

Korea National Oil Corporation

Financial statements

Years ended December 31, 2008 and 2007

with

Independent auditors' report

Korea National Oil Corporation
December 31, 2008 and 2007

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Independent auditors' report

The Board of Directors and Owner
Korea National Oil Corporation

We have audited the accompanying balance sheets of Korea National Oil Corporation (the "Company") as of December 31, 2008 and 2007, and the related statements of income, appropriations of retained earnings, changes in equity and cash flows for the years then ended, all expressed in Korean won. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above expressed in Korean won present fairly, in all material respects, the financial position of Korea National Oil Corporation as of December 31, 2008 and 2007, and the results of its operations, its changes in retained earnings and equity and its cash flows for the years then ended in conformity with accounting principles for government-controlled corporations, as established by the Ministry of Strategy and Finance (previously called Ministry of Finance and Economy) of the Republic of Korea.

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

(1) Change in accounting policy

As discussed in Note 2 to the financial statements, due to the change in accounting principles for government-controlled corporations, the Company changed its depreciation method for oil production wells and related property, plant and equipment from the unit-of-production method based on total proven reserves to the unit-of-production method based on residual proven reserves and applied retrospectively the effect of the change in accounting policy, resulting in an increase in depreciation and amortization by ₩7,979 million and ₩18,838 million for the financial years ended December 31, 2008 and 2007, respectively.

(2) Prior period error corrections

As discussed in Note 2 to the financial statements, the Company found an error regarding the classification of investments in oil fields and accounted for the effect of the error correction retrospectively in 2008. Further, as a result of an audit by the Board of Audit and Inspection of the Korean government in 2008, the Company was ordered to return the administration grants for stockpiling oil to the Korean government, which had been received from 2003 to 2008 and had been accounted for as sales in the respective periods. Accordingly, the Company reflected the effect of the error correction retrospectively by reversing the sales previously recognized in the corresponding periods.



The Board of Directors and Owner
Korea National Oil Corporation

As a result of the effects of the change in accounting policy and prior period error corrections above, the comparative 2007 financial statements were restated, resulting in decreases in net income by ₩39,956 million for the year ended December 31, 2007 and in retained earnings by ₩40,744 million as of January 1, 2007.

Accounting principles and auditing standards and their application in practice vary among countries. The accompanying financial statements are prepared in accordance with accounting principles for government-controlled corporations and are not intended to present the financial position, results of operations, changes in retained earnings and equity and cash flows in accordance with accounting principles and practices generally accepted in countries other than the Republic of Korea. In addition, the procedures and practices utilized in the Republic of Korea to audit such financial statements may differ from those generally accepted and applied in other countries. Accordingly, this report and the accompanying financial statements are for use by those who are knowledgeable about accounting principles for government-controlled corporations and Korean accounting principles and auditing standards and their application in practice.

A large, stylized handwritten signature in black ink that reads 'Ernst & Young Han Young'.

February 21, 2009

This audit report is effective as of February 21, 2009, the auditors' report date. Accordingly, certain material subsequent events or circumstances may have occurred during the period from the auditors' report date to the time this audit report is used. Such events and circumstances could significantly affect the accompanying financial statements and may result in modifications to this report.

Korea National Oil Corporation
Balance sheets
As of December 31, 2008 and 2007

Assets	Korean won in millions		US dollars in thousands (Note 2)	
	2008	(As restated) 2007	2008	(As restated) 2007
Current assets:				
Cash and cash equivalents (Note 15)	₩ 1,696,119	₩ 606,533	\$ 1,348,803	\$ 482,333
Short-term financial instruments	150,100	486,607	119,364	386,964
Trade accounts receivable, less allowance for doubtful accounts of ₩14,521 million in 2008 and nil in 2007 (Notes 15 and 16)	164,010	183,947	130,425	146,280
Short-term loans, net (Notes 7, 15 and 16)	264,184	223,500	210,087	177,733
Other accounts receivable (Note 15)	100,335	55,232	79,790	43,922
Inventories (Notes 3 and 8)	2,512,668	1,887,882	1,998,146	1,501,298
Derivative assets (Note 19)	184,761	-	146,927	-
Deferred income tax assets (Note 26)	33,966	-	27,011	-
Other current assets (Notes 4 and 15)	76,707	95,633	60,999	76,050
Total current assets	5,182,850	3,539,334	4,121,552	2,814,580
Non-current assets:				
Available-for-sale securities (Note 5)	45,022	57,736	35,803	45,913
Equity method investments (Notes 6 and 7)	15,885	11,458	12,632	9,112
Long-term loans, less allowance for doubtful accounts of ₩14,080 million in 2008 and ₩6,117 million in 2007 (Notes 15 and 16)	2,211,631	2,019,802	1,758,753	1,606,204
Long-term trade accounts receivable, less present value discount of ₩10,379 million in 2008 and ₩9,589 million in 2007 (Note 16)	51,089	52,088	40,628	41,421
Loans to affiliates, less allowance for doubtful accounts of ₩103,566 million in 2008 and nil in 2007 (Note 7)	321,099	237,086	255,347	188,538
Long-term guarantee deposits	3,878	4,149	3,084	3,299
Deferred income tax assets (Note 26)	-	18,240	-	14,505
Property, plant and equipment, net (Note 8)	1,966,276	1,917,071	1,563,639	1,524,510
Intangible assets, net (Notes 9 and 18)	3,189,608	1,533,137	2,536,468	1,219,194
Other non-current assets (Notes 7 and 10)	34,723	13,094	27,611	10,413
Total non-current assets	7,839,211	5,863,861	6,233,965	4,663,109
Total assets	₩ 13,022,061	₩ 9,403,195	\$ 10,355,517	\$ 7,477,689

(Continued)
See accompanying notes.

