

Korea Aerospace Industries, Ltd. and Subsidiary

Consolidated Financial Statements
December 31, 2016 and 2015



Korea Aerospace Industries, Ltd. and Subsidiary
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December 31, 2016 and 2015

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Independent Auditor's Report

(English Translation of a Report Originally Issued in Korean)

To the Board of Directors and Shareholders of
Korea Aerospace Industries, Ltd.

We have audited the accompanying consolidated financial statements of Korea Aerospace Industries, Ltd. and its subsidiary (collectively referred to as the "the Group"), which comprise the consolidated statements of financial position as of December 31, 2016 and 2015, and the consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended, and notes to the consolidated financial statements including a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Korea Aerospace Industries, Ltd. and its subsidiary as of December 31, 2016 and 2015, and their financial performance and cash flows for the years then ended in accordance with the Korean IFRS.

Emphasis of Matters

Without qualifying our opinion, we draw attention to the following area of focus.

(1) Auditor's emphasis on area of focus on construction contracts

Area of focus on construction contracts in accordance with the Practical Guidance of Auditing Standard 2016-1 are those matters that, in the auditor's professional judgment and communication with those charged with governance, were of most significance in the audit of the interim consolidated financial statements of the current period. These matters were addressed in the context of the audit of the financial statements as a whole, and the auditor does not provide a separate opinion on these matters.

We have addressed the output of the audit process for the area of focus as below in forming an audit opinion on the financial statements of Korea Aerospace Industries, Ltd. as a whole.

A. General Information

Common information applied to the area of focus on construction contract described in this audit report are as follows:

As explained in Note 2.19 to the financial statements (Revenue Recognition), the Group recognizes contract revenue associated with the construction contract as revenue based on the percentage of completion of the contract activity at the end of the reporting period when the outcome of a construction contract can be estimated reliably and it is highly probable that the contract will be profitable. The percentage of completion of the contract activity is the proportion that costs incurred to date, excluding any contract cost that does not reflect the work performed, bear to the estimated total costs of the contract. The Group presents the gross amount due from customer for contract work as an asset for all contracts in progress for which costs incurred plus recognized profits (less recognized losses) exceed progress billings, and presents the gross amount due to customers for contract work as a liability for all contracts in progress for which progress billings exceed costs incurred plus recognized profits (less recognized losses).

¹ This paragraph is being included in accordance with the Practical Guidance of Auditing Standard 2016-1, Practical Guidance for Special Consideration in Auditing Construction Contracts, prescribed by Korean Institute of Certified Public Accountants, and should not be considered as a communication of key audit matter described in the International Standards on Auditing 700 (Revised).

B. Revenue recognition based on the input method

As explained in Note 2.19 to the financial statements (Revenue Recognition), total contract revenue is measured based on the initial amount of revenue agreed in the contract. However, the measurement of contract revenue is affected by a variety of uncertainties that depend on the outcome of future event; for example, the amount of contract revenue may increase as a result of variations in contract work, claims and incentive payments, on the other hand, the amount of contract revenue may decrease as a result of penalties arising from delays caused by the Group in the completion of the contract. The measurement of contract revenue is also affected by the percentage of completion measured based on the aggregated amount costs incurred. Total contract costs are estimated based on future estimates of material costs, labor costs, construction period and others. Moreover, as detailed in Note 22 to the interim financial statements (Sales), for the year ended December 31, 2016, the estimated total contract revenue increased by ~~₩~~63,963 million and estimated total contract cost increased by ~~₩~~17,001 million. According to the changes, the profit or loss for the current period has increased by ~~₩~~24,955 million, and the profit or loss for the succeeding year is estimated to increase by ~~₩~~22,007 million. Based on these nature of construction contract, the uncertainty of estimating total contract revenue has increased and it is probable that the changes in estimated total contract revenue and costs may have impacts on the profit or loss for the current period (or for the succeeding year); therefore, we identified revenue recognition based on the input method as a significant risk.

As of December 31, 2016, in respect of the Group's revenue recognition based on the input method, we have performed the following audit procedures.

- We reviewed the appropriateness of accounting policy of revenue recognition, and inquired to determine if there were any changes in the accounting policy of revenue recognition.
- We reviewed internal control of the Group in relation to determining and approval process of accounting policy of revenue recognition for new contract.
- We performed analytical review procedures on current progress and significant changes in major projects.

C. Uncertainty of estimated total contract costs

As explained in Note 2.19 to the financial statements (Revenue Recognition), total contract costs are estimated based on future estimates of material costs, labor costs, construction period and others. Also, as detailed in Note 22 to the financial statements (Sales), for the year ended December 31, 2016, the estimated total contract costs increased by ~~₩~~17,001 million. Based on these nature of construction contract, it is probable that the changes in estimated total contract costs may have impacts on the profit or loss for the current period (or for the succeeding year); therefore, we identified uncertainty of estimated total contract costs as a significant risk.

As of December 31, 2016, in respect of the Group's uncertainty of estimated total contract costs, we have performed the following audit procedures.

- We compared the aggregated contract costs incurred and estimated total contract costs of projects that has been completed during the year ended December 31, 2016 to identify if there are projects with significant differences. For the identified projects with the significant differences, we determined reasons of significant differences.
- We compared and analyzed actual and estimated cost to identify if there are contacts with significant differences. For the identified contacts with the significant differences, we determined reasons of significant differences.

D. Measurement of percentage of completion

As explained in Note 2.19 to the financial statements (Revenue Recognition), the percentage of completion of the contract activity is the proportion that costs incurred to date bear to the estimated total costs of the contract. Based on these nature of construction contract, it is probable that the aggregated contract cost incurred and measurement of percentage of completion may have impacts on the profit or loss for the current period (or for the succeeding year); therefore, we identified measurement of percentage of completion as a significant risk.

As of December 31, 2016, in respect of the Group's measurement of percentage of completion, we have performed the following audit procedures.

- We independently recalculated the percentage of completion for construction contracts.
- We tested appropriateness of selected projects' percentage of completion based on the input method with their inspection confirmations (or delivery confirmations).
- We reviewed internal control of the Group in relation to approval of estimated total contract cost of new contract.
- We obtained and reviewed accounting slip presenting cost allocation between construction projects.

E. Collectability of the gross amount due from customer for contract work

As explained in Note 22 to the financial statements (Sales), as of December 31, 2016, the Group recognized the gross amount due from customer for contract work amounts to ~~¥~~¥618,194 million, which is a critical portion of the financial statements. Therefore, we identified collectability of the gross amount due from customer for contract work as a significant risk.

As of December 31, 2016, in respect of the Group's collectability of the gross amount due from customer for contract work, we have performed the following audit procedures.

- We reconciled contractual and actual billing details of projects with gross amount due from customer for contract work exceeding a certain threshold.

- We reviewed the management's evidence of the collectability of the gross amount due from customer for contract work.

F. Accounting treatment regarding variation in contract work

As explained in Note 2.19 to the financial statements (Revenue Recognition), the Group measures total contract revenue at the initial amount of revenue agreed in the contract; however, the measurement of contract revenue is affected by a variety of uncertainties that depend on the outcome of future events such as increase contract revenue due to variations in contract work, claims and incentive payment; or decrease contract revenue as a result of penalties arising from delay caused by the Group in the completion of the contract. A variation is included in contract revenue by the Group when variations in contract work, claims and incentive payments are agreed with the customer and reliably measured. Based on these nature of construction contract, the uncertainty of estimating total contract revenue has been increased and it is probable that the changes in estimated total contract revenue may have impacts of changes on the profit or loss for the current period (or for the succeeding year); therefore, we identified accounting treatment regarding variation in contract work as a significant risk.

As of December 31, 2016, in respect of accounting treatment regarding variations in contract work, we have performed the following audit procedures.

- We compared the estimated total contract costs as at December 31, 2016 and 2015 of major projects, and identified projects with significant differences. For identified projects with significant differences, we obtained amended contracts due to variations in contract works.
- We inquired to determine any projects that are probable with penalties due to delay caused by the Group.

Samil PricewaterhouseCoopers

Seoul, Korea
March 16, 2017

This report is effective as of March 16, 2017, the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying consolidated financial statements and notes thereto. Accordingly, the readers of the audit report should understand that there is a possibility that the above audit report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

Korea Aerospace Industries, Ltd. and Subsidiary
Consolidated Statements of Financial Position
December 31, 2016 and 2015

(In thousands of Korean won)

	Notes	2016	2015
Assets			
Current Assets			
Cash and cash equivalents	5	₩ 53,578,894	₩ 10,730,894
Short-term financial instruments	4,5	16,090,272	17,379,578
Trade receivables	5,6	550,441,942	197,917,560
Due from customers for contract work	5,22	618,194,249	877,359,110
Other short-term financial assets	5,6	36,157,046	23,064,959
Inventories	7	506,266,182	466,848,702
Other assets	11	183,017,018	204,663,672
Total current assets		1,963,745,603	1,797,964,475
Non-current assets			
Long-term available-for-sale financial assets	5,8	27,064,803	23,933,704
Other long-term financial assets	4,5,6	7,974,449	9,675,045
Investments in associate and joint venture	9	5,566,348	5,261,371
Property, plant and equipment	10	522,062,503	506,943,034
Intangible assets	10	246,031,334	235,202,221
Deferred income tax assets	27	160,771,426	133,315,437
Total non-current assets		969,470,863	914,330,812
Total assets		₩ 2,933,216,466	₩ 2,712,295,287

Korea Aerospace Industries, Ltd. and Subsidiary
Consolidated Statements of Financial Position
December 31, 2016 and 2015

(In thousands of Korean won)

	Notes	2016	2015
Liabilities and Equity			
Current Liabilities			
Trade payables	5,12	₩ 280,803,104	₩ 231,546,111
Other short-term financial liabilities	5,12	106,463,966	103,290,895
Short-term borrowings	5,13	99,521,595	125,287,749
Current debentures payable	5,13	200,000,000	-
Due to customers for contract work	22	106,591,518	306,458,863
Income tax payable		65,908,710	60,976,793
Other short-term liabilities	14	72,283,521	40,616,183
Total current liabilities		931,572,414	868,176,594
Non-current liabilities			
Long-term borrowings	5,13	45,711,576	125,954,032
Long-term debentures payable	5,13	199,452,326	199,673,040
Other long-term financial liabilities	5,12	23,661,852	19,084,194
Net defined benefit liabilities	15	298,723,051	272,894,493
Other provisions	16,30	12,497,559	41,652,497
Other long-term liabilities		15,307,802	13,008,154
Total non-current liabilities		595,354,166	672,266,410
Total liabilities		1,526,926,580	1,540,443,004
Equity attributable to owners of the parent			
Capital stock	18	487,375,535	487,375,535
Share premium		124,077,486	124,077,486
Retained earnings	19	783,983,425	549,910,404
Other components of equity	20	10,853,440	10,488,858
		1,406,289,886	1,171,852,283
Non-controlling interests		-	-
Total equity		1,406,289,886	1,171,852,283
Total liabilities and equity		₩ 2,933,216,466	₩ 2,712,295,287

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

Korea Aerospace Industries, Ltd. and Subsidiary
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2016 and 2015

(In thousands of Korean won, except per share amounts)

	Notes	2016	2015
Sales	22	₩ 3,100,674,854	₩ 2,901,032,363
Cost of sales	23	2,649,206,791	2,486,702,245
Gross profit		451,468,063	414,330,118
Selling, general and administrative expenses	23,24	136,506,067	128,674,819
Operating income		314,961,996	285,655,299
Other income	25	13,072,443	6,749,444
Other expenses	25	24,843,136	66,134,052
Financial income	26	82,254,699	71,167,796
Financial expenses	26	64,248,008	58,199,968
Gain on valuation of equity-method investments	9	336,952	159,915
Loss on valuation of equity-method investments	9	31,975	56,073
Profit before income tax		321,502,971	239,342,361
Income tax expense	27	53,390,016	58,776,807
Profit for the year		268,112,955	180,565,554
Profit attributable to :			
Owners of the parent		268,112,955	180,565,554
Non-controlling interests		-	-
Other comprehensive income (loss)			
Items that will not be reclassified subsequently to profit or loss:			
Remeasurement of net defined benefit liabilities	15	6,530,486	(28,403,410)
Income tax effect of other comprehensive income		(1,580,378)	6,874,634
Items to be subsequently reclassifiable to profit or loss:			
Gain on valuation of long-term available-for-sale financial assets	8	464,499	560,434
Foreign currency translation differences		12,493	28,953
Income tax effect of other comprehensive income		(112,409)	(135,625)
		5,314,691	(21,075,014)
Total comprehensive income for the year		₩ 273,427,646	₩ 159,490,540

Korea Aerospace Industries, Ltd. and Subsidiary
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2016 and 2015

(In thousands of Korean won, except per share amounts)

	Notes	2016	2015
Comprehensive income attributable to :			
Owners of the parent		273,427,646	159,490,540
Non-controlling interests		-	-
Earnings per share attributable to owners of the parent (in Korean won)			
Basic earnings per share	21 ₩	2,751 ₩	1,852
Diluted earnings per share	21 ₩	2,751 ₩	1,852

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

Korea Aerospace Industries, Ltd. and Subsidiary
Consolidated Statements of Changes in Equity
Years Ended December 31, 2016 and 2015

(In thousands of Korean won)

	Equity attributable to owners of the parent				
	Capital stock	Share premium	Retained earnings	Other components of equity	Total
Balance at January 1, 2015	₩ 487,375,535	₩ 124,077,486	₩ 415,242,402	₩ 10,035,096	₩ 1,036,730,519
Comprehensive income					
Profit for the year	-	-	180,565,554	-	180,565,554
Gains on valuation of available-for-sale financial assets	-	-	-	424,809	424,809
Foreign currency translation differences	-	-	-	28,953	28,953
Remeasurement of net defined benefit liabilities	-	-	(21,528,776)	-	(21,528,776)
Total comprehensive income	-	-	159,036,778	453,762	159,490,540
Transactions with owners					
Cash dividends	-	-	(24,368,776)	-	(24,368,776)
Total transactions with owners	-	-	(24,368,776)	-	(24,368,776)
Balance at December 31, 2015	₩ 487,375,535	₩ 124,077,486	₩ 549,910,404	₩ 10,488,858	₩ 1,171,852,283

Korea Aerospace Industries, Ltd. and Subsidiary
Consolidated Statements of Changes in Equity
Years Ended December 31, 2016 and 2015

(In thousands of Korean won)

	Equity attributable to owners of the parent					
	Capital stock	Share premium	Retained earnings	Other components of equity	Non-controlling interests	Total
Balance at January 1, 2016	₩ 487,375,535	₩ 124,077,486	₩ 549,910,404	₩ 10,488,858	₩ -	₩ 1,171,852,283
Comprehensive income						
Profit for the year	-	-	268,112,955	-	-	268,112,955
Gains on valuation of available-for-sale financial assets	-	-	-	352,089	-	352,089
Foreign currency translation differences	-	-	-	12,493	-	12,493
Remeasurement of net defined benefit liabilities	-	-	4,950,109	-	-	4,950,109
Total comprehensive income	-	-	273,063,064	364,582	-	273,427,646
Transactions with owners						
Cash dividends	-	-	(38,990,043)	-	-	(38,990,043)
Total transactions with owners	-	-	(38,990,043)	-	-	(38,990,043)
Balance at December 31, 2016	487,375,535	124,077,486	783,983,425	10,853,440	-	1,406,289,886

The accompanying notes are an integral part of these consolidated financial statements

Korea Aerospace Industries, Ltd. and Subsidiary
Consolidated Statements of Cash Flows
December 31, 2016 and 2015

(In thousands of Korean won)

