

Korea Aerospace Industries, Ltd. and Subsidiaries

Consolidated Financial Statements

December 31, 2013 and 2012

Korea Aerospace Industries, Ltd. and Subsidiaries
Index
December 31, 2013 and 2012

	Pages
Report of Independent Auditors	1 - 2
Consolidated Financial Statements	
Consolidated Statements of Financial Position	3 - 4
Consolidated Statements of Comprehensive Income.....	5 - 6
Consolidated Statements of Changes in Equity	7 - 8
Consolidated Statement of Cash Flows	9 - 10
Notes to the Consolidated Financial Statements	11 – 67

Report of Independent Auditors

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

We have audited the accompanying consolidated statements of financial position of Korea Aerospace Industries, Ltd. and its subsidiaries (collectively referred to as the “the Group”) as of December 31, 2013 and 2012, and the related consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, expressed in Korean won. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements, referred to above, present fairly, in all material respects, the financial position of Korea Aerospace Industries, Ltd. and its subsidiaries as of December 31, 2013 and 2012, and their financial performance and cash flows for the years then ended, in accordance with International Financial Reporting Standards as adopted by the Republic of Korea (“Korean IFRS”).



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

Seoul, Korea
March 13, 2014

This report is effective as of March 13, 2014, the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying 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 Subsidiaries
Consolidated Statements of Financial Position
December 31, 2013 and 2012

(In millions of Korean won)

	Notes	2013	2012
Assets			
Current Assets			
Cash and cash equivalents	5	₩ 137,531	₩ 223,403
Short-term financial instruments	4,5	53,043	14,467
Short-term available-for-sale financial assets	5,8	-	13
Trade receivables	5,6	94,960	226,911
Due from customers for contract work	5,22	247,207	142,128
Other short-term financial assets	5,6	51,699	21,620
Inventories	7	359,325	349,712
Other assets	11	200,898	197,778
Income tax refund receivable		-	6,674
Total current assets		<u>1,144,663</u>	<u>1,182,706</u>
Non-current assets			
Long-term available-for-sale financial assets	5,8	20,096	19,295
Other long-term financial assets	4,5,6	7,510	9,561
Investments in associate and joint venture	9	3,117	3,578
Property, plant and equipment	10	493,689	401,684
Intangible assets	10	222,976	220,272
Deferred income tax assets	27	84,021	55,426
Total assets		<u>₩ 1,976,072</u>	<u>₩ 1,892,522</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Consolidated Statements of Financial Position
December 31, 2013 and 2012

(In millions of Korean won)

	Notes	2013	2012
Liabilities and Equity			
Current Liabilities			
Trade payables	5,12	₩ 121,028	₩ 137,915
Other short-term financial liabilities	5,12	77,145	76,751
Short-term borrowings	5,13	86,179	56,122
Short-term debentures payable	5,13	100,000	-
Due to customers for contract work	22	284,918	265,847
Income tax payable		18,828	-
Other short-term liabilities	14	33,610	36,103
Total current liabilities		721,708	572,738
Non-current liabilities			
Long-term borrowings	5,13	90,965	161,133
Long-term debentures payable	5,13	-	100,000
Other long-term financial liabilities	5,12	16,630	17,756
Net defined benefit liabilities	15	170,820	150,324
Other provisions	16,30	11,844	-
Other long-term liabilities		2,542	3,234
Total liabilities		1,014,509	1,005,185
Equity attributable to owners of the parent			
Capital stock	18	487,376	487,376
Share premium		124,078	124,078
Retained earnings	19	340,543	267,082
Other components of equity	20	9,493	9,027
		961,490	887,563
Non-controlling interests		73	(226)
Total equity		961,563	887,337
Total liabilities and equity		₩ 1,976,072	₩ 1,892,522

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

Korea Aerospace Industries, Ltd. and Subsidiaries
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2013 and 2012

(in millions of Korean won, except per share amounts)

	Notes	2013	2012
Sales	22	₩ 2,016,339	₩ 1,534,606
Cost of sales	23	1,773,849	1,310,614
Gross profit		242,490	223,992
Selling, general and administrative expenses	23,24	117,925	98,207
Operating income		124,565	125,785
Other income	25	6,667	8,984
Other expenses	25	28,640	16,749
Financial income	26	35,536	29,339
Financial expenses	26	45,433	54,653
Gain on valuation of equity-method investments	9	128	-
Loss on valuation of equity-method investments	9	589	1,222
Profit before income tax		92,234	91,484
Income tax expense	27	1,852	17,455
Profit for the year		90,382	74,029
Profit(loss) attributable to :			
Owners of the parent		90,083	74,105
Non-controlling interests		299	(76)
Other comprehensive income(loss)			
Items that will not be reclassified subsequently to profit or loss:			
Remeasurement of net defined benefit liabilities	15	3,790	(17,635)
Income tax effect of other comprehensive income		(917)	4,267
Items to be subsequently reclassifiable to profit or loss:			
Gain on valuation of long-term available-for-sale financial assets	8	800	771
Foreign currency translation differences		(55)	(44)
Income tax effect of other comprehensive income		(194)	(185)
		3,424	(12,826)
Total comprehensive income for the year		₩ 93,806	₩ 61,203

Korea Aerospace Industries, Ltd. and Subsidiaries
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2013 and 2012

Comprehensive income attributable to :

Owners of the parent			93,507		61,279
Non-controlling interests			299		(76)

Earnings per share attributable to owners of the parent (in Korean won)

Basic earnings per share	21	₩	924	₩	760
Diluted earnings per share	21	₩	924	₩	760

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

Korea Aerospace Industries, Ltd. and Subsidiaries
Consolidated Statements of Changes in Equity
Years ended December 31, 2013 and 2012

(In millions of Korean won)

	Equity attributable to owners of the parent				Non-controlling interests	Total
	Capital stock	Share premium	Retained earnings	Other components of equity		
Balance at January 1, 2012	₩ 487,376	₩ 124,078	₩ 225,840	₩ 8,425	₩ (150)	₩ 845,569
Comprehensive income						
Profit for the year	-	-	74,105	-	(76)	74,029
Gains on valuation of available-for-sale financial assets	-	-	-	586	-	586
Foreign currency translation differences	-	-	-	(44)	-	(44)
Remeasurement of net defined benefit liabilities	-	-	(13,368)	-	-	(13,368)
Total comprehensive income	-	-	60,737	542	(76)	61,203
Transactions with owners						
Cash dividends	-	-	(19,495)	-	-	(19,495)
Stock options	-	-	-	60	-	60
Total transactions with owners	-	-	(19,495)	60	-	(19,435)
Balance at December 31, 2012	₩ 487,376	₩ 124,078	₩ 267,082	₩ 9,027	₩ (226)	₩ 887,337

Korea Aerospace Industries, Ltd. and Subsidiaries
Consolidated Statements of Changes in Equity
Years ended December 31, 2013 and 2012

(In millions of Korean won)

	Equity attributable to owners of the parent				Non-controlling interests	Total
	Capital stock	Share premium	Retained earnings	Other components of equity		
Balance at January 1, 2013	₩ 487,376	₩ 124,078	₩ 267,082	₩ 9,027	₩ (226)	₩ 887,337
Comprehensive income						
Profit for the year	-	-	90,083	-	299	90,382
Gains on valuation of available-for-sale financial assets	-	-	-	606	-	606
Foreign currency translation differences	-	-	-	(55)	-	(55)
Remeasurement of net defined benefit liabilities	-	-	2,873	-	-	2,873
Total comprehensive income	-	-	92,956	551	299	93,806
Transactions with owners						
Cash dividends	-	-	(19,495)	-	-	(19,495)
Stock options	-	-	-	(85)	-	(85)
Total transactions with owners	-	-	(19,495)	(85)	-	(19,580)
Balance at December 31, 2013	₩ 487,376	₩ 124,078	₩ 340,543	₩ 9,493	₩ 73	₩ 961,563

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

Korea Aerospace Industries, Ltd. and Subsidiaries
Consolidated Statements of Cash Flows
Years ended December 31, 2013 and 2012

(In millions of Korean won)

	Notes	2013	2012
Cash Flows from operating activities			
Profit for the year		₩ 90,382	₩ 74,029
Adjustments	28	167,759	137,289
Changes in operating assets and liabilities	28	(41,642)	288,001
Interest received		3,435	1,356
Interest paid		(12,356)	(18,646)
Income tax paid		(6,078)	(33,690)
Net cash generated from operating activities		201,500	448,339
Cash flows from investing activities			
Net proceeds(outflow) from short-term financial instruments		(38,576)	(1,309)
Proceeds from disposal of available-for-sale financial assets		13	31
Increase in other financial assets		(1,951)	(430)
Decrease in other financial assets		1,680	694
Proceeds from disposal of property, plant and equipment		633	198
Acquisition of property, plant and equipment		(141,663)	(63,559)
Proceeds from disposal of intangible assets		1	130
Acquisition of intangible assets		(60,653)	(41,196)
Net cash used in investing activities		(240,516)	(105,441)