Korea National Oil Corporation
Balance sheets (cont'd)
As of December 31, 2008 and 2007

	Korean won in millions		US dollars in thousands (Note 2)	
	(As restated)		(As restated)	
	2008	2007	2008	2007
Liabilities and owner's equity				
Current liabilities:				
Trade accounts payable (Note 16)	₩ 18,524	₩ 18,367	\$ 14,730	\$ 14,606
Short-term borrowings (Notes 11 and 15)	565,875	-	450,000	-
Other accounts payable (Note 15)	470,928	221,154	374,496	175,868
Withholdings	11,378	5,412	9,048	4,304
Accrued expenses	3,218	11,172	2,559	8,885
Income taxes payable	1	-	1	-
Current portion of long-term borrowings and ABS liabilities (Notes 12, 13 and 15)	662,163	323,967	526,571	257,628
Deferred income tax liabilities (Note 26)	-	2,884	-	2,293
Derivative liabilities (Note 19)	119,481	-	95,015	-
Other current liabilities	92,041	77,643	73,194	61,744
Total current liabilities	1,943,609	660,599	1,545,614	525,328
Non-current liabilities:				
Long-term borrowings denominated in Korean won (Note 12)	1,109,221	1,292,702	882,084	1,027,994
Long-term borrowings denominated in foreign currencies, less present value discount of ₩391 million in 2008 and ₩535 million in 2007 (Notes 12, 15 and 16)	1,978,330	1,408,319	1,573,224	1,119,936
Long-term trade accounts payable, less present value discount of ₩8,495 million in 2008 and ₩7,730 million in 2007 (Note 16)	46,519	47,102	36,994	37,457
Asset-backed securitization ("ABS") liabilities (Note 13)	50,454	94,067	40,123	74,804
Severance and retirement benefits, net (Note 14)	10,201	15,573	8,112	12,384
Provision for restoration costs (Note 17)	186,870	116,367	148,604	92,538
Deferred income tax liabilities (Note 26)	116,955	-	93,006	-
Other long-term liabilities	63,753	48,253	50,699	38,371
Total non-current liabilities	3,562,303	3,022,383	2,832,846	2,403,484
Total liabilities	5,505,912	3,682,982	4,378,460	2,928,812
Commitments and contingencies (Notes 18 and 19)				
Owner's equity:				
Paid-in capital (Notes 20 and 24)	5,914,815	4,684,913	4,703,630	3,725,577
Capital surplus	24,954	24,954	19,844	19,844
Accumulated other comprehensive income (loss) (Notes 22 and 23)	382,398	(6,399)	304,094	(5,089)
Retained earnings (Note 21):				
Appropriated	1,074,489	890,749	854,465	708,349
Unappropriated	119,493	125,996	95,024	100,196
	1,193,982	1,016,745	949,489	808,545
Total owner's equity	7,516,149	5,720,213	5,977,057	4,548,877
Total liabilities and owner's equity	₩ 13,022,061	₩ 9,403,195	\$ 10,355,517	\$ 7,477,689

See accompanying notes.

Korea National Oil Corporation
Statements of income
Years ended December 31, 2008 and 2007

	Korean won in millions		US dollars in thousands (Note 2)	
	2008	(As restated) 2007	2008	(As restated) 2007
Sales (Note 30)	₩ 1,747,480	₩ 1,069,335	\$ 1,389,646	\$ 850,366
Cost of sales (Notes 27 and 29)	1,065,778	674,999	847,537	536,779
Gross profit	681,702	394,336	542,109	313,587
Selling and administrative expenses (Notes 25, 27 and 29)	78,575	65,186	62,485	51,838
Operating income	603,127	329,150	479,624	261,749
Other income (expenses):				
Interest income	59,232	34,341	47,103	27,309
Interest expense	(32,630)	(14,626)	(25,948)	(11,631)
Interest expense on ABS	(36,967)	(9,578)	(29,397)	(7,617)
Equity in earnings of equity method investments (Note 6)	2,012	260	1,600	207
Gain (loss) on foreign currency translation, net	(139,386)	6,585	(110,844)	5,237
Gain on foreign currency transactions, net	837	805	666	640
Gain on disposal of intangible assets, net	26,532	-	21,099	-
Gain (loss) on disposal of property, plant and equipment, net	130	(46)	104	(36)
Gain from liabilities exempted (Note 16)	3,021	2,812	2,403	2,236
Other bad debt expense (Notes 7 and 16)	(130,319)	(3,404)	(103,634)	(2,707)
Donations (Note 29)	(536)	(511)	(426)	(406)
Impairment loss on oil interests (Note 2)	(5,697)	(4,536)	(4,531)	(3,607)
Gain on valuation of firm commitments, net (Note 19)	113,380	26,712	90,163	21,242
Loss on transactions of derivative instruments, net	(592)	(41,067)	(471)	(32,657)
Loss on valuation of derivative instruments, net (Note 19)	(113,380)	-	(90,163)	-
Dues on income from oil fields	(14,291)	(11,926)	(11,365)	(9,484)
Provision for restoration costs (Note 17)	(7,995)	(3,908)	(6,358)	(3,108)
Non-operating income (expenses) from overseas oil fields, net (Note 17)	28,831	(465)	22,927	(369)
Others, net	16,249	873	12,921	693
	(231,569)	(17,679)	(184,151)	(14,058)
Income before income taxes	371,558	311,471	295,473	247,691
Provision for income taxes (Note 26)	171,365	144,731	136,274	115,094
Net income	₩ 200,193	₩ 166,740	\$ 159,199	\$ 132,597

See accompanying notes.

Korea National Oil Corporation
Statements of appropriations of retained earnings
Years ended December 31, 2008 and 2007

	Korean won in millions		US dollars in thousands (Note 2)	
	2008	(As restated) 2007	2008	(As restated) 2007
Unappropriated retained earnings before appropriations:				
Unappropriated retained earnings (undisposed accumulated deficit) carried forward from the prior year	₩ (80,700)	₩ -	\$ (64,175)	\$ -
Cumulative effect of change in accounting policy (Note 2)	-	3,470	-	2,759
Correction of prior period errors	-	(44,214)	-	(35,160)
Net income	200,193	166,740	159,199	132,597
	<u>119,493</u>	<u>125,996</u>	<u>95,024</u>	<u>100,196</u>
Appropriations (2008-proposed):				
Legal reserve (Note 21)	47,178	91,870	37,517	73,058
Reserve for business expansion (Note 21)	47,177	91,870	37,517	73,058
Cash dividends (Note 24)	25,138	22,956	19,990	18,255
	<u>119,493</u>	<u>206,696</u>	<u>95,024</u>	<u>164,371</u>
Unappropriated retained earnings (undisposed accumulated deficit) to be carried forward to the next year	<u>₩ -</u>	<u>₩ (80,700)</u>	<u>\$ -</u>	<u>\$ (64,175)</u>

See accompanying notes.

