financial statements.

2.2 Subsidiaries and Associates

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

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Notes to Separate Financial Statements
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2.3 Segment Reporting

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

2.4 Foreign Currency Translation

(a) Functional and presentation currency

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

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss.

Exchange differences arising on non-monetary financial assets and liabilities such as equity instruments at fair value through profit or loss and available-for-sale equity instruments are recognized in profit or loss and included in other comprehensive income, respectively, as part of the fair value gain or loss.

2.5 Cash and Cash Equivalents

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

2.6 Financial Assets

2.6.1 Classification and Measurement

The Company classifies its financial assets in the following categories: financial assets at fair value through profit or loss, available-for-sale financial assets, loans and receivables, and held-to-maturity financial assets. Regular purchases and sales of financial assets are recognized on trade date.

Regular purchases and sales of financial assets are recognized on the trade date. At initial recognition, financial assets are measured at fair value plus, in the case of financial assets not carried at fair value through profit or loss, transaction costs. Transaction costs of financial assets

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carried at fair value through profit or loss are expensed in the statement of income. After the initial recognition, available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables, and held-to-maturity investments are subsequently carried at amortized cost using the effective interest rate method.

Changes in fair value of financial assets at fair value through profit or loss are recognized in profit or loss and changes in fair value of available-for-sale financial assets are recognized in other comprehensive income. When the available-for-sale financial assets are sold or impaired, the fair value adjustments recorded in equity are reclassified into profit or loss.

2.6.2 Impairment

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

Impairment of loans and receivables is presented as a deduction in an allowance account. Impairment of other financial assets is directly deducted from their carrying amount. The Company writes off financial assets when the assets are determined to be no longer recoverable.

The objective evidence that a financial asset is impaired includes significant financial difficulty of the issuer or obligor; a delinquency in interest or principal payments; or the disappearance of an active market for that financial asset because of financial difficulties.

2.6.3 Derecognition

If the Company transfers a financial asset and the transfer does not result in derecognition because the Company has retained substantially of all risks and rewards of ownership of the transferred asset due to a recourse in the event the debtor defaults, the Company continues to recognize the transferred asset in its entirety and recognizes a financial liability for the consideration received. The related financial liability is classified as 'borrowings' in the statement of financial position.

2.7 Trade Receivables

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

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2.8 Inventories

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

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

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

Tobacco leaf inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognized industry practice. The estimated amounts of inventories in current assets which are not expected to be realized within 12 months are ₩ 316,168 million and ₩ 347,489 million as of December 31, 2013 and 2012, respectively.

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

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

2.10 Property, Plant and Equipment

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

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

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

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

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

2.11 Borrowing Costs

Borrowing costs incurred in the acquisition or construction of a qualifying asset are capitalized in the period when it is prepared for its intended use, and investment income earned on the temporary investment of borrowings made specifically for the purpose obtaining a qualifying asset is deducted from the borrowing costs eligible for capitalization during the period. Other borrowing costs are recognized as expenses for the period in which they are incurred.

2.12 Government Grants

Government grants are recognized at their fair values when there is reasonable assurance that the grant will be received and the Company will comply with the conditions attaching to it. Government grants related to assets are presented by deducting the grants in arriving at the carrying amount of the assets, and grants related to income are deferred and presented by deducting the related expenses for the purpose of the government grants.

2.13 Intangible Assets

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

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The estimated useful lives are as follows:

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

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

2.14 Investment Property

Property held to earn rentals or for capital appreciation or both is classified as investment property. Investment property is measured initially at its cost. After recognition as an asset, investment property is carried at cost less accumulated depreciation and impairment losses. Investment property, except for land, is depreciated using the straight-line method over their useful lives from 10 to 60 years.

2.15 Impairment of Non-financial Assets

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

2.16 Financial Liabilities

(a) Classification and measurement

Financial liabilities at fair value through profit or loss are financial instruments held for trading. Financial liabilities are classified in this category if incurred principally for the purpose of repurchasing them in the near term. Derivatives that are not designated as hedges or bifurcated from financial instruments containing embedded derivatives are also categorized as held-for-trading.

The Company classifies non-derivative financial liabilities, except for financial liabilities at fair value through profit or loss, financial guarantee contracts and financial liabilities that arise when a transfer of financial assets does not qualify for derecognition, as financial liabilities carried at amortized cost and presented as 'trade payables', 'borrowings', and 'other financial liabilities' in the

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statement of financial position.

Preferred shares that provide for a mandatory redemption at a particular date are classified as liabilities. Interest expenses on these preferred shares calculated using the effective interest method are recognized in the statement of income as 'finance costs', together with interest expenses recognized on other financial liabilities.

(b) Derecognition

Financial liabilities are removed from the statement of financial position when it is extinguished, for example, when the obligation specified in the contract is discharged, cancelled or expired or when the terms of an existing financial liability are substantially modified.

2.17 Financial Guarantee Contracts

Financial guarantees contracts provided by the Company are initially measured at fair value on the date the guarantee was given. Subsequent to initial recognition, the Company's liabilities under such guarantees are measured at the higher of the amounts below and recognized as 'other financial liabilities':

- the amount determined in accordance with Korean IFRS 1037, *Provisions, Contingent Liabilities and Contingent Assets*; or
- the initial amount, less accumulated amortization recognized in accordance with Korean IFRS1018, *Revenue*.

2.18 Trade Payables

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

2.19 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of comprehensive income over the period of the borrowings using the effective interest method. The Company recognizes borrowings as current assets unless it has an unconditional right to delay the settlement of the borrowing.

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2.20 Compound Financial Instruments

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

2.21 Provisions

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation and the increase in the provision due to passage of time is recognized as interest expense.

2.22 Current and Deferred Income Tax

The tax expense for the period consists of current and deferred tax. Tax is recognized on the profit for the period in the statement of income, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively. The tax expense is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period.

Deferred tax is recognized for temporary differences arising between the tax bases of assets and liabilities and their carrying amounts as expected tax consequences at the recovery or settlement of the carrying amounts of the assets and liabilities. However, deferred tax assets and liabilities are not recognized if they arise from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences can be utilized.

Deferred tax liability is recognized for taxable temporary differences associated with investments in subsidiaries, associates, and interests in joint ventures, except to the extent that the Company 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. In addition, deferred tax asset is recognized for deductible temporary differences arising from such investments to the extent that it is probable the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

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

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2.23 Employee Benefits

(a) Defined benefit liability

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

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

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

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

(b) Termination benefits

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

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2.24 Share Capital

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

2.25 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, 2013 and 2012, were ₩ 3,459,862 million and ₩ 3,508,517 million, respectively.

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

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

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

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

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

2.26 Lease

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

2.27 Dividend Distribution

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

2.28 Approval of Issuance of the Financial Statements

The issuance of the December 31, 2013 financial statements of the Company was approved by the Board of Directors on January 16, 2014, which is subject to change with approval at the annual shareholder's meeting.

3. Critical Accounting Estimates and Judgments

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

(a) Income taxes

The Company is operating in numerous countries and the income generated from these operations is subject to income taxes based on tax laws and interpretations of tax authorities in numerous jurisdictions. There are many transactions and calculations for which the ultimate tax determination is uncertain (Note 27).

(b) Fair value of financial instruments

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

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period (Note 4).

(c) Net defined benefit liability

The present value of net defined benefit liability depends on a number of factors that are determined on an actuarial basis using a number of assumptions including the discount rate (Note 23).

4. Financial Risk Management

4.1 Financial Risk Factors

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

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

(a) Market Risk

i) Foreign exchange risk

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

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

(in millions of Korean won)

	2013							
	USD		EUR		RUB		THB and others	
Assets								
Cash and cash equivalents	₩	10,926	₩	27	₩	-	₩	-
Trade and other receivables		439,194		27,932		1,873		47,073
Long-term deposits		219,760		-		-		-
	₩	669,880	₩	27,959	₩	1,873	₩	47,073
Liabilities								

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Trade and other payables	₩	30,655	₩	10,993	₩	-	₩	-
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(in millions of Korean won)

	2012							
	USD		EUR		RUB		THB and others	
Assets								
Cash and cash equivalents	₩	10,695	₩	1	₩	-	₩	-
Trade and other receivables		497,705		23,059		2,156		290
Long-term deposits		168,667		-		-		-
	₩	677,067	₩	23,060	₩	2,156	₩	290
Liabilities								
Trade and other payables	₩	3,047	₩	1,896	₩	-	₩	-

As of December 31, 2013 and 2012, the effects of a 10% strengthening or weakening of functional currency against the US dollar other than functional currency on profit before tax were as follows:

(in millions of Korean won)	2013				2012			
	10% strengthening		10% weakening		10% strengthening		10% weakening	
US dollar	₩	63,923	₩	(63,923)	₩	67,402	₩	(67,402)

ii) Price risk

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

As of December 31, 2013 and 2012, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income are as follows:

(in millions of Korean won)	2013				2012			
	5% increase		5% decrease		5% increase		5% decrease	
Other comprehensive income before tax	₩	6,811	₩	(6,811)	₩	5,266	₩	(5,266)
Tax effect		(1,648)		1,648		(1,274)		1,274
Other comprehensive income after tax	₩	5,163	₩	(5,163)	₩	3,992	₩	(3,992)

iii) Interest rate risk

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

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(b) Credit Risk

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

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of December 31, 2013 and 2012, is as follows:

<i>(in millions of Korean won)</i>	2013	2012
Available-for-sale financial assets	₩ 2,500	₩ 2,500
Long-term deposits in MSA Escrow Fund	219,760	168,667
Trade and other receivables	855,966	872,572
Other financial assets	660,000	620,000
Cash and cash equivalents	245,838	266,720
Financial guarantee contracts	152,263	-
	<u>₩ 2,136,327</u>	<u>₩ 1,930,459</u>

(c) Liquidity Risk

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

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The maturity analysis with a residual contractual maturity of financial liabilities as of December 31, 2013 and 2012, is as follows:

	2013						
	Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years	
Trade and other payables	₩ 307,074	₩ 308,297	₩ 278,805	₩ -	₩ 29,492	₩ -	-
Short-term borrowings	4,920	4,920	4,920	-	-	-	-
Financial guarantee contracts	-	152,263	-	-	152,263	-	-

	2012						
	Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years	
Trade and other payables	₩ 172,634	₩ 173,878	₩ 145,309	₩ -	₩ 28,569	₩ -	-
Short-term borrowings	5,477	5,477	5,477	-	-	-	-

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.

4.2 Capital Management

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.

As of December 31, 2013 and 2012, the Company defines net debt and equity attributable to owners of the Parent as follows:

<i>(in millions of Korean won)</i>		2013	2012
Total borrowings	₩	4,920	₩ 5,477
Less:			
-Cash and cash equivalents		(245,838)	(266,720)
-Other financial assets, current		(660,000)	(620,000)
-Available-for-sale financial assets, current		-	(1,000)
Net debt(Net asset)		(900,918)	(882,243)
Equity attributable to owners of the parent	₩	<u>5,032,435</u>	<u>₩ 4,903,315</u>

4.3 Fair Value

There are no significant changes in the business or economic circumstances that affect the fair value of the Company's financial assets and financial liabilities during 2013.

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4.3.1 Fair Value of Financial Instruments by Category

Carrying amount and fair value of financial instruments by category as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013		2012	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets				
Available-for-sale financial assets ¹	₩ 279,797	₩ 279,797	₩ 247,950	₩ 247,950
Long-term deposits in MSA Escrow Fund	219,760	219,760	168,667	168,667
Long-term trade and other receivables	134,498	134,498	146,174	146,174
Other financial assets	660,000	660,000	620,000	620,000
Trade and other receivables	721,468	721,468	726,397	726,397
Cash and cash equivalents	245,838	245,838	266,720	266,720
	<u>₩ 2,261,361</u>	<u>₩ 2,261,361</u>	<u>₩ 2,175,908</u>	<u>₩ 2,175,908</u>
Financial liabilities				
Long-term trade and other payables	₩ 28,269	₩ 28,269	₩ 27,325	₩ 27,325
Short-term borrowings	4,920	4,920	5,477	5,477
Trade and other payables	278,805	278,805	145,309	145,309
	<u>₩ 311,994</u>	<u>₩ 311,994</u>	<u>₩ 178,111</u>	<u>₩ 178,111</u>

¹ Equity instruments that do not have a quoted price in an active market are measured at cost because their fair value cannot be measured reliably and excluded from the fair value disclosures.

4.3.2 Financial Instruments Measured at Cost

Details of financial instruments measured at cost as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013	2012
Available-for-sale financial assets		
MASTERN 2 Co., Ltd.	₩ 10,000	₩ 10,000
U&i Corp.	3,000	3,000
SJ BIOMED Inc.	1,000	1,000
Others	2,594	2,594
	<u>₩ 16,594</u>	<u>₩ 16,594</u>

4.3.3 Fair Value Hierarchy

Assets measured at fair value or for which the fair value is disclosed are categorized within the fair value hierarchy, and the defined levels are as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, prices) or indirectly (that is, derived from prices) (Level 2).

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- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

Fair value hierarchy classifications of the financial assets and financial liabilities that are measured at fair value or its fair value is disclosed as of December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale financial assets	₩ 217,331	₩ 62,466	₩ -	₩ 279,797
Investment property	-	-	461,672	461,672

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

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

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

Specific valuation techniques used to value financial instruments include:

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

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4.3.4 Valuation Technique and the Inputs

Valuation techniques and inputs used in the recurring, non-recurring fair value measurements and disclosed fair values categorized within Level 2 and Level 3 of the fair value hierarchy as of December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	Fair value		level	Valuation techniques
Available-for-sale financial assets				
Real estate investment trusts	₩	62,466	2	Market approach
Unlisted stock		-	3	Details ¹
Investment property				
Investment property		461,672	3	Yield capitalization method and other method

¹ Unlisted stocks are shares in Dream Hub PFV Co., Ltd., which was established for the development of Yongsan Station area. The Company recognized 100% of the carrying amount as impairment loss for this period due to financial difficulties of this investee (Note 6)

5. Financial Instruments by Category

Categorizations of financial assets as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013							
	Loans and receivables		Assets at fair value through profit or loss		Derivative financial instruments		Assets classified as available-for-sale	Total
Available-for-sale financial assets, non- current	₩	-	₩	-	₩	-	₩ 296,391	₩ 296,391
Long-term deposits in MSA Escrow Fund		219,760		-		-	-	219,760
Long-term trade and other receivables		134,498		-		-	-	134,498
Trade and other receivables, current		721,468		-		-	-	721,468
Other financial assets, current		660,000		-		-	-	660,000
Cash and cash equivalents		245,838		-		-	-	245,838
	₩	1,981,564	₩	-	₩	-	₩ 296,391	₩ 2,277,955

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(in millions of Korean won)	2012					
	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for- sale	Total	
Available-for-sale financial assets, non-current	₩ -	₩ -	₩ -	₩ 263,544	₩ 263,544	
Long-term deposits in MSA Escrow Fund	168,667	-	-	-	168,667	
Long-term trade and other receivables	146,174	-	-	-	146,174	
Trade and other receivables, current	726,397	-	-	-	726,397	
Available-for-sale financial assets, current	-	-	-	1,000	1,000	
Other financial assets, current	620,000	-	-	-	620,000	
Cash and cash equivalents	266,720	-	-	-	266,720	
	₩ 1,927,958	₩ -	₩ -	₩ 264,544	₩ 2,192,502	

Categorizations of financial liabilities as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

(in millions of Korean won)	2013								
	Liabilities at fair value through profit or loss		Derivative financial instruments		Other financial liabilities at amortized cost		Other financial liabilities		Total
Borrowings, current	₩	-	₩	-	₩	-	₩	4,920	₩ 4,920
Trade and other payables, current		-		-		278,805		-	278,805
Trade and other payables, non-current		-		-		28,269		-	28,269
	₩	-	₩	-	₩	307,074	₩	4,920	₩ 311,994

(in millions of Korean won)

(in millions of Korean won)	2012								
	Liabilities at fair value through profit or loss		Derivative financial instruments		Other financial liabilities at amortized cost		Other financial liabilities		Total
Borrowings, current	₩	-	₩	-	₩	-	₩	5,477	₩ 5,477
Trade and other payables, current		-		-		145,309		-	145,309
Trade and other payables, non-current		-		-		27,325		-	27,325
	₩	-	₩	-	₩	172,634	₩	5,477	₩ 178,111

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Income and loss of financial instruments by category for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Available-for-sale financial assets		
Gain(Loss) on valuation (Other comprehensive income(loss))	₩ 25,065	₩ 1,220
Gain(Loss) on disposal (Profit or loss)	-	(287)
Interest income	290	229
Dividend income	12,216	8,903
Impairment	(15,000)	-
Cash and cash equivalents		
Interest income	24,929	26,097
Gain(Loss) on foreign currency translation	(14)	(20)
Foreign currency transaction gain (loss)	(286)	(1,654)
Trade and other receivables		
Interest income	9,300	10,099
Gain(Loss) on foreign currency translation	(31,943)	(38,222)
Foreign currency transaction gain(loss)	4,867	(12,877)
Other financial liabilities at amortized cost		
Interest costs	(753)	(898)
Gain(Loss) on foreign currency translation	115	24
Foreign currency transaction gain (loss)	(405)	1,229

6. Available-for-sale Financial Assets

The changes in available-for-sale financial assets as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
At January 1	₩ 264,544	₩ 248,062
Additions	13,780	16,500
Gain(loss) on valuation (before tax)	30,280	1,610
Transfer to others	2,787	-
Impairment losses	(15,000)	-
Disposals	-	(1,628)
At December 31	296,391	264,544
Less: current portion	-	(1,000)
Non-current portion	₩ 296,391	₩ 263,544

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Available-for-sale financial assets as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
Available-for-sale debt instruments:				
Corporate bonds	₩	2,500	₩	2,500
Total available-for-sale debt instruments		<u>2,500</u>		<u>2,500</u>
Available-for-sale equity instruments:				
Listed				
Yonhap Television News(YTN)		23,380		29,581
Oscotech, Inc.		916		869
Shinhan Financial Group Co., Ltd.		189,595		155,725
Rexahn Pharmaceuticals, Inc.		3,440		2,122
		<u>217,331</u>		<u>188,297</u>
Unlisted				
Dream Hub PFV Co., Ltd. ¹		-		12,213
Others		76,560		61,534
		<u>76,560</u>		<u>73,747</u>
Total available-for-sale equity instruments		<u>293,891</u>		<u>262,044</u>
Total available-for-sale financial assets	₩	<u>296,391</u>	₩	<u>264,544</u>

¹ Unlisted stocks are shares in Dream Hub PFV Co., Ltd., which was established for the development of Yongsan Station area. The Company recognized 100% of the carrying amount as impairment loss for this period due to financial difficulties of this investee.