Korea Aerospace Industries, Ltd. and Subsidiaries
Consolidated Statements of Cash Flows
Years ended December 31, 2013 and 2012

(In millions of Korean won)

	Notes	2013	2012
Cash flows from financing activities			
Proceeds from short-term borrowings	₩	417,448	₩ 317,317
Repayment of short-term borrowings		(475,202)	(546,320)
Proceeds from long-term borrowings		17,847	54,146
Payment of dividends		(19,494)	(19,493)
Receipt of governments grants		12,426	8,737
Net cash used in financial activities		<u>(46,975)</u>	<u>(185,613)</u>
Effects of exchange rate changes on cash and cash equivalents		119	167
Net increase(decrease) in cash and cash equivalents		<u>(85,872)</u>	157,452
Beginning of the year		223,403	65,951
End of the year	₩	<u>137,531</u>	<u>₩ 223,403</u>

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

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

1. General Information

Korea Aerospace Industries, Ltd. (“the Company”) and its subsidiaries (collectively referred to as ‘the Group’) has prepared the consolidated financial statements in accordance with Korean IFRS 1110, ‘*Consolidated financial statements*’. Its consolidated subsidiaries are Korea Aerospace F.W. Inc. and KAI Image. KAI-EC and S&K Aerospace 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, 2013, the share capital of the Company amounts to ₩487,376 million and the Company’s major shareholder is Korea Finance Corporation with 26.41% ownership (Note 18).

The Company’s consolidated subsidiaries as of December 31, 2013, are as follows:

Subsidiaries	Location	Year end	Percentage of ownership(%)
KAI Image	Domestic	December 31	50.00 ¹
Korea Aerospace F.W. Inc	America	December 31	100.00

¹ As the Company has the power to appoint and dismiss the majority of the members of the board of directors according to the agreement with other shareholders, KAI Image is included as a consolidated subsidiary, even though the ownership in KAI Image is 50%.

A summary of financial data of subsidiaries as of and for the year ended December 31, 2013, follows:

(In thousands of Korean won)

Name of subsidiaries	KAI Image	Korea Aerospace F.W. Inc
Assets	329,684	641,646
Liabilities	183,477	14,189
Equity	146,207	627,457
Sales	1,496,216	2,087,727
Profit for the year	597,659	38,004
Total comprehensive income for the year	597,659	38,004

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

Korea Aerospace Industries, Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2013 and 2012

consolidated financial statements have been condensed, restructured and translated into English from the Korean language financial statements.

Certain information attached to the Korean language financial statements, but not required for a fair presentation of the 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 for the annual period beginning on January 1, 2013:

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

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

- Amendment to Korean IFRS 1019, *Employee Benefits*

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

- Korean IFRS 1110, *Consolidated Financial Statements*

Korean IFRS 1110, *Consolidated Financial Statements*, introduces a single control concept and provides a specific guidance for the control. The adoption of this standard does not have an impact on consolidation scope in the consolidated financial statements.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

- Korean IFRS 1111, *Joint Arrangements*

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

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

Korean IFRS 1112, *Disclosure of Interests in Other Entities*, provides disclosure requirements for all types of equity investments in other entities including subsidiaries, associates, joint ventures and unconsolidated structured entities. The adoption of this standard does not have an impact on the consolidated financial statements.

- Korean IFRS 1113, *Fair Value Measurement*

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

(b) New standards and interpretations not yet adopted

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

- Amendment to Korean IFRS 1110, *Consolidated Financial Statements*

Amendment to Korean IFRS 1110, *Consolidated Financial Statements*, provides that, if a parent company qualifies as an investment entity, it is required to measure its investments in subsidiaries at fair value through profit and loss instead of consolidating these subsidiaries in its consolidated financial statements. The amendment does not apply for a parent of an investment entity if the parent itself is not an investment entity. This amendment is effective for annual periods beginning on or after January 1, 2014, with early adoption permitted. The Group expects that the application of this amendment would not have a material impact on its consolidated financial statements.

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

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

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

Amendment to Korean IFRS 1039, *Financial Instruments: Recognition and Measurement*, allows the continuation of hedge accounting for a derivative that has been designated as a hedging

Korea Aerospace Industries, Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2013 and 2012

instrument in a circumstance in which that derivative is novated to a central counterparty (CCP) as a consequence of laws or regulations. This amendment is effective for annual periods beginning on or after January 1, 2014, with early adoption permitted. The Group is assessing the impact of application of this amendment on its consolidated financial statements.

- Enactment of Korean IFRS 2121, *Levies*

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

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 (including special purpose entities) over which the Company has control. The Company controls the corresponding investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Consolidation of a subsidiary begins from the date the Company obtains control of a subsidiary and ceases when the Company loses control of the subsidiary.

The Group applies the acquisition method to account for business combinations. The consideration transferred is measured at the fair values of the assets transferred, and identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are initially measured at their fair values at the acquisition date. The Group recognizes any non-controlling interest in the acquiree on an acquisition-by-acquisition basis in the event of liquidation, either at fair value or at the non-controlling interest's proportionate share of the recognized amounts of acquiree's identifiable net assets. All other non-controlling interests are measured at their acquisition-date fair values, unless another measurement basis is required by IFRSs. Acquisition-related costs are expensed as incurred.

Goodwill is recognized as the excess of the aggregate of the consideration transferred, the amount of any non-controlling interest in the acquiree, and the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree over the identifiable net assets acquired. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss.

Balances of receivables and payables, income and expenses and unrealized gains on transactions between the Group subsidiaries are eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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

In transactions with non-controlling interests, which do not result in loss of control, the Group recognizes directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

(c) Disposal of subsidiaries

If the Group loses control of a subsidiary, any investment continuously retained in the subsidiary is re-measured at its fair value at the date when control is lost and any resulting differences are recognized in profit or loss.

(d) Associates

Associates are all entities over which the Group has significant influence, and investments in associates are initially recognized at acquisition cost using the equity method. 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 any objective evidence that the investment in the associate is impaired, the Group recognizes the difference between the recoverable amount of the associate and its book value as impairment loss.

(e) Joint ventures

A joint arrangement of which two or more parties have joint control is classified as either a joint operation or a joint venture. A joint operator has rights to the assets, and obligations for the liabilities, relating to the joint operation and recognizes the assets, liabilities, revenues and expenses relating to its interest in a joint operation. A joint venturer has rights to the net assets relating to the joint venture and accounts for that investment using the equity method.

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 the each entity operates (the "functional currency"). The consolidated financial statements are presented in Korean won, which is the Controlling Company's functional and presentation currency.

(b) Transactions and balances

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

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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

2.5 Cash 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

The Group classifies its financial assets in the following categories: loans and receivables, available-for-sale financial assets, and financial liabilities at amortized cost. The classification depends on the purpose for which the financial assets and liabilities were acquired. Management determines the classification of its financial assets at initial recognition.

Loans and receivables

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

Available-for-sale financial assets

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

Financial liabilities carried at amortized cost

The Company classifies non-derivative financial liabilities as financial liabilities measured at amortized cost, except for financial liabilities at fair value through profit or loss or financial liabilities that arise when a transfer of a financial asset does not qualify for de-recognition. In this case, the transferred asset continues to be recognized and a financial liability is measured as the consideration received. Financial liabilities carried at amortized cost are included in non-current liabilities, except for maturities less than 12 months after the end of the reporting period, which are classified as current liabilities.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

(b) Recognition and Measurement

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

Gains or losses arising from changes in the fair value of the financial assets carried at fair value through profit or loss are presented in the comprehensive income statement within 'other operating gains and losses, net' in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognized in the comprehensive income statement as part of 'other operating income' when the Group's right to receive dividend payments is established.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the comprehensive income statement as 'other gains and losses, net'. Dividends on available-for-sale equity instruments are recognized in the comprehensive income statement as part of 'other income' when the Group's right to receive dividend payments is established.

(c) Offsetting financial instruments

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

(d) De-recognition

Financial assets are derecognized when the contractual rights to receive cash flows from the investments have expired or have been transferred and the Group has substantially transferred all risks and rewards of ownership. If the risk and rewards of ownership of transferred assets have not been substantially transferred, the Group reviews the level of control retained over that asset and the extent of its continuing involvement to determine if transfers do not qualify for de-recognition.

(e) Impairment of financial assets

(1) Assets carried at amortized cost

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.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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

- Significant financial difficulty of the issuer or obligor;
- For economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- It becomes probable that the borrower will enter bankruptcy or other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties;

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

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

(2) Assets classified as available-for-sale

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. For debt securities, the Company uses the criteria refer to (1) above. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in profit or loss – is removed from equity and recognized in the statement of comprehensive income. Impairment losses on equity instruments recognized in the statement of comprehensive income are not reversed through the statement of comprehensive income. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the statement of comprehensive income.

2.8 Trade Receivables

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

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

2.10 Property, Plant and Equipment

Property, plant and equipment is 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 outcome of development plan is for practical enhancement, 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 by straight-line method and unit of production method over their useful lives. In presentation, 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.