Korea National Oil Corporation
Statements of changes in equity
Years ended December 31, 2008 and 2007

	Korean won in millions				
	Paid-in capital	Capital surplus	Accumulated other comprehensive income (loss)	Retained earnings	Total
January 1, 2007 (as previously reported)	₩ 3,964,542	₩ 24,954	₩ (9,717)	₩ 909,382	₩ 4,889,161
Cumulative effect of change in accounting policy	-	-	-	3,470	3,470
Correction of prior period errors	-	-	-	(44,214)	(44,214)
January 1, 2007 (as restated)	3,964,542	24,954	(9,717)	868,638	4,848,417
Dividends	-	-	-	(18,633)	(18,633)
Addition to paid-in capital	720,371	-	-	-	720,371
Net income for the year	-	-	-	166,740	166,740
Exchange differences on translation of foreign operations	-	-	1,899	-	1,899
Gain on valuation of available-for-sale securities	-	-	1,187	-	1,187
Capital adjustment arising from equity method investments	-	-	232	-	232
December 31, 2007 (as restated)	₩ 4,684,913	₩ 24,954	₩ (6,399)	₩ 1,016,745	₩ 5,720,213
US dollars in thousands (Note 2)	\$ 3,725,577	\$ 19,844	\$ (5,089)	\$ 808,545	\$ 4,548,877
January 1, 2008 (as previously reported)	₩ 4,684,913	₩ 24,954	₩ (6,620)	₩ 1,097,445	₩ 5,800,692
Cumulative effect of change in accounting policy	-	-	-	(5,455)	(5,455)
Correction of prior period errors	-	-	221	(75,245)	(75,024)
January 1, 2008 (as restated)	4,684,913	24,954	(6,399)	1,016,745	5,720,213
Dividends	-	-	-	(22,956)	(22,956)
Addition to paid-in capital	1,229,902	-	-	-	1,229,902
Net income for the year	-	-	-	200,193	200,193
Exchange differences on translation of foreign operations	-	-	252,916	-	252,916
Loss on valuation of available-for-sale securities	-	-	(981)	-	(981)
Capital adjustment arising from equity method investments	-	-	991	-	991
Gain on valuation of derivative instruments	-	-	135,871	-	135,871
December 31, 2008	₩ 5,914,815	₩ 24,954	₩ 382,398	₩ 1,193,982	₩ 7,516,149
US dollars in thousands (Note 2)	\$ 4,703,630	\$ 19,844	\$ 304,094	\$ 949,489	\$ 5,977,057

See accompanying notes.

Korea National Oil Corporation

Statements of cash flows

Years ended December 31, 2008 and 2007

	Korean won in millions		US dollars in thousands (Note 2)	
	2008	(As restated) 2007	2008	(As restated) 2007
Cash flows from operating activities:				
Net income	₩ 200,193	₩ 166,740	\$ 159,199	\$ 132,597
Adjustments to reconcile net income				
to net cash provided by used in operating activities:				
Provision for severance and retirement benefits	9,702	12,383	7,716	9,847
Depreciation	91,040	77,086	72,398	61,301
Amortization	199,059	131,312	158,297	104,423
Other bad debt expense	130,319	3,404	103,634	2,707
Loss (gain) on disposal of property, plant and equipment, net	(130)	46	(104)	36
Loss (gain) on foreign currency translation, net	139,356	(5,629)	110,820	(4,476)
Equity in earnings of equity method investments	(2,012)	(260)	(1,600)	(207)
Gain from liabilities exempted	(3,021)	(2,812)	(2,403)	(2,236)
Reversal of allowance for doubtful accounts	(539)	(868)	(429)	(690)
Interest income	(24,940)	(47,116)	(19,833)	(37,468)
Interest expense	35,870	45,904	28,524	36,504
Impairment loss on oil interests	5,697	4,536	4,531	3,607
Loss on valuation of derivative instruments, net	113,380	-	90,163	-
Provision for restoration costs	7,995	3,908	6,358	3,108
Gain on disposal of intangible assets, net	(26,532)	-	(21,099)	-
Loss from inventory obsolescence	61	50	49	40
Gain on valuation of firm commitments, net	(113,380)	(26,712)	(90,163)	(21,242)
Others, net	142	1,102	113	876
Changes in operating assets and liabilities:				
Trade accounts receivable	28,744	(93,898)	22,858	(74,671)
Short-term loans	223,310	205,976	177,582	163,798
Other accounts receivable	(41,585)	(3,732)	(33,069)	(2,967)
Inventories	(511,468)	81,199	(406,734)	64,571
Long-term loans	(200,060)	(241,150)	(159,094)	(191,769)
Deferred income taxes	56,790	(12,672)	45,161	(10,077)
Other assets, net	(11,454)	40,180	(9,108)	31,952
Trade accounts payable	(13,413)	(20,202)	(10,667)	(16,065)
Other accounts payable	241,223	88,413	191,827	70,308
Withholdings	5,986	1,092	4,760	868
Accrued expenses	(7,954)	10,450	(6,325)	8,311
Income taxes payable	1	(5,273)	1	(4,194)
Current portion of long-term borrowings	(223,310)	(205,976)	(177,582)	(163,798)
Long-term borrowings denominated in Korean won	24,575	14,967	19,543	11,902
Long-term borrowings denominated in foreign currencies	175,485	226,183	139,551	179,867
Operational assets for pension plan	(10,371)	(8,629)	(8,247)	(6,862)
Deposits for severance and retirement benefits	-	1	-	1
Exchange differences on translation of foreign operations	252,916	1,899	201,126	1,510
Derivative assets	(1,701)	(2,621)	(1,353)	(2,084)
Other liabilities, net	27,874	36,790	22,166	29,257
Payment of severance and retirement benefits	(4,704)	(1,600)	(3,741)	(1,272)
Total adjustments	572,951	307,731	455,627	244,716
Net cash provided by operating activities	₩ 773,144	₩ 474,471	\$ 614,826	\$ 377,313

(Continued)

See accompanying notes.

Korea National Oil Corporation
Statements of cash flows (cont'd)
Years ended December 31, 2008 and 2007

	Korean won in millions		US dollars in thousands (Note 2)	
	2008	(As restated) 2007	2008	(As restated) 2007
Cash flows from investing activities:				
Decrease (increase) in short-term financial instruments, net	₩ 336,507	₩ (242,827)	\$ 267,600	\$ (193,103)
Proceeds from disposal of available-for-sale securities	17,268	149	13,732	118
Proceeds from disposal of equity method investments	-	7	-	6
Increase in loans to affiliates, net	(186,490)	(116,979)	(148,303)	(93,025)
Increase in short-term loans, net	(11,322)	-	(9,004)	-
Decrease (increase) in long-term guarantee deposits, net	270	(1,570)	215	(1,248)
Proceeds from disposal of property, plant and equipment	367	144	292	114
Proceeds from disposal of intangible assets	35,288	-	28,062	-
Acquisition of available-for-sale securities	(5,477)	(9,935)	(4,356)	(7,901)
Acquisition of equity method investments	(1,140)	(1,548)	(907)	(1,231)
Acquisition of property, plant and equipment	(140,482)	(159,676)	(111,715)	(126,979)
Acquisition of intangible assets	(1,790,709)	(258,104)	(1,424,023)	(205,252)
Others, net	(1,669)	(721)	(1,327)	(573)
Net cash used in investing activities	(1,747,589)	(791,060)	(1,389,734)	(629,074)
Cash flows from financing activities:				
Increase in short-term borrowings	607,161	-	482,832	-
Increase in long-term borrowings denominated in foreign currencies	361,315	126,430	287,328	100,541
Proceeds from addition to paid-in capital	1,229,902	720,371	978,053	572,860
Repayment of current portion of long-term borrowings	(38,648)	(65,702)	(30,734)	(52,248)
Repayment of long-term borrowings denominated in foreign currencies	(21,054)	(43,530)	(16,742)	(34,616)
Repayment of asset-backed securitization liabilities	(51,689)	(47,182)	(41,104)	(37,520)
Payment of dividends	(22,956)	(18,633)	(18,255)	(14,818)
Others, net	-	(25)	-	(20)
Net cash provided by financing activities	2,064,031	671,729	1,641,378	534,179
Net increase in cash and cash equivalents	1,089,586	355,140	866,470	282,418
Cash and cash equivalents at the beginning of the year	606,533	251,393	482,333	199,915
Cash and cash equivalents at the end of the year	₩ 1,696,119	₩ 606,533	\$ 1,348,803	\$ 482,333