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

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

7. Trade and Other Receivables

Trade and other receivables as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 8,680	₩ 29,884	₩ 7,186	₩ 22,408
Loans	2,205	58,609	6,453	71,216
Other receivables	82,129	9,567	82,335	15,128
Guarantee deposits	-	36,437	-	37,422
Accrued income	5,495	-	8,291	-
Trade receivables	622,958	-	622,131	-
	<u>₩ 721,467</u>	<u>₩ 134,497</u>	<u>₩ 726,396</u>	<u>₩ 146,174</u>

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Trade and other receivables as of December 31, 2013 and 2012, reported in the separate statements of financial position, net of allowances, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 780,542	₩ 140,779	₩ 746,111	₩ 146,174
Allowance account				
- Other receivables	(7,711)	-	(2,083)	-
- Trade receivables	(44,395)	-	(17,631)	-
- Accrued revenues	(2,044)	-	-	-
- Loans to subsidiaries	(4,925)	(6,282)	-	-
	<u>₩ (59,075)</u>	<u>₩ (6,282)</u>	<u>₩ (19,714)</u>	<u>₩ -</u>
Net amount	₩ 721,467	₩ 134,497	₩ 726,397	₩ 146,174

Changes in the allowance account for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Beginning	₩ 19,714	₩ 5,365
Impairment	45,643	14,349
Reversal of impairment	-	-
Write-off	-	-
Ending	<u>₩ 65,357</u>	<u>₩ 19,714</u>

The aging schedule of trade and other receivables as of December 31, 2013 and 2012, is as follows:

<i>(in millions of Korean won)</i>	2013	2012
Not past due	₩ 404,941	₩ 413,203
Past due but not impaired		
Within 30 days	37,487	46,417
Between 30 and 60 days	20,590	34,941
Beyond 60 days	20,148	25,114
Beyond 90 days	184,187	120,087
	<u>₩ 667,353</u>	<u>₩ 639,762</u>

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

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Details of trade and other receivables that are measured at amortized cost as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013			2012		
	Effective interest rate(%)	Current	Non-current	Effective interest rate(%)	Current	Non-current
Loans to employees	3.00~5.68	₩ 8,680	₩ 29,884	3.00~5.68	₩ 7,186	₩ 22,408
Other receivables	3.79	7,997	7,705	3.79	8,300	15,128
Guarantee deposits	3.00~5.68	-	36,437	3.00~5.68	-	37,422
		<u>₩ 16,677</u>	<u>₩ 74,026</u>		<u>₩ 15,486</u>	<u>₩ 74,958</u>

Transferred trade receivables

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

In case the customers default, the Company has an obligation to pay the related amount to the bank. As a result, this transaction treated as a transaction with recourse, has been accounted for as collateralized borrowings. The borrowings recognized in relation to the said transaction as of December 31, 2013 and 2012, are ₩ 4,920 million and ₩ 5,477 million, respectively (Note 22).

8. Long-term Deposits

Long-term deposits of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
MMF	₩	15,080	₩	10,496
T-note		204,680		158,170
	<u>₩</u>	<u>219,760</u>	<u>₩</u>	<u>168,666</u>

As discussed in Note 31 to the separate financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the years ended December 31, 2013 and 2012, are ₩ 56,067 million and ₩34,096 million, respectively.

Investment income on long-term deposits in MSA Escrow Fund for the years ended December 31, 2013 and 2012, are ₩756 million and ₩18 million, respectively.

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9. Property, Plant and Equipment

Changes in property, plant and equipment for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 410,763	₩ -	₩ 410,763
Buildings	668,449	(268,135)	400,314
Structures	42,717	(25,744)	16,973
Machinery	940,615	(705,689)	234,926
Vehicles	2,607	(2,245)	362
Tools	34,206	(31,071)	3,135
Furniture and fixture	176,171	(141,647)	34,524
Others	1,162	-	1,162
Construction-in-progress	80,604	-	80,604
	<u>₩ 2,357,294</u>	<u>₩ (1,174,531)</u>	<u>₩ 1,182,763</u>

(in millions of Korean won)

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

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Korean won)

	2013						
	Opening net book value	Additions	Disposal	Depreciation charge	Transfer of construction-in- process	Others ¹	Net book amount
Land	₩ 397,900	₩ 120	₩ (1,048)	₩ -	₩ 13,630	₩ 161	₩ 410,763
Buildings	394,889	2,635	(143)	(25,209)	25,302	2,840	400,314
Structures	16,716	1,364	(15)	(1,950)	639	219	16,973
Machinery	261,847	8,819	(1,850)	(58,903)	25,013	-	234,926
Vehicles	529	104	-	(271)	-	-	362
Tools	2,733	2,088	(376)	(1,362)	52	-	3,135
Furniture and fixture	36,807	13,153	(72)	(17,505)	2,141	-	34,524
Others	1,115	34	-	-	13	-	1,162
Construction-in- progress	50,684	96,870	(10)	-	(66,940)	-	80,604
	₩ 1,163,220	₩ 125,187	₩ (3,514)	₩ (105,200)	₩ (150)	₩ 3,220	₩ 1,182,763

¹ Other changes include ₩ 3,743 million of reclassification from investment property to property, plant equipment and ₩ 523 million of reclassification from property, plant and equipment to held-for-sale non-current assets.

(in millions of
Korean won)

	2012						
	Opening net book value	Additions	Disposal	Depreciation charge	Transfer of construction-in- process	Others ¹	Net book amount
Land	₩ 397,775	₩ 3,898	₩ (11,808)	₩ -	₩ 16,808	₩ (8,773)	₩ 397,900
Buildings	411,217	5,623	(7,168)	(26,905)	25,781	(13,659)	394,889
Structures	19,038	435	(329)	(2,212)	1,242	(1,458)	16,716
Machinery	254,484	16,671	(1,193)	(61,129)	53,059	(45)	261,847
Vehicles	703	240	(121)	(293)	-	-	529
Tools	2,620	1,468	(8)	(1,500)	153	-	2,733
Furniture and fixture	36,362	18,741	(126)	(18,619)	449	-	36,807
Others	1,078	-	-	-	37	-	1,115
Construction-in- progress	40,084	108,129	-	-	(97,529)	-	50,684
	₩ 1,163,361	₩ 155,205	₩ (20,753)	₩ (110,658)	₩ -	₩ (23,935)	₩ 1,163,220

¹ Other changes represent the reclassified amount from property, plant and equipment to held-for-sale non-current assets.

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10. Intangible Assets

Changes in intangible assets for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013			
	Industrial property rights	Facility usage rights	Intangible assets under development	Total
At January 1, 2013	₩ 1,632	₩ 16,585	₩ 1,720	₩ 19,937
Additions	-	773	-	773
Transfer-in(out)	-	-	545	545
Disposals	-	(1)	-	(1)
Amortization	(60)	-	-	(60)
Other changes	53	-	(53)	-
Others ¹	-	-	(3)	(3)
Acquisition cost	6,973	17,357	2,209	26,539
Accumulated depreciation and impairment cost	(5,348)	-	-	(5,348)
Net book amount	₩ 1,625	₩ 17,357	₩ 2,209	₩ 21,191

¹ Represents amounts reclassified to expenses.

(in millions of Korean won)

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

Research and development expenses for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013	2012
Cost of goods sold	₩ 326	₩ 372
Selling and administrative expenses	12,053	15,788
	₩ 12,379	₩ 16,160

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11. Investment Property

Changes in investment property for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013		
	Land	Building	Total
Beginning net book value	₩ 22,121	₩ 131,786	₩ 153,907
Subsequent expenditure	558	1,178	1,736
Transfers ¹	(433)	(3,160)	(3,593)
Depreciation	-	(6,016)	(6,016)
Acquisition cost	22,246	170,023	192,269
Accumulated depreciation	-	(46,235)	(46,235)
Net book amount	₩ 22,246	₩ 123,788	₩ 146,034

¹ Other changes represent the reclassified amount to property, plant and equipment.