	Notes	2016	2015
Cash Flows from operating activities			
Profit for the year		₩ 268,112,955	₩ 180,565,554
Adjustments	28	284,588,906	284,898,226
Changes in operating assets and liabilities	28	(317,784,674)	(334,243,593)
Interest received		810,705	182,669
Interest paid		(12,836,124)	(12,713,112)
Income tax paid		(77,606,875)	(58,837,865)
Net cash inflow from operating activities		145,284,893	59,851,879
Cash flows from investing activities			
Net proceeds from short-term financial instruments		1,289,306	5,445,712
Decrease(Increase) in long-term financial instruments		(4,610)	4,000
Proceeds from disposal of available-for-sale financial assets		3,700	200,000
Acquisition of available-for-sale financial assets		(2,670,300)	(3,030,000)
Increase in other financial assets		(2,014,589)	(2,257,311)
Decrease in other financial assets		3,803,321	2,242,936
Proceeds from disposal of property, plant and equipment		860,549	17,619
Acquisition of property, plant and equipment		(81,874,014)	(65,276,888)
Proceeds from disposal of intangible assets		497,273	-
Acquisition of intangible assets		(100,587,133)	(73,771,021)
Acquisition of associates		-	(1,800,000)
Receipt of governments grants		21,971,011	14,990,226
Net cash outflow from investing activities		(158,725,486)	(123,234,727)

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Consolidated Statements of Cash Flows
December 31, 2016 and 2015

(In thousands of Korean won)

	Notes	2016	2015
Cash flows from financing activities			
Proceeds from short-term borrowings		₩ 477,078,920	₩ 452,893,000
Repayment of short-term borrowings		(620,120,337)	(456,162,590)
Proceeds from long-term borrowings		38,700,000	88,978,704
Proceeds from debentures		199,452,600	-
Payment of dividends		(38,989,803)	(24,368,364)
Net cash inflow from financial activities		<u>56,121,380</u>	<u>61,340,750</u>
Effects of exchange rate changes on cash and cash equivalents		<u>167,213</u>	<u>202,519</u>
Net increase (decrease) in cash and cash equivalents		42,848,000	(1,839,579)
Beginning of the year		10,730,894	12,570,473
End of the year		<u>₩ 53,578,894</u>	<u>₩ 10,730,894</u>

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

**Korea Aerospace Industries, Ltd. and Subsidiary
Notes to the Consolidated Financial Statements
December 31, 2016 and 2015**

1. General Information

Korea Aerospace Industries, Ltd. (“the Company”) and its subsidiary (collectively referred to as ‘the Group’) have prepared the consolidated financial statements in accordance with Korean IFRS 1110, ‘*Consolidated financial statements*’. Its consolidated subsidiary is Korea Aerospace F.W. Inc. KAI-EC, S&K Aerospace Co., Ltd and Korea Surface Treatment Co., Ltd are accounted for using the equity method of accounting.

Korea Aerospace Industries, Ltd. was incorporated on October 1, 1999, under the laws of the Republic of Korea. The Company is engaged in the production and sale of aircraft and its spare parts. On June 30, 2011, the Company was listed on the Korea Stock Exchange. As of December 31, 2016, the share capital of the Company amounts to ₩ 487,376 million and the Company’s major shareholder is Korea Development Bank with 19.02% ownership (Note 18).

The Company’s consolidated subsidiary as of December 31, 2016 and 2015, consist of the following:

Subsidiary	Location	Year end	Percentage of ownership (%)	
			2016	2015
Korea Aerospace F.W. Inc.	U.S.A.	December 31	100.00	100.00

A summary of financial data of the subsidiary as of and for the year ended December 31, 2016 and 2015, follows:

(In thousands of Korean won)

Name of subsidiary	Korea Aerospace F.W. Inc.	
	2016	2015
Assets	557,235	532,626
Liabilities	290,205	288,610
Equity	267,030	244,016
Sales	2,716,942	3,053,033
Profit for the year	10,521	61,319
Total comprehensive income for the year	10,521	61,319

2. Summary of Significant Accounting Policies

The principal accounting policies applied in the preparation of these consolidated 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 Group 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 consolidated financial statements have been condensed, restructured and translated into English

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from the Korean language financial statements.

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

The consolidated financial statements of the Group have been prepared in accordance with Korean IFRS. These are the standards, subsequent amendments and related interpretations issued by the International Accounting Standards Board (IASB) that have been adopted by the Republic of Korea.

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

2.2 Changes in Accounting Policy and Disclosures

(a) New and amended standards adopted by the Group

The Group newly applied the following amended and enacted standards and interpretations for the annual period beginning on January 1, 2016, the disclosure that is required in connection with the contract-based industry was disclosed in Note 22.

- Amendment to Korean IFRS 1001, *Presentation of Financial Statements*

Korean IFRS 1001 *Presentation of Financial Statements* clarifies that materiality applies to the exclusion or inclusion or aggregation of the disclosures in the notes. And also, clarifies that the share of OCI arising from equity-accounted should be presented in total for items which will and will not be reclassified to profit or loss. Additional amendments are made in relation to a particular order of the notes and other.

- *Clarification of Acceptable methods of Depreciation and Amortization* – Amendments to Korean IFRS 1016 *Property, Plant and Equipment*, and Korean IFRS 1038 *Intangible assets*

Amendments to Korean IFRS 1016 *Property, Plant and Equipment* clarify that a revenue-based method should not be used to calculate the depreciation of items of property, plant and equipment. Korean IFRS 1038 *Intangible assets* now includes a rebuttable presumption that the amortization of intangible assets based on revenue is inappropriate. This presumption can be overcome if either; the intangible asset is expressed as a measure of revenue, or it can be shown that revenue and the consumption of economic benefits generated by the asset are highly correlated.

- *Investment entities: Applying the Consolidation Exception* – Amendments to Korean IFRS 1110 *Consolidated Financial Statements*, Korean IFRS 1028 *Investments in Associates and Joint Ventures*, and Korean IFRS 1112 *Disclosures of Interests in Other Entities*

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Amendments made to Korean IFRS 1110 *Consolidated Financial Statements* clarify that the exception from preparing consolidated financial statement is also available to intermediate parent entities which are subsidiaries of investment entities. If an investment entity has a subsidiary that is an investment entity and whose activities are providing services that related to the investment entity's investment activities, the investment entity measures the subsidiary at fair value through profit or loss.

Amendments made to Korean IFRS 1028 *Investments in Associates and Joint Ventures* clarify that entities which are not investment entities but have an interest in an associate which is an investment entity have a policy choice when applying the equity method of accounting.

Amendments made to Korean IFRS 1112 *Disclosures of Interests in Other Entities* clarify that an investment entity which does not prepare consolidated financial statements should present disclosures relating to investment entities required by Korean IFRS 1112.

- Accounting for Acquisitions of Interests in Joint Operations – Amendments to Korean IFRS 1111 Joint Arrangements

Amendments to Korean IFRS 1111 *Joint Arrangements* clarify the accounting for the acquisition of an interest in a joint operation where the activities of the operation constitute a business. An investor requires to apply the principles of business combination accounting when the investor acquires an interest in a joint operation that constitutes a business.

- Annual Improvements to Korean IFRS 2012-2014 Cycle

Annual Improvements to Korean IFRS 2012-2014 *Cycle* consist of the following amendments. The application does not have a material impact on the consolidated financial statements.

Korean IFRS 1105 *Non-current Assets Held for Sale and Discontinued Operation* – clarifies when an asset (or disposal group) is reclassified from 'held for sale' to 'held for distribution' or vice versa, this does not have to be accounted for as such.

Korean IFRS 1107 *Financial Instruments: Disclosures* – clarifies the specific guidance for transferred financial assets to help management determine whether the terms of a servicing arrangement constitute 'continuing involvement', and also clarifies that the additional disclosures relating to the amendments in 2012 '*Offsetting of Financial Assets and Financial Liabilities*' only need to be included in interim reports if required by Korean IFRS 1034 *Interim Financial Reporting*.

Korean IFRS 1019 *Employee Benefits* clarifies that when determining the discount rate for post-employment benefit obligations, it is the currency in which the liabilities are denominated that is important, and not the country where they arise.

Korean IFRS 1034 *Interim Financial Reporting* clarifies what is meant by the reference in the standard to '*information disclosed elsewhere in the interim financial report*'; and also amended requirements for a cross-reference from the interim financial statements to the

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Notes to the Consolidated Financial Statements
December 31, 2016 and 2015

location of that information.

- Korean IFRS 1011 *Construction Contract*, Korean IFRS 1037 *Provisions, Contingent Liabilities and Contingent Assets* and Interpretation 2115 *Arrangements for Property Construction*

These standards and interpretation clarify the accounting information disclosure requirement for construction contracts. The accounting estimates and potential risk information of the construction contracts should be disclosed in detail by either individual construction or operating segment.

(b) New standards and interpretations not yet adopted by the Group

Certain new accounting standards and interpretations that have been published that are not mandatory for December 31, 2016 reporting periods and have not been early adopted by the Group are set out below.

- Amendments to Korean IFRS 1007 *Statement of Cash Flows*

Amendments to Korean IFRS 1007 *Statement of Cash flows* requires to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash flows. The Group will apply this amendment for annual reporting periods beginning on or after January 1, 2017 with early application permitted. The Group does not expect the amendments to have a significant impact on the consolidated financial statements.

- Amendments to Korean IFRS 1012 *Income Tax*

Amendments to Korean IFRS 1012 clarify how to account for deferred tax assets related to debt instruments measured at fair value. Korean IFRS 1012 provides requirements on the recognition and measurement of current or deferred tax liabilities or assets. The amendments issued clarify the requirements on recognition of deferred tax assets for unrealized losses, to address diversity in practice. The Group will apply the amendments for annual periods beginning on or after January 1, 2017 with early application permitted. The Group does not expect the amendments to have a significant impact on the consolidated financial statements.

- Amendments to Korean IFRS 1102 *Share-based Payment*

Amendments to IFRS 2 clarifies accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. And also, clarifies that the measurement approach should treat the terms and conditions of a cash-settled award in the same way as for an equity-settled award. The Group will apply the amendments for annual periods beginning on or after January 1, 2018 with early application permitted. The Group does not expect the amendments to have a significant impact on the consolidated financial statements.

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- Korean IFRS 1109 *Financial Instruments*

The new standard for financial instruments issued on September 25, 2015 are effective for annual periods beginning on or after January 1, 2018 with early application permitted. This standard will replace Korean IFRS 1039 *Financial Instruments: Recognition and Measurement*. The Group will apply the standards for annual periods beginning on or after January 1, 2018.

The standard requires retrospective application with some exceptions. For example, an entity is not required to restate prior period in relation to classification and measurement (including impairment) of financial instruments. The standard requires prospective application of its hedge accounting requirements for all hedging relationships except the accounting for time value of options and other exceptions.

Korean IFRS 1109 *Financial Instruments* requires all financial assets to be classified and measured on the basis of the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial assets. A new impairment model, an expected credit loss model, is introduced and any subsequent changes in expected credit losses will be recognized in profit or loss. Also, hedge accounting rules amended to extend the hedging relationship, which consists only of eligible hedging instruments and hedged items, qualifies for hedge accounting.

An effective implementation of Korean IFRS 1109 requires preparation processes including financial impact assessment, accounting policy establishment, accounting system development and the system stabilization. The impact on the Group's financial statements due to the application of the standard is dependent on judgements made in applying the standard, financial instruments held by the Group and macroeconomic variables.

With the implementation of Korean IFRS 1109, the Group neither prepared for internal management process nor began to adjust accounting system for financial instruments reporting. Also, the Group did not analyze the financial effects of applying the standard. However, the following areas are likely to be affected in general.

(a) *Classification and Measurement of Financial Assets*

When implementing Korean IFRS 1109, the classification of financial assets will be driven by the Group's business model for managing the financial assets and contractual terms of cash flow. The following table shows the classification of financial assets measured subsequently at amortized cost, at fair value through other comprehensive income and at fair value through profit or loss. If a hybrid contract contains a host that is a financial asset, the classification of the hybrid contract shall be determined for the entire contract without separating the embedded derivative.

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<i>Business model for the contractual cash flows characteristics</i>	Solely represent payments of principal and interest	All other
<i>Hold the financial asset for the collection of the contractual cash flows</i>	Measured at amortized cost ¹	
<i>Hold the financial asset for the collection of the contractual cash flows and trading</i>	Recognized at fair value through other comprehensive income ¹	Recognized at fair value through profit or loss ²
<i>Hold for trading</i>	Recognized at fair value through profit or loss	

¹ A designation at fair value through profit or loss is allowed only if such designation mitigates an accounting mismatch (irrevocable).

² Equity investments not held for trading can be recorded in other comprehensive income (irrevocable).

With the implementation of Korean IFRS 1109, the criteria to classify the financial assets at amortized cost or at fair value through other comprehensive income are more strictly applied than the criteria applied with Korean IFRS 1039. Accordingly, the financial assets at fair value through profit or loss may increase by implementing Korean IFRS 1109 and may result an extended fluctuation in profit or loss.

As of December 31, 2016, the Group has loans and receivables amounting to \ 1,282,437 million and available-for-sale financial assets amounting to \ 170 million as amortized cost.

According to Korean IFRS 1109, under the terms of a contract, a cash flow consisting of only interest on principal and principal balance on a certain date occurs, and only the debt instruments that are intended to receive contractual cash flows can be measured at amortized cost. As of December 31, 2016, the Group has recognized amortized cost on loans and receivables amounting to \ 1,282,437 million and available-for-sale financial assets amounting to \ 170 million.

(b) Classification and Measurement of Financial Liabilities

Korean IFRS 1109 requires the amount of the change in the liability's fair value attributable to changes in the credit risk to be recognized in other comprehensive income, unless this treatment of the credit risk component creates or enlarges a measurement mismatch. Amounts presented in other comprehensive income are not subsequently transferred to profit or loss.

Under Korean IFRS 1039, all financial liabilities designated at fair value through profit or loss recognized their fair value movements in profit or loss. However, under Korean IFRS 1109, certain fair value movements will be recognized in other comprehensive income and as a result profit or loss from fair value movements may decrease.

As of December 31, 2016, the Group has no financial liabilities designated as at fair value through fair value measurement.

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(c) Impairment: Financial Assets and Contract Assets

Korean IFRS 1109 sets out a new forward looking 'expected loss' impairment model which replaces the incurred loss model under Korean IFRS 1039 that impaired assets if there is an objective evidence and applies to:

- Financial assets measured at amortized cost
- Debt investments measured at fair value through other comprehensive income, and
- Certain loan commitments and financial guaranteed contracts.

Under Korean IFRS 1109 'expected loss' model, a credit event (or impairment 'trigger') no longer has to occur before credit losses are recognized. The Group will always recognize (at a minimum) 12-month expected credit losses in profit or loss. Lifetime expected losses will be recognized on assets for which there is a significant increase in credit risk after initial recognition.

Stage ¹	Loss allowance
1 No significant increase in credit risk after initial recognition ²	12-month expected credit losses (expected credit losses that result from those default events on the financial instrument that are possible within 12 months after the reporting date)
2 Significant increase in credit risk after initial recognition	Lifetime expected credit losses (expected credit losses that result from all possible default events over the life of the financial instrument)
3 Credit-impaired	

¹ A loss allowance for lifetime expected credit losses is required for a financial instrument if the credit risk on that financial instrument has increased significantly since initial recognition. It is also required for contract assets or trade receivables that are not, according to Korean IFRS 1115 *Revenue from Contracts with Customers*, considered to contain a significant financing component. Additionally, the Group can elect an accounting policy of recognizing lifetime expected credit losses for all contract assets and/or all trade receivables, including those that contain a significant financing component.

² If the financial instrument has low credit risk at the reporting date, the Group may assume that the credit risk has not increased significantly since initial recognition.

Under Korean IFRS 1109, the asset that is credit-impaired at initial recognition would recognize all changes in lifetime expected credit losses since the initial recognition as a loss allowance with any changes recognized in profit or loss.