See accompanying notes.

Korea National Oil Corporation
Notes to financial statements
December 31, 2008 and 2007

1. Corporate information

Korea National Oil Corporation (the "Company") was incorporated on March 3, 1979 to engage in the development of oil fields, distribution of crude oil, maintenance of petroleum reserve stock and improvement of the petroleum distribution structure under the Korea National Oil Corporation Act.

The Company's head office is located in Anyang, Gyeonggi-do in Korea. The Company also has 9 petroleum stockpile offices, 3 construction offices, 2 overseas branches, 14 overseas offices and 1 domestic office.

The Company acquired an 80% ownership interest in oil fields located in the United States of America from Taylor Energy Company LLC for US\$1,097 million on March 20, 2008.

As of December 31, 2008 and 2007, the Company is wholly owned by the Korean government.

2. Summary of significant accounting policies

Basis of financial statement preparation

The Company maintains its official accounting records in Korean won and prepares statutory financial statements in the Korean language in conformity with accounting principles for government-controlled corporations, as established by the Ministry of Strategy and Finance (previously called Ministry of Finance and Economy). The accounting standards for government-controlled corporations requires that the accounting principles generally accepted in the Republic of Korea to be applied where there is no specific guidance under accounting standards for government-controlled corporations. Certain accounting principles applied by the Company that conform with financial accounting standards and accounting principles in the Republic of Korea may not conform with generally accepted accounting principles in other countries. Accordingly, these financial statements are intended for use by those who are informed about Korean accounting principles and practices. The accompanying financial statements have been condensed, restructured and translated into English (with certain expanded descriptions) from the Korean language financial statements. In the event of any differences in interpreting the financial statements or the independent auditors' report thereon, the Korean version, which is used for regulatory reporting purposes, shall prevail.

Financial statement translation

The accompanying financial statements are expressed in Korean won and, solely for the convenience of the reader, have been translated into United States dollars ("US dollars") at the rate of ₩1,257.50 to US\$1, the exchange rate on December 31, 2008. Such translation should not be construed as a representation that the Korean won amounts can actually be converted into US dollars at the exchange rate used for purposes of such translation.

2. Summary of significant accounting policies (cont'd)

Adoption of new and revised Statements of Korea Accounting Standards ("SKAS"), Korea Financial Accounting Standards ("KFAS") and Korea Accounting Institute Opinion ("KAI Opinion")

The Company has adopted the following new and revised SKAS, KFAS and KAI Opinion for the current financial year which are effective in 2008.

- KFAS Article 70-2 - *Special Exemption to Derivatives Accounting*
- SKAS 8 *Amendments - Investments in Securities*
- SKAS 15 *Amendments - Investments in Associates*
- SKAS 16 *Amendments - Income Taxes*
- KAI Opinion 06-02 *Amendments - Accounting for the Recognition of Deferred Income Tax Assets/Liabilities associated with Investments in Subsidiaries, Branches and Associates, and Interests in Joint Ventures*

Adoption of these new and revised standards did not have a material effect on the Company's financial statements, except for SKAS 16. SKAS 16 requires an entity to apply revised disclosures which enable users of the financial statements to better understand the components of income taxes reported in the financial statements. These revised disclosures are presented in Note 26.

Revenue recognition

Revenue from the sale of petroleum is recognized when significant risks and rewards of ownership of the petroleum have been transferred to the buyer, usually upon delivery thereof. Revenue from sales activities other than petroleum is recognized when the Company's earnings process has been substantially completed, the amount of revenue can be measured reliably, and it is probable that the economic benefits associated with the transaction will flow to the Company.

Cash equivalents

Highly liquid deposits and marketable securities with original maturities of three months or less, and which have no significant risk of loss in value by interest rate fluctuations, are considered as cash equivalents.

Financial instruments

Financial instruments, such as time deposits and restricted bank deposits, which are traded by financial institutions and are held for short-term cash management purposes or which will mature within one year, are accounted for as short-term financial instruments. Financial instruments other than cash equivalents and short-term financial instruments are recorded as long-term financial instruments.

Allowance for doubtful accounts

The Company provides an allowance for doubtful accounts in consideration of the estimated losses that may arise from non-collection of its receivables. The estimate of losses, if any, is based on a review of the aging and current status of the outstanding receivables.

2. Summary of significant accounting policies (cont'd)

Inventories

Inventories are stated at the lower of cost or net realizable value, with cost being determined using the moving-average method. A perpetual inventory system is used to record inventories, in which inventories are adjusted to physical inventory counts that are performed at the end of the year.

When a decline in the value of inventory indicates that its cost exceeds net realizable value or replacement costs, a valuation loss will be recognized to write the inventory down to its net realizable value, except for oil stockpile inventory, which is recorded at acquisition cost regardless of whether acquisition cost is lower than net realizable value in accordance with the Special Accounting Provisions of the Ministry of Strategy and Finance.

Investments in securities

Investments in securities within the scope of SKAS 8 *Investments in Securities* are classified as either trading, held-to-maturity and available-for-sale securities, as appropriate, and are initially measured at cost, including incidental expenses with cost being determined using the moving-average method. The Company determines the classification of its investments after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year end.

Securities that are acquired and held principally for the purpose of selling them in the near term are classified as trading securities. Debt securities which carry fixed or determinable payments and fixed maturity are classified as held-to-maturity if the Company has the positive intention and ability to hold to maturity. Securities that are not classified as either trading or held-to-maturity are classified as available-for-sale securities.