(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.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

(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.

	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 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.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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.

(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.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

2.17 Provisions

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

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.

(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

A construction contract 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. Contract costs are recognized as expenses by reference to the stage of completion of the contract activity at the end of the reporting period. When it is probable that total contract costs will exceed total contract revenue, the expected loss on the

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

construction contract is immediately recognized 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. Contract costs are recognized as an expense in the period in which they are incurred.

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 attaching to it. Government grants related to assets are presented by deducting the grants in arriving at the carrying amount of the assets, and grants related to income are deferred and presented by deducting the related expenses for the purpose of the government grants.

2.21 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

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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.

2.24 Approval of financial statements

The issuance of the December 31, 2013 financial statements of the Company was approved by the Board of Directors on February 6, 2014.

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.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

(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.

(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, 2013 and 2012, consist of the following:

<i>(In millions of Korean won)</i>	2013	2012	Restriction
Short-term financial instruments	3,043	9,467	Government grants
Other long-term finance assets	17	17	Deposits for checking accounts
Total	<u>3,060</u>	<u>9,484</u>	

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

5. Financial instruments by category

Categorizations of financial instruments as of December 31, 2013, are as follows:

(In millions of Korean won)

	Loans and receivables	Available-for- sale financial assets	Total	Fair value
Assets				
Cash and cash equivalents	137,531	-	137,531	2
Short -term financial instruments	53,043	-	53,043	2
Available-for-sale financial assets ¹	-	20,096	20,096	20,096
Trade receivables	94,960	-	94,960	2
Due from customers for contract work	247,207	-	247,207	2
Other financial assets	59,209	-	59,209	2

(In millions of Korean won)

	Financial liabilities measured at amortized cost	Fair value
Liabilities		
Trade payables	121,028	2
Borrowings ³	177,144	173,202
Debentures ³	100,000	101,269
Other financial liabilities ³	93,775	95,042

Categorizations of financial instruments as of December 31, 2012, are as follows:

(In millions of Korean won)

	Loans and receivables	Available-for- sale financial assets	Total	Fair value
Assets				
Cash and cash equivalents	223,403	-	223,403	2
Short -term financial instruments	14,467	-	14,467	2
Available-for-sale financial assets ¹	-	19,308	19,308	19,308
Trade receivables	226,911	-	226,911	2
Due from customers for contract work	142,128	-	142,128	2
Other financial assets	31,182	-	31,182	2

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

<i>(In millions of Korean won)</i>	Financial liabilities measured at amortized cost	Fair value
Liabilities		
Trade payables	137,915	²
Borrowings ³	217,255	215,127
Debentures ³	100,000	102,540
Other financial liabilities ³	94,507	96,508

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).

Income and loss of financial instruments by category as of December 31, 2013, are as follows:

<i>(In millions of Korean won)</i>	Loans and receivables	Available-for- sale financial assets	Financial Liabilities measured at amortized cost	Total
Interest income	5,894	30	-	5,924
Interest expenses	-	-	12,917	12,917
Gain on foreign currency translation	-	-	218	218
Loss on foreign currency translation	10,539	-	-	10,539
Other comprehensive income	-	607	-	607

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

Income and loss of financial instruments by category as of December 31, 2012, are as follows:

<i>(In millions of Korean won)</i>	Loans and receivables	Available-for- sale financial assets	Financial liabilities measured at amortized cost	Total
Interest income	3,232	48	-	3,280
Interest expenses	-	-	19,306	19,306
Reversal of allowance for bad debts	66	-	-	66
Gain on foreign currency translation	1,240	-	513	1,753
Loss on foreign currency translation	4,707	-	-	4,707
Other comprehensive income	-	585	-	585

The settlement of loans and receivables and financial liabilities at amortized costs, which are denominated in the relevant foreign currencies, incurred foreign exchange gain of ₩29,394 million (2012: ₩24,308 million) and loss of ₩21,978 million (2012: ₩30,640 million).

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.

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

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

The following table presents the financial assets and liabilities that are measured at fair value at December 31, 2013 and 2012 :

(In millions of Korean won)

	2013			
	Level 1	Level 2	Level 3	Total
Recurring fair value measurement				
Available-for-sale financial assets	-	-	19,975	19,975

	2012			
	Level 1	Level 2	Level 3	Total
Recurring fair value measurement				
Available-for-sale financial assets	-	-	19,187	19,187

The changes in the financial assets on level 3, December 31, 2013 and 2012, are as follows:

	2013	2012
	(Available-for-sale financial assets)	(Available-for-sale financial assets)
Balance as of January 1	19,187	18,447
Disposals	(12)	(31)
Valuation (Other Comprehensive income)	800	771
Balance as of December 31	<u>19,975</u>	<u>19,187</u>

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

		2013	2012
Available-for-sale financial assets	Korea Software Financial Cooperative	121	121

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.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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

(in millions of Korean won)

	2013			
	Fair value	level	Valuation techniques	Inputs
Available-for-sale financial assets				
Korea Defense Industrial Association	19,571	3	Asset approach	Net asset value

6. Trade receivables and other financial assets

Trade receivables and other financial assets as of December 31, 2013 and 2012, consist of the following:

(In millions of Korean won)

	2013	2012
Current assets		
Trade receivables	94,960	226,911
Other receivables	51,678	21,529
Accrued income	21	92
	<u>146,659</u>	<u>248,532</u>
Non-current asset		
Long-term financial instruments	96	78
Long-term other receivables	4,903	7,225
Long-term loans to employees	126	93
Deposits	2,385	2,165
	<u>7,510</u>	<u>9,561</u>
Total	<u>154,169</u>	<u>258,093</u>

The aging analysis of trade receivables as of December 31, 2013 and 2012, follows:

(In millions of Korean won)

	2013	2012
Receivables not past due	91,887	220,482
Past due but not impaired		
Up to 12 months	1,925	6,142
Over 12 months	1,148	287
	<u>3,073</u>	<u>6,429</u>
Impaired		
Over 12 months	1,004	1,004
Total	<u>95,964</u>	<u>227,915</u>
Provision	<u>(1,004)</u>	<u>(1,004)</u>
	<u>94,960</u>	<u>226,911</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

Changes in provision for impairment of trade receivables for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Balance as of January 1	1,004	1,070
Reversal of allowance for bad debts	-	(66)
Balance as of December 31	<u>1,004</u>	<u>1,004</u>

7. Inventories

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

<i>(In millions of Korean won)</i>	2013	2012
Finished goods	24,204	7,407
Work-in-process	185,856	154,590
Raw materials	120,131	110,420
Supplies	6,392	9,089
Raw materials in-transit	22,742	68,206
Total	<u>359,325</u>	<u>349,712</u>

As of December 31, 2013, the Group's inventories and property, plant and equipment are insured for ₩1,348 billion (2012: ₩1,208 billion). In addition, the Group carries product liability insurance with a ceiling of ₩2,613 billion (2012: ₩2,261 billion).

8. Available-for-sale financial assets

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

<i>(In millions of Korean won)</i>	2013		2012
	Acquisition cost	Book value	Book value
Government and public bonds	4	4	16
Subordinated bonds	400	400	400
Equity securities	12,645	19,692	18,892
	<u>13,049</u>	<u>20,096</u>	<u>19,308</u>
Less: current portion	-	-	(13)
Total	<u>13,049</u>	<u>20,096</u>	<u>19,295</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

Debt securities as of December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	Maturities	2013	2012
Municipal bonds	-	-	12
Government housing bonds	2016.09.30	4	4
Woori Bank subordinated bonds	2014.09.17 ~2015.06.19	400	400
Total		<u>404</u>	<u>416</u>

Equity securities as of December 31, 2013 and 2012, consist of the following:

<i>(In millions of Korean won)</i>	Ownership percentage (%)	2013	2012
Korea Defense Industrial Association ¹	18.4	19,571	18,771
Korea Software Financial Cooperative ²	0.1	121	121
Total		<u>19,692</u>	<u>18,892</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, 2013 and 2012, consist of the following:

<i>(in millions of Korean won)</i>	2013		
	January 1	Changes	December 31
Valuation amount	6,247	800	7,047
Deferred income tax effect	(1,488)	(194)	(1,682)
Total	<u>4,759</u>	<u>606</u>	<u>5,365</u>

<i>(in millions of Korean won)</i>	2012		
	January 1	Changes	December 31
Valuation amount	5,476	771	6,247
Deferred income tax effect	(1,303)	(185)	(1,488)
Total	<u>4,173</u>	<u>586</u>	<u>4,759</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

9. Investments in associate and joint venture

Investments in associate and joint venture as of December 31, 2013 and 2012, and their summarized financial information as of and for the years ended December 31, 2013 and 2012, is as follows:

<i>(In millions of Korean won)</i>	2013							
	Ownership (%)	Acquisition Cost	Net Asset Value	Recorded Book Value	Assets	Liability	Sales	Net income(loss)
Joint venture								
KAI-EC ¹	51.00	2,805	353	353	694	2	-	(1,156)
Associate								
S&K Aerospace Co., Ltd.	29.41	1,000	2,764	2,764	38,036	28,639	15,573	436
Total		3,805	3,117	3,117				