As of December 31, 2016, the Group has loans and receivables amounting to \ 1,282,437 million and available-for-sale financial assets amounting to \ 170 million as amortized cost. The loss allowance recognized for these assets is \ 7,749 million

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- Korean IFRS 1115 *Revenue from Contracts with Customers*

The Group will apply Korean IFRS 1115 *Revenue from Contracts with Customers* issued on November 6, 2015 for annual reporting periods beginning on or after January 1, 2018, and earlier application is permitted. This standard replaces Korean IFRS 1018 *Revenue*, Korean IFRS 1011 *Construction Contracts*, Interpretation 2031 *Revenue-Barter Transactions Involving Advertising Services*, Interpretation 2113 *Customer Loyalty Programs*, Interpretation 2115 *Agreements for the Construction of Real Estate* and Interpretation 2118 *Transfers of assets from customers*. The Group must apply Korean IFRS 1115 *Revenue from Contracts with Customers* within annual reporting periods beginning on or after January 1, 2018, and will apply the standard retrospectively to prior reporting period presented in accordance with Korean IFRS 1008 *Accounting Policies, Changes in Accounting Estimates and Errors* and apply simplified transition method with no restatement for completed contracts and other as at January 1, 2017.

The new standard is based on the principle that revenue is recognized when control of a good or service transfers to a customer so the notion of control replaces the existing notion of risks and rewards. A new five-step process must be applied before revenue from contract with customer can be recognized:

- Identify contracts with customers
- Identify the separate performance obligation
- Determine the transaction price of the contract
- Allocate the transaction price to each of the separate performance obligations, and
- Recognize the revenue as each performance obligation is satisfied.

As at December 31, 2016, the Group neither prepared for internal management process nor began to adjust accounting system in relation to implementation of Korean IFRS 1115. Also, the Group did not analyze the financial effects of applying the standard.

2.3 Consolidation

The Group has prepared the consolidated financial statements in accordance with Korean IFRS 1110 *Consolidated Financial Statements*.

(a) Subsidiaries

Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

The acquisition method of accounting is used to account for business combinations by the Group. The consideration transferred is measured at the fair values of the assets transferred, and

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identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognizes any non-controlling interest in the acquired entity on an acquisition-by-acquisition basis either at fair value or at the non-controlling interest's proportionate share of the acquired entity's net identifiable assets. All other non-controlling interests are measured at fair values, unless otherwise required by other standards. Acquisition-related costs are expensed as incurred.

The excess of consideration transferred, amount of any non-controlling interest in the acquired entity and acquisition-date fair value of any previous equity interest in the acquired entity over the fair value of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the business acquired, the difference is recognized directly in the profit or loss as a bargain purchase.

Intercompany transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the transferred asset. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group

(b) Changes in ownership interests in subsidiaries without change of control

The Group treats transactions with non-controlling interests that do not result in a loss of control as transactions with equity owners of the Group. A changed in ownership interest results in an adjustment between the carrying amounts of the controlling and non-controlling interest to reflect their relative interest in the subsidiary. Any difference between the amount of the adjustment to non-controlling interest and any consideration paid or received is recognized in a separate reserve within equity attributable to owners of the Parent Company.

(c) Disposal of subsidiaries and loss of control

When the Group ceases to consolidate for a subsidiary because of a loss of control, any retained interest in the subsidiary is remeasured to its fair value with the changed in carrying amount recognized in profit or loss.

(d) Associates

Associates are entities over which the Group has significant influence but not control or joint control. Investments in associates are accounted for using the equity method of accounting, after initially being recognized at cost. Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. If there is objective evidence of impairment for the investment in the associate, the Group recognizes the difference between the recoverable amount of the associate and its book amount as impairment loss.

(e) Joint Arrangements

A joint arrangement, wherein two or more parties have joint control, is classified as either a joint operation or a joint venture. A joint operator recognizes its direct right to the assets, liabilities, revenues and expenses of joint operations and its share of any jointly held or incurred assets,

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liabilities, revenues and expenses. Interests in joint ventures are accounted for using the equity method, after initially being recognized at cost in the consolidated statement of financial position.

2.4 Foreign Currency Translation

(a) Functional and presentation currency

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

(b) Transactions and balances

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

Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Translation differences on assets and liabilities carried at fair value are reported as part of the fair value gain or loss. For example, translation differences on non-monetary assets and liabilities such as equities held at fair value through profit or loss are recognized in profit or loss as part of the fair value gain or loss and translation differences on non-monetary assets such as equities classified as available-for-sale financial assets are recognized in other comprehensive income.

2.5 Cash Flow Statements

Cash flow statements are prepared using the indirect method and foreign currency cash flows are translated at average exchange rates.

2.6 Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Bank overdrafts are considered as short-term borrowings in the statements of financial position.

2.7 Financial assets

(a) Classification and measurement

The Group classifies its financial assets into 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 way purchases and sales of financial assets are recognized on trade-date, the date on which the Group commits to purchase or sell the asset.

At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at fair value

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through profit or loss are expensed in profit or loss. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. And, loans and receivables and held-to-maturity investments are subsequently carried at amortized cost using the effective interest method.

Gains or losses arising from changes in the fair value of financial assets at fair value through profit or loss are recognized in profit or loss within other income or other expenses. Gains or losses arising from changes in the available-for-sale financial assets are recognized in other comprehensive income, and amounts are reclassified to profit or loss when the associated assets are sold or impaired.

(b) Impairment

The Group 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, and that of other financial assets is directly deducted from their carrying amount.

The Group considers that there is objective evidence of impairment if significant financial difficulties of the debtor, or delinquency in interest or principal payments.

(c) Derecognition

If a transfer does not result in derecognition because the Group has retained substantially all the risks and rewards of ownership of the transferred asset, the Group continues to recognize the transferred asset in its entirety and recognizes a financial liability for the consideration received. The Group classified the financial liability as "borrowings" in the statement of financial position.

(d) Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount reported in the consolidated statements of financial position where there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the assets and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the Group or the counterparty.

2.8 Trade Receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets. Trade receivables are recognized

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initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment.

2.9 Inventories

Inventories are stated at the lower of cost and net realizable value. The cost of inventories are determined by the specific identification, except for raw materials, sub-materials and supplies on which FIFO method is applied.

2.10 Property, Plant and Equipment

Property, plant and equipment are stated at its cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditures that is directly attributable to the acquisition of the items.

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:

	<u>Estimated useful lives</u>
Buildings and Structures	30 years
Machinery	8 years
Tools and equipment	4 years
Vehicles	4 years

The depreciation method, residual values and useful lives of property, plant and equipment are reviewed at the end of each reporting period and, if appropriate, accounted for as changes in accounting estimates.

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 Intangible Assets

(a) Development costs and Long-term development projects

The Group capitalizes certain development costs when the outcome of development plan is for practical enhancement, the probability of technical and commercial achievement for the development plans are high, and the necessary cost is reliably estimable. Capitalized costs, comprising raw materials, direct labor and related overhead, are amortized using the straight-line method and unit of production method over their useful lives. In the presentation, the accumulated amortization amount and accumulated impairment amount are deducted from capitalized costs associated with development activities. The Group recognizes other development costs as an expense in the period in which they are incurred.

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(b) Membership rights

Membership rights are regarded as intangible assets with indefinite useful life and not amortized because there is no foreseeable limit to the period over which the asset is expected to generate net cash flows for the entity. All membership rights are tested annually for impairment and stated at cost less accumulated impairment.

(c) Industrial property rights

Industrial property rights are shown at historical cost. Industrial property rights have a finite useful life and are carried at cost less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of industrial property rights over their estimated useful lives.

(d) Other intangible assets

Other intangible assets, such as software which meet the definition of an intangible asset, are amortized using the straight-line method over their estimated useful lives when the asset is available for use. Other intangible assets are tested 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 carrying amount exceeds its recoverable amount.

(e) Amortization method and estimated useful lives of intangible assets

	Amortization method	Estimated useful lives
Development costs	Straight-line method	5 ~ 20 years
Long-term development projects	Unit of production method	-
Industrial property rights	Straight-line method	5 ~ 20 years
Other intangible assets	Straight-line method	20 years

2.13 Impairment of Non-financial Assets

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

2.14 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

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from financial instruments containing embedded derivatives are also categorized as held-for-trading.

The Group 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 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.

2.15 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 comprehensive income statement over the period of the borrowings using the effective interest method. The Group classifies the liability as current unless it has an unconditional right to delay the settlement of the borrowing.

2.16 Employee Benefits

(a) Net defined benefit liabilities

The Group operates retirement benefit plans. A retirement 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. 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 and that have terms to maturity approximating to the terms of the related pension obligation. The remeasurements of the net defined benefit liability are recognized in other comprehensive income.

If any plan amendments, curtailments, or settlements occur, past service costs or any gains or losses on settlement are recognized as profit or loss for the year.

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(b) Share-based payments

Equity-settled, share-based payments granted to employees are estimated at the grant date fair value of equity instruments and recognized as employee benefit expenses over the vesting period. The number of equity instruments expected to vest is remeasured with consideration to non-market vesting conditions at the end of the reporting period, with any changes from the original measurement recognized in the profit for the year and equity.

When the options are exercised, the Group issues new shares. The proceeds received, net of any directly attributable transaction costs, are recognized as share capital (nominal value) and share premium.

2.17 Provisions and Contingent Liabilities

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.

A contingent liability is recognized when the Group has a possible obligation arising from past events whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or the Group has a present obligation as a result of past events but it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient liability.

2.18 Dividend Distribution

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

2.19 Revenue Recognition

Revenue is measured at the fair value of the consideration received or receivable for the sale of goods or rendering of services arising from the normal activities of the Group. It is stated as net of value added taxes, returns, rebates and discounts, after elimination of intra-company transactions.

The Group recognizes revenue when the amount of revenue can be reliably measured; when it is probable that future economic benefits will flow to the entity; and when specific criteria have been met for each of the Group's activities, as described below. The Group bases its estimate on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

(a) Sales of goods

Revenue from the sale of goods is recognized when products are delivered to the purchaser.

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(b) Sales of services

The Group recognizes revenue from the sale of services under the percentage-of-completion method. Revenue is generally recognized based on the costs incurred to date as a percentage to the total estimated costs to be incurred.

(c) Construction contracts

To recognize project sales, the Group applies a construction contract which is defined by Korean IFRS 1011, *Construction Contracts*, as a contract specifically negotiated for the construction of an asset

When the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, contract revenue is recognized over the period of the contract by reference to the stage of completion. When the total contract cost is likely to exceed the total contract revenue, the expected loss is recognized immediately as an expense. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognized only to the extent of contract costs incurred that are likely to be recoverable. Variations in contract work, claims and incentive payments are included in contract revenue to the extent that may have been agreed with the customer and are capable of being reliably measured.

The Group uses the 'percentage-of-completion method' to determine the appropriate amount to recognize in a given period. The stage of completion is measured by reference to the contract costs incurred up to the end of the reporting period as a percentage of total estimated costs for each contract. Costs incurred in the year in connection with future activity on a contract are excluded from contract costs in determining the stage of completion. These amounts are recognized as inventory, prepaid expenses or other assets.

On the statement of financial position, the Group reports the net contract position for each contract as either an asset or a liability. A contract represents an asset where costs incurred plus recognized profits (less recognized losses) exceed progress billings (due from customers for contract work); a contract represents a liability where the opposite is the case (due to customers for contract work).

(d) Interest income

Interest income is recognized using the effective interest method according to the time passed. When a loan and receivable is impaired, the Group reduces the carrying amount to its recoverable amount and continues unwinding the discount as interest income. Interest income on impaired loans and receivables is recognized using the original effective interest rate.

(e) Dividend income

Dividend income is recognized when the right to receive payment is established.

2.20 Government Grants

Government grants are recognized at their fair values when there is reasonable assurance that the grant will be received and the Group will comply with the conditions attached to it. Government grants related to assets are presented by deducting the grants in arriving at the carrying amount of

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the assets, and grants related to income are deferred and presented by deducting the related expenses for the purpose of the government grants.

2.21 Income Tax Expense and Deferred Taxes

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 Group 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.

2.22 Earnings per Share

Basic earnings per share is calculated by dividing the profit attributable to owner of the parent by the weighted average number of common shares outstanding during reporting period.

Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of dilutive potential common shares. Dilutive potential common shares are included in the calculation of diluted earnings per share only when the dilution is effective.

2.23 Segment reporting

Information of each operating segment is reported in a manner consistent with the business segment reporting provided to the chief operating decision-maker (Note 32). The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the steering committee that makes strategic decisions.

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2.24 Approval of Financial Statements

The issuance of the December 31, 2016 consolidated financial statements of the Company was approved by the Board of Directors on February 9, 2017.

3. Critical Accounting Estimates and Judgments

The Group 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) Revenue recognition

Revenue from construction contract work is recognized using the percentage-of-completion method, applied by the Statements of K-IFRS1101, *Construction contracts*, under which revenue is generally based on the costs incurred to date as a percentage to the total estimated costs to be incurred.

(b) Income tax

The Group 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. The Group recorded, based on its best estimate, current taxes and deferred taxes that the Group will be liable in the future for the operating results as of the financial year end. However, the final tax outcome in the future may be different from the amounts that were initially recorded. Such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made (Note 27).

(c) Provisions

The Group recognizes provisions for construction warranty claims and loss in construction contracts as of the reporting date. The amounts are estimated based on historical data (Note 16).

(d) Net defined benefit liabilities

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 15).

4. Financial assets subject to withdrawal restrictions

Short and long-term financial instruments subject to withdrawal restrictions as of December 31, 2016 and 2015, consist of the following:

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	2016	2015	Restriction
Short-term financial instruments	16,090,272	5,379,578	Government grants
Other long-term finance assets	13,000	13,000	Deposits for checking accounts
Total	16,103,272	5,392,578	

5. Financial instruments by category

Categorizations of financial instruments as of December 31, 2016, are as follows:

(In thousands of Korean won)

	Loans and receivables	Available-for- sale financial assets	Total	Fair value
Assets				
Cash and cash equivalents	53,578,894	-	53,578,894	2
Short-term financial instruments	16,090,272	-	16,090,272	2
Available-for-sale financial assets ¹	-	27,064,803	27,064,803	27,064,803
Trade receivables	550,441,942	-	550,441,942	2
Due from customers for contract work	618,194,249	-	618,194,249	2
Other financial assets	44,131,495	-	44,131,495	2

(In thousands of Korean won)

	Financial liabilities measured at amortized cost	Fair value
Liabilities		
Trade payables	280,803,104	2
Borrowings ³	145,233,171	145,656,947
Debentures ³	399,452,326	401,111,186
Other financial liabilities ³	130,125,818	131,574,986

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Categorizations of financial instruments as of December 31, 2015, are as follows:

(In thousands of Korean won)

	Loans and receivables	Available-for- sale financial assets	Total	Fair value
Assets				
Cash and cash equivalents	10,730,894	-	10,730,894	2
Short-term financial instruments	17,379,578	-	17,379,578	2
Available-for-sale financial assets ¹	-	23,933,704	23,933,704	23,933,704
Trade receivables	197,917,560	-	197,917,560	2
Due from customers for contract work	877,359,110	-	877,359,110	2
Other financial assets	32,740,002	-	32,740,002	2

(In thousands of Korean won)

	Financial liabilities measured at amortized cost	Fair value
Liabilities		
Trade payables	231,546,111	2
Borrowings ³	251,241,781	247,880,993
Debentures ³	199,673,040	200,438,774
Other financial liabilities ³	122,375,088	123,747,621

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.

² Short-term trade receivables and payables and others whose carrying amount is a reasonable approximation of fair value are excluded from the fair value disclosures.