After initial measurement, available-for-sale securities are measured at fair value with unrealized gains or losses being recognized directly in equity in as other comprehensive income or loss. Likewise, trading securities are also measured at fair value after initial measurement, but with unrealized gains or losses reported as part of net income. Held-to-maturity securities are measured at amortized cost after initial measurement. The cost is computed as the amount initially recognized minus principal repayments, plus or minus the cumulative amortization using the effective-interest-rate method for any difference between the initially recognized amount and the maturity amount.

The fair value of trading and available-for-sale securities that are traded actively in the open market (marketable securities) is measured at the closing price of those securities at the balance sheet date, except for non-marketable equity securities which are measured at cost subsequent to initial measurement if their fair values cannot be reliably estimated. Non-marketable debt securities are carried at a value using the present value of future cash flows discounted using an appropriate interest rate which reflects the issuer's credit rating announced by a public independent credit rating agency. If the application of such measurement method is not feasible, estimates of fair values may be made using a reasonable valuation model or quoted market prices of similar debt securities issued by entities conducting business in similar industries.

2. Summary of significant accounting policies (cont'd)

Investment in securities (cont'd)

Trading securities are classified as current assets. Available-for-sale and held-to-maturity securities are classified as long-term investments, except that securities maturing within one year or are certain to be disposed of within one year from the balance sheet date are classified as short-term investments.

The Company recognizes an impairment loss on its investments in securities if there is objective evidence that the securities are impaired. The impairment loss is charged to the statement of income.

Equity method investments

Investments in entities over which the Company has control or significant influence are accounted for using the equity method.

Under the equity method of accounting, the Company's initial investment in an investee is recorded at acquisition cost. Subsequently, the carrying amount of the investment is adjusted to reflect the Company's share of income or loss of the investee in the statement of income and share of changes in equity that have been recognized directly in the equity of the investee in the related equity account of the Company on the balance sheet. If the Company's share of losses of the investee equals or exceeds its interest in the investee, it suspends recognizing its share of further losses. However, if the Company has other long-term interests in the investee, it continues recognizing its share of further losses to the extent of the carrying amount of such long-term interests.

The Company's share in the investee's unrealized profits and losses resulting from transactions between the Company and its investee are eliminated.

In translating the financial statements of foreign investees into Korean won, assets and liabilities are translated at the exchange rate on the balance sheet date and income and expenses are translated at the weighted-average exchange rate for the period. All resulting exchange differences are recognized as exchange differences on translation of foreign operations in other comprehensive income or loss within equity.

Investments in entities engaging in oil field activities

For investments in entities engaging in exploratory, developing and producing oil fields, when the Company has substantial control over the investee and has the significant risks and rewards from the operations of the investee, the Company accounts for its proportionate share of assets, liabilities, profits and expenses of the investee directly within the corresponding line items on its financial statements based on percentage ownership. Otherwise, the Company accounts for its interest as either equity method investments or available-for-sale securities, as appropriate.

2. Summary of significant accounting policies (cont'd)

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation.

Maintenance and repairs are expensed in the year in which they are incurred. Expenditures which enhance the value or extend the useful life of the related assets are capitalized.

Property, plant and equipment used for oil production wells are depreciated using the unit-of-production method. Depreciation of other property, plant and equipment is provided using the declining-balance method, except for buildings and structures for which the straight-line method is used, over the estimated useful lives of the assets as follows:

	<u>Years</u>
Buildings	40
Structures	40
Machinery and equipment	5
Vehicles	5
Furniture and fixtures	5
Oil prospecting vessels	12

When there is a legal or contractual obligation for dismantling and removing facilities and restoring sites on which they are located to their original condition at the end of the useful lives of the facilities, the present value of the estimated future restoration costs are capitalized at the acquisition date as additions to the cost of facilities and are accounted for as a provision. The Company subsequently depreciates the restoration costs using the unit-of-production method and the difference between estimated restoration costs and their present value will be charged to current operations by applying the effective-interest-rate method over the useful lives of the facilities.

Intangible assets

Intangible assets of the Company consist of oil wells, development costs and other intangible assets, which are stated at cost less accumulated amortization and impairment losses.

(i) Oil exploratory, development and production wells

The Company engages in the development of overseas natural resources either by entering into contracts for sharing the extracted natural resources or by acquiring interests in the related projects. The acquisition cost of the interests in oil fields is included in oil interests in exploration, development or production in intangible assets.

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2. Summary of significant accounting policies (cont'd)

Intangible assets (cont'd)

- (1) Oil exploratory wells consist of geomorphic and geophysical investigation costs, and excavation costs on promising structures for exploratory drilling. When proved successful, the cost is reclassified to oil development wells.
- (2) Oil development wells consist of costs for oil field valuation, construction of production facility and offshore rig operation by using obtained information through exploration step. The cost is reclassified to oil production wells upon the commercial production of petroleum.
- (3) Oil production wells consist of operation costs for improving productivity, oil reservoir management for prediction of oil output and production optimization, and increasing the return rate of crude oil.

The costs of production wells are amortized using the unit-of-production method in accordance with accounting principles for government-controlled corporations established by the Ministry of Strategy and Finance. For exploratory wells proven to be unsuccessful upon evaluation, the investments in such wells are immediately charged to current operations and the Company is exempt from its obligation to repay the borrowings associated with the unsuccessful exploratory wells in accordance with the Special Accounts for Energy and Resources ("SAER") and a gain from liabilities exempted is recognized. No gains from liabilities exempted were recognized for unsuccessful wells during the years ended December 31, 2008 and 2007.

(ii) Other intangible assets

Development costs in intangible assets are amortized using the straight-line method. Amortization of the asset begins when development is completed and the asset is available for use, over the estimated useful lives of 5 years. The amortization expenses are stated as manufacturing costs or selling and administrative expenses.

Other intangible assets other than oil wells and development costs are amortized using the straight-line method, except for software for which the declining-balance method is used, over the estimated useful lives of the assets as follows:

	<u>Years</u>
Patents	5
Other intangible assets	5, 20

2. Summary of significant accounting policies (cont'd)

Impairment of assets

When the recoverable amount of an asset is less than its carrying amount due to obsolescence, physical damage or unexpected decline in the market value of the asset, the decline in value, if material, is deducted from the carrying amount and recognized as an asset impairment loss in the current year. The Company recognized an impairment loss on oil interests amounting to ₩5,697 million and ₩4,536 million for the years ended December 31, 2008 and 2007, respectively.

Subsequently, if the recoverable amount of the asset exceeds its carrying amount which has been impaired, the carrying amount is increased to the lower of the carrying amount that would have been determined, net of amortization or depreciation had no impairment loss been recognized for the asset in prior periods, or its recoverable amount.