(in millions of Korean won)

	2012		
	Land	Building	Total
Beginning net book value	₩ 22,683	₩ 142,370	₩ 165,053
Subsequent expenditure	-	51	51
Transfers ¹	(562)	(4,482)	(5,044)
Depreciation	-	(6,153)	(6,153)
Acquisition cost	22,121	172,621	194,742
Accumulated depreciation	-	(40,835)	(40,835)
Net book amount	₩ 22,121	₩ 131,786	₩ 153,907

¹ Other changes represent the reclassified amount to held-for-sale non-current assets.

The amounts recognized in profit or loss from investment property for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013	2012
Rental income	₩ 32,833	₩ 32,320
Direct operating expense	(6,016)	(7,265)
	₩ 26,817	₩ 25,055

Fair values and book values of investment property as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013		2012	
	Fair value	Book value	Fair value	Book value
Land	₩ 281,311	₩ 22,246	₩ 284,993	₩ 22,120
Building	180,361	123,788	186,671	131,787
	₩ 461,672	₩ 146,034	₩ 471,664	₩ 153,907

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12. Non-current Assets Held for Sale

Changes in non-current assets held for sale for the year ended December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	Land	Buildings	Structures	Total
At January 1, 2013				
Acquisition cost	₩ 625	₩ 215	₩ 64	₩ 904
Accumulated depreciation	-	(96)	(46)	(142)
Net book amount	₩ 625	₩ 119	₩ 18	₩ 762
Changes				
Transfer from property, plant and equipment	₩ 422	101	-	523
Disposals	(1,044)	(220)	(18)	(1,282)
	₩ (622)	₩ (119)	₩ (18)	₩ (759)
At December 31, 2013				
Acquisition cost	₩ 3	₩ -	₩ -	₩ 3
Accumulated depreciation	-	-	-	-
Net book amount	₩ 3	₩ -	₩ -	₩ 3

13. Pledged Assets

The following assets were pledged as collateral for the Company's borrowings and others as of December 31, 2013:

<i>(in millions of Korean won)</i>					
Asset	Book amount	Reason	Borrowings	Collateralized amount	Lender /Leaseholder
Investment property	₩ 74,555	Leasehold deposits received	₩ 9,020	₩ 9,020	Metlife Insurance Korea Co., Ltd. and 26 others
Trade receivables	4,920	Borrowings	4,920	4,920	National Agricultural Cooperative Federation and Other bank

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

<i>(in millions of Korean won)</i>					
Asset	Book amount	Reason	Borrowings	Collateralized amount	Lender /Leaseholder
Investment property	₩ 80,783	Leasehold deposits received	₩ 8,169	₩ 8,502	Metlife Insurance Korea Co., Ltd. and 24 others
Trade receivables	5,477	Borrowings	5,477	5,477	National Agricultural Cooperative Federation and Other bank

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14. Investments in Associates and Subsidiaries

Investments in associates and subsidiaries as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

(in millions of Korean won)			2013		2012	
	Location	Principal operation	Interest (%)	Carrying Amount	Interest (%)	Carrying Amount
Associates						
Cosmo Tobacco Co., Ltd.	Mongolia	Manufacturing and selling tobaccos	40.00	₩ -	40.00	₩ -
Lite Pharm Tech, Inc	Korea	Manufacturing and Medical supplies	25.34	1,830	25.34	1,830
Korean Carbon Finance, Inc.	Korea	Emissions trading	-	-	20.00	1,000
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	13,995	49.02	13,995
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	7,300	29.67	7,300
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	7,000	22.06	7,000
JR REIT V Co., Ltd.	China	Selling and renting of real estate	34.63	5,600	34.63	5,600
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	10,000	21.74	10,000
LSK Global Pharma Services Co., Ltd.	Korea	Research and developing new drug	23.15	-	23.15	1,500
JR REIT X Co., Ltd.	Korea	Selling and renting of real estate	28.78	9,500	28.78	9,500
JR REIT XIII Co., Ltd.		Selling and renting of real estate		5,000		
				60,225		57,725
Subsidiaries						
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00	599,023	100.00	599,023
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceuticals	53.00	66,355	53.00	66,355
Tae-a Industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00	15,698	100.00	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	Manufacturing and selling tobaccos	99.99	54,049	99.99	54,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf Tobaccos	99.90	535	99.90	535
KT&G Pars	Iran	Manufacturing and selling tobaccos	99.99	-	99.99	-
KT&G Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00	110,297	100.00	110,297
KG Life & Gin Co., Ltd.	Korea	Selling ginseng	100.00	44,100	100.00	52,900
Global Trading, Inc.	USA	Selling tobaccos	100.00	4,913	100.00	4,913
Jilin Hanzheng Ginseng Co., Ltd.	China	Manufacturing and selling ginseng	100.00	47,675	100.00	31,333
Somang Cosmetics Co., Ltd. ¹	Korea	Manufacturing and selling cosmetics	60.00	60,721	60.00	60,721
Renzoluc Pte., Ltd. ²	Singapore	Manufacturing and selling tobaccos	100.00	66,356	100.00	89,756
KT&G Life Science ³	Korea	Medical researching and developing	73.94	31,232	73.94	31,232
Yebon Nongwon Agriculture Co., Ltd.	Korea	Corporate agriculture	90.00	90	90.00	90
KGC Yebon	Korea	Corporate agriculture	100.00	43,927	100.00	43,927
K-Q HongKong I,Limited ⁴	Hong Kong	Manufacturing and selling ginseng	100.00	17,761	100.00	17,761
PT KT&G Indonesia		Manufacturing and selling tobaccos	99.96	3,746		
				1,166,478		1,178,590
				₩ 1,226,703		₩ 1,236,315

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¹ The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

² The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Company's percentage of ownership would be 68.91% if convertible preferred shares are included.

³ The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Company's percentage of ownership would be 59.48% if convertible preferred shares are included.

⁴ The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

Changes in investments in associates and subsidiaries for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013				
	Beginning balance	Acquisition	Disposals	Impairment	Ending balance
Associates					
Cosmo Tabacco Co., Ltd.	₩ -	₩ -	₩ -	₩ -	₩ -
Lite Pharm Tech, Inc	1,830	-	-	-	1,830
Korean Carbon Finance, Inc.	1,000	-	(1,000)	-	-
JR CR-REIT IV Co., Ltd.	13,995	-	-	-	13,995
KVG REIT 1 Co., Ltd.	7,300	-	-	-	7,300
KOCREF REIT 17 Co., Ltd.	7,000	-	-	-	7,000
JR REIT V Co., Ltd.	5,600	-	-	-	5,600
JR REIT VIII Co., Ltd.	10,000	-	-	-	10,000
LSK Global Pharma Services Co., Ltd. ¹	1,500	-	-	(1,500)	-
JR REIT X Co., Ltd.	9,500	-	-	-	9,500
JR REIT XIII Co., Ltd.	-	5,000	-	-	5,000
	<u>57,725</u>	<u>5,000</u>	<u>(1,000)</u>	<u>(1,500)</u>	<u>60,225</u>
Subsidiaries					
Korea Ginseng Corporation	599,023	-	-	-	599,023
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	66,355
Tae-a Industry Co., Ltd.	15,698	-	-	-	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	535	-	-	-	535
KT&G Pars	-	-	-	-	-
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KG Life & Gin Co., Ltd. ²	52,900	38,000	-	(46,800)	44,100
Global Trading, Inc.	4,913	-	-	-	4,913
Jilin Hanzheng Ginseng Co., Ltd.	31,333	16,342	-	-	47,675
Somang Cosmetics Co., Ltd.	60,721	-	-	-	60,721
Renzoluc Pte., Ltd.	89,756	-	-	(23,400)	66,356
KT&G Life Science	31,232	-	-	-	31,232
Yebon Nongwon Agriculture Co., Ltd.	90	-	-	-	90
KGC Yebon	43,927	-	-	-	43,927
K-Q HongKong I,Limited	17,761	-	-	-	17,761

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PT KT&G Indonesia	-	3,746	-	-	3,746
	1,178,590	58,088	-	(70,200)	1,166,478
	₩ 1,236,315	₩ 63,088	₩ (1,000)	₩ (71,700)	₩ 1,226,703

¹ The Company recognized 100% of the carrying amount as impairment loss for this period due to financial difficulty of associate.

² The Company recognized ₩ 46,800 million and ₩ 23,800 million as impairment loss for this period due to its carrying amount exceeds its recoverable amount.