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

<i>(In millions of Korean won)</i>	2012							
	Ownership (%)	Acquisition Cost	Net Asset Value	Recorded Book Value	Assets	Liability	Sales	Net loss
Joint venture								
KAI-EC ¹	51.00	2,805	942	942	2,573	726	-	(2,147)
Associate								
S&K Aerospace Co., Ltd.	29.41	1,000	2,636	2,636	37,793	28,832	12,483	(431)
Total		3,805	3,578	3,578				

¹ Considering unanimity rule in the articles 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 associate and joint venture under the equity method for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013		
	January 1	Gain(loss) on valuation of equity method	December 31
Joint venture			
KAI-EC	942	(589)	353
Associate			
S&K Aerospace Co., Ltd.	2,636	128	2,764
Total	3,578	(461)	3,117

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

<i>(In millions of Korean won)</i>	2012		
	January 1	Gain(loss) on valuation of equity method	December 31
Joint venture			
KAI-EC	2,037	(1,095)	942
Associate			
S&K Aerospace Co., Ltd.	2,762	(127)	2,636
Total	4,799	(1,222)	3,578

Summary of condensed financial information of associates and joint ventures, details of adjustments from the book value, and dividends received as of and for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	KAI-EC		S&K Aerospace Co., Ltd.	
	2013	2012	2013	2012
Current Assets	652	2,256	4,154	4,395
Non-current assets	42	317	33,882	33,398
Current Liabilities	2	643	18,053	4,379
Non-current liabilities	-	83	10,586	24,453
Equity	692	1,847	9,397	8,961
Ownership percentage (%)	51	51	29.41	29.41
Net assets of equity shares	353	942	2,764	2,636
Book value of investments in associate and jointly controlled entity	353	942	2,764	2,636

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

10. Property, Plant and Equipment, and Intangible Assets

Property, plant and equipment as of December 31, 2013 and 2012, consist of the following:

<i>(In millions of Korean won)</i>	2013		
	Acquisition cost	Accumulated depreciation	Balance
Land	83,521	-	83,521
Buildings	278,084	(86,735)	191,349
Structures	38,624	(13,949)	24,675
Machinery	265,461	(157,449)	108,012
Tools and equipment	251,902	(210,401)	41,501
Vehicles	3,104	(1,529)	1,575
Construction-in-progress	37,797	-	37,797
Machinery-in-transit	5,259	-	5,259
Total	<u>963,752</u>	<u>(470,063)</u>	<u>493,689</u>

<i>(In millions of Korean won)</i>	2012		
	Acquisition cost	Accumulated depreciation	Balance
Land	83,521	-	83,521
Buildings	244,828	(78,196)	166,632
Structures	37,619	(12,753)	24,866
Machinery	210,610	(145,664)	64,946
Tools and equipment	235,877	(189,964)	45,913
Vehicles	1,780	(1,125)	655
Construction-in-progress	9,726	-	9,726
Machinery-in-transit	5,425	-	5,425
Total	<u>829,386</u>	<u>(427,702)</u>	<u>401,684</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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

<i>(In millions of Korean won)</i>	2013					December 31
	January 1	Acquisitions / Capital expenditures	Disposals / Abandonment / Impairment	Depreciation	Transfers	
Land	83,521	-	-	-	-	83,521
Buildings	166,632	31,035	-	(8,539)	2,221	191,349
Structures	24,865	982	-	(1,197)	25	24,675
Machinery	64,946	53,524	(75)	(13,910)	3,526	108,011
Tools and equipment	45,914	8,150	(80)	(21,835)	9,353	41,502
Vehicles	655	1,319	-	(425)	26	1,575
Construction-in-progress	9,726	37,797	-	-	(9,726)	37,797
Machinery-in-transit	5,425	5,259	-	-	(5,425)	5,259
Total	401,684	138,066	(155)	(45,906)	-	493,689

<i>(In millions of Korean won)</i>	2012					December 31
	January 1	Acquisitions / Capital expenditures	Disposals / Abandonment / Impairment	Depreciation	Transfers	
Land	83,521	-	-	-	-	83,521
Buildings	170,472	2,743	-	(8,124)	1,541	166,632
Structures	24,539	1,201	-	(1,146)	271	24,865
Machinery	48,800	20,934	-	(10,695)	5,907	64,946
Tools and equipment	33,028	29,227	(6)	(20,629)	4,294	45,914
Vehicles	512	395	-	(252)	-	655
Construction-in-progress	10,248	9,134	-	-	(9,656)	9,726
Machinery-in-transit	4,261	3,521	-	-	(2,357)	5,425
Total	375,381	67,155	(6)	(40,846)	-	401,684

As of December 31, 2013, the Group's inventories, and property, plant and equipment are insured for ₩1,348 billion (2012: ₩1,208 billion). In addition, the Group carries product liability insurance with a ceiling of ₩2,613 billion (2012: ₩2,261 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, 2013 and 2012, the Group's property, plant and equipment are pledged as collaterals for borrowings from Korea Development Bank for up to ₩550 billion.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

The depreciation expense classified by accounts for the years ended December 31, 2013 and 2012, is as follows:

<i>(In millions of Korean won)</i>	2013	2012
Cost of sales	44,580	40,001
Development costs	5	57
Selling, general and administrative expenses	1,321	787
Total	<u>45,906</u>	<u>40,845</u>

Intangible assets as of December 31, 2013 and 2012, consist of the following:

2013				
<i>(In millions of Korean won)</i>	Acquisition cost	Accumulated amortization	Accumulated impairment	Book value
Industrial property rights	1,074	(616)	(1)	457
Software	11,188	(5,171)	-	6,017
Facility usage rights	78	(59)	-	19
Long-term development projects	101,045	(25,501)	-	75,544
Development costs	238,256	(63,138)	(43,253)	131,865
Memberships	1,928	-	-	1,928
Other intangible assets	10,311	(3,165)	-	7,146
Total	<u>363,880</u>	<u>(97,650)</u>	<u>(43,254)</u>	<u>222,976</u>

2012				
<i>(In millions of Korean won)</i>	Acquisition cost	Accumulated amortization	Accumulated impairment	Book value
Industrial property rights	833	(559)	(1)	273
Software	10,427	(3,324)	-	7,103
Facility usage rights	78	(56)	-	22
Long-term development projects	83,002	(17,913)	-	65,089
Development costs	211,301	(29,750)	(43,253)	138,298
Memberships	1,756	-	-	1,756
Other intangible assets	10,311	(2,580)	-	7,731
Total	<u>317,708</u>	<u>(54,182)</u>	<u>(43,254)</u>	<u>220,272</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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

<i>(In millions of Korean won)</i>	2013				
	January 1	Acquisitions / Capital expenditures¹	Disposals / Impairment	Amortization	December 31
Industrial property rights	272	241	-	(56)	457
Software	7,103	761	-	(1,847)	6,017
Facility usage rights	22	-	-	(3)	19
Long-term development projects	65,089	18,043	-	(7,588)	75,544
Development costs	138,298	26,956	(10,571)	(22,818)	131,865
Memberships	1,756	172	-	-	1,928
Other intangible assets	7,731	-	-	(585)	7,146
Total	220,271	46,173	(10,571)	(32,897)	222,976

<i>(In millions of Korean won)</i>	2012				
	January 1	Acquisitions / Capital expenditures¹	Disposals / Impairment	Amortization	December 31
Industrial property rights	198	119	-	(45)	272
Software	3,388	4,886	-	(1,171)	7,103
Facility usage rights	25	-	-	(3)	22
Long-term development projects	59,657	6,557	-	(1,125)	65,089
Development costs	137,042	22,331	(11,004)	(10,071)	138,298
Memberships	1,450	439	(132)	-	1,757
Other intangible assets	8,278	-	-	(547)	7,731
Total	210,038	34,332	(11,136)	(12,962)	220,272

¹ Amounts after deducting the government grants(2013 : ₩14,478 million, 2012 : ₩6,864 million).