Government subsidy

Government subsidy, which is used for the acquisition of certain assets, is accounted for as a deduction from the acquisition cost of the acquired assets. Such subsidy amount is offset against the depreciation or amortization of the acquired assets during the useful lives of such assets. Government subsidy that is required to be repaid is recorded as a liability in the balance sheet. Government subsidy with no repayment obligation, which is used to purchase a designated asset or to develop a certain technology, is presented as a deduction of the related asset and is amortized as an offset to depreciation or amortization expense of the related asset. Government subsidy contributed to compensate for specific expenses is offset against the related expenses as incurred.

Severance and retirement benefits

In accordance with the Employee Retirement Benefit Security Act ("ERBSA") and the Company's employee benefit policy, employees terminating their employment with at least one year of service, except for the employees who are transferred to the Company's defined benefit or contribution plans, are entitled to severance and retirement benefits based on the rates of pay in effect at the time of termination, years of service and certain other factors. The provision for the years ended December 31, 2008 and 2007 is sufficient to state the liability at the estimated obligation arising from services performed to and at rates of pay in effect as of December 31, 2008 and 2007. Separate funding of the liability is not required by Korean law.

In 2006, the Company introduced a defined benefit pension plan under which eligible employees were credited for their service periods prior to the effective date of the plan. Under the defined benefit pension plan, each eligible employee receives a fixed amount of pension upon retirement and the Company has accrued severance and retirement benefits for the pension plan as of the balance sheet date. The Company is also required to purchase pension products on behalf of the eligible employees electing to receive the pension benefit in the form of an annuity. Accordingly, the Company does not have additional liability for the defined benefit pension plan after employees' retirement. As of December 31, 2008 and 2007, operational assets associated with the pension plan have been offset against the liability for retirement and severance benefits on the balance sheets.

2. Summary of significant accounting policies (cont'd)

Severance and retirement benefits (cont'd)

Effective June 30, 2008, the Company allowed employees to change their participation from the defined benefit plan to a newly established defined contribution plan and paid the severance and retirement to such employees as of the date of change in plan participation. The Company periodically contributes to pension operational companies and recognizes expense as the employees render service.

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The provision is used only for expenditures for which the provision was originally recognized. If the effect of the time value of money is material, provisions are stated at present value.

Income taxes

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered or paid to the tax authorities. Deferred income taxes are provided using the liability method for the tax effect of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred income tax assets and liabilities are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse, and are classified as current or non-current, respectively, based on the classification of the related asset or liability in the balance sheet. In addition, current tax and deferred tax are charged or credited directly to equity if the tax relates to items that are credited or charged directly to equity.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available against which the unused tax losses and credits and deductible temporary differences can be utilized. Deferred income tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Valuation of receivables (payables) at present value

Receivables (payables) arising from long-term installment transactions are stated at present value. The difference between the carrying amount and present value of the receivables (payables) is amortized using the effective-interest-rate method and credited (charged) to the statement of income over the installment period.

When credit terms (e.g., principal, interest rate, payment period) of receivables or payables between debtors or creditors experiencing financial difficulties (e.g., court receivership, debt restructuring, financial workout) are unfavorably changed from the perspective of the Company, such receivables or payables are stated at present value calculated by discounting the future cash flows in accordance with the modified terms of the restructured receivables or payables by using the effective-interest-rate method from the origination date and the difference between the carrying amount and present value of such receivables or payables is charged or credited to the statement of income.

2. Summary of significant accounting policies (cont'd)

Foreign currency translation

Transactions involving foreign currencies are recorded at the exchange rates prevailing at the time the transactions are made. Non-monetary items that are re-measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Korean won at the appropriate exchange rates on the balance sheet dates. The resulting unrealized foreign currency translation gains or losses are credited or charged to current operations. However, monetary liabilities denominated in foreign currencies incurred in connection with the Company's loans to an investee engaging in developing oil fields, whose repayment obligation is contingent upon the success of the project, are translated into Korean won using the exchange rates on the dates of the initial transactions until the development is proven to be a success.

Translation of overseas financial statements stated in foreign currency

Financial statements of overseas business locations are maintained in the currencies of the countries in which they conduct their operations. In translating the foreign currency financial statements of these foreign business branches or offices into Korean won, assets and liabilities are translated at the current exchange rates on the balance sheet dates and income and expenses are translated at the weighted-average exchange rates during the respective year. All resulting exchange differences are recognized as exchange differences on translation of foreign operations in the other comprehensive income or loss account within equity. In the case of disposal, close-down or liquidation of a branch or office, the deferred cumulative amount recognized in equity relating to that particular operation is recognized in net income. As such, the Company credited ₩245,098 million as of December 31, 2008 and debited ₩7,818 million as of December 31, 2007 as exchange differences on translation of foreign operations in accumulated other comprehensive income (loss).

Derivative financial instruments

Derivative financial instruments are presented as assets or liabilities valued principally at the fair value of the rights or obligations associated with the derivative contracts. The unrealized gain or loss from a derivative transaction with the purpose of hedging the exposure to changes in the fair value of a recognized asset or liability or unrecognized firm commitment is recognized in net income. For a derivative instrument with the purpose of hedging the exposure to the variability of cash flows of a recognized asset or liability or a forecasted transaction, the hedge-effective portion of the derivative instrument's gain or loss is deferred as other comprehensive income or loss in equity. The ineffective portion of the gain or loss is charged or credited to net income. Derivative instruments that do not meet the criteria for hedge accounting, or contracts for which the Company has not elected hedge accounting are measured at fair value with unrealized gains or losses reported in net income.

Significant judgments and accounting estimates

The preparation of financial statements in accordance with Korean GAAP requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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Notes to financial statements
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2. Summary of significant accounting policies (cont'd)

Reclassifications

Certain amounts in the 2007 financial statements have been reclassified to conform with the 2008 presentation. Such reclassifications had no effect on the Company's net income and retained earnings as previously reported.

Restatement of the 2007 financial statements

(i) Change in accounting policy

Due to the change in accounting principles for government-controlled corporations, the Company changed its depreciation method for oil production wells and related property, plant and equipment from unit-of-production method based on total proven reserves to unit-of-production method based on residual proven reserves and applied retrospectively the effect of the change in accounting policy, resulting in an increase in cost of sales by ₩7,979 million for the year ended December 31, 2008 and an increase in the opening retained earnings by ₩3,470 million as of January 1, 2007.