³ The fair value of current borrowings with the maturity of less than one year from the issuance date equals their carrying amount, as the impact of discounting is not significant. The fair value of borrowings with the maturity of one or more years from the issuance date is based on cash flows discounted at a weighted average interest rate (Note 13).

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Income and loss of financial instruments by category as of December 31, 2016, are as follows:

<i>(In thousands of Korean won)</i>	Loans and receivables	Available-for-sale financial assets	Financial Liabilities measured at amortized cost	Total
Interest income	2,276,436	-	-	2,276,436
Interest expenses	-	-	13,469,402	13,469,402
Gain on foreign currency translation	25,565,210	-	1,166,092	26,731,302
Loss on foreign currency translation	1,804,914	-	3,386,841	5,191,755
Bad debt expenses	7,746,527	-	-	7,746,527
Loss on disposal of trade receivables	1,903,421	-	-	1,903,421
Other comprehensive income	-	352,090	-	352,090

In addition to the above, gain on foreign currency transactions of \ 53,247 million (2015: \ 61,588 million) and loss on foreign currency transactions of \ 45,587 million (2015: \ 40,349 million) were recognized in settlement of loans and receivables and financial liabilities measured at amortized cost.

Income and loss of financial instruments by category as of December 31, 2015, are as follows:

<i>(In thousands of Korean won)</i>	Loans and receivables	Available-for-sale financial assets	Financial Liabilities measured at amortized cost	Total
Interest income	3,759,624	5,904	-	3,765,528
Interest expenses	-	-	14,905,882	14,905,882
Gain on foreign currency translation	4,918,156	-	896,000	5,814,156
Loss on foreign currency translation	827,969	-	2,116,713	2,944,682
Other comprehensive income	-	424,809	-	424,809

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:

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

For available-for-sale financial assets that do not have a quoted market price in an active market and whose fair value cannot be measured reliably are measured at cost.

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Valuation methods to measure fair value of financial instruments are as follows:

- Quoted prices or dealer prices of similar instruments
- Other techniques, such as discounted cash flow analysis

Following table presents the financial assets and liabilities that are measured at fair value at December 31, 2016 and 2015:

(In thousands of Korean won)

	2016			
	Level 1	Level 2	Level 3	Total
Recurring fair value measurement				
Available-for-sale financial assets	-	170,300	26,743,503	26,913,803

(In thousands of Korean won)

	2015			
	Level 1	Level 2	Level 3	Total
Recurring fair value measurement				
Available-for-sale financial assets	-	3,700	23,779,005	23,782,705

The changes in the financial assets on level 3 for the years ended December 31, 2016 and 2015, are as follows:

(In thousands of Korean won)

	2016	2015
	(Available-for-sale financial assets)	(Available-for-sale financial assets)
Balance as of January 1	23,779,004	20,218,571
Acquisition	2,500,000	3,000,000
Valuation (Other Comprehensive income)	464,499	560,434
Balance as of December 31	<u>26,743,503</u>	<u>23,779,005</u>

Details of financial instruments measured at cost as of December 31, 2016 and 2015, are as follows:

(In thousands of Korean won)

		2016	2015
		Available-for-sale financial assets	Korea Software Financial Cooperative

The above equity securities are unlisted securities and are measured at cost because the variability of estimated cash flows is significant and the probabilities of the various estimates cannot be reasonably assessed. The Group has no intention to dispose of the aforementioned financial instruments in the short term.

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Valuation techniques and inputs used in the recurring fair value measurements categorized within Level 3 of the fair value hierarchy as of December 31, 2016 and 2015, are as follows:

(In thousands of Korean won)

	2016			
	Fair value	level	Valuation techniques	Inputs
Available-for-sale financial assets				
Korea Defense Industrial Association	26,743,503	3	Asset approach	Net asset value

(In thousands of Korean won)

	2015			
	Fair value	level	Valuation techniques	Inputs
Available-for-sale financial assets				
Korea Defense Industrial Association	23,779,005	3	Asset approach	Net asset value

6. Trade receivables and other financial assets

Trade receivables and other financial assets as of December 31, 2016 and 2015, consist of the following:

(In thousands of Korean won)

	2016	2015
Current assets		
Trade receivables	550,441,942	197,917,560
Other receivables	26,454,944	22,471,226
Guarantee deposits	9,680,859	593,019
Accrued income	21,243	713
	<u>586,598,988</u>	<u>220,982,518</u>
Non-current asset		
Long-term financial instruments	239,348	234,738
Long-term other receivables	1,787,242	1,703,716
Long-term loans to employees	108,991	187,088
Deposits	5,838,868	7,549,503
	<u>7,974,449</u>	<u>9,675,045</u>
Total	<u>594,573,437</u>	<u>230,657,563</u>

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The aging analysis of trade receivables and other receivables as of December 31, 2016 and 2015, follows:

	2016			2015		
	Trade receivables	Other receivables	Long-term other receivables	Trade receivables	Other receivables	Long-term other receivables
Receivables not past due	369,370,360	26,454,944	1,787,242	190,562,611	22,471,226	1,703,716
Past due but not impaired ¹						
Up to 12 months	24,103,749	-	-	7,339,424	-	-
Over 12 months	37,122	-	-	15,525	-	-
	<u>24,140,871</u>	<u>-</u>	<u>-</u>	<u>7,354,949</u>	<u>-</u>	<u>-</u>
Impaired ²						
Up to 12 months	161,784,238	-	-	-	-	-
Over 12 months	22,021	2,893,000	-	22,021	-	-
	<u>161,806,259</u>	<u>2,893,000</u>	<u>-</u>	<u>22,021</u>	<u>-</u>	<u>-</u>
Total	<u>555,317,490</u>	<u>29,347,944</u>	<u>1,787,242</u>	<u>197,939,581</u>	<u>22,471,226</u>	<u>1,703,716</u>
Provision	<u>(4,875,548)</u>	<u>(2,893,000)</u>	<u>-</u>	<u>(22,021)</u>	<u>-</u>	<u>-</u>
	<u>550,441,942</u>	<u>26,454,944</u>	<u>1,787,242</u>	<u>197,917,560</u>	<u>22,471,226</u>	<u>1,703,716</u>

¹ Loans that are past due but not impaired are related to several independent customers with no recent bankruptcy records.

² The Group has recognized the provision for impairment of \ 4,876 million (2015: \ 70 million) for trade receivables and \ 2,893 million for other receivables as of December 31, 2016.

Changes in provision for impairment of trade receivables and other receivables for the years ended December 31, 2016 and 2015, are as follows:

	2016		2015	
	Trade receivables	Other receivables	Trade receivables	Other receivables
Balance as of January 1	22,021	-	22,021	-
Bad debt expenses	4,853,527	2,893,000	-	-
Balance as of December 31	<u>4,875,548</u>	<u>2,893,000</u>	<u>22,021</u>	<u>-</u>

The Group transferred trade receivables to the financial institutions for \ 46,144 million and derecognized the trade receivables from the financial statements for the periods ended December 31, 2016. Accordingly, the Group recognized a loss on disposal for \ 311 million.

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7. Inventories

Inventories as of December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Finished goods	25,770,809	28,398,859
Work-in-process	247,319,946	190,959,741
Raw materials	177,371,158	192,937,972
Supplies	11,924,447	10,334,410
Raw materials in-transit	44,317,245	44,655,143
Valuation allowance	(437,423)	(437,423)
Total	<u>506,266,182</u>	<u>466,848,702</u>

As of December 31, 2016, the Group's inventories and property, plant and equipment are insured for \ 1,553 billion (2015: \ 1,382 billion). In addition, the Group carries product liability insurance with a ceiling of \ 4,789 billion (2015: \ 4,956 billion).

Cost of inventories recognized as cost of sales amounts to \ 1,564,945 million (2015: \ 1,534,073 million).

8. Available-for-sale financial assets

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

<i>(In thousands of Korean won)</i>	2016		2015
	Acquisition cost	Book value	Book value
Government and public bonds	170,300	170,300	3,700
Equity securities	26,894,503	26,894,503	23,930,004
Total	<u>27,064,803</u>	<u>27,064,803</u>	<u>23,933,704</u>

Debt securities as of December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	Maturities	2016	2015
Jeju development bonds 16-03	2021.03.31	170,300	-
Government housing bonds		-	3,700
Total		<u>170,300</u>	<u>3,700</u>

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Equity securities as of December 31, 2016 and 2015, consist of the following:

<i>(In thousands of Korean won)</i>	Ownership percentage (%)	2016	2015
Korea Defense Industrial Association ¹	15.3	26,743,503	23,779,004
Korea Software Financial Cooperative ²	0.1	151,000	151,000
Total		<u>26,894,503</u>	<u>23,930,004</u>

¹ The Group's net proportionate share in the assets of the investee is measured at fair value.

² Fair value could not be determined reliably. Therefore, it has been valued as its acquisition cost.

² Korea Software Financial Cooperative provided a guarantee to the Group and the investment has been pledged as collateral for Korea Software Financial Cooperative (Note 17).

Changes in gain on valuation of available-for-sale financial assets as of December 31, 2016 and 2015, consist of the following:

<i>(In thousands of Korean won)</i>	2016		
	January 1	Changes	December 31
Valuation amount	8,255,332	464,499	8,719,831
Deferred income tax effect	(1,974,897)	(112,409)	(2,087,306)
Total	<u>6,280,435</u>	<u>352,090</u>	<u>6,632,525</u>

<i>(In thousands of Korean won)</i>	2015		
	January 1	Changes	December 31
Valuation amount	7,694,898	560,434	8,255,332
Deferred income tax effect	(1,839,272)	(135,625)	(1,974,897)
Total	<u>5,855,626</u>	<u>424,809</u>	<u>6,280,435</u>

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9. Investments in associates and joint venture

Investments in associates and joint venture as of December 31, 2016 and 2015, and their summarized financial information as of and for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>		2016							
		Ownership (%)	Acquisition Cost	Net Asset Value	Recorded Book Value	Assets	Liabilities	Sales	Net income (loss)
Joint venture									
	KAI-EC ¹	51.00	2,805,000	289,175	289,175	567,836	825	-	(42,749)
Associates									
	S&K Aerospace Co., Ltd.	29.41	1,000,000	3,431,881	3,431,880	41,224,801	29,556,407	20,540,691	1,145,636
	Korea Surface Treatment Co., Ltd.	29.69	1,900,000	1,845,292	1,845,293	7,231,909	1,016,713	-	(34,265)
	Total		5,705,000	5,566,348	5,566,348				

¹ Considering unanimity rule in the Articles of Incorporation of KAI-EC, it is classified as a joint venture, irrespective of the Group's ownership percentage of 51%.

<i>(In thousands of Korean won)</i>		2015							
		Ownership (%)	Acquisition Cost	Net Asset Value	Recorded Book Value	Assets	Liabilities	Sales	Net income (loss)
Joint venture									
	KAI-EC ¹	51.00	2,805,000	310,977	310,977	609,759	-	-	22,623
Associates									
	S&K Aerospace Co., Ltd.	29.41	1,000,000	3,094,928	3,094,928	37,768,094	27,245,336	17,437,125	543,712
	Korea Surface Treatment Co., Ltd.	29.69	1,900,000	1,855,466	1,855,466	6,249,461	-	-	(150,539)
	Total		5,705,000	5,261,371	5,261,371				

¹ Considering unanimity rule in the Articles of Incorporation of KAI-EC, it is classified as a joint venture, irrespective of the Group's ownership percentage of 51%.

Details of changes in investments in associates and joint venture under the equity method for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016		
	Gain(loss) on valuation of equity method		
	January 1	December 31	December 31
Joint venture			
KAI-EC	310,977	(21,802)	289,175
Associates			
S&K Aerospace Co., Ltd.	3,094,928	336,952	3,431,880
Korea Surface Treatment Co., Ltd.	1,855,466	(10,173)	1,845,293
Total	5,261,371	304,977	5,566,348

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<i>(In thousands of Korean won)</i>	2015			
	January 1	Acquisition	Gain(loss) on valuation of equity method	December 31
Joint venture				
KAI-EC	322,516	-	(11,539)	310,977
Associates				
S&K Aerospace Co., Ltd.	2,935,013	-	159,915	3,094,928
Korea Surface Treatment Co., Ltd.	-	1,900,000	(44,534)	1,855,466
Total	3,257,529	1,900,000	103,842	5,261,371

The joint venture and associate above are non-listed entities

Summary of condensed financial information of associates and joint venture, and their book values as of and for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	KAI-EC		S&K Aerospace Co., Ltd.		Korea Surface Treatment Co., Ltd.	
	2016	2015	2016	2015	2016	2015
Current Assets	529,107	609,759	8,822,240	3,654,159	2,216,084	6,249,461
Non-current assets	38,729	-	32,402,561	34,113,935	5,015,825	-
Current Liabilities	825	-	15,839,919	6,085,804	16,713	-
Non-current liabilities	-	-	13,716,488	21,159,532	1,000,000	-
Equity	567,011	609,759	11,668,394	10,522,758	6,215,196	6,249,461
Ownership percentage (%)	51.00%	51.00%	29.41%	29.41%	29.69%	29.69%
Net assets of equity shares	289,175	310,977	3,431,880	3,094,928	1,845,293	1,855,466
Book value of investments in associate and jointly controlled entity	289,175	310,977	3,431,880	3,094,928	1,845,293	1,855,466

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10. Property, Plant and Equipment, and Intangible Assets

Property, plant and equipment as of December 31, 2016 and 2015, consist of the following:

<i>(In thousands of Korean won)</i>	2016		
	Acquisition cost	Accumulated depreciation	Balance
Land	83,521,192	-	83,521,192
Buildings	357,084,574	(117,333,821)	239,750,753
Structures	44,457,448	(17,843,409)	26,614,039
Machinery	345,148,027	(226,690,770)	118,457,257
Tools and equipment	280,737,399	(251,495,976)	29,241,423
Vehicles	4,816,289	(3,458,801)	1,357,488
Construction-in-progress	22,231,167	-	22,231,167
Machinery-in-transit	889,184	-	889,184
Total	<u>1,138,885,280</u>	<u>(616,822,777)</u>	<u>522,062,503</u>

<i>(In thousands of Korean won)</i>	2015		
	Acquisition cost	Accumulated depreciation	Balance
Land	83,521,192	-	83,521,192
Buildings	329,789,934	(105,935,907)	223,854,027
Structures	41,552,968	(16,438,551)	25,114,417
Machinery	324,719,702	(199,445,948)	125,273,754
Tools and equipment	267,402,317	(235,418,678)	31,983,639
Vehicles	4,671,371	(2,609,761)	2,061,610
Construction-in-progress	14,104,661	-	14,104,661
Machinery-in-transit	1,029,734	-	1,029,734
Total	<u>1,066,791,879</u>	<u>(559,848,845)</u>	<u>506,943,034</u>

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Changes in property, plant and equipment for the years ended December 31, 2016 and 2015, are as follows:

2016						
<i>(In thousands of Korean won)</i>	January 1	Acquisitions / Capital expenditures	Disposals / Abandonment / Impairment	Depreciation	Transfers	December 31
Land	83,521,192	-	-	-	-	83,521,192
Buildings	223,854,027	767,881	(207,323)	(11,431,353)	26,767,521	239,750,753
Structures	25,114,417	24,480	-	(1,404,858)	2,880,000	26,614,039
Machinery	125,273,754	8,693,371	(9)	(29,468,931)	13,959,072	118,457,257
Tools and equipment	31,983,639	10,822,880	19,441	(19,170,477)	5,585,940	29,241,423
Vehicles	2,061,610	144,918	-	(849,040)	-	1,357,488
Construction-in-progress	14,104,661	43,288,683	-	-	(35,162,177)	22,231,167
Machinery-in-transit	1,029,734	13,889,806	-	-	(14,030,356)	889,184
Total	506,943,034	77,632,019	(187,891)	(62,324,659)	-	522,062,503

2015						
<i>(In thousands of Korean won)</i>	January 1	Acquisitions / Capital expenditures	Disposals / Abandonment / Impairment	Depreciation	Transfers	December 31
Land	83,521,192	-	-	-	-	83,521,192
Buildings	184,948,448	382,761	-	(9,752,436)	48,275,254	223,854,027
Structures	25,444,389	273,770	(49,691)	(1,304,051)	750,000	25,114,417
Machinery	134,397,403	7,536,847	(2,908,265)	(23,009,238)	9,257,007	125,273,754
Tools and equipment	35,800,782	6,563,839	(981)	(19,786,288)	9,406,287	31,983,639
Vehicles	1,369,231	1,197,320	(15)	(645,668)	140,742	2,061,610
Construction-in-progress	28,501,461	41,572,614	-	-	(55,969,414)	14,104,661
Machinery-in-transit	512,810	12,376,800	-	-	(11,859,876)	1,029,734
Total	494,495,716	69,903,951	(2,958,952)	(54,497,681)	-	506,943,034

As of December 31, 2016, the Group's inventories, and property, plant and equipment are insured for \ 1,553 billion (2015: \ 1,382 billion). In addition, the Group carries product liability insurance with a ceiling of \ 4,789 billion (2015: \ 4,956 billion) and general insurance for vehicles. The aforementioned package of insurance has been pledged as collateral for borrowings from Korea Development Bank up to a maximum of \ 550 billion.