(in millions of Korean won)

	2012				
	Beginning balance	Acquisition	Disposals	Impairment	Ending balance
Associates					
Cosmo Tabacco Co., Ltd.	₩ -	₩ -	₩ -	₩ -	₩ -
Lite Pharm Tech, Inc.	1,830	-	-	-	1,830
Korean Carbon Finance, Inc.	1,000	-	-	-	1,000
JR CR-REIT IV Co., Ltd.	13,995	-	-	-	13,995
KVG REIT 1 Co., Ltd.	7,300	-	-	-	7,300
KOCREF REIT 17 Co., Ltd.	7,000	-	-	-	7,000
JR REIT V Co., Ltd.	5,600	-	-	-	5,600
JR REIT VIII Co., Ltd.	-	10,000	-	-	10,000
LSK Global Pharma Services Co., Ltd.	-	1,500	-	-	1,500
JR REIT X Co., Ltd.	-	9,500	-	-	9,500
	36,725	21,000	-	-	57,725
Subsidiaries					
Korea Ginseng Corporation ¹	559,882	39,141	-	-	599,023
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	66,355
Tae-a Industry Co., Ltd.	15,698	-	-	-	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	394	141	-	-	535
KT&G Pars ²	5,733	-	-	(5,733)	-
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KG Life & Gin Co., Ltd	31,500	21,400	-	-	52,900
KT&G Bio Corp.	900	-	(900)	-	-
Global Trading, Inc.	4,913	-	-	-	4,913
Jilin Hanzheng Ginseng Co., Ltd.	23,247	8,086	-	-	31,333
Somang Cosmetics Co., Ltd.	60,721	-	-	-	60,721
Renzoluc Pte., Ltd.	89,756	-	-	-	89,756
KT&G Life Science	31,232	-	-	-	31,232
Yebon Nongwon Agriculture Co., Ltd.	90	-	-	-	90
KGC Yebon ³	-	43,927	-	-	43,927
K-Q HongKong I, Limited	-	17,761	-	-	17,761
	1,054,767	130,456	(900)	(5,733)	1,178,590
	₩ 1,091,492	₩ 151,456	₩ (900)	₩ (5,733)	₩ 1,236,315

¹ The amount of acquisition during the year ended December 31, 2012, represents the Company's investment in kind.

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² The Company recognized 100% of the carrying amount as impairment loss for this period due to financial difficulty of subsidiary.

³ ₩13,927 million of acquisition during the year ended December 31, 2012, represents the Company's investment in kind.

15. Inventories

Inventories as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013			2012		
	Acquisition	Allowance	Book amount	Acquisition	Allowance	Book amount
Finished goods	₩ 107,950	₩ (2,135)	₩ 105,815	₩ 83,809	₩ (574)	₩ 83,235
Work in progress	11,889	-	11,889	15,207	-	15,207
Raw materials	704,494	-	704,494	694,871	-	694,871
Supplies	24,500	-	24,500	22,877	-	22,877
By-products	6,512	-	6,512	5,034	-	5,034
Goods-in-transit	79,262	-	79,262	44,831	-	44,831
Unfinished housing	840	-	840	227	-	227
Lots	6,432	-	6,432	6,551	-	6,551
	<u>₩ 941,879</u>	<u>₩ (2,135)</u>	<u>₩ 939,744</u>	<u>₩ 873,407</u>	<u>₩ (574)</u>	<u>₩ 872,833</u>

The cost related inventories for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013	2012
Cost of sales		
Loss(profit) on inventory valuation	₩ 1,561	₩ 102
Loss on retirement of inventories	3,227	2,350
Other expenses		
Loss on retirement of inventories	944	1,429
	<u>₩ 5,732</u>	<u>₩ 3,881</u>

16. Cash and Cash Equivalents

Cash and cash equivalents as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013	2012
Cash on hand	₩ 3,147	₩ 3,405
Demand deposits	82,691	93,315
Short-term investment assets	160,000	170,000
	<u>₩ 245,838</u>	<u>₩ 266,720</u>

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Other financial assets as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Short-term financial assets		
Time deposits	₩ 20,000	₩ 170,000
Money trust	620,000	260,000
Certificate of deposit	20,000	190,000
	<u>₩ 660,000</u>	<u>₩ 620,000</u>

17. Equity and Share Premium

Details of share capital as of December 31, 2013 and 2012, are as follows:

<i>(in Korean won, except number of shares)</i>	2013	2012
Number of ordinary shares		
Authorized	800,000,000	800,000,000
Issued	137,292,497	137,292,497
Par value per share	₩ 5,000	₩ 5,000
Ordinary shares	₩ 954,959,485,000	₩ 954,959,485,000

The Company has reacquired and retired 53,699,400 shares of treasury shares. Accordingly, as of December 31, 2013, the Company's ordinary shares differ from the aggregate par value of issued shares by ₩ 268,497 million.

Changes in the number of shares for the years ended December 31, 2013 and 2012, are as follows:

<i>(Number of shares)</i>	2013			2012		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning	137,292,497	(11,393,697)	125,898,800	137,292,497	(11,543,697)	125,748,800
Acquisition of treasury shares	-	-	-	-	-	-
Issuance of treasury shares	-	-	-	-	150,000	150,000
Ending	<u>137,292,497</u>	<u>(11,393,697)</u>	<u>125,898,800</u>	<u>137,292,497</u>	<u>(11,393,697)</u>	<u>125,898,800</u>

No changes in the other capital surplus for the years ended December 31, 2013 and 2012.

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18. Treasury Shares

Changes in the treasury shares for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Beginning balance	11,393,697	₩ 339,059	11,543,697	₩ 343,522
Acquisition of treasury shares	-	-	-	-
Issuance of treasury shares	-	-	(150,000)	(4,463)
Ending balance	<u>11,393,697</u>	<u>₩ 339,059</u>	<u>11,393,697</u>	<u>₩ 339,059</u>

Changes in gain on reissuance of treasury shares for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Beginning	₩ 492,032	₩ 485,922
Gain on reissuance of treasury shares before tax	-	8,061
Less: tax at Income tax effects	-	(1,951)
Gain on reissuance of treasury shares, net of tax	-	6,110
Ending	<u>₩ 492,032</u>	<u>₩ 492,032</u>

19. Reserves

Details of reserves as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Available-for-sale financial assets reserve	₩ (5,570)	₩ (30,635)
Legal reserve	602,937	602,937
Voluntary reserve	2,813,732	2,466,732
	<u>₩ 3,411,099</u>	<u>₩ 3,039,034</u>

Available-for-sale financial assets reserve as of December 31, 2013 and 2012, are summarized as follows:

<i>(in millions of Korean won)</i>	2013	2012
Available-for-sale financial assets reserve before tax	₩ (7,348)	₩ (40,415)
Tax effect	1,778	9,780
Available-for-sale financial assets reserve after tax	<u>₩ (5,570)</u>	<u>₩ (30,635)</u>

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

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Details of the Company's voluntary reserve as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Reserve for business rationalization	₩ 12,851	₩ 12,851
Reserve for research and human resource development	90,000	60,000
Reserve for business expansion	698,881	698,881
Other reserve	2,012,000	1,695,000
	<u>₩ 2,813,732</u>	<u>₩ 2,466,732</u>

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 Research and Human Resource Development

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

Reserve for Business Expansion and other reserve

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

20. Retained Earnings

Changes in retained earnings for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Beginning	₩ 752,766	₩ 763,738
Transfer from other reserve	(317,000)	(359,000)
Transfer from Reserve for research and human resources development	(30,000)	-
Dividends	(402,876)	(402,396)
Profit for the year	501,315	768,438
Remeasurements of the net defined benefit liability	5,615	(18,014)
Ending	<u>₩ 509,820</u>	<u>₩ 752,766</u>

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

The appropriation of retained earnings for the years ended December 31, 2013 and 2012, is as follows:

<i>(In millions of Korean won, in Korean won for common stock)</i>		2013	2012
At January 1			
Unappropriated retained earnings carried over from prior year	₩	2,890	₩ 2,342
Net income (loss)		501,315	768,438
Actuarial gains and losses		5,615	(18,014)
Transfers such as discretionary reserves			
Reserve for research and human resource development		47,479	-
Total		<u>557,299</u>	<u>752,766</u>
Dividends			
(Cash dividend (%):			
Common stock: 2013: ₩ 3,200(64%)			
2012: ₩ 3,200(64%)		(402,876)	(402,876)
Reserve for R&D		-	(30,000)
Discretionary appropriated retained earnings		<u>(152,000)</u>	<u>(317,000)</u>
Appropriation		<u>(554,876)</u>	<u>(749,876)</u>
At December 31	₩	<u>2,423</u>	₩ <u>2,890</u>

21. Trade and Other Payables

Trade and other payables as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	₩ 27,585	₩ -	₩ 27,325
Trade payable	60,436	-	19,037	-
Withholdings	3,823	-	5,540	-
Value added tax withheld	119,761	-	115,995	-
Accrued expenses	123,419	-	105,071	-
Other payables	94,950	684	21,201	-
	<u>₩ 402,389</u>	<u>₩ 28,269</u>	<u>₩ 266,844</u>	<u>₩ 27,325</u>

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22. Borrowings

Details of borrowings as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
Current				
Bank borrowings ¹	₩	4,920	₩	5,477

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

Details of bank borrowings as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>					
	Creditor	Latest maturity date	Annual interest rate(%) in 2013	2013	2012
Korean won	National Agricultural Cooperative Federation	Short-term Borrowings	7.35%	₩ 4,061	₩ 4,575
Korean won	Korea Exchange Bank	Short-term Borrowings	CD(91) + 2.5%	859	902
				<u>₩ 4,920</u>	<u>₩ 5,477</u>

23. Defined Benefit Liability

The amounts recognized on the statements of income for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
Defined benefit plans :				
Current service cost	₩	28,978	₩	25,255
Interest expenses		6,862		6,727
Expected return on plan assets		(4,677)		(5,050)
Effect of past service cost or settlement		(550)		87
		<u>30,613</u>		<u>27,019</u>
Defined contribution plans :				
Pension costs		2,054		1,740
Total	₩	32,667	₩	28,759

Retirement benefits for the year ended December 31, 2013, were ₩1,168 million (2012: ₩1,194 million). Out of total expenses, ₩11,263 million (2012: ₩9,960 million) and ₩22,572 million (2012: ₩19,992 million) were included in 'cost of sales' and 'selling and administrative expenses', respectively.