The principal effect of this change for the preceding three financial years is as follows (Korean won in millions):

Accounts	2007		2006		2005	
	Before	After	Before	After	Before	After
Cost of sales	₩ 656,161	₩ 674,999	₩ 543,575	₩ 544,490	₩ 503,954	₩ 504,101

(ii) Prior period error corrections

Prior to 2008, the Company had accounted for certain indirect investments in oil fields over which the Company did not have substantial control as intangible assets while such investments should have been treated as equity method investments or available-for-sale securities, as appropriate. In 2008, the Company corrected its accounting for such investments retrospectively in its financial statements. The principal effects of these corrections for the preceding three financial years are as follows (Korean won in millions):

Accounts	2007		2006		2005	
	Before	After	Before	After	Before	After
Intangible assets	₩ 1,788,462	₩ 1,533,137	₩ 1,616,106	₩ 1,478,719	₩ 674,311	₩ 674,311
Equity method investments	1,592	11,458	1,420	7,784	169,807	169,807
Loans to affiliates	-	237,086	-	136,118	87,961	87,961

Further, as a result of an audit by the Board of Audit and Inspection of the Korean government in 2008, the Company was ordered to return the grants received from Korean government prior to 2008 in relation to its administration of oil stockpiles for the government, which had been accounted for as sales in prior periods. Accordingly, the Company made a prior period error correction by reversing the sales previously recognized resulting in decreases in sales of ₩25,667 million for the year ended December 31, 2007 and in retained earnings of ₩44,214 million as of January 1, 2007.

Korea National Oil Corporation
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2. Summary of significant accounting policies (cont'd)

Restatement of the 2007 financial statements (cont'd)

The effect of this error correction on sales for the preceding three financial years is as follows (Korean won in millions):

Accounts	2007		2006		2005	
	Before	After	Before	After	Before	After
Sales	₩ 1,095,002	₩ 1,069,335	₩ 918,133	₩ 900,375	₩ 956,791	₩ 938,462

As a result of the above change in accounting policy and prior period error corrections, the comparative 2007 financial statements were restated and the resulting aggregated effects on the statements of income for the preceding three financial years are as follows (Korean won in millions):

Accounts	2007		2006		2005	
	Before	After	Before	After	Before	After
Sales	₩ 1,095,002	₩ 1,069,335	₩ 918,133	₩ 900,375	₩ 956,791	₩ 938,462
Cost of sales	656,161	674,999	543,575	544,490	503,955	504,101
Operating income	380,098	329,150	325,937	307,263	406,020	387,545
Income before income taxes	354,808	311,471	276,811	257,003	415,420	396,710
Net income	206,696	166,740	185,209	165,602	279,480	260,802

3. Inventories

Inventories as of December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
Finished goods	₩ 9,226	₩ 18,236
Raw materials	11,521	6,749
Oil stockpile	2,485,070	1,854,519
Supplies	6,851	8,378
	<u>₩ 2,512,668</u>	<u>₩ 1,887,882</u>

4. Other current assets

Other current assets as of December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
Accrued income	₩ 5,478	₩ 2,222
Advance payments	28,567	29,120
Prepaid expenses	4,341	2,676
Other	38,321	61,615
	<u>₩ 76,707</u>	<u>₩ 95,633</u>

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5. Available-for-sale securities

Available-for-sale securities as of December 31, 2008 and 2007 consist of the following (Korean won in millions):

	2008					Impairment loss	
	Ownership (%)	Acquisition cost	Fair value	Book value	Unrealized gain	prior to 2008	2008
Non-marketable securities:							
Micronic Korea Co., Ltd. (*1)	16.70	₩ 775	₩ -	₩ 379	₩ -	₩ 396	₩ -
Daehan Oil Pipeline Corporation (*2)	3.69	8,298	9,139	9,139	841	-	-
Petronado S.A. (*1)	5.64	22,755	-	14,320	-	4,371	-
Yemen LNG Company Ltd. (*1)	1.06	21,184	-	21,184	-	-	-
		₩ 53,012	₩ 9,139	₩ 45,022	₩ 841	₩ 4,767	₩ -
	2007					Impairment loss	
	Ownership (%)	Acquisition cost	Fair value	Book value	Unrealized gain	prior to 2007	2007
Non-marketable securities:							
Micronic Korea Co., Ltd. (*1)	16.70	₩ 775	₩ -	₩ 379	₩ -	₩ 396	₩ -
Daehan Oil Pipeline Corporation (*2)	3.69	8,298	9,935	9,935	1,637	-	-
Petronado S.A. (*1)	5.64	22,755	-	18,235	-	4,371	-
Yemen LNG Company Ltd. (*1)	1.06	29,187	-	29,187	-	-	-
		₩ 61,015	₩ 9,935	₩ 57,736	₩ 1,637	₩ 4,767	₩ -

(*1) The equity securities are measured at cost less any impairment loss since their fair value cannot be reliably determined.

(*2) The fair value of equity securities are determined by reference to the amounts provided by NICE Pricing Services Inc., which is an independent appraisal company in Korea.

Korea National Oil Corporation
Notes to financial statements
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6. Equity method investments

Investments in equity securities accounted for using the equity method as of December 31, 2008 and 2007 are as follows (Korean won in millions):

Investee	2008				Book value
	Ownership (%)	Acquisition cost	Proportionate net asset value		
KNOC Samsung Lantian Oil Development Co., Ltd.	44	₩ 5,858	₩ 5,784	₩	5,784
Oiltanking KNOC Yeosu	29	1,095	1,095		1,095
Dolphin Property Limited	75	58	58		58
Kernhem B.V.	30	6	6		6
KNOC Bazian Limited	38	-	-		-
KNOC Inam Limited	40	-	-		-
KNOC Kamchatka Petroleum Limited	55	1	1		1
Fosco B.V.	33	7	7		7
KC Karpovsky B.V.	35	9	9		9
KNOC Nigerian West Oil Company Limited	75	57	57		57
KNOC Nigerian East Oil Company Limited	75	57	57		57
KNOC Aral Ltd.	51	-	-		-
Korea Kamchatka Co., Ltd.	50	6,737	6,737		6,737
KC Kazakh B.V.	35	233	233		233
Korea Offshore Logistics Co., Ltd.	30	1,100	1,841		1,841
		₩ 15,218	₩ 15,885	₩	15,885

Investee	2007				Book value
	Ownership (%)	Acquisition cost	Proportionate net asset value		
KNOC Samsung Lantian Oil Development Co., Ltd.	44	₩ 5,858	₩ 2,701	₩	2,701
Dolphin Property Limited	75	58	58		58
Kernhem B.V.	30	6	6		6
KNOC Bazian Limited	38	-	-		-
KNOC Inam Limited	40	-	-		-
KNOC Kamchatka Petroleum Limited	55	1	1		1
Fosco B.V.	33	7	7		7
KC Karpovsky B.V.	35	9	9		9
KNOC Nigerian West Oil Company Limited	75	57	57		57
KNOC Nigerian East Oil Company Limited	75	57	57		57
KNOC Aral Ltd.	51	-	-		-
Korea Kamchatka Co., Ltd.	50	6,737	6,737		6,737
KC Kazakh B.V.	35	233	233		233
Korea Offshore Logistics Co., Ltd.	30	1,100	1,592		1,592
		₩ 14,123	₩ 11,458	₩	11,458