As of December 31, 2016 and 2015, the Group's property, plant and equipment are pledged as collateral for borrowings from Korea Development Bank for up to \ 550 billion.

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The depreciation expense classified by accounts for the years ended December 31, 2016 and 2015, is as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Cost of sales	61,096,294	52,549,662
Selling, general and administrative expenses	1,228,365	1,948,019
Total	<u>62,324,659</u>	<u>54,497,681</u>

Intangible assets as of December 31, 2016 and 2015, consist of the following:

2016				
<i>(In thousands of Korean won)</i>	Acquisition cost	Accumulated amortization	Accumulated impairment	Book value
Industrial property rights	1,631,652	(912,720)	(1,431)	717,501
Software	36,831,296	(13,649,905)	-	23,181,391
Facility usage rights	77,721	(66,854)	-	10,867
Long-term development projects	147,659,426	(64,206,012)	-	83,453,414
Development costs	332,269,643	(119,543,007)	(81,368,894)	131,357,742
Memberships	2,131,598	-	(410,727)	1,720,871
Other intangible assets	10,162,815	(4,573,267)	-	5,589,548
Total	<u>530,764,151</u>	<u>(202,951,765)</u>	<u>(81,781,052)</u>	<u>246,031,334</u>

2015				
<i>(In thousands of Korean won)</i>	Acquisition cost	Accumulated amortization	Accumulated impairment	Book value
Industrial property rights	1,541,285	(799,905)	(1,431)	739,949
Software	13,691,938	(9,315,650)	-	4,376,288
Facility usage rights	77,721	(64,116)	-	13,605
Long-term development projects	148,406,861	(46,777,309)	-	101,629,552
Development costs	278,689,868	(94,667,516)	(63,563,684)	120,458,668
Memberships	2,185,077	-	(298,607)	1,886,470
Other intangible assets	10,162,815	(4,065,126)	-	6,097,689
Total	<u>454,755,565</u>	<u>(155,689,622)</u>	<u>(63,863,722)</u>	<u>235,202,221</u>

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Changes in intangible assets for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016					December 31
	January 1	Acquisitions / Capital expenditures ¹	Disposals / Impairment ²	Amortization	Transfers	
Industrial property rights	739,949	90,367	-	(112,815)	-	717,501
Software	4,376,288	23,139,358	-	(4,334,255)	-	23,181,391
Facility usage rights	13,605	-	-	(2,738)	-	10,867
Long-term development projects	101,629,552	1,399,366	-	(17,428,703)	(2,146,801)	83,453,414
Development costs	120,458,668	53,579,775	(17,805,210)	(24,875,491)	-	131,357,742
Memberships	1,886,470	459,900	(625,499)	-	-	1,720,871
Other intangible assets	6,097,689	-	-	(508,141)	-	5,589,548
Total	235,202,221	78,668,766	(18,430,709)	(47,262,143)	(2,146,801)	246,031,334

¹ Amounts after deducting the government grants (2016: ₩21,918 million; 2015: ₩14,513 million).

² In connection with the development of aviation electronics system and electronic flight control technology development project of helicopter, the Group has determined that the future economic benefits to be obtained in future are uncertain, and the total development costs incurred in connection with the project amounted to ₩17,805,210 thousand were recognized as other operating expenses.

<i>(In thousands of Korean won)</i>	2015					December 31
	January 1	Acquisitions / Capital expenditures ¹	Disposals / Impairment ²	Amortization	December 31	
Industrial property rights	672,480	170,071	-	(102,602)	-	739,949
Software	5,205,655	1,308,468	-	(2,137,835)	-	4,376,288
Facility usage rights	16,342	-	-	(2,737)	-	13,605
Long-term development projects	99,768,615	13,626,758	-	(11,765,821)	-	101,629,552
Development costs	110,560,808	44,153,357	(8,346,065)	(25,909,432)	-	120,458,668
Memberships	2,185,077	-	(298,607)	-	-	1,886,470
Other intangible assets	6,605,830	-	-	(508,141)	-	6,097,689
Total	225,014,807	59,258,654	(8,644,672)	(40,426,568)	-	235,202,221

¹ Amounts after deducting the government grants (2016: ₩21,918 million; 2015: ₩14,513 million).

² In connection with the subsequent development project of police helicopter, the Group has determined that the future economic benefits to be obtained in future are uncertain, and the total development costs incurred in connection with the project amounted to ₩8,346,065 thousand were recognized as other operating expenses.

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The amortization expense for the years ended December 31, 2016 and 2015, is as follows:

<i>(In thousands of Korean won)</i>	<u>2016</u>	<u>2015</u>
Cost of sales	42,547,073	34,405,476
Selling, general and administrative expenses	4,714,950	6,021,092
Development expense	120	-
Total	<u>47,262,143</u>	<u>40,426,568</u>

Details of property, plant and equipment provided as collateral as of December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	<u>2016</u>				
	<u>Carrying amount</u>	<u>Secured amount</u>	<u>Related line item</u>	<u>Related amount</u>	<u>Secured party</u>
Land	83,521,192	550,000,000	Borrowings (Note 13)	80,000,000	Korea Development Bank
Buildings	114,062,310		Guaranteed (Note 17)	USD 521,917,501	

<i>(In thousands of Korean won)</i>	<u>2015</u>				
	<u>Carrying amount</u>	<u>Secured amount</u>	<u>Related line item</u>	<u>Related amount</u>	<u>Secured party</u>
Land	83,521,192	550,000,000	Borrowings (Note 13)	99,392,200	Korea Development Bank
Buildings	121,473,327		Guaranteed (Note 17)	USD 548,645,390	

11. Other assets

Other assets as of December 31, 2016 and 2015, consist of the following:

<i>(In thousands of Korean won)</i>	<u>2016</u>	<u>2015</u>
Current assets		
Advanced payments	163,498,794	183,433,104
Prepaid expenses	19,518,224	21,230,568
Total	<u>183,017,018</u>	<u>204,663,672</u>

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12. Trade payables and Other financial liabilities

Trade payables and other financial liabilities as of December 31, 2016 and 2015, consist of the following:

<i>(In thousands of Korean won)</i>	2016	2015
Current liabilities		
Trade payables	280,803,104	231,546,111
Other payables	17,909,207	18,095,782
Accrued expenses	88,537,034	85,177,627
Unpaid dividends	17,725	17,485
	<u>387,267,070</u>	<u>334,837,005</u>
Non-current liabilities		
Long-term other payables	23,661,852	19,084,194
Total	<u>410,928,922</u>	<u>353,921,199</u>

13. Borrowings and Debentures payable

Short-term and long-term borrowings as of December 31, 2016 and 2015, consist of the following:

<i>(In thousands of Korean won)</i>	Interest rate(%)	2016	2015
Current liabilities			
Short-term borrowings	-	-	102,040,000
Current maturities of long-term borrowings		100,489,890	23,826,497
Less : Present value discount ¹	1%~2.63%	(968,295)	(578,748)
		<u>99,521,595</u>	<u>125,287,749</u>
Non-current liabilities			
Long-term borrowings		47,390,970	126,355,780
Less : Present value discount ¹	1.69%~2%	(1,679,394)	(401,748)
		<u>45,711,576</u>	<u>125,954,032</u>
Total		<u>145,233,171</u>	<u>251,241,781</u>

¹ The interest rate of the defense industry loans is lower than the market interest rate (3.97%~5.39%). The loan amount is discounted using the market interest rate as its fair value. The difference between the undiscounted amount and the fair value has been accounted for as government grants.

As of December 31, 2016 and 2015, the Group's property, plant and equipment are pledged as collateral for borrowings from Korea Development Bank for up to \ 550 billion (Note 10).

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Debentures as of December 31, 2016 and 2015, consist of the following:

<i>(In thousands of Korean won)</i>	Issue date	Maturity date	Interest rate(%)	2016	2015
				Book value	Book value
18 th (Unguaranteed, Public offering)	2014.08.22	2017.08.22	2.87	200,000,000	200,000,000
19 th (Unguaranteed, Public offering)	2016.04.11	2019.04.11	1.80	200,000,000	-
	Less: Present value discount			(547,674)	(326,960)
	Less: Current portion			(200,000,000)	-
	Total			199,452,326	199,673,040

Book value and fair value of the long-term borrowings and debentures as of December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016		2015	
	Book value	Fair value ¹	Book value	Fair value ¹
Short-term borrowings	99,521,595	99,521,595	125,287,749	125,287,749
Long-term borrowings	45,711,576	46,135,352	125,954,032	122,593,244
Debentures	399,452,326	401,111,186	199,673,040	200,438,774
Total	544,685,497	546,768,133	450,914,821	448,319,767

¹ The fair value of long-term borrowings is calculated by discounting the nominal amount of cash outflows with the weighted average interest rate.

14. Other liabilities

Other liabilities as of December 31, 2016 and 2015, consist of the following:

<i>(In thousands of Korean won)</i>	2016	2015
Advances received	63,114,318	33,977,448
Unearned revenues	994,265	1,170,739
Withholdings	7,614,531	4,960,236
Deposits received	560,407	507,760
Total	72,283,521	40,616,183

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15. Net defined benefit liabilities

Net defined benefit liabilities recognized on the statements of financial position as of December 31, 2016 and 2015, are as follows:

(In thousands of Korean won)

	<u>2016</u>	<u>2015</u>
Present value of funded defined benefit obligations	13,558,497	8,355,491
Present value of unfunded defined benefit obligations	289,880,125	269,671,849
Present value of retirement benefit obligation	303,438,622	278,027,340
Fair value of plan assets	(4,715,571)	(5,132,847)
	<u>298,723,051</u>	<u>272,894,493</u>

Changes in the carrying amount of retirement benefit obligations for the years ended December 31, 2016 and 2015, are as follows:

(In thousands of Korean won)

	<u>2016</u>	<u>2015</u>
Balance as of January 1	278,027,340	224,317,728
Current service cost	32,359,390	26,441,350
Interest expense	8,981,062	8,440,068
Remeasurements:		
Actuarial gains and losses arising from changes in demographic assumptions	-	(6,779,844)
Actuarial gains and losses arising from changes in financial assumptions	(5,119,486)	27,029,260
Actuarial gains and losses arising from experience adjustments	(1,511,824)	8,044,204
Payments from plans:		
Benefit payments	(9,297,860)	(9,465,426)
Balance as of December 31	<u>303,438,622</u>	<u>278,027,340</u>

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Changes in the fair value of plan assets for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	<u>2016</u>	<u>2015</u>
Balance as of January 1	5,132,847	5,067,113
Interest income	161,285	185,404
Remeasurements:		
Return on plan assets (excluding amounts included in interest income)	(100,823)	(109,789)
Contributions:		
Employers	-	1,049,938
Payments from plans:		
Benefit payments	(477,738)	(1,059,819)
Balance as of December 31	<u>4,715,571</u>	<u>5,132,847</u>

The details of pension expenses recognized in the statements of comprehensive income for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	<u>2016</u>	<u>2015</u>
Current service cost	32,359,390	26,441,350
Interest expenses of retirement benefit obligations	8,981,062	8,440,068
Expected return on plan assets	(161,285)	(185,404)
Total	<u>41,179,167</u>	<u>34,696,014</u>
Cost of sales	36,662,553	29,653,446
Selling, general and administrative expenses	4,516,614	5,042,568
Total	<u>41,179,167</u>	<u>34,696,014</u>

The key assumptions used for retirement benefit obligation calculations as of December 31, 2016 and 2015, are as follows:

	<u>2016</u>	<u>2015</u>
Discount rate	3.35%	3.27%
Salary increase rate	5.90%	6.00%

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Plan assets as of December 31, 2016 and 2015, consist of:

<i>(In thousands of Korean won)</i>	2016		2015	
	<u>Quoted price</u>	<u>Composition</u>	<u>Quoted price</u>	<u>Composition</u>
Cash and cash equivalents	4,575,649	97.0%	4,992,925	97.3%
Others	<u>139,922</u>	<u>3.0%</u>	<u>139,922</u>	<u>2.7%</u>
	<u>4,715,571</u>	<u>100.0%</u>	<u>5,132,847</u>	<u>100.0%</u>

The sensitivity of the defined benefit obligations as of December 31, 2016 and 2015, to changes in the principal assumptions is:

<i>(In thousands of Korean won)</i>	<u>Discount rate</u>		<u>Salary growth rate</u>	
	<u>1% increase</u>	<u>1% decrease</u>	<u>1% increase</u>	<u>1% decrease</u>
Amount	277,027,175	334,222,763	333,140,748	277,375,073
Ratio	91%	110%	110%	91%

A decrease in corporate bond yields will increase plan liabilities, although this will be partially offset by an increase in the value of the plans' bondholding.

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. The sensitivity of the defined benefit obligation to changes in principal actuarial assumptions is calculated using the projected unit credit method, the same method applied when calculating the defined benefit obligations recognized on the statement of financial position. The methods and types of assumptions used in preparing the sensitivity analysis did not change compared to the previous period.

Contribution to plan assets, which is expected to be made by the Group in 2017, amounts to \ 540 million.

Weighted average maturities of defined benefit obligations as of December 31, 2016 and 2015, are as follows:

	<u>2016</u>	<u>2015</u>
Weighted average maturities	12.7 years	12.5 years

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16. Provisions

The changes in provisions for the years ended December 31, 2016 and 2015, are as follows:

(In thousands of Korean won)

	2016			December 31
	January 1	Increase	Decrease	
Construction contracts				
Loss on the construction contract ¹	38,706,673	-	(7,146,250)	31,560,423
Penalty for construction delays ²	309,858	36,977,718	-	37,287,576
Provision for construction warranty claims ³	13,429,564	5,759,339	(5,626,035)	13,562,868
Other construction contracts ⁴	21,897,759	36,159,800	-	58,057,559
	<u>74,343,854</u>	<u>78,896,857</u>	<u>(12,772,285)</u>	<u>140,468,426</u>
Others				
Provision for pending lawsuits ⁵	41,652,497	-	(29,154,938)	12,497,559
Total	<u>115,996,351</u>	<u>78,896,857</u>	<u>(41,927,223)</u>	<u>152,965,985</u>

(In thousands of Korean won)

	2015			December 31
	January 1	Increase	Decrease	
Construction contracts				
Loss on the construction contract ¹	17,833,283	20,873,390	-	38,706,673
Penalty for construction delays ²	309,858	-	-	309,858
Provision for construction warranty claims ³	9,178,160	5,778,209	(1,526,805)	13,429,564
Other construction contracts ⁴	-	21,897,759	-	21,897,759
	<u>27,321,301</u>	<u>48,549,358</u>	<u>(1,526,805)</u>	<u>74,343,854</u>
Others				
Provision for pending lawsuits ⁵	11,844,000	29,808,497	-	41,652,497
Total	<u>39,165,301</u>	<u>78,357,855</u>	<u>(1,526,805)</u>	<u>115,996,351</u>

¹ Provision for loss on the construction contract is made when there is an expected loss on the construction contract.