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The defined benefit liability as of December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Present value of funded defined benefit liability	₩ 227,259	₩ 213,387
Fair value of plan assets	(166,986)	(147,176)
Liability in the statement of financial position	<u>₩ 60,273</u>	<u>₩ 66,211</u>

The movements in the defined benefit obligation for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Beginning balance	₩ 213,387	₩ 168,419
Current service cost	28,978	25,255
Interest cost	6,862	6,727
Gains (Losses) on settlement	(550)	87
Actuarial (gains)/losses (before tax)	(7,137)	23,893
Payments, including the amount transferred to the defined contribution plan	(14,029)	(10,977)
Transfer from related companies	69	-
Transfer to related companies	(321)	-
Changes in accrued expenses	-	(17)
Ending balance	<u>₩ 227,259</u>	<u>₩ 213,387</u>

The movements in the fair value of plan assets for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Beginning balance	₩ 147,176	₩ 120,779
Expected return on plan assets	4,677	5,050
Actuarial gains/(losses) (before tax)	272	128
Payment into plan assets	27,300	29,100
Payments, including the amount transferred to the defined contribution plan	(11,747)	(7,345)
Transfer from related companies	55	(536)
Transfer to related companies	(272)	-
Changes in accrued expenses	(475)	-
Ending balance	<u>₩ 166,986</u>	<u>₩ 147,176</u>

Actual return on plan assets for the years ended December 31, 2013 and 2012, are ₩4,949 million and ₩5,178 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.

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Actuarial gains and losses recognized as other comprehensive income for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Actuarial gains (losses) before income tax	₩ 7,409	₩ (23,765)
Income tax effects	(1,793)	5,751
Actuarial gains (losses) after income tax	5,616	(18,014)

The components of plan assets as of December 31, 2013, are as follows:

<i>(In millions of Korean won)</i>	2013
Cash and cash equivalents	₩ 1,077
Equity instruments	34,140
Debt instruments	14,023
Others	117,746
	<u>₩ 166,986</u>

The principal actuarial assumptions as of December 31, 2013 and 2012, are as follows:

	2013	2012
Rate of salary increases	5.00%	5.00%
Discount rate	3.70	3.30

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

<i>(In millions of Korean won)</i>	1% Increase	1% Decrease
Rate of salary increases:		
Increase(decrease) in defined benefit obligations	₩ 25,016	₩ (21,843)
Increase(decrease) in retirement benefits before tax	3,301	(2,845)
Discount rate:		
Increase(decrease) in defined benefit obligations	(23,280)	27,358
Increase(decrease) in retirement benefits before tax	(2,778)	3,290

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24. Operating Income and Other Income

(1) Material items of operating income and expense

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

(2) Employee benefit costs for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Salaries	₩ 319,065	₩ 335,650
Retirement benefits	32,667	28,759
Termination benefits	1,168	1,194
Employee welfare	41,786	40,422
	<u>₩ 394,686</u>	<u>₩ 406,025</u>

(3) Selling and administrative expenses for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Salaries	₩ 215,000	₩ 221,050
Retirement benefits	22,572	19,992
Employee welfare	29,186	28,076
Travel	5,512	6,756
Communications	3,497	3,636
Utilities	8,329	8,534
Taxes and dues	13,290	14,621
Supplies	1,641	2,308
Rent	14,068	14,421
Depreciation	31,905	33,302
Amortization	60	24
Repairs and maintenance	5,107	10,154
Vehicles	8,849	9,253
Insurance	303	461
Commissions	69,751	70,239
Freight and custody	20,377	25,218
Conferences	3,085	3,997
Advertising	154,076	173,520
Training	3,880	4,560
Prizes and rewards	1,768	2,576
Normal research and development	12,054	15,788
Bad debts expense	26,763	14,349
	<u>₩ 651,073</u>	<u>₩ 682,836</u>

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(4) Details of other income for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Foreign currency transaction gain	₩ 12,366	₩ 5,623
Foreign currency translation gain	861	44
Gain on sale of property, plant and equipment	19,234	70,781
Gain on sale of intangible assets	-	-
Miscellaneous revenues	15,453	16,203
	<u>₩ 12,366</u>	<u>₩ 92,651</u>

(5) Details of other expenses for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Foreign currency transaction loss	₩ 8,190	₩ 18,926
Foreign currency translation loss	32,703	38,263
Impairment loss on other receivables	18,880	-
Donations	4,465	20,596
Loss on sale of investments in associates	388	-
Impairment loss on investments in associates	1,500	-
Impairment loss on investments in subsidiaries	70,200	5,733
Loss on sale of property, plant and equipment	277	4,255
Loss on sale of intangible assets	-	337
Miscellaneous expenses ¹	109,749	2,904
	<u>₩ 246,352</u>	<u>₩ 91,014</u>

¹ ₩ 103,468 million of miscellaneous expenses of the Company is recognized in relation to tax investigation which was implemented for the year ended December 31, 2013.

25. Expenses by Nature

Expenses by nature for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Changes in inventories	₩ (66,911)	₩ 31,279
Raw materials and consumables purchased	822,113	756,947
Salary and wage	319,065	335,650
Retirement and termination benefits	33,835	29,953
Depreciation charges	111,216	116,811
Amortization charges	60	24
Employee benefits	41,786	40,422
Advertising costs	154,229	173,688
Service fees	92,207	93,887
Other expenses	79,528	86,272
Total cost of sales and administrative expenses	<u>₩ 1,587,128</u>	<u>₩ 1,664,933</u>

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26. Finance Income and Costs

Finance income and costs for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Finance cost		
Interest costs	₩ (753)	₩ (898)
Loss on sale of available-for-sale financial assets	-	(287)
Impairment loss on available-for-sale financial assets	(15,000)	-
	<u>(15,753)</u>	<u>(1,185)</u>
Finance income		
Interest income	34,518	36,425
Dividend income	12,216	8,903
Investment income on long-term deposits in MSA Escrow Fund	756	18
	<u>47,490</u>	<u>45,346</u>
Net financial income	<u>₩ 31,737</u>	<u>₩ 44,161</u>

Details of interest costs for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Trade and other payables	₩ (753)	₩ (898)

Details of interest income for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Deposits	₩ 25,206	₩ 26,097
Available-for-sale financial assets	290	229
Trade and other receivables	9,023	10,099
	<u>₩ 34,519</u>	<u>₩ 36,425</u>

27. Income Tax and Deferred Income Tax

Income tax expense for the years ended December 31, 2013 and 2012, consists of:

<i>(In millions of Korean won)</i>	2013	2012
Current tax expense:		
Current tax on profits for the year	₩ 246,514	₩ 248,195
Adjustments in respect of prior years ¹	45,893	410
Total current tax	<u>292,407</u>	<u>248,605</u>
Deferred tax:		
Origination and reversal of temporary differences	(36,919)	1,435
Income tax expense	<u>₩ 255,488</u>	<u>₩ 250,040</u>

¹ ₩ 46,737 million of adjustments is recognized in relation to tax investigation which was implemented for the year ended December 31, 2013.