The amortization expense for the years ended December 31, 2013 and 2012, is as follows:

<i>(In millions of Korean won)</i>	2013	2012
Cost of sales	24,788	8,310
Development costs	1	1
Selling, general and administrative expenses	8,108	4,650
Total	32,897	12,961

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

Details of property, plant and equipment provided as collaterals as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013				
	Carrying amount	Secured amount	Related line item	Related amount	Secured party
Land	83,521	300,000	Borrowings (Note 13)	97,235	Korea Development Bank
Buildings	135,151	250,000			

(in millions of Korean won)

	2012				
	Carrying amount	Secured amount	Related line item	Related amount	Secured party
Land	83,521	300,000	Borrowings (Note 13)	140,786	Korea Development Bank
Buildings	142,489	250,000			

11. Other assets

Other assets as of December 31, 2013 and 2012, consist of the following:

(In millions of Korean won)

	2013	2012
Current assets		
Advanced payments	193,897	192,330
Prepaid expenses	7,001	5,448
Total	<u>200,898</u>	<u>197,778</u>

12. Trade payables and Other financial liabilities

Trade payables and other financial liabilities as of December 31, 2013 and 2012, consist of the following:

(In millions of Korean won)

	2013	2012
Current liabilities		
Trade payables	121,028	137,915
Other payables	7,085	22,081
Accrued expenses	70,044	54,654
Unpaid dividends	16	16
	<u>198,173</u>	<u>214,666</u>
Non-current liabilities		
Long-term other payables	16,630	17,756
Total	<u>214,803</u>	<u>232,422</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

13. Borrowings and Debentures payable

Short-term and long-term borrowings as of December 31, 2013 and 2012, consist of the following:

<i>(In millions of Korean won)</i>	2013	2012
Current liabilities		
Short-term borrowings	50,000	657
Current maturities of long-term borrowings	37,566	57,315
Less : Present value discount ¹	(1,387)	(1,850)
	<u>86,179</u>	<u>56,122</u>
Non-current liabilities		
Long-term borrowings	92,434	163,198
Less : Present value discount ¹	(1,469)	(2,065)
	<u>90,965</u>	<u>161,133</u>
Total	<u>177,144</u>	<u>217,255</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, 2013 and 2012, the Group's property, plant and equipment are pledged as collaterals for borrowings from Korea Development Bank for up to ₩550 billion (Note 10).

Debentures as of December 31, 2013 and 2012, consist of the following:

<i>(In millions of Korean won)</i>				2013	2012
<i>17th</i>	Issue date	Maturity date	Interest Rate(%)	Book value	Book value
(Unguaranteed, Public offering)	2011.10.10	2014.10.10	4.35	100,000	100,000

The debentures are classified into current debentures as of December 31, 2013.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

Book value and fair value of the long-term borrowings and debentures as of December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013		2012	
	Book value	Fair value¹	Book value	Fair value¹
Short-term borrowings	86,179	86,179	56,122	56,122
Long-term borrowings	90,965	87,023	161,133	159,005
Debentures	100,000	101,269	100,000	102,540
Total	<u>277,144</u>	<u>274,471</u>	<u>317,255</u>	<u>317,667</u>

¹ The fair value of long-term borrowings is calculated by discounting the nominal amount of cash outflows with the weighted average interest rate of 4.03% (2012: 3.48%).

14. Other liabilities

Other liabilities as of December 31, 2013 and 2012, consist of the following:

<i>(In millions of Korean won)</i>	2013	2012
Advances received	28,792	28,730
Unearned revenues	1,563	2,139
Withholdings	2,945	2,871
Deposits received	310	2,363
Total	<u>33,610</u>	<u>36,103</u>

15. Net defined benefit liabilities

Net defined benefit liabilities recognized on the statements of financial position as of December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Present value of funded defined benefit obligations	5,390	8,249
Present value of unfunded defined benefit obligations	170,641	151,760
Present value of retirement benefit obligation	176,031	160,009
Fair value of plan assets	(5,211)	(9,685)
	<u>170,820</u>	<u>150,324</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

Changes in the carrying amount of retirement benefit obligations for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Balance as of January 1	160,009	128,859
Current service cost	21,386	18,110
Interest expense	6,977	6,808
Remeasurements:		
Actuarial gains and losses arising from changes in demographic assumptions	503	(679)
Actuarial gains and losses arising from changes in financial assumptions	(7,943)	32,147
Actuarial gains and losses arising from experience adjustments	3,426	(13,866)
Payments from plans:		
Benefit payments	(8,327)	(11,370)
Balance as of December 31	<u>176,031</u>	<u>160,009</u>

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

<i>(in millions of Korean won)</i>	2013	2012
Balance as of January 1	9,685	6,979
Interest income	416	307
Remeasurements:		
Return on plan assets (excluding amounts included in interest income)	(224)	(33)
Contributions:		
Employers	926	2,438
Payments from plans:		
Benefit payments	(5,592)	(6)
Balance as of December 31	<u>5,211</u>	<u>9,685</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

The details of pension expense recognized in the statements of comprehensive income for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Current service cost	21,386	18,110
Interest expenses of retirement benefit obligations	6,977	6,807
Expected return on plan assets	(416)	(307)
Total	<u>27,947</u>	<u>24,610</u>
Cost of sales	24,455	21,167
Selling, general and administrative expenses	3,436	2,814
Development costs	56	629
Total	<u>27,947</u>	<u>24,610</u>

Details of accumulated actuarial loss recognized as other comprehensive income are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Balance as of January 1	42,341	28,973
Actuarial losses for the year	(2,873)	13,368
Balance as of December 31	<u>39,468</u>	<u>42,341</u>

The key assumptions used for retirement benefit obligation calculations as of December 31, 2013 and 2012, are as follows:

	2013	2012
Discount rate	4.81%	4.39%
Salary increase rate	5.5%	5.5%

Plan assets as of December 31, 2013 and 2012, consist of:

<i>(in millions of Korean won)</i>	2013		2012	
	<u>Quoted price</u>	<u>Composition</u>	<u>Quoted price</u>	<u>Composition</u>
Cash and cash equivalents	5,068	97.3%	9,541	98.5%
Others	143	2.7%	144	1.5%
	<u>5,211</u>	<u>100.0%</u>	<u>9,685</u>	<u>100.0%</u>

The sensitivity of the defined benefit obligations as of December 31, 2013, to changes in the principal assumptions is:

<i>(in millions 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	158,331	196,709	196,370	158,271
Ratio	90%	112%	112%	90%

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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' bondholdings.

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 2014, amounts to ₩ 563 million.

Weighted average maturities of defined benefit obligations as of December 31, 2013 and 2012, are as follows:

	<u>2013</u>	<u>2012</u>
Weighted average maturities	13.6 years	13.5 years

16. Provisions

The changes in provisions for the years ended December 31, 2013 and 2012, are as follows:

(In millions of Korean won)

	<u>2013</u>				<u>2012</u>			
	<u>January 1</u>	<u>Increase</u>	<u>Decrease</u>	<u>December 31</u>	<u>January 1</u>	<u>Increase</u>	<u>Decrease</u>	<u>December 31</u>
Loss on the construction contract ¹	1,795	7,312	3,646	5,461	-	1,795	-	1,795
Penalty for construction delays ²	7,816	13,016	14,507	6,325	-	7,816	-	7,816
Provision for construction warranty claims ³	1,702	2,869	-	4,571	910	792	-	1,702
Other provisions ⁴	-	11,844	-	11,844	-	-	-	-
	<u>11,313</u>	<u>35,041</u>	<u>18,153</u>	<u>28,201</u>	<u>910</u>	<u>10,403</u>	<u>-</u>	<u>11,313</u>

¹ Provision for loss on the construction contract is made when there is an expected loss on the construction contract. Provision for loss on the construction contract as of December 31, 2013 and 2012, arises from the Police Multipurpose Helicopter Project and others.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

² As of December 31, 2013 and 2012, 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 the pending lawsuits, the Group recognizes the best estimate as other provisions (Note 30).

The aforementioned provisions, excluding other provisions, 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.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

17. Commitments and Contingencies

(1) Major commitments with financial institutions as of December 31, 2013 and 2012, are as follows:

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

Description	Financial institutions	Limit amount	
		2013	2012
	Woori Bank	7,000	7,000
Bank Overdrafts	Korea Exchange Bank ²	10,000	10,000
	Shinhan Bank	10,000	10,000
	Citibank ¹	-	8,000
Note Discounting arrangement		20,000	20,000
B2B Note Issuing arrangement	Woori Bank	30,000	-
Short-term loan agreement		-	50,000
Foreign currency checks and notes purchase agreement	Citibank ¹	-	USD 2,000
Foreign currency L/C arrangement	Korea Development Bank	USD 5,000	USD 5,000
Foreign currency general loan agreement		USD 2,500	USD 2,500
General loan agreement		30,000	30,000
Other notes purchase agreement	Korea Exchange Bank ²	USD 6,000	USD 6,000
Other foreign currency payment guarantee agreement		USD 1,500	USD 1,500
Import L/C agreement		USD 40,000	USD 40,000
Integrated revolving limit agreement	The Export-Import Bank of Korea	USD 20,000	-
Import finance limit agreement		USD 40,000	-
Limit of short-term financial agreement	Meritz Securities Co., Ltd.	30,000	-

¹ Aggregate limit amount of the agreements with Citibank is ₩13,000 million.