² As of December 31, 2016 and 2015, provision for the penalty in relation to the delay of project is based on the best estimate.

³ The Group makes provision for repair and maintenance based on the past experience.

⁴ In relation to construction contracts, the Group makes provision when there is a present obligation as a result of a past event and resources are expected to flow out in the future.

⁵ In relation to the pending lawsuits, the Group recognizes the best estimate as other provisions (Note 30).

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The aforementioned provisions, excluding other provision for pending lawsuits, have been either deducted from the gross amount due from customers for contract work or added to the gross amount due to customers for contract work.

17. Commitments and Contingencies

(1) Major commitments with financial institutions as of December 31, 2016 and 2015, are as follows:

(In thousands of Korean won and in thousands of US dollars)

Description	Financial institutions	Limit amount	
		2016	2015
Bank Overdrafts	KEB Hana Bank	-	10,000,000
	Shinhan Bank	10,000,000	10,000,000
General loan agreement	Kyongnam Bank	30,000,000	30,000,000
	NongHyup Bank	30,000,000	30,000,000
	Woori Bank	64,000,000	40,000,000
	B2B Note Issuing arrangement	Woori Bank	21,000,000
Foreign currency L/C arrangement	Korea Development Bank	-	USD 5,000
	KEB Hana Bank	-	USD 40,000
	Woori Bank	USD 2,500	-
Foreign currency loan agreement	Kookmin Bank	-	USD 30,000
	Shinhan Bank	-	USD 40,000
	Suhyup Bank	USD 30,000	-
Integrated revolving limit agreement	The Export-Import Bank of Korea	USD 40,000	USD 10,000
Import finance limit agreement		-	USD 40,000
Limit of short-term financial agreement	Meritz Securities Co., Ltd.	30,000,000	30,000,000
	Shinhan Bank	40,000,000	-
Foreign currency payment guarantee agreement	Crédit - Agricole		
	Corporate & Investment Bank Seoul Branch	USD 100,000	USD 100,000
	Kookmin Bank	USD 50,000	USD 50,000
	Shinhan Bank	USD 1,750	USD 1,750
	KEB Hana Bank ¹	USD 43,600	USD 56,500
	Woori Bank	USD 16,314	USD 16,314
Foreign currency trade receivables factoring agreement	BNP Paribas Seoul Branch	USD 80,000	-

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¹ Aggregate limit amount of foreign currency payment guarantee agreement (USD 42,100,000), excluding the other foreign currency payment guarantee agreement (USD 1,500,000) with KEB Hana Bank, is ₩50,000 million. The total limit amount with KEB Hana Bank is ₩190,186 million

(2) Details of payment guarantees provided by financial institutions as of December 31, 2016 and 2015, are as follows:

<i>(In thousands of US dollars and Euros)</i>	Guaranteed by	Guaranteed amount	
		2016	2015
Performance guarantee/ off-set performance guarantees of KT-1 Turkey Advance payment guarantee of KT-1 Peru, and others	Korea Development Bank	USD 38,926	USD 65,654
KHP EC S/B LC guarantee	Seoul Guarantee Insurance	-	EUR 10,022
Performance guarantee/ Advance payment guarantee/ Maintenance guarantee of FA-50 Philippine Spare part Performance guarantee of KT-1 Indonesia Spare part Performance guarantee of T-50 Indonesia Spare part Performance guarantee of KT-1 Peru Spare part Performance guarantee of KT-1 Turkey and others	KEB Hana Bank	USD 64,485	USD 90,203
Performance guarantees / Advance payment guarantee of C-130 and others	Shinhan Bank	USD 1,750	USD 1,750
Performance guarantee / Advance payment guarantee of T-50 to Iraq and others	Korea Development Bank	USD 395,241	USD 395,241
Performance guarantee / Advance payment guarantee of Iraq military base	Korea Development Bank	USD 87,750	USD 87,750
Performance guarantee / Advance payment guarantee of T-50 Thailand	Woori Bank	USD 16,314	USD 16,314
Advance payment guarantee of T-50 Iraq ¹	KEB Hana Bank Kookmin Bank	USD 35,000 USD 50,000	USD 35,000 USD 50,000

¹ Advance payment guarantee of T-50 Iraq is pledged as collateral for guarantees from Korea Development Bank.

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(3) With respect to the export of KT-1 to Turkey and Peru, the Group has to perform an offset agreement such as purchasing equipment from customers, and technology transfer.

(4) As of December 31, 2016, Seoul Guarantee Insurance, Korea Software Financial Cooperative, and Korea Federation of Small and Medium Business have provided guarantees for repair and maintenance, and for advances received from customers for up to approximately ₩ 435 billion (2015: ₩479 billion), ₩10.8 billion (2015: ₩10.8 billion), and ₩8.8 billion (2015: ₩11.6 billion), respectively. Also, the Group was guaranteed by Export Guarantee Insurance Corporation for up to US\$ 116,279 thousand (2015: US\$121,918 thousand). Guarantee by Export Guarantee Insurance Corporation is pledged as collateral for borrowings from Korea Development Bank.

(5) The Group has payment guarantees provided by Korea Defense Industry Association of up to ₩ 2,652 billion (2015: ₩2,315 billion). The total credit limit, which is 100 times of the total contribution, amounts to ₩2,674 billion (December 31, 2015: ₩ 2,378 billion).

(6) As of December 31, 2016 and 2015, the Group has issued three (2015: three) blank promissory notes as collateral for its borrowings and contract fulfillments.

18. Capital Stock and Share premium

The number of authorized shares of the Company is 200 million shares and capital stock as of December 31, 2016 and 2015, are as follows:

(In thousands of Korean won, except number of shares and par value)

	Authorized Shares	Issued and outstanding Shares	Par value per share	Capital Stock
Common stock	200,000,000	97,475,107	₩ 5,000	₩ 487,375,535

The Company is allowed to grant stock options to the employees, who contributed or are capable to contribute to the Company's establishment, management, and technological innovation, through a special resolution at the shareholders' meeting or through a related law.

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As of December 31, 2016, the shareholders of the Company are as follows:

(In thousands of shares)

	2016	
	Number of Shares	Ownership (%)
Korea Development Bank	18,538	19.0%
The Export-Import Bank of Korea	7,541	7.7%
Hanwha Techwin Co., Ltd.	5,848	6.0%
National Pension Service	8,054	8.3%
KAI employee stock ownership association	1,523	1.6%
Hana Financial Investment Co., Ltd	4,731	4.9%
Foreign investors	4,438	4.6%
Other shareholders	46,802	48.0%
Total	<u>97,475</u>	<u>100.00%</u>

19. Retained Earnings

Retained earnings as of December 31, 2016 and 2015, consist of the following:

(In thousands of Korean won)

	2016	2015
Legal reserve ¹	14,613,070	10,714,066
Appropriated retained earnings for business expansion	169,250,000	169,100,000
Appropriated retained earnings for research and human resource development	30,000,000	30,000,000
Unappropriated retained earnings	570,120,355	340,096,338
Total	<u>783,983,425</u>	<u>549,910,404</u>

¹ The Commercial Code of the Republic of Korea requires the Company to appropriate, as a legal reserve, an amount equal to a minimum of 10% cash dividend paid, until such reserve equals 50% of its issued capital stock. The reserve is not available for the payment of cash dividends, but may be transferred to capital stock, or used to reduce accumulated deficit, if any, with the ratification of the Group's majority shareholders.

The Company declared cash dividends to shareholders of common stock and preferred stock for the years ended December 31, 2016 and 2015. Details of year-end dividends are as follows:

	2016	2015
	Common stock	Common stock
Number of shares (total stock)	97,475,107	97,475,107
Dividend amount per share (In Korean won)	₩ 680	₩ 400
Dividend amount	₩ 66,283 million	₩ 38,990 million

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20. Other components of equity

Other components of equity as of December 31, 2016 and 2015, consist of the following:

<i>(In thousands of Korean won)</i>	<u>2016</u>	<u>2015</u>
Gain on valuation of available-for-sale financial assets	6,632,525	6,280,434
Gain on disposal of treasury stock	184,272	184,273
Gain on capital reduction	4,053,367	4,053,367
Loss on overseas operation translation	(16,724)	(29,217)
Total	<u>10,853,440</u>	<u>10,488,857</u>

21. Earnings per Share

Weighted-average number of common stock for the year ended December 31, 2016, is as follows:

	<u>Shares</u>	<u>Number of shares outstanding</u>	<u>No. of days</u>	<u>Cumulative number of shares</u>
January 1, 2016	97,475,107	97,475,107	366	35,675,889,162

Number of shares outstanding for the year ended December 31, 2016: $35,675,889,162 \div 366 = 97,475,107$

Weighted-average number of common stock for the year ended December 31, 2015, is as follows:

	<u>Shares</u>	<u>Number of shares outstanding</u>	<u>No. of days</u>	<u>Cumulative number of shares</u>
January 1, 2015	97,475,107	97,475,107	365	35,578,414,055

Number of shares outstanding for the year ended December 31, 2015: $35,578,414,055 \div 365 = 97,475,107$

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

<i>(In thousands of Korean won)</i>	<u>2016</u>	<u>2015</u>
Net income	268,112,955	180,565,554
Weighted-average number of common stock	97,475,107	97,475,107
Basic earnings per share (in Korean won)	<u>2,751</u>	<u>1,852</u>

For the year ended December 31, 2016, the diluted earnings per share equals basic earnings per share as the Group does not issue dilutive potential ordinary shares.

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22. Sales

Details of sales for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Sales		
Sales of goods	1,088,010,650	922,562,413
Construction contract revenue	2,012,664,204	1,978,469,950
	<u>3,100,674,854</u>	<u>2,901,032,363</u>
Interest income	2,276,436	3,765,528
Total	<u>3,102,951,290</u>	<u>2,904,797,891</u>

Backlog balance as of December 31, 2016 and 2015, is as follows:

<i>(In thousands of Korean won)</i>	Total contract balance as of January 1	Increase and decrease¹	Recognition of construction	Backlog balance as of December 31²
2016	9,365,938,561	2,594,385,529	2,012,664,204	9,974,659,886
2015	3,760,985,602	7,583,422,909	1,978,469,950	9,365,938,561

¹ The amount of increase / decrease includes new contract amount, additional contract amount and contract change amount.

² Balance of foreign currency contracts is expressed in Korean Won balances by applying exchange rate at the end of the year.

The Group provides contract performance guarantees, and guarantees for repair and maintenance, and advances received from customers in connection with the aforementioned revenue. Various related guarantees have been provided to the Group by Seoul Guarantee Insurance and others (Note 17).

Accumulated construction contract revenue, cost of construction, construction profit and advanced payment on the ongoing projects as of December 31, 2016 and 2015, consist of the following:

<i>(In thousands of Korean won)</i>		Accumulated revenue recognized	Cost of construction	Construction profit	Advanced payment
Segment					
2016	Government defense business and aircraft export business	4,789,570,356	4,194,525,939	595,044,417	111,506,256
2015	Government defense business and aircraft export business	4,065,223,229	3,502,087,481	563,135,748	306,458,863

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The gross amounts due from and due to customers for contract work as of December 31, 2016 and 2015, are as of the follows:

<i>(In thousands of Korean won)</i>	<u>2016</u>	<u>2015</u>
The gross amount due from customers for contract work	618,194,249	877,359,110
The gross amount due to customers for contract work	106,591,518	306,458,863

Details of major contracts that total contract amounts are more than 5% of the previous fiscal year's sales as of December 31, 2016 are as follows:

(In thousands of Korean won)

<u>Name of contract</u>	<u>Contract date</u>	<u>Completion date (Delivery date)</u>	<u>Percentage of completion (%)</u>	<u>Dues from customers for contract work</u>		<u>Trade receivables</u>	
				<u>Total</u>	<u>Accumulated impairment loss</u>	<u>Total</u>	<u>Provision</u>
KUH 2 nd production	December 19, 2013	December 31, 2017	90.87	449,353,508	-	-	-
KUH 3 rd production	December 27, 2016	December 31, 2022	5.42	37,160,347	-	-	-
Amphibious helicopter	December 27, 2016	November 30, 2023	6.66	37,146,068	-	-	-
FA-50 subsequent production	May 6, 2013	December 31, 2016	100.00	-	-	17,729	-
T-50 export A	December 12, 2013	January 31, 2018	84.72	-	-	381,634,363	4,853,527
FA-50 export B	March 28, 2014	September 30, 2017	86.14	-	-	-	-
KF-X development	December 28, 2015	June 30, 2026	5.22	146,553,117	-	-	-
LAH development	June 25, 2015	June 30, 2023	18.46	-	-	-	-
T-50 PBL 2 nd	November 30, 2016	November 30, 2021	0.33	535,410	-	-	-
KT-1 Export C	March 8, 2007	February 28, 2017	98.99	-	-	-	-
F-15SA	December 12, 2011	January 21, 2018	67.86	5,528,709	-	-	-
D base construction	January 18, 2015	March 31, 2018	9.55	-	-	-	-
KT-1 export E	November 7, 2012	April 30, 2017	99.22	-	-	-	-

Group's every project that applies a construction contract is included in government defense business and aircraft export business (Note 32).

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Due to the factors causing the rise in civil and plant costs in 2015, the estimated total revenue and estimated total costs for contracts in progress have changed. Details of changes in estimated total contract costs, profits or loss for the year and the succeeding year, and the impact on due from customers for contract work are as follows

<i>(In thousands of Korean won)</i>	Changes in estimated total contract revenue¹	Changes in estimated total contract cost¹	Impact on profit or loss for the year	Impact on profit or loss for the succeeding year	Changes in due from customers for contract work	Changes in due to customers for contract work
Government defense business and aircraft export business	₩ 63,963,037	₩ 17,001,278	₩ 24,954,888	₩ 22,006,871	₩ (3,201,540)	₩ (28,156,428)

¹ The effects on foreign exchange is included.

The impact on profit or loss for the year and the succeeding year is determined based on total contract costs, which are estimated based on the circumstances present from the start of the contract to the end of current year, and the estimated contract revenue as of December 31, 2016. Contract costs and contract revenue may change in the future.

The contract to use the ratio of cumulative contract costs incurred as of the end of the current term to the estimated total contract cost is used for progress measurement as follows:

<i>(In thousands of Korean won)</i>	provision for construction loss	Changes in construction contract profit or loss		Changes in estimated total contract cost		Due from customers for contract work	
		Changes in accounting estimates	Error correction	Changes in accounting estimates	Error correction	Total amounts	Accumulated impairment
Government defense business and aircraft export business	31,560,423	24,954,888	-	17,001,278	-	618,194,249	-

The Group transferred the due from customers for contract work to the financial institutions for ₩262,900 million and derecognized the due from customers for contract work from the financial statements for the periods ended December 31, 2016. Accordingly, the Group recognized a loss on disposal for ₩1,592 million.