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Reconciliation of net income before tax and income expense for the years ended December 31, 2013 and 2012, follows:

<i>(In millions of Korean won)</i>	2013	2012
Profit before tax	₩ 756,803	₩ 1,018,478
Income tax based on statutory rate	₩ 182,684	₩ 246,010
Tax effects of:		
Expenses not deductible for tax purposes	(1)	2,958
Tax credit	28,688	(2,360)
Adjustment in respect of prior years	(2,317)	410
Re-measurement of deferred tax expense – change in the Korean tax rate	45,893	-
Non-deduction of dividend income	(696)	(233)
Others	1,237	3,255
Income tax expense	₩ 255,488	₩ 250,040

The tax (charged) / credited directly to other comprehensive income and equity as of December 31, 2013 and 2012, is as follows:

<i>(In millions of Korean won)</i>	2013		
	Before tax	Tax (charge) credit	After tax
The tax (charge) / credit relating to components of other comprehensive income:			
Fair value gains(losses) from available-for-sale financial assets	₩ 33,067	₩ (8,002)	₩ 25,065
Actuarial gains(losses) on retirement benefit obligations	7,409	(1,793)	5,616
	40,476	(9,795)	30,681
The income tax (charged) / credited directly to equity:			
Gains (Losses) on disposal of treasury shares	-	-	-
	₩ 40,476	₩ (9,795)	₩ 30,681

<i>(In millions of Korean won)</i>	2012		
	Before tax	Tax (charge) credit	After tax
The tax (charge) / credit relating to components of other comprehensive income:			
Fair value gains(losses) from available-for-sale financial assets	₩ 1,610	₩ (390)	₩ 1,220
Actuarial gains(losses) on retirement benefit obligations	(23,765)	5,751	(18,014)
	(22,155)	5,361	(16,794)
The income tax (charged) / credited directly to equity:			
Gains (Losses) on disposal of treasury shares	8,061	(1,951)	6,110
	₩ (14,094)	₩ 3,410	₩ (10,684)

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The analysis of deferred tax assets and deferred tax liabilities as of December 31, 2013 and 2012, is as follows:

<i>(in millions of Korean won)</i>	2013	2012
Deferred tax assets		
Deferred tax asset to be recovered after more than 12 months	₩ 93,741	₩ 73,121
Deferred tax asset to be recovered within 12 months	<u>36,374</u>	<u>25,921</u>
	<u>130,115</u>	<u>99,042</u>
Deferred tax liabilities		
Deferred tax liability to be recovered after more than 12 months	(182,884)	(178,637)
Deferred tax liability to be recovered within 12 months	<u>(1,054)</u>	<u>(1,353)</u>
	<u>(183,938)</u>	<u>(179,990)</u>
Deferred tax assets (liabilities), net	<u>₩ (53,823)</u>	<u>₩ (80,948)</u>

The gross movement on the deferred income tax account for the years ended December 31, 2013 and 2012, is as follows:

<i>(In millions of Korean won)</i>	2013	2012
Beginning balance	₩ (80,948)	₩ (82,923)
Tax charged to the statement of income	36,920	(3,386)
Tax charge/ (credit) relating to components of other comprehensive income	<u>(9,795)</u>	<u>5,361</u>
Ending balance	<u>₩ (53,823)</u>	<u>₩ (80,948)</u>

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

<i>(In millions of Korean won)</i>	January 1, 2013	Beginning adjustment	Credited to profit(Charged to loss)	Charged to other comprehensive income	Charged or credited directly to equity	December 31, 2013
Deferred tax assets						
Available-for-sale financial assets	₩ 11,118	₩ -	₩ 3,630	₩ -	₩ -	₩ 14,748
Accrued expense	22,740	-	(1,214)	-	-	21,526
Defined benefit liability	7,077	15	762	(1,793)	-	6,061
Depreciation	6,262	(508)	2,494	-	-	8,248
Change in value of available-for-sale financial assets	9,779	-	-	(8,002)	-	1,777
Allowance for doubtful accounts	3,009	20	10,941	-	-	13,970
Others	381	(348)	3,381	-	-	3,414
	<u>₩ 60,366</u>	<u>₩ (821)</u>	<u>₩ 19,994</u>	<u>₩ (9,795)</u>	<u>₩ -</u>	<u>₩ 69,744</u>
Deferred tax liabilities						
Investment in subsidiaries	₩ (104,775)	₩ -	₩ 14,799	₩ -	₩ -	₩ (89,976)
Treasury stock	(8,808)	-	-	-	-	(8,808)
Voluntary reserve	(13,238)	(82)	3,030	-	-	(10,290)
Provision for advanced depreciation	(14,493)	-	-	-	-	(14,493)
	<u>₩ (141,314)</u>	<u>₩ (82)</u>	<u>₩ 17,829</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ (123,567)</u>

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

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28. Earnings per Share

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

Basic earnings per ordinary share for the years ended December 31, 2013 and 2012, is as follows:

<i>(in Korean won, except number of shares)</i>	2013	2012
Profit for the period	₩ 501,315 million	₩ 768,438 million
Weighted-average number of ordinary shares outstanding	125,898,800	125,756,587
Basic and diluted earnings per share in won	<u>₩ 3,982</u>	<u>₩ 6,111</u>

29. Dividends

Dividend distribution to the Company's shareholders amounted to ₩ 402,396 million for the year ended December 31, 2012, was paid in March 2013. A dividend in respect of the year ended December 31, 2013, of ₩ 3,200 per share, amounting to a total dividend of ₩ 402,876 million, is to be proposed at the annual general meeting on March 7, 2014. These financial statements do not reflect this dividend payable.

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30. Cash Generated from Operations

Cash generated from operations for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
Profit	₩	501,315	₩	768,438
Adjustments for:				
Income tax expense		255,488		250,040
Finance costs		15,753		1,185
Finance income		(47,490)		(45,346)
Depreciation		111,216		116,811
Amortization		60		24
Retirement and termination benefits		30,613		27,019
Foreign currency translations loss		32,703		38,263
Loss on the write-down of inventories		1,561		102
Impairment loss on trade and other receivables		45,643		14,349
Loss on sale of property, plant and equipment		277		4,255
Loss on sale of intangible assets		-		337
Loss on sale of investments in associates		388		-
Impairment loss on investments in associates		1,500		-
Impairment loss on investments in subsidiaries		70,200		5,733
Other expense		84,167		3,780
Foreign currency translations gain		(861)		(44)
Gain on sale of property, plant and equipment		(19,234)		(70,781)
		<u>1,083,299</u>		<u>1,114,165</u>
Changes in working capital				
Trade and other receivables		(34,653)		(130,454)
Advance payments		13,731		(4,605)
Prepaid expenses		3,937		(3,665)
Prepaid tobacco excise and other taxes		(8,208)		(56,340)
Inventories		(72,643)		27,397
Trade and other payables		30,244		18,077
Advance receipts		(4,979)		24,556
Tobacco excise and other taxes payable		(56,370)		93,686
Payment of retirement benefits		(29,142)		(32,213)
Cash generated from operations	₩	<u>925,216</u>	₩	<u>1,050,604</u>

Non-cash transactions

<i>(in millions of Korean won)</i>	2013	
Transfer to retained earnings in voluntary reserves	₩	347,000
Reclassification of construction-in-progress to property, plant and equipment		66,790

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31. Contingencies and Commitments

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

As of December 31, 2013, tobacco lawsuits claiming damages of ₩ 584 million are filed against the Company and the Korean government. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of December 31, 2013. Additionally, as of December 31, 2013, the Company is involved in seven lawsuits as a defendant for alleged damages totaling ₩ 1,007million. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of December 31, 2013.

As of December 31, 2013, the Company has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 57,000 thousand.

As of December 31, 2013, the Company's trade receivables from the export of cigarettes are insured against non-payment up to USD 39,207 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of December 31, 2013, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries and also for an opening of L/C up to USD 40,000 thousand by Korea Exchange Bank and others. In addition, the Company provides Customs Bond with limits in the aggregate of USD 8,900 thousand to Korea Exchange Bank, regarding an opening of L/C for import and customs with relation to a subsidiary located in U.S.A (Global Trading Inc.). The Company also provides Bid Bond with limits in the aggregate of THB 6,907 thousand in relation to an opening of L/C for export of tobacco sheet for Thailand Tobacco Monopoly as of December 31, 2013.

As of December 31, 2013, the Company and 28 other companies are guaranteed ₩ 240,000 million by Seoul Guarantee Insurance Co., Ltd. related to the Yongsan International Commercial Development Project. Seoul Guarantee Insurance Co., Ltd. can request amounts for recourse to the Company and 28 other companies based on their ownership rate, if Seoul Guarantee Insurance Co., Ltd. paid the insurance proceeds to KORAIL. As KORAIL requested the corresponding payment to Seoul Guarantee Insurance Co., Ltd. during the reporting period, the Company paid the maximum amount ₩ 5,136 million on July 31, 2013 and recognized the amount as current expenses.

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

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

1) Conditional put option granted to the Individual Shareholder

The Company shall be required to purchase the Individual Shareholder's shares, in whole or in

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part, at the agreed price if the following conditions are met:

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

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

2) Right of first refusal held by the Company

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

3) Tag-along right held by The Individual Shareholder

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

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

1) Restriction of disposal

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

2) Right of first refusal held by the Company

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

3) Tag-along right held by the Individual Shareholder

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

Upon the resolution of the Board of Directors on January 23, 2013, the Parent Company guarantees the principal and the related interest that buyers of Andong Central Xi Apartment have borrowed from the National Agricultural Cooperative Federation, as of September 30, 2013. The amount of guarantee is ₩152,263 million and the guarantee will expire on June 30, 2015.