² Aggregate limit amount of the agreements excluding other foreign currency payment guarantee agreement with Korea Exchange Bank is ₩50,000 million.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

(2) Details of payment guarantees provided by financial institutions as of December 31, 2013, are as follows:

<i>(in thousands of US dollars and Euros)</i>	Guaranteed by	Guaranteed amount	
		2013	2012
Export guarantee of KT-1 and T-50 to Indonesia	The Export-Import Bank of Korea	US\$50,893	US\$84,589
Export guarantee for KT-1 TEU, Refund guarantees for deposits received for KT-1 Peru, KT1-TEU off-set performance guarantees, and others	Korea Development Bank	US\$101,239	US\$ 127,372
KHP EC S/B LC guarantee and others	BNP Paribas and others	EUR54,794 -	EUR 54,794 US\$ 1,600
Performance guarantee of KT-1 to Indonesia and others	Korea Exchange Bank	US\$362	US\$2,456
Export guarantee for KT-1 TEU and C-130 and others	Shinhan Bank	US\$2,754	US\$1,592
Export guarantee of T-50 to Iraq and others	Korea Finance Corporation	US\$56,463	-

(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, 2013, 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 ₩460 billion (2012: ₩489 billion), ₩10.1 billion (2012: ₩11.3 billion), and ₩17.1 billion, respectively. Also, the Group was guaranteed by Export Guarantee Insurance Corporation for up to US\$38,555 thousand (2010: US\$65,462 thousand).

(5) The Group has payment guarantees provided by Korea Defense Industry Association of up to ₩1,587 billion (2012: ₩1,358 billion).

(6) As of December 31, 2013 and 2012, the Group has issued four blank promissory notes as collaterals for its borrowings and contract fulfillments.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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, 2013 and 2012, are as follows:

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

	Authorized Shares	Issued and outstanding Shares	Par value	Capital Stock
Common stock	200,000,000	97,475,107	₩ 5,000	₩ 487,376

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, in the way decided by special resolution at the shareholders' meeting or by the related law. The Company granted 10,000 shares to the formal CEO in 2011. However, as the granted stock options were terminated during the contractual service period, there are no shares granted as stock options as of December 31, 2013 (Note 20).

As of December 31, 2013, the shareholders of the Company are as follows:

(In number of shares)

	2013	
	Number of Shares	Ownership (%)
Korea Finance Corporation	25,745,964	26.4
Samsung Techwin Co., Ltd.	9,747,511	10.0
Hyundai Motors Co., Ltd.	9,747,511	10.0
DIP Holdings	4,873,754	5.0
Odin Holdings	4,873,757	5.0
Other shareholders	42,486,610	43.6
Total	<u>97,475,107</u>	<u>100.0</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

19. Retained Earnings

Retained earnings as of December 31, 2013 and 2012, consist of the following:

<i>(In millions of Korean won)</i>	<u>2013</u>	<u>2012</u>
Legal reserve ¹	6,328	4,378
Appropriated retained earnings for business expansion	169,100	-
Unappropriated retained earnings	165,115	262,704
Total	<u>340,543</u>	<u>267,082</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 reduced 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, 2013 and 2012. Details of year-end dividends are as follows:

	<u>2013</u>	<u>2012</u>
	<u>Common stock</u>	<u>Common stock</u>
Number of shares(total stock)	97,475,107	97,475,107
Number of shares(treasury stock)	-	-
Number of shares(eligible for dividends)	97,475,107	97,475,107
Dividend amount per share(In Korean won)	₩ 200	₩ 200
Dividend amount	₩ 19,495 million	₩ 19,495 million

20. Other components of equity

Other components of equity as of December 31, 2013 and 2012, consist of the following:

<i>(In millions of Korean won)</i>	<u>2013</u>	<u>2012</u>
Gain on valuation of available-for-sale financial assets	5,365	4,759
Gain on disposal of treasury stock	184	184
Stock compensation ¹	-	85
Gain on capital reduction	4,053	4,053
Loss on overseas operation translation	(109)	(54)
Total	<u>9,493</u>	<u>9,027</u>

¹ As of August 17, 2011, 10,000 shares were granted with an exercise price of ₩27,279. The vesting period is two years and exercise period is eight years after the end of the vesting period.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

The Company calculates compensation costs on the stock options granted up until the prior year using fair value approach method. The costs are allocated over the contractual service period and recognized as expenses and other components of equity. As of December 31, 2012, the Company recognized accumulated amount of ₩85,421 thousand including the recognized amount of ₩60,279 thousand in 2012. However, the amount was reversed in 2013 due to its termination during 2013.

21. Earnings per Share

Weighted-average number of common stock for the year ended December 31, 2013, 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, 2013	97,475,107	97,475,107	365	35,578,414,055

Number of shares outstanding for the year ended December 31, 2013 : $35,578,414,055 \div 365 = 97,475,107$

Weighted-average number of common stock for the year ended December 31, 2012, 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, 2012	97,475,107	97,475,107	366	35,675,889,162

Number of shares outstanding for the year ended December 31, 2012 : $35,675,889,162 \div 366 = 97,475,107$

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

<i>(In millions of Korean won)</i>	<u>2013</u>	<u>2012</u>
Net income	90,083	74,105
Weighted-average number of common stock	97,475,107	97,475,107
Basic earnings per share (in Korean won)	<u>924</u>	<u>760</u>

For the year ended December 31, 2013, the diluted earnings per share equals basic earnings per share as the Group does not issue dilutive potential ordinary shares. For the year ended December 31, 2012, as 10,000 shares in stock options did not have dilution effects, basic earnings per share was identical to diluted earnings per share.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

22. Sales

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

<i>(In millions of Korean won)</i>	2013	2012
Sales	2,016,339	1,534,606
Sales of goods	626,577	544,979
Construction contract revenue	1,389,762	989,627
Interest income	5,924	3,279
Total	<u>2,022,263</u>	<u>1,537,885</u>

Backlog balance as of December 31, 2013 and 2012, is as follows:

<i>(In millions of Korean won)</i>	Total contract balance as of January 1	Increase and decrease	Recognition of construction	Backlog balance as of December 31
2013	1,429,827	4,520,125	1,389,762	4,560,190
2012	1,422,557	996,897	989,627	1,429,827

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 and construction profit on the ongoing projects as of December 31, 2013 and 2012, consist of the following:

<i>(In millions of Korean won)</i>	2013	2012
Accumulated revenue recognized	2,009,806	2,911,890
Cost of construction	1,715,951	2,488,863
Construction profit	<u>293,855</u>	<u>423,027</u>

The gross amounts due from and due to customers for contract work as of December 31, 2013 and 2012, are as of the follows:

<i>(In millions of Korean won)</i>	2013	2012
The gross amount due from customers for contract work	247,207	142,128
The gross amount due to customers for contract work	(284,918)	(265,847)

As of December 31, 2013 and 2012, advanced payments related to projects that are included in due to customers for contract work and other liabilities are amounts to ₩298,798 million and ₩280,107 million.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

23. Expenses by Nature

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

<i>(In millions of Korean won)</i>	<u>2013</u>	<u>2012</u>
Changes in inventories	(9,613)	(63,427)
Purchase of raw and other materials	1,025,051	708,440
Wages and salaries	281,832	235,094
Depreciation and amortization	78,803	53,807
Commission expenses	46,666	27,396
Royalty and development expenses	90,448	125,107
Outside processing expenses	227,302	172,987
Welfare expenses	50,403	48,370
Travel expenses	13,784	15,311
Others	87,097	85,736
Total	<u>1,891,773</u>	<u>1,408,821</u>

24. Selling, general and administrative expenses

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

<i>(In millions of Korean won)</i>	<u>2013</u>	<u>2012</u>
Wages and salaries	31,459	25,356
Severance and retirement benefits	3,436	2,814
Welfare expense	6,711	5,984
Travel expenses	3,291	3,447
Taxes and dues	1,353	970
Entertainment	816	528
Vehicles maintenance	501	517
Depreciation	1,321	787
Commission	8,716	4,281
Amortization	8,108	4,650
Rental expense	1,556	1,691
Advertising expense	3,906	11,899
Sales commission	6,484	10,205
Transportation expense	8,735	4,586
Development expense	13,555	8,719
Reversal of allowance for bad debts	-	(66)
Others	17,977	11,839
Total	<u>117,925</u>	<u>98,207</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

25. Other income and expenses

Other income and expenses for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Other income		
Commission income	32	16
Rental income	174	948
Gain on disposal of property, plant and equipment	503	192
Others	5,958	7,828
Total	<u>6,667</u>	<u>8,984</u>

<i>(In millions of Korean won)</i>	2013	2012
Other expenses		
Donations	1,103	1,424
Loss from disposal of property, plant and equipment	6	1
Loss from disposal of intangible assets	-	3
Impairment losses on intangible assets	10,571	11,005
Other provisions	11,844	-
Others	5,116	4,316
Total	<u>28,640</u>	<u>16,749</u>

26. Finance income and expenses

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

<i>(In millions of Korean won)</i>	2013	2012
Finance income		
Interest income	5,924	3,279
Gain on foreign currency transactions	29,394	24,308
Gain on foreign exchange translation	218	1,752
Total	<u>35,536</u>	<u>29,339</u>

<i>(In millions of Korean won)</i>	2013	2012
Other finance expenses		
Interest expense	12,917	19,306
Loss on foreign currency transactions	21,978	30,640
Loss on foreign exchange translation	10,538	4,707
Total	<u>45,433</u>	<u>54,653</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