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23. Expenses by Nature

Expenses by nature for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Changes in inventories	(39,417,480)	(33,753,595)
Purchase of raw and other materials	1,604,362,894	1,567,826,469
Wages and salaries	397,655,935	344,437,664
Depreciation and amortization	109,586,802	94,924,249
Commission expenses	71,665,109	72,743,033
Royalty and development expenses	167,975,139	119,520,748
Outside processing expenses	318,703,558	318,630,000
Welfare expenses	65,701,387	58,982,032
Travel expenses	17,695,336	15,786,092
Others	71,784,178	56,280,371
Total	<u>2,785,712,858</u>	<u>2,615,377,063</u>

24. Selling, general and administrative expenses

Selling, general and administrative expenses for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Wages and salaries	35,847,764	38,629,206
Severance and retirement benefits	4,516,614	5,042,568
Welfare expense	6,663,289	8,044,370
Travel expenses	3,704,335	4,338,698
Taxes and dues	1,450,958	1,378,401
Entertainment	1,201,100	1,667,161
Vehicles maintenance	535,589	724,798
Depreciation	1,228,365	1,948,019
Commission	6,105,160	4,883,440
Amortization	4,714,950	6,021,092
Rental expense	1,155,216	1,183,514
Advertising expense	2,719,603	4,231,721
Sales commission	59,136	386,525
Transportation expense	7,138,661	7,215,277
Development expense	29,644,058	12,500,340
Others	29,821,269	30,479,689
Total	<u>136,506,067</u>	<u>128,674,819</u>

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25. Other income and expenses

Other income and expenses for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Other income		
Commission income	44,156	39,782
Rental income	270,930	203,858
Gain on disposal of property, plant and equipment	673,382	79,487
Others	12,083,975	6,426,317
Total	<u>13,072,443</u>	<u>6,749,444</u>
<i>(In thousands of Korean won)</i>	2016	2015
Other expenses		
Donations	1,927,728	1,020,984
Loss from disposal of property, plant and equipment	3,173	50,819
Loss from disposal of intangible assets	36,268	-
Impairment losses on intangible assets	17,917,330	8,644,672
Loss from disposal of trade receivables	1,903,421	-
Others	3,055,216	56,417,577
Total	<u>24,843,136</u>	<u>66,134,052</u>

26. Finance income and expenses

Finance income and expenses for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Finance income		
Interest income	2,276,436	3,765,528
Gain on foreign currency transactions	53,246,961	61,588,112
Gain on foreign exchange translation	26,731,302	5,814,156
Total	<u>82,254,699</u>	<u>71,167,796</u>
<i>(In thousands of Korean won)</i>	2016	2015
Other finance expenses		
Interest expense	13,469,402	14,905,882
Loss on foreign currency transactions	45,586,851	40,349,404
Loss on foreign exchange translation	5,191,755	2,944,682
Total	<u>64,248,008</u>	<u>58,199,968</u>

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27. Income Tax

Income tax expense for the years ended December 31, 2016 and 2015, consists of the following:

<i>(In thousands of Korean won)</i>	2016	2015
Current taxes	102,450,555	81,981,382
Deferred income tax due to temporary difference	(27,455,989)	(30,288,260)
Tax charged directly to equity	(1,692,787)	6,739,009
Reversal due to claim for tax rectification	(19,911,763)	-
Adjustment for prior periods	-	344,676
Income tax expense	<u>53,390,016</u>	<u>58,776,807</u>

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated entities as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Profit before income tax	<u>321,502,971</u>	<u>239,342,362</u>
Income tax based on statutory rate	77,298,523	57,445,861
Adjustment		
Non-taxable income/Non-deductible expense	696,341	2,467,692
Tax credit	(5,943,702)	(2,253,599)
Reversal due to claim for tax rectification	(19,911,763)	-
Others	1,250,617	1,116,853
Income tax expense	<u>53,390,016</u>	<u>58,776,807</u>
Effective tax rate	<u>16.61%</u>	<u>24.56%</u>

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Deferred income tax assets and liabilities from the tax effects of temporary differences as of December 31, 2016 and 2015, are as follows:

2016

<i>(In thousands of Korea won)</i>	Temporary Differences			Deferred Income Tax Assets (Liabilities)		
	Beginning Balance	Increase (Decrease)	Ending Balance	Beginning Balance	Increase (Decrease)	Ending Balance
Deferred tax arising from taxable temporary differences (1)						
Deposits for severance benefits	(4,992,925)	417,277	(4,575,648)	(1,208,288)	100,981	(1,107,307)
Reserve for R&D	(30,000,000)	10,000,000	(20,000,000)	(7,260,000)	2,420,000	(4,840,000)
Others	(13,937,943)	413,644	(13,524,299)	(3,372,982)	100,102	(3,272,880)
	<u>(48,930,868)</u>	<u>10,830,921</u>	<u>(38,099,947)</u>	<u>(11,841,270)</u>	<u>2,621,083</u>	<u>(9,220,187)</u>
Deferred tax arising from deductible temporary differences (2)						
Accrued severance benefits	184,671,682	47,393,200	232,064,882	44,690,547	11,469,154	56,159,701
Impairment loss on intangible assets	38,534,521	4,835,796	43,370,317	9,325,354	1,170,263	10,495,617
Government grants	106,526,972	18,570,350	125,097,322	25,779,527	4,494,025	30,273,552
Accrued liability	33,669,023	3,191,520	36,860,543	8,147,904	772,347	8,920,251
Depreciation	14,982,754	(6,866,383)	8,116,371	3,625,826	(1,661,664)	1,964,162
Provisions	116,433,774	37,125,932	153,559,706	28,176,973	8,984,476	37,161,449
Others	30,904,329	5,368,149	36,272,478	7,584,760	1,299,092	8,883,852
	<u>525,723,055</u>	<u>109,618,564</u>	<u>635,341,619</u>	<u>127,330,891</u>	<u>26,527,693</u>	<u>153,858,584</u>
Items charged directly to equity (3)						
Gain on valuation of long-term available-for-sale financial assets	(8,255,331)	(464,499)	(8,719,830)	(1,974,897)	(112,409)	(2,087,306)
Actuarial losses	82,353,377	(6,530,486)	75,822,891	19,800,713	(1,580,378)	18,220,335
	<u>74,098,046</u>	<u>(6,994,985)</u>	<u>67,103,061</u>	<u>17,825,816</u>	<u>(1,692,787)</u>	<u>16,133,029</u>
Total (1+2+3)	<u>550,890,233</u>	<u>113,454,500</u>	<u>664,344,733</u>	<u>133,315,437</u>	<u>27,455,989</u>	<u>160,771,426</u>

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2015

<i>(In thousands of Korea won)</i>	Temporary Differences			Deferred Income Tax Assets (Liabilities)		
	Beginning	Increase	Ending	Beginning	Increase	Ending
	Balance	(Decrease)	Balance	Balance	(Decrease)	Balance
Deferred tax arising from taxable temporary differences (1)						
Deposits for severance benefits	(4,925,072)	(67,853)	(4,992,925)	(1,191,867)	(16,421)	(1,208,288)
Reserve for R&D	(30,000,000)	-	(30,000,000)	(7,260,000)	-	(7,260,000)
Others	(14,260,141)	322,198	(13,937,943)	(3,450,954)	77,972	(3,372,982)
	<u>(49,185,213)</u>	<u>254,345</u>	<u>(48,930,868)</u>	<u>(11,902,821)</u>	<u>61,551</u>	<u>(11,841,270)</u>
Deferred tax arising from deductible temporary differences (2)						
Accrued severance benefits	153,999,756	30,671,926	184,671,682	37,267,941	7,422,606	44,690,547
Impairment loss on intangible assets	60,137,516	(21,602,995)	38,534,521	14,553,279	(5,227,925)	9,325,354
Government grants	82,842,482	23,684,490	106,526,972	20,047,881	5,731,646	25,779,527
Accrued liability	42,604,929	(8,935,906)	33,669,023	10,310,393	(2,162,489)	8,147,904
Depreciation	22,882,968	(7,900,214)	14,982,754	5,537,678	(1,911,852)	3,625,826
Provisions	39,511,301	76,922,473	116,433,774	9,561,735	18,615,238	28,176,973
Others	26,683,330	4,220,999	30,904,329	6,564,284	1,020,476	7,584,760
	<u>428,662,282</u>	<u>97,060,773</u>	<u>525,723,055</u>	<u>103,843,191</u>	<u>23,487,700</u>	<u>127,330,891</u>
Items charged directly to equity (3)						
Gain on valuation of long-term available-for-sale financial assets	(7,694,897)	(560,434)	(8,255,331)	(1,839,272)	(135,625)	(1,974,897)
Actuarial losses	53,949,967	28,403,410	82,353,377	12,926,079	6,874,634	19,800,713
	<u>46,255,070</u>	<u>27,842,976</u>	<u>74,098,046</u>	<u>11,086,807</u>	<u>6,739,009</u>	<u>17,825,816</u>
Total (1+2+3)	<u>425,732,139</u>	<u>125,158,094</u>	<u>550,890,233</u>	<u>103,027,177</u>	<u>30,288,260</u>	<u>133,315,437</u>

The Group periodically assesses its ability to realize deferred income tax assets. In the event of significant uncertainty regarding the Group's ultimate ability to realize such assets, a valuation allowance is recorded to reduce the assets to their estimated realized value.

The analysis of deferred tax assets and deferred tax liabilities is as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Deferred tax assets		
More than 12 months	132,885,116	115,755,752
Within 12 months	39,193,803	31,375,852
	<u>172,078,919</u>	<u>147,131,604</u>
Deferred tax liabilities		
More than 12 months	(11,010,799)	(13,671,340)
Within 12 months	(296,694)	(144,827)
	<u>(11,307,493)</u>	<u>(13,816,167)</u>
Deferred tax assets, net	<u>160,771,426</u>	<u>133,315,437</u>

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28. Cash Generated from Operations

Cash generated from operations for the years ended December 31, 2016 and 2015, is as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Adjustments for:		
Interest expenses	13,469,402	14,905,882
Loss on foreign exchange translation	5,191,755	2,944,682
Loss on disposal of property, plant and equipment	3,173	50,819
Loss on disposal of intangible assets	36,268	-
Depreciation expense	62,324,659	54,497,681
Amortization expense	47,262,143	40,426,568
Impairment losses on intangible assets	17,917,330	8,644,672
Severance and retirement benefits	41,179,166	34,696,014
Loss on disposal of trade receivables	1,903,421	-
Loss on valuation of equity method investment	31,975	56,073
Gain on valuation of equity method investment	(336,952)	(159,915)
Interest income	(2,276,436)	(3,765,528)
Gain on foreign exchange translation	(26,731,302)	(5,814,156)
Gain on disposal of property, plant and equipment	(673,382)	(79,487)
Miscellaneous income	(9,656,497)	-
Provision for penalty for construction delay	36,977,718	-
Provision for construction loss	(7,146,250)	20,873,390
Provision for other construction contracts	36,159,800	21,897,759
Provision for construction warranty claims	5,759,339	5,778,209
Other employee benefits	2,057,033	1,268,835
Miscellaneous expense	-	29,808,497
Bad debt expense	7,746,527	-
Loss on valuation of inventories	-	91,423
Income tax expense	53,390,016	58,776,808
Total	<u>284,588,906</u>	<u>284,898,226</u>
Changes in assets and liabilities:		
Increase in trade receivables	(351,631,605)	(39,291,033)
Decrease(Increase) in the gross amount due from customers for construction work	203,761,615	(553,534,728)
Decrease(Increase) in other financial assets	(14,318,365)	41,453,821
Decrease(Increase) in other assets	21,643,583	(14,046,155)
Increase in inventories	(37,270,679)	(33,740,447)
Increase in trade payables	47,036,243	86,413,987
Increase(Decrease) in the gross amount due to customers for contract work	(199,867,345)	204,044,406
Increase(Decrease) in other financial liabilities	10,525,971	(14,631,453)
Increase(Decrease) in other liabilities	30,654,471	(1,456,445)
Employee benefits paid	(9,297,860)	(9,465,427)
Increase in retirement pension assets	477,738	9,881
Provisions paid	(19,498,441)	-
Total	<u>(317,784,674)</u>	<u>(334,243,593)</u>

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Significant transactions not affecting cash flows for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Gain on valuation of available-for-sale financial assets	464,499	560,434
Income tax effect of gain on valuation of available-for-sale financial assets	112,409	135,625
Remeasurement of net defined benefit liabilities	6,530,486	28,403,410
Income tax effect of remeasurement of net defined benefit liabilities	1,580,378	6,874,634
Current portion of long-term borrowings	300,489,890	23,826,497
Transfer of government grants to intangible assets	21,918,366	14,512,974
Transfer of construction in progress to property, plant and equipment	35,162,177	55,969,414
Transfer of machinery in transit	14,030,356	11,859,876
Increase(Decrease) in other accounts payable related to acquisition of property and equipment	(4,241,995)	4,627,063
Increase in other receivables related to disposals of property and equipment	-	2,970,000
Transfer of available-for-sale financial assets to equity-method investments	-	100,000

The Group recorded net cash inflows and outflows from short-term financial instruments with frequent transactions and maturities in the short term.

29. Related party transactions

Related parties of the Group as of December 31, 2016 and 2015, are as follows:

2016		
Description	Related Party	Relation
Joint venture	KAI-EC	Investee
Associate	S&K Aerospace Co., Ltd.	Investee
	Korea Surface Treatment Co., Ltd	Investee

As Korea Development Bank lost significant influence over the Group by investing 7.7% of the shares of the Group to the Korea Export-Import Bank, KDB and the subsidiaries of KDB are excluded from the scope of related parties.

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2015		
Description	Related Party	Relation
The entity which has significant influence	Korea Development Bank	Largest shareholder
Joint venture	KAI-EC	Investee
Associate	S&K Aerospace Co., Ltd.	Investee
	Korea Surface Treatment Co., Ltd	Investee
Other	KDB Financial Group Inc. Daewoo Securities Co., Ltd. KDB Capital Corporation KDB Asset Management Co., Ltd. KDB Infrastructure Investments Asset Management Co., Ltd. Daewoo Engineering & Construction Co., Ltd. and others	Subsidiaries of Korea Development Bank

Sales and purchases with related parties for the years ended December 31, 2016 and 2015, are as follows:

(In thousands of Korean won)

	Counterparty	2016			
		Sales	Interest Income	Purchases	Interest expense
The entity which has significant influence	Korea Development Bank ¹	-	3,464	-	1,474,050
Associate	S&K Aerospace Co., Ltd.	163,497	-	17,171,277	-
Other	Daewoo Securities Co., Ltd ¹	-	18,098	-	-

¹ Amount of transactions up to the period when the scope of related parties is maintained.

(In thousands of Korean won)

	Counterparty	2015				
		Sales	Other income	Interest income	Purchases	Interest expense
The entity which has significant influence	Korea Development Bank	-	-	21,963	-	3,266,092
Associate	S&K Aerospace Co., Ltd.	134,942	276,753	-	11,994,568	-
Other	KDB Daewoo Securities	-	-	2,096	-	-

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Details of receivables and payables as of December 31, 2016 and 2015, are as follows:

(In thousands of Korean won)

		2016			
		Other receivables	Borrowings	Trade payables	Interest payables
Associates	S&K Aerospace Co., Ltd.	62,196	-	741,234	-

(In thousands of Korean won)

		2015				
		Cash and cash equivalents	Other receivables	Borrowings	Trade payables	Interest payables
The entity which has significant influence	Korea Develop- ment Bank	390,252	-	99,392,200	-	422,941
Associates	S&K Aerospace Co., Ltd.	-	175,056	-	836,365	-

Key management includes directors and members of the Executive Committee. The compensation paid or payable to key management for employee services consists of:

(In thousands of Korean won)

	2016	2015
Salaries	1,438,742	1,092,896
Severance and retirement benefits	385,900	318,886
Total	<u>1,824,642</u>	<u>1,411,782</u>

Key management consists of registered executive officers and auditors who have the authority and responsibility in planning, operations and control of the Group's operations.

Fund transactions with related parties for the years ended December 31, 2016 and 2015, are as follows:

(In thousands of Korean won)

		2016	
		Borrowings	Repayment
The entity which has significant influence	Korea Development Bank ¹	-	18,921,100

¹ Amount of transactions up to the period when the scope of related parties is maintained.