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32. Related Party Transactions

The subsidiaries and parent companies of subsidiaries as of December 31, 2013 and 2012, are as follows:

Subsidiaries	Location	Immediate parent companies	Percentage of ownership (%)					
			2013			2012		
			Parent companies	Subsidiaries	Total	Parent companies	Subsidiaries	Total
Korea Ginseng Corporation			100.00	-	100.00	100.00	-	100.00
Yungjin Pharm. Ind. Co., Ltd.			53.00	-	53.00	53.00	-	53.00
Tae-a Industry Co., Ltd.	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	KT&G	99.99	-	99.99	99.99	-	99.99
Korea Tabacos do Brasil Ltda.	Brazil	KT&G	99.90	-	99.90	99.90	-	99.90
KT&G Pars	Iran	KT&G	99.99	-	99.99	99.99	-	99.99
KT&G Rus L.L.C.	Russia	KT&G	100.00	-	100.00	100.00	-	100.00
KGC Life & Gin Co., Ltd	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
Global Trading, Inc.	USA	KT&G	100.00	-	100.00	100.00	-	100.00
Jilin Hanzheng Ginseng Co., Ltd.	China	KT&G	100.00	-	100.00	100.00	-	100.00
Somang Cosmetics Co., Ltd. ¹	Korea	KT&G	60.00	-	60.00	60.00	-	60.00
Renzoluc Pte., Ltd. ²	Singapore	KT&G	100.00	-	100.00	100.00	-	100.00
PT Trisakti Purwosari Makmur	Indonesia	Renzoluc Pte., Ltd.	-	60.17	60.17	-	60.17	60.17
PT Mandiri Maha mulia	Indonesia	Renzoluc Pte., Ltd.	-	66.47	66.47	-	-	-
PT Sentosa Ababi Purwosari	Indonesia	PT Trisakti Purwosari Makmur	-	99.24	99.24	-	99.24	99.24
PT Purindo Ilufa	Indonesia	PT Trisakti Purwosari Makmur	-	100.00	100.00	-	100.00	100.00
KT&G Life Science ³	Korea	KT&G	73.94	-	73.94	73.94	-	73.94
Yebon Nongwon Agriculture Co., Ltd	Korea	KT&G	90.00	-	90.00	90.00	-	90.00
KGC Yebon ⁵	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
K-Q HongKong I, Limited ⁴	HongKong	KT&G	100.00	-	100.00	100.00	-	100.00
PT KT&G Indonesia ⁵	Indonesia	KT&G	99.96	-	99.96	-	-	-
Cheong Kwan Jang Taiwan Corporation	Taiwan	Korea Ginseng Corporation	-	100.00	100.00	-	100.00	100.00
Korean Red Ginseng Corp., Inc.	USA	Korea Ginseng Corporation	-	100.00	100.00	-	100.00	100.00
Korea Ginseng (China) Corp.	China	Korea Ginseng Corporation	-	100.00	100.00	-	100.00	100.00
Korea Ginseng Corporation Japan	Japan	Korea Ginseng Corporation	-	100.00	100.00	-	100.00	100.00
PT CKJ INDONESIA	Indonesia	Korea Ginseng Corporation	-	99.88	99.88	-	99.88	99.88

¹ The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

² The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Company's percentage of ownership would be 68.91% if convertible preferred shares are included.

³ The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Company's percentage of ownership would be 59.48% if convertible preferred shares are included.

⁴ The Parent Company's percentage of ownership, shown above, excludes convertible preferred

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shares. As of December 31, 2013, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

⁵ During the year ended December 31, 2013, KT&G INDONESIA was included as a subsidiary.

Transactions with related parties for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
Sales and other income				
Korea Ginseng Corporation	₩	9,256	₩	8,680
Yungjin Pharm. Ind. Co., Ltd.		273		222
Tae-a industry Co., Ltd.		2,016		-
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		9,604		10,160
KT&G Pars		3,407		7,228
KT&G Rus L.L.C.		17,608		29,177
KGC Life & Gin Co., Ltd		1,833		1,651
Global Trading, Inc.		56,297		45,490
Jilin Hanzheng Ginseng Co., Ltd.		-		325
Renzoluc Pte., Ltd.		4,545		5,372
KT&G Life Science		81		109
PT Trisakti Purwosari Makmur		193		437
Somang Cosmetics Co., Ltd.		167		-
PT KT&G Indonesia		526		-
KGC Yebon		21		-
PT Mandiri Maha mulia		2,315		-
	₩	<u>108,142</u>	₩	<u>108,851</u>
Purchases and other expenses				
Korea Ginseng Corporation	₩	1,348	₩	1,971
Yungjin Pharm. Ind. Co., Ltd.		21		41
Tae-a industry Co., Ltd.		14,185		16,221
KGC Life & Gin Co., Ltd		824		641
Somang Cosmetics Co., Ltd.		142		199
	₩	<u>16,520</u>	₩	<u>19,073</u>

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Details of related party receivables and liabilities as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
Receivables from related parties				
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	₩	31,845	₩	27,203
KT&G Pars ¹		40,149		36,004
KT&G Rus L.L.C.		26,691		27,135
Global Trading, Inc.		2,697		17,274
Renzoluc Pte., Ltd.		46,989		59,404
PT Mandiri Maha mulia		3,655		-
Somang Cosmetics Co., Ltd.		21		29
PT Trisakti Purwosari Makmur		192		599
Korea Ginseng Corporation		8		645
PT KT&G Indonesia		7,615		-
KGC Life & Gin Co., Ltd.		116		577
Korea Tabacos do Brasil Ltda.		94		-
	₩	160,072	₩	168,870
Payables to related parties				
Korea Ginseng Corporation	₩	1,817	₩	1,828
Somang Cosmetics Co., Ltd.		37		-
Tae-a industry Co., Ltd.		810		1,325
Yungjin Pharm. Ind. Co., Ltd.		413		413
KGC Life & Gin Co., Ltd.		115		212
KT&G Life Science		813		813
	₩	4,005	₩	4,591

¹ Above receivables are the gross amounts before ₩ 23,002 million of allowance for doubtful accounts.

Fund transactions with related parties for the years ended December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>		Loan transactions		Equity contributions
		Loans	Repayments	in cash
Subsidiaries	Korea Tabacos do Brasil Ltda.	₩ 94	₩ -	₩ -
	Jilin Hanzheng Ginseng Co., Ltd.	-	-	16,342
	Renzoluc Pte., Ltd.	4,121	-	-
	PT KT&G Indonesia	7,418	-	3,746
	KGC Life & Gin Co., Ltd.	2,600	2,600	38,000

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Fund transactions with related parties for the years ended December 31, 2012, are as follows:

(in millions of Korean won)		Loan transactions				Equity contributions in cash	
		Loans		Repayments			
Subsidiaries	Korea Tabacos do Brasil Ltda.	₩	-	₩	-	₩	141
	KT&G Rus L.L.C.		-		8,980		-
	Global Trading, Inc.		-		2,332		-
	Jilin Hanzheng Ginseng Co., Ltd.		-		8,476		8,086
	Yebon Nongwon Agriculture Co., Ltd.		-		-		13,000
	KGC Yebon		-		-		30,000
	K-Q HongKong I,Limited		-		-		17,761
	KGC Life & Gin Co., Ltd.		-		-		21,400

The compensation paid or payable to key management for employee services for the years ended December 31, 2013 and 2012, consists of:

<i>(in millions of Korean won)</i>	2013		2012	
Short-term employee benefits	₩	15,763	₩	15,817
Retirement benefits		1,752		2,431
	₩	<u>17,515</u>	₩	<u>18,248</u>

33. Basis of Translating Financial Statements

The financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩ 1,055.30 to US\$1, the basic exchange rate on December 31, 2013, posted by Seoul Money Brokerage Services, solely for the convenience of the reader. This translation should not be construed as a representation that any or all of the amounts shown could be converted into U.S. dollars at this or any other rate.

Report of Independent Accountants' Review of Internal Accounting Control System

To the President of KT&G Corporation

We have reviewed the accompanying management's report on the operations of the Internal Accounting Control System ("IACS") of KT&G Corporation (the "Company") as of December 31, 2013. The Company's management is responsible for designing and operating IACS and for its assessment of the effectiveness of IACS. Our responsibility is to review the management's report on the operations of the IACS and issue a report based on our review. The management's report on the operations of the IACS of the Company states that "based on its assessment of the operations of the IACS as of December 31, 2013, the Company's IACS has been designed and is operating effectively as of December 31, 2013, in all material respects, in accordance with the IACS standards established by the Internal Accounting Control System Operations Committee (IACSOC) of the Korea Listed Companies Association."

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

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

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

Our review is based on the Company's IACS as of December 31, 2013, and we did not review management's assessment of its IACS subsequent to December 31, 2013. This report has been prepared pursuant to the Acts on External Audit for Stock Companies in Korea and may not be appropriate for other purposes or for other users.

Samil PricewaterhouseCoopers
Seoul, Korea
February 12, 2014

Notice to Readers

This report is annexed in relation to the audit of the financial statements as of December 31, 2013 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.