27. Income Tax

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

<i>(In millions of Korean won)</i>	2013	2012
Current taxes	19,965	7,748
Deferred income tax due to temporary difference	(28,595)	5,684
Tax charged directly to equity	(1,111)	4,023
Reversal due to claim for rectification	(32,835)	-
Additional tax payment due to tax investigation	44,428	-
Income tax expense	<u>1,852</u>	<u>17,455</u>

Deferred tax assets and liabilities charged or credited directly to equity for the years ended December 31, 2013 and 2012, consist of the following:

<i>(In millions of Korean won)</i>	2013		
	Beginning Balance	Increase (Decrease)	Ending Balance
Gains on valuation of available-for-sale financial assets	(1,489)	(194)	(1,683)
Actuarial gains(losses)	8,443	(917)	7,526
Total	<u>6,954</u>	<u>(1,111)</u>	<u>5,843</u>

<i>(In millions of Korean won)</i>	2012		
	Beginning Balance	Increase (Decrease)	Ending Balance
Gains on valuation of available-for-sale financial assets	(1,303)	(186)	(1,489)
Actuarial gains(losses)	4,234	4,209	8,443
Total	<u>2,931</u>	<u>4,023</u>	<u>6,954</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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 millions of Korean won)</i>	<u>2013</u>	<u>2012</u>
Profit before income tax	92,234	91,484
Income tax based on statutory rate	21,731	21,674
Adjustment		
Non-taxable income/Non-deductible expense	734	192
Tax credit	(5,524)	(3,184)
Reversal due to claim for rectification	(32,835)	-
Additional tax payment due to tax investigation	44,428	-
Changes in deferred tax assets due to tax investigation	(27,086)	-
Other	404	(1,227)
Income tax expense	<u>1,852</u>	<u>17,455</u>
Effective tax rate	<u>2.0%</u>	<u>19.1%</u>

Deferred income tax assets and liabilities from the tax effects of temporary differences as of December 31, 2013 and 2012, are as follows:

<i>(In millions of Korea won)</i>	<u>2013</u>					
	<u>Temporary Differences</u>			<u>Deferred Income Tax Asset (Liabilities)</u>		
	<u>Beginning Balance</u>	<u>Increase (Decrease)</u>	<u>Ending Balance</u>	<u>Beginning Balance</u>	<u>Increase (Decrease)</u>	<u>Ending Balance</u>
Deferred tax arising from temporary differences (1)						
Deposits for severance benefits	(9,541)	4,473	(5,068)	(2,274)	1,048	(1,226)
Reserve for R&D	-	(30,000)	(30,000)	-	(7,260)	(7,260)
Accrued severance benefits	105,316	18,564	123,880	25,100	4,879	29,979
Impairment loss on intangible assets	38,921	11,305	50,226	9,276	2,879	12,155
Government grants	24,327	60,364	84,691	5,798	14,799	20,597
Accrued liability	17,328	4,154	21,482	4,130	1,069	5,199
Depreciation	518	33,553	34,071	124	8,121	8,245
Provisions	11,320	16,881	28,201	2,698	4,127	6,825
Others	13,895	(43)	13,852	3,312	40	3,351
	<u>202,084</u>	<u>119,251</u>	<u>321,335</u>	<u>48,164</u>	<u>29,701</u>	<u>77,865</u>
Items charged directly to equity (2)						
Gain on valuation of long-term available-for-sale financial assets	(6,247)	(800)	(7,047)	(1,489)	(194)	(1,683)
Actuarial losses	35,424	(3,790)	31,634	8,443	(917)	7,526
	<u>29,177</u>	<u>(4,590)</u>	<u>24,587</u>	<u>6,954</u>	<u>(1,111)</u>	<u>5,843</u>
Unrealizable temporary differences (3)						
Investment in the associate	(1,292)	-	(1,292)	(308)	(5)	(313)
Total (1+2-3)	<u>232,553</u>	<u>114,661</u>	<u>347,214</u>	<u>55,426</u>	<u>28,595</u>	<u>84,021</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

2012

<i>(In millions of Korea won)</i>	Temporary Differences			Deferred Income Tax Asset (Liabilities)		
	Beginning Balance	Increase (Decrease)	Ending Balance	Beginning Balance	Increase (Decrease)	Ending Balance
Deferred tax arising from temporary differences (1)						
Deposits for severance benefits	(6,829)	(2,712)	(9,541)	(1,625)	(649)	(2,274)
Accrued severance benefits	90,735	14,581	105,316	21,597	3,503	25,100
Impairment loss on intangible assets	24,052	14,870	38,922	5,725	3,551	9,276
Government grants	16,383	7,943	24,326	3,900	1,898	5,798
Accrued liability	16,444	884	17,328	3,914	216	4,130
Depreciation	4	514	518	1	123	124
Provisions	89,032	(77,712)	11,320	21,192	(18,494)	2,698
Others	13,308	586	13,894	3,169	143	3,312
	<u>243,129</u>	<u>(41,046)</u>	<u>202,083</u>	<u>57,873</u>	<u>(9,709)</u>	<u>48,164</u>
Items charged directly to equity (2)						
Gain on valuation of long-term available-for-sale financial assets	(5,476)	(770)	(6,246)	(1,303)	(185)	(1,488)
Actuarial losses	17,789	17,635	35,424	4,234	4,209	8,443
	<u>12,313</u>	<u>16,865</u>	<u>29,178</u>	<u>2,931</u>	<u>4,024</u>	<u>6,955</u>
Unrealizable temporary differences (3)						
Investment in the associate	(1,292)	-	(1,292)	(307)	-	(307)
Total (1+2-3)	<u>256,734</u>	<u>(24,181)</u>	<u>232,553</u>	<u>61,111</u>	<u>(5,685)</u>	<u>55,426</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.

Details of deductible (taxable) temporary differences which are not recognized as deferred assets (liabilities) as of December 31, 2013, are as follows:

<i>(In millions of Korean won)</i>	2013	2012	Reason
Interests in subsidiaries	(337)	515	Undistributed profits is expected to be permanently reinvested.
Interests in subsidiaries	55	45	No plan to sell

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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

<i>(In millions of Korean won)</i>	<u>2013</u>	<u>2012</u>
Deferred tax assets		
Within 12 months	66,329	47,779
More than 12 months	26,196	11,751
	<u>92,525</u>	<u>59,530</u>
Deferred tax liabilities		
Within 12 months	(8,499)	(3,764)
More than 12 months	(5)	(340)
	<u>(8,504)</u>	<u>(4,104)</u>
Deferred tax assets(liabilities), net	<u>84,021</u>	<u>55,426</u>

28. Cash Generated from Operations

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

<i>(In millions of Korean won)</i>	<u>2013</u>	<u>2012</u>
Adjustments for:		
Interest expenses	12,917	19,306
Loss on foreign exchange translation	10,538	4,707
Loss on disposal of property, plant and equipment	6	1
Loss on intangible assets	-	3
Depreciation expense	45,906	40,845
Amortization expense	32,897	12,961
Impairment losses on intangible assets	10,571	11,005
Severance and retirement benefits	27,947	24,610
Share-based compensation	(85)	60
Loss on valuation of equity method investment	589	1,222
Gain on valuation of equity method investment	(128)	-
Interest income	(5,924)	(3,279)
Gain on foreign exchange translation	(218)	(1,752)
Gain on disposal of property, plant and equipment	(503)	(192)
Provision for construction delay	13,016	7,816
Provision for construction loss	3,665	1,795
Provision for construction warranty claims	2,869	792
Provisions for others	11,844	(66)
Tax expense	1,852	17,455
Total	<u>167,759</u>	<u>137,289</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

Changes in assets and liabilities:		
Decrease(Increase) in trade receivables	124,970	(151,798)
Decrease(Increase) in the gross amount due from customers for construction work	(127,775)	371,544
Increase in other financial assets	(25,423)	(11,395)
Increase in other assets	(3,118)	(103,905)
Increase in inventories	(9,613)	(63,427)
Increase(Decrease) in trade payables	(17,058)	5,800
Increase in the gross amount due to customers for contract work	19,071	247,179
Increase in other financial liabilities	3,007	16,338
Decrease in other liabilities	(2,042)	(8,533)
Employee benefits paid	(8,327)	(11,370)
Decrease(Increase) in retirement pension assets	4,666	(2,432)
Total	<u>(41,642)</u>	<u>288,001</u>

Significant transactions not affecting cash flows for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	<u>2013</u>	<u>2012</u>
Gain on valuation of available-for-sale financial assets	800	771
Income tax effect of gain on valuation of available-for-sale financial assets	194	185
Remeasurement of net defined benefit liabilities	3,790	17,635
Income tax effect of remeasurement of net defined benefit liabilities	917	4,209
Current portion of long-term borrowings	87,566	59,476
Current portion of debentures	100,000	-
Transfer of government grants to intangible assets	14,478	6,864
Transfer of construction in progress to property, plant and equipment	9,726	9,656
Transfer of machinery in transit	5,425	2,357
Increase in other accounts payable due to acquisition of property, plant and equipment in 2012	-	3,597
Decrease in other accounts payable due to acquisition of property, plant and equipment in 2012	3,597	-