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(In thousands of Korean won)

		2015	
		Borrowings	Repayment
The entity which has significant influence	Korea Development Bank	80,000,000	85,092,200

There are no collateral and payment guarantees provided to the related parties as of December 31, 2016 and December 31, 2015

There are no collateral and payment guarantees provided by the related parties as of December 31, 2016. Details of payment guarantees and collaterals provided by the related parties as of December 31, 2015, are as follows:

(In thousands of US dollars)	Guaranteed by	Guaranteed amount
		2015
Performance guarantee/off-set performance guarantees of KT-1 Turkey, Advance payment guarantee of KT-1 Peru, and others	Korea Development Bank	USD 65,654
Performance guarantee / Advance payment guarantee of T-50 to Iraq and others	Korea Development Bank	USD 395,241
Performance guarantee / Advance payment guarantee of Iraq military base and others	Korea Development Bank	USD 87,750

30. Pending litigation

(1) The Company and its co-defendant, Doosan Infracore Co., Ltd., are facing a lawsuit (US\$49,747 thousand) filed by the Russian group, Penzenskoe Konstruktorskoye Byuro Modelirovaniya(PKBM), for alleged copyright infringement in 2004 due to an infringement of copyright for using the source technology in relation to the development of KT-1 Simulator S/W. On October 21, 2013, the Arbitration Appeals Court of Moscow, Russia, ordered the Company to pay US\$49,747,048 in the first trial. The Company filed an appeal against the ruling of the second trial on April 23, 2014. On June 30, 2014, the court quashed judicial decisions of the verdict in the first and second trial, and returned the case to the Arbitration Appeals Court for a new ruling. The date for the fifteenth pleading was September 28, 2016, assigned co-appraiser. After the co-appraisal result comes out, the pleading date is expected to assign it. The ultimate outcome of the legal action cannot be determined as of reporting date and the Company recognized provisions for this lawsuit (Note 16).

(2) The Company refused to submit satellite components estimates requested by Satrec Initiative Co., Ltd., which had been selected as a preferred bidder, in relation to the KOMPSAT-3A BUS development bidding. The Fair Trade Commission determined that the Company has committed a breach of Monopoly Regulation and Fair Trade Act regarding unfair refusal of a transaction, and ordered the Company to correct its fault and imposed a penalty on the Company. However, the Company filed a lawsuit against the Fair Trade Commission on November 12, 2011, and the Seoul High Court rendered a ruling in favor of the Company. The Fair Trade Commission decided to appeal

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against the ruling of the verdict to the Supreme Court of Korea. On February 12, 2015, the Supreme Court reversed the initial ruling and remanded the case back to the Seoul High Court on the grounds of inadequate judicial proceedings. The first trial of the case is in progress, and the ultimate outcome cannot be determined as of the report date.

(3) The Company is a defendant in a lawsuit amounting to ₩10 billion filed by the Saterc Initiative Co., Ltd. on December 22, 2011, in relation to the KOMPSAT-3A BUS development bidding. The Saterc Initiative Co., Ltd. insists that they have suffered enormous losses such as being disqualified from the position as a preferred bidder as well as losing its competitive place in the domestic satellite market, including multi-purpose satellite market, and the Daejeon District Court decided partially in favor of the plaintiff on January 11, 2017, and the Company appealed on January 25, 2017. The ultimate outcome cannot be determined as of the report date.

(4) A portion of the KHP project costs incurred as a result of changing the design was not qualified for reimbursement by the Defense Acquisition Program Administration. The Company filed a lawsuit against the Korean Government for the amount of ₩13,400 million on March 14, 2013, and partially won the case in the first trial on February 13, 2014. The outcome of the lawsuit cannot be predicted as of the report date. Both parties appealed on March 4, 2014, and the lawsuit is on its second trial. The ultimate outcome of the legal action cannot be determined as of report date.

(5) A portion of the KHP project costs incurred as a result of inflation and fluctuation of the foreign exchange rates was not qualified for reimbursement by the Defense Acquisition Program Administration. The Company filed a lawsuit against the Korean Government for the amount of ₩12,600 million on April 30, 2013, and won the case in the first trial on January 10, 2014. As the defendant appealed on January 14, 2014, and partially won the case in the second trial on April 1, 2016. Both parties appealed, and the lawsuit is on its third trial. The ultimate outcome of the lawsuit cannot be predicted as of the report date.

(6) The Company was fined for ₩13.6 billion by the Defense Acquisition Program Administration in relation to the production of KUH Surion. On December 30, 2014, the Company filed a lawsuit against the Defense Acquisition Program Administration for the delay charge amounting to ₩10.1 billion, excluding the ₩3.5 billion provided by Airbus Helicopter, and lose the case in the first trial on September 8, 2016, and the Company appealed on September 29, 2016, and the lawsuit is on its second trial. The outcome of the lawsuit cannot be predicted as of reporting date.

(7) The Defense Acquisition Program Administration took administrative action to the Company which includes "Restrictions on Qualification for Participation of Improper Provider in Tendering" in accordance with Clause 1 of Article 27 of the National Contract Law and the Enforcement Clause 1.8 of Article 76 of the Law because the Company submitted a test certificate that was given by a subcontractor to the Defense Agency for Technology and Quality without confirming whether the test certificate was fabricated. The Company filed a lawsuit against The Defense Acquisition Program Administration on August 4, 2015, for cancelling the restriction with requesting an injunction for suspension of the execution, and the Court granted the injunction on August 25, 2015, and won the case in the first trial on September 22, 2016. It plans to judgment sentence of the second trial on March 16, 2017, and the Court suspended restrictions on qualification in tendering until judgment sentence of the second trial. The outcome of the lawsuit cannot be predicted as of reporting date

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(8) The Defense Acquisition Program Administration cancelled the authentication of the defense cost management system and rejected the renewal of the authentication based on the audit result of the Board of Audit and Inspection of KOREA in relation to outsourcing expenses. The Company filed a lawsuit against the Defense Acquisition Program Administration on January 18, 2016, for cancelling the revocation of the defense cost management system authentication. The Seoul Administrative Court has ruled dismissal decision on June 23, 2016, and the Seoul High Court has ruled dismissal the appeal on February 8, 2016. The Company appealed on February 23, 2017, and the lawsuit is on its third trial. The ultimate outcome of the lawsuit cannot be determined as of the report date.

(9) The Defense Acquisition Program Administration has offset ₩37.3 billion of goods price to be paid to the Company due to an injustice calculation of the general and administrative expenses and profit in relation to the contract cost for investment compensation and technology transfer costs of overseas manufacturers. On February 16, 2016, the Company filed a lawsuit against the Defense Acquisition Program Administration. The first trial of the case is in progress, and the ultimate outcome cannot be determined as of the report date.

(10) The Defense Acquisition Program Administration has offset ₩15.7 billion of payables to the Company in order to return the government capital that has been paid to the Company because of the failure of the domestic production of Surion power transmission device. On April 21, 2016, the Company filed a lawsuit against the Defense Acquisition Program Administration. The first trial of the case is in progress, and the ultimate outcome cannot be determined as of the report date.

(11) The management expects that the outcome of above lawsuits will not have any significant impact on the Company's financial position.

31. Financial risk management

The Group's activities are exposed to a variety of financial risks: market risk (including currency risk, interest rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

Risk management is carried out by a treasury department, which settles risk management policies, identifies, evaluates and hedges financial risks.

The Group's risk management activity covers financial assets such as cash and cash equivalents, short-term financial instruments, available-for-sale financial assets, trade receivables and other receivables. The Group's risk management activity also covers financial liabilities such as trade payables, other payable and borrowings.

(1) Market risk

(a) Foreign exchange risk

The Group is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar. To minimize foreign exchange risk arising from operating activities, the Group's foreign exchange management policy requires all normal business transactions to be in local currency, or cash- in currency be matched with cash-out currency. The Group's foreign risk management policy also defines foreign exchange risk, measurement period, controlling responsibilities, and management procedures.

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The Group limits all speculative foreign exchange transactions and operates a system to manage receivables and payables denominated in foreign currency. The Group's foreign currency management system evaluates, manages and reports foreign exchange risk every month.

A summary of assets and liabilities denominated in foreign currencies of the Group as of December 31, 2016 and 2015, is as follows:

(In thousands of foreign currencies)

	2016				
	USD	EUR	GBP	JPY	CHF
Cash and cash equivalents	13,912	-	-	-	-
Trade receivables	445,974	-	-	-	-
Due from customers for contract work	7,950	-	-	-	-
Other short-term financial assets	4,080	-	-	-	-
Other long-term financial assets	3,420	-	-	-	-
Trade payables	63,359	5,574	461	2,125	3

(In thousands of foreign currencies)

	2015			
	USD	EUR	GBP	JPY
Cash and cash equivalents	2,503	-	-	-
Trade receivables	151,657	-	-	-
Due from customers for contract work	213,672	-	-	-
Other short-term financial assets	6,720	-	-	-
Other long-term financial assets	3,360	-	-	-
Trade payables	46,196	880	1,773	2,425
Short-term borrowings	70,000	-	-	-
Accrued expenses	53	-	-	-

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As of December 31, 2016 and 2015, if the foreign exchange rate of the Korean won fluctuated by 5% while other variables were fixed, the effects on profit before income tax would be as follows:

<i>(In thousands of Korean won)</i>	2016		2015	
	5% Increase	5% Decrease	5% Increase	5% Decrease
Financial assets	28,722,165	(28,722,165)	22,145,633	(22,145,633)
Financial liabilities	(4,217,183)	4,217,183	(7,023,594)	7,023,594
Net effect	24,504,982	(24,504,982)	15,122,039	(15,122,039)

(b) Interest rate risk

The Group is exposed to interest rate risk mainly arising through interest-bearing liabilities and assets. The Group's position with regard to interest rate risk exposure is mainly driven by its debt obligations such as borrowings and interest-bearing deposits. The Group's policy includes interest risk management to optimize the balance between minimizing uncertainty caused by fluctuations in interest rates and net interest expenses.

In order to manage its exposure to interest rate risk, the Group maintains minimum external borrowings by facilitating its internal cash pooling system, and a reasonable balance between borrowings with fixed and variable interest rates. Also the Group manages its exposure to interest rate risk by improving the structure of short-term and long-term borrowings, and by reducing high interest loans. The Group monitors domestic and global trends of weekly and monthly interest rates.

As of December 31, 2016, if interest rates fluctuate by 100bp without changing other variables, interest expenses related to borrowings with variable interest rates for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016		2015	
	0.1% Increase	0.1% Decrease	0.1% Increase	0.1% Decrease
Interest expense	-	-	83,332	(83,332)

(c) Price risk

The Group is exposed to price risk because of investments held by the Group and classified on the statement of financial position as available-for-sale financial assets.

(2) Credit risk

Credit risk arises during the normal course of transactions and investing activities, where counterparty fails to discharge an obligation. The Group monitors and sets the counterparty's credit limit on a periodic basis based on the counterparty's financial conditions, default history and other important factors.

Credit risk arises from cash and cash equivalents, savings and derivative instruments transactions with financial institutions. To minimize such risk, the Group transacts with banks which have strong international credit rating.

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The maximum exposure credit risk in regard to financial assets is as follows:

(In thousands of Korean won)

Financial assets	December 31, 2016	December 31, 2015
Cash and cash equivalents ¹	53,542,582	10,642,543
Short -term financial instruments	16,090,272	17,379,578
Available-for-sale financial assets	170,300	3,700
Trade receivables	550,441,942	197,917,560
Due from customs for construction work	618,194,249	877,359,110
Other financial assets	44,131,495	32,740,002
Total	<u>1,282,570,840</u>	<u>1,136,042,493</u>

¹ The rest of cash and cash equivalents in the statement of financial position is cash on hand.

There was no loss exceeding the credit limit during the year, and management does not anticipate any loss from default due to the above customers.

(3) Liquidity risk

The Group manages its liquidity risk to maintain adequate net working capital. The Group forecasts its cash flow and liquidity status, and sets plans on a regular base to manage liquidity risk proactively. Beyond effective working capital and cash management, the Group mitigates liquidity risk by contracting with financial institutions with respect to bank overdrafts or banking facility agreement.

The following table shows details of non-derivative financial liabilities classified in accordance with remaining maturities as of December 31, 2016 and 2015, the presented cash flows are the amount of principal and interests that are not discounted into present value.

<i>(In thousands of Korean won)</i>	December 31, 2016			
	Within 1 year	1-5 Years	Over 5 years	Total
Trade payables	280,803,104	-	-	280,803,104
Other financial liabilities	106,463,966	26,139,147	-	132,603,113
Borrowings	103,667,179	48,797,454	-	152,464,633
Debentures payable	207,908,000	205,409,000	-	413,317,000
Total	<u>698,842,249</u>	<u>280,345,601</u>	<u>-</u>	<u>979,187,850</u>

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<i>(In thousands of Korean won)</i>	December 31, 2015			
	Within 1 year	1-5 Years	Over 5 years	Total
Trade payables	231,546,111	-	-	231,546,111
Other financial liabilities	108,742,835	19,426,461	2,898,497	131,067,793
Borrowings	130,065,307	126,229,482	5,095,347	261,390,136
Debentures payable	5,736,000	204,302,000	-	210,038,000
Total	476,090,253	349,957,943	7,993,844	834,042,040

(4) Capital risk management

The object of capital management is to maintain optimal capital structure to safeguard the Group's ability to provide continuing returns for shareholders as a going concern and to reduce the cost of capital.

The debt-to-equity ratios at December 31, 2016 and 2015, are as follows

<i>(In thousands of Korean won)</i>	2016	2015
Total debts (A)	1,526,926,580	1,540,443,004
Total equity (B)	1,406,289,886	1,171,852,283
Debt-to-equity ratio (A/B)	108.58%	131.45%

32. Segment Information

(a) The Group's reporting segments are classified as follows:

Operating segments are determined by management who makes strategic decisions. The management assesses the performance of the operating segments and resources distributed to each segment based on gross profit. The Group's business segments consists of government defense business/aircraft export business, airframe part business, and others.

(b) The Group's management accesses each segment's performance based on its sales and gross profits. The following table shows segment information for the years ended December 31, 2016 and 2015:

<i>(In thousands of Korean won)</i>	2016				
	Government defense business and aircraft export business	Airframe part business	Other	Intercompany transactions	Total
Sales	1,981,958,611	1,118,716,243	2,716,942	(2,716,942)	3,100,674,854
Gross profit	222,001,186	226,749,935	2,716,942	-	451,468,063

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<i>(In thousands of Korean won)</i>	2015				
	Government defense business and aircraft export business	Airframe part business	Other	Intercompany transactions	Total
Sales	1,929,754,740	971,277,623	2,985,126	(2,985,126)	2,901,032,363
Gross profit	216,009,023	195,335,969	2,985,126	-	414,330,118

(c) Information about geographic areas

Sales by geographic areas for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016	2015
Domestic	1,354,310,842	1,134,709,202
Asia	836,115,291	993,764,440
Europe	506,117,804	390,572,091
North America	385,447,577	345,129,502
South America	18,683,339	36,857,128
Total	<u>3,100,674,853</u>	<u>2,901,032,363</u>

The sales to major customers whose amounts exceed 10% for the years ended December 31, 2016 and 2015, are as follows:

<i>(In thousands of Korean won)</i>	2016	2015	Segment
Defense Acquisition program administration and other government authorities	1,338,550,763	1,117,890,270	Government defense business/aircraft export business
A company	359,618,727	636,950,168	Government defense business/aircraft export business
B company	452,979,883	363,170,997	Airframe part business
C company	346,525,647	303,448,582	Airframe part business
Total	<u>2,497,675,020</u>	<u>2,421,460,017</u>	