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

29. Related party transactions

Related parties of the Group as of December 31, 2013 and 2012, are as follows:

Description	Related Party	Relation
The entity which has significant influence	Korea Finance Corporation	Largest shareholder
Joint venture	KAI-EC	Investee
Associate	S&K Aerospace Co., Ltd.	Investee
Other	Korea Development Bank	Subsidiary of Korea Finance Corporation

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

(In millions of Korean won)

	Count party	2013			
		Sales	Interest income	Purchases	Interest expense
The entity which has significant influence	Korea Finance Corporation	-	-	-	1,128
Associate	S&K Aerospace Co., Ltd.	367	-	16,803	-
Other	Korea Development Bank	-	826	-	6,949

(In millions of Korean won)

	Count party	2012			
		Sales	Interest income	Purchases	Interest expense
The entity which has significant influence	Korea Finance Corporation	-	-	-	210
Associate	S&K Aerospace Co., Ltd.	182	-	12,055	-
Other	Korea Development Bank	-	21	-	10,175

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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

<i>(In millions of Korean won)</i>		2013					
		Short-term financial instruments	Other receivables	Borrowings	Debentures	Trade payables	Interest payables
The entity which has significant influence	Korea Finance Corporation	-	-	30,000	-	-	210
Associates	S&K Aerospace Co., Ltd.	-	201	-	-	852	-
Other related parties	Korea Development Bank	76,095	4	97,235	50,000	-	1,139

<i>(In millions of Korean won)</i>		2012					
		Short-term financial instruments	Other receivables	Borrowings	Debentures	Trade payables	Interest payables
The entity which has significant influence	Korea Finance Corporation	-	-	30,000	-	-	210
Associates	S&K Aerospace Co., Ltd.	-	57	-	-	962	-
Other related parties	Korea Development Bank	55,133	22	140,786	50,000	-	1,288

Key management includes directors, members of the Executive Committee. The compensation paid or payable to key management for employee services is as follows:

<i>(In millions of Korean won)</i>	2013	2012
Salaries	1,077	912
Severance and retirement benefits	563	275
Share-based compensation	(85)	60
Total	<u>1,555</u>	<u>1,247</u>

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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

		2013	
		Borrowings	Repayment
The entity which has significant influence	Korea Finance Corporation	-	-
Other related parties	Korea Development Bank	-	43,551
		2012	
		Borrowings	Repayment
The entity which has significant influence	Korea Finance Corporation	30,000	-
Other related parties	Korea Development Bank	-	87,435

Details of payment guarantees and collaterals provided by the related parties as of December 31, 2013, are as follows(Note 17):

<i>(In thousands of US dollars)</i>	Guaranteed by	Guaranteed amount	
		2013	2012
Export guarantee for KT-1 TEU, refund guarantees for deposits received for KT-1 Peru, KT1-TEU off-set performance guarantees, and others	Korea Development Bank	US\$106,239	US\$127,372
Export guarantee of T-50 to Iraq and others	Korea Finance Corporation	US\$56,463	-

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 January 27, 2014, the 9th Arbitration Appeal Court of Moscow, Russia, ordered the Company and Doosan Infracore to pay US\$49,747,048 in the second trial. As the Company management believed that there was an error in the actual fact and the judicial decision of the verdict in the first trial, they filed an appeal on November 22, 2013. However, the court returned the aforementioned verdict against the Company. The Company decided to appeal against the ruling of the second trial and is in preparation for the trial. The ultimate outcome of the legal action cannot be determined as of report date and the Company recognized provisions for this lawsuit.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

(2) The Company is a defendant in a lawsuit amounting to ₩10 billion filed by Satrec Initiative Co., Ltd. on December 22, 2011, in relation to the KOMPSAT-3A BUS development bidding. As of report date, the case is still pending and the final resolution cannot yet be determined.

(3) A portion of the KHP project costs incurred as a result of changing the design was not qualified for reimbursement by the Defence Acquisition Program Administration. The Company filed a suit 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 14, 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.

(4) 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 Defence Acquisition Program Administration. The Company filed a suit 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 defendant appealed on January 14, 2014, the second trial is in progress, and the outcome of the lawsuit cannot be predicted as of the report date.

(5) Other than the litigation mentioned above, as of December 31, 2013, the Company is a plaintiff in two lawsuits amounting to approximately ₩200 million, and the Company is a defendant in two lawsuits amounting to approximately ₩300 million. The Company's management estimated that the results of this litigation will have no material effect on the Group'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.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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, 2013 and 2012, is as follows:

(In thousands of foreign currencies)

	December 31, 2013				December 31, 2012			
	USD	EUR	GBP	JPY	USD	EUR	GBP	JPY
Cash and cash equivalents	19,424	-	-	-	94,045	-	-	-
Short-term financial instruments	-	-	-	-	-	-	-	-
Trade receivables	82,644	-	-	-	68,257	-	-	-
Due from customers for contract work	78,834	-	-	-	53,919	-	-	-
Other short-term financial assets	4,050	-	-	-	2,875	-	-	-
Other long-term financial assets	5,715	-	-	-	8,520	-	-	-
Trade payables	26,136	8,192	705	22	36,897	2,481	333	-

As of December 31, 2013 and 2012, 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:

(In millions of Korean won)

	2013		2012	
	5% Increase	5% Decrease	5% Increase	5% Decrease
Financial assets	10,061	(10,061)	12,190	(12,190)
Financial liabilities	(2,038)	2,038	(2,180)	2,180
Net effect	8,023	(8,023)	10,010	(10,010)

(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 also 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.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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

(In millions of Korean won)

	2013		2012	
	0.1% Increase	0.1% Decrease	0.1% Increase	0.1% Decrease
Interest expense	99	(99)	196	(196)

(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.

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

(In millions of Korean won)

Financial assets	December 31, 2013	December 31, 2012
Cash and cash equivalents ¹	137,466	223,370
Short -term financial instruments	53,043	14,467
Available-for-sale financial assets	404	416
Trade receivables	94,960	226,911
Due from customs for construction work	247,207	142,128
Other financial assets	59,209	31,182
Total	592,289	638,474

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

(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.

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

The following table shows details of non-derivative financial liabilities classified in accordance with remaining maturities as of December 31, 2013 and 2012, the presented cash flows are the amount of principles and interests that are not discounted into present value.

December 31, 2013				
<i>(In millions of Korean won)</i>	Within 1 year	1-5 Years	Over 5 years	Total
Trade payables	121,028	-	-	121,028
Other financial liabilities	77,145	8,730	13,520	99,395
Borrowings	90,484	86,479	11,831	188,794
Debentures payable	104,350	-	-	104,350
Total	<u>393,007</u>	<u>95,209</u>	<u>25,351</u>	<u>513,567</u>

December 31, 2012				
<i>(In millions of Korean won)</i>	Within 1 year	1-5 Years	Over 5 years	Total
Trade payables	137,915	-	-	137,915
Other financial liabilities	76,751	4,596	19,573	100,920
Borrowings	64,927	158,649	14,201	237,777
Debentures payable	4,350	104,350	-	108,700
Total	<u>283,943</u>	<u>267,595</u>	<u>33,774</u>	<u>585,312</u>

(4) Capital risk management

The object of capital management is maintaining 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, 2013 and 2012, are as follows:

(In millions of Korean won)

	<u>2013</u>	<u>2012</u>
Total debts (A)	1,014,508	1,005,185
Total equity (B)	961,563	887,337
Debt-to-equity ratio (A/B)	105.51%	113.28%

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

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, 2013 and 2012:

<i>(In millions of Korean won)</i>	2013				
	Government defense business and aircraft export business	Airframe part business	Other	Intercompany transactions	Total
Sales	1,345,217	671,092	3,584	(3,554)	2,016,339
Gross profit	109,396	130,219	2,894	(19)	242,490

<i>(In millions of Korean won)</i>	2012				
	Government defense business and aircraft export business	Airframe part business	Other	Intercompany transactions	Total
Sales	1,023,489	511,056	2,002	(1,941)	1,534,606
Gross profit	133,683	88,307	2,002	-	223,992

(c) Information about geographic areas

Sales by geographic areas for the years ended December 31, 2013 and 2012, are as follows :

<i>(In millions of Korean won)</i>	2013	2012
Domestic	1,139,250	762,894
Asia	333,205	374,892
Europe	165,430	110,991
North America	320,921	285,829
South America	57,533	-
Total	2,016,339	1,534,606

Korea Aerospace Industries, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2013 and 2012

The sales to major customers whose amounts exceed 10% for the years ended December 31, 2013 and 2012, are as follows :

<i>(In millions of Korean won)</i>	2013	2012
Defence Acquisition Program Administration and other government authorities	1,116,525	732,601
The Boeing Company	293,573	242,303
Total	<u>1,410,098</u>	<u>974,904</u>