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6. Equity method investments (cont'd)

Changes in the net carrying value of equity method investments for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008					
	Jan. 1, 2008	Additions (disposals)	Equity in earnings of investee	Changes in equity adjustments	Other	Dec. 31, 2008
KNOC Samsung Lantian Oil Development Co., Ltd.	₩ 2,701	₩ 146	₩ 1,651	₩ 1,286	₩ -	₩ 5,784
Oiltanking KNOC Yeosu	-	1,095	-	-	-	1,095
Dolphin Property Limited	58	-	-	-	-	58
Kernhem B.V.	6	-	-	-	-	6
KNOC Bazian Limited	-	-	-	-	-	-
KNOC Inam Limited	-	-	-	-	-	-
KNOC Kamchatka Petroleum Limited	1	-	-	-	-	1
Fosco B.V.	7	-	-	-	-	7
KC Karpovsky B.V.	9	-	-	-	-	9
KNOC Nigerian West Oil Company Limited	57	-	-	-	-	57
NOC Nigerian East Oil Company Limited	57	-	-	-	-	57
KNOC Aral Ltd.	-	-	-	-	-	-
Korea Kamchatka Co., Ltd.	6,737	-	-	-	-	6,737
KC Kazakh B.V.	233	-	-	-	-	233
Korea Offshore Logistics Co., Ltd.	1,592	(101)	361	(11)	-	1,841
	<u>₩ 11,458</u>	<u>₩ 1,140</u>	<u>₩ 2,012</u>	<u>₩ 1,275</u>	<u>₩ -</u>	<u>₩ 15,885</u>

	2007					
	Jan. 1, 2007	Additions (disposals)	Equity in earnings of investee	Changes in equity adjustments	Other	Dec. 31, 2007
KNOC Samsung Lantian Oil Development Co., Ltd.	₩ 3,071	₩ -	₩ -	₩ (370)	₩ -	₩ 2,701
Dolphin Property Limited	60	(2)	-	-	-	58
Kernhem B.V.	6	-	-	-	-	6
KNOC Bazian Limited	-	-	-	-	-	-
KNOC Inam Limited	-	-	-	-	-	-
KNOC Kamchatka Petroleum Limited	-	1	-	-	-	1
Fosco B.V.	7	-	-	-	-	7
KC Karpovsky B.V.	9	-	-	-	-	9
KNOC Nigerian West Oil Company Limited	60	(3)	-	-	-	57
KNOC Nigerian East Oil Company Limited	60	(3)	-	-	-	57
KNOC Aral Ltd.	-	-	-	-	-	-
Korea Kamchatka Co., Ltd.	1	1,314	-	-	5,422	6,737
KC Kazakh B.V.	-	233	-	-	-	233
Korea Offshore Logistics Co., Ltd.	1,420	-	260	12	(100)	1,592
	<u>₩ 4,694</u>	<u>₩ 1,540</u>	<u>₩ 260</u>	<u>₩ (358)</u>	<u>₩ 5,322</u>	<u>₩ 11,458</u>

Korea National Oil Corporation
Notes to financial statements
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6. Equity method investments (cont'd)

In connection with the unaudited financial information below, the Company has performed the following procedures to determine the reliability of such financial statements:

- a. Obtained the financial statements signed by the Chief Executive Officer and statutory auditors of the investees.
- b. Reviewed the financial statements to understand whether important transactions or events that may have material accounting implications or impact, either publicly announced or otherwise known to the Company, were properly reflected in the financial statements.

The summary of financial position of the investees as of December 31, 2008 and the results of their operations for the year then ended, is presented as follows (Korean won in millions):

<u>Investee</u>	<u>Total assets</u>	<u>Total liabilities</u>	<u>Sales</u>	<u>Net income (loss)</u>
KNOC Samsung Lantian Oil Development Co., Ltd.	₩ 24,525	₩ 11,380	₩ 11,907	₩ 5,350
Oiltanking KNOC Yeosu	3,647	64	-	(192)
Dolphin Property Limited	9,676	8,440	-	999
Kernhem B.V.	67,423	67,438	-	-
KNOC Bazian Limited	60,992	60,935	-	30
KNOC Inam Limited	74,421	74,343	-	35
KNOC Kamchatka Petroleum Limited	92,084	94,002	-	-
Fosco B.V.	35,160	35,126	-	2
KC Karpovsky B.V.	30,240	41,969	-	-
KNOC Nigerian West Oil Company Limited	172,122	189,130	-	(7)
KNOC Nigerian East Oil Company Limited	283,301	302,211	-	4
KNOC Aral Ltd.	16,827	16,825	-	1
Korea Kamchatka Co., Ltd.	316,673	302,776	-	5
KC Kazakh B.V.	13,103	12,108	-	-
Korea Offshore Logistics Co., Ltd.	11,724	5,588	10,031	1,202

7. Related party disclosures

The related parties of the Company and nature of their relationship with the Company are as follows:

<u>Relationship</u>	<u>Company name</u>
Affiliates	KNOC Samsung Lantian Oil Development Co., Ltd., Oiltanking KNOC Yeosu, Dolphin Property Limited, Kernhem B.V., KNOC Bazian Limited, KNOC Inam Limited, KNOC Kamchatka Petroleum Limited, Fosco B.V., KC Karpovsky B.V., KNOC Nigerian West Oil Company Limited, KNOC Nigerian East Oil Company Limited, KNOC Aral Ltd., Korea Kamchatka Co., Ltd., KC Kazakh B.V., Korea Offshore Logistics Co., Ltd.

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7. Related party disclosures (cont'd)

Outstanding balances with related parties as of December 31, 2008 and 2007 are as follows (Korean won in millions):

<u>Related parties</u>	<u>Account</u>	<u>2008</u>	<u>2007</u>
KNOC Samsung Lantian Oil Development Co., Ltd.	Loans to affiliates	₩ 4,285	₩ 5,007
Dolphin Property Limited	Loans to affiliates	4,697	4,682
Kernhem B.V.	Loans to affiliates	34,295	27,021
KNOC Bazian Limited	Loans to affiliates	21,398	10,523
KNOC Inam Limited	Loans to affiliates	22,985	6,931
	Valuation allowance	(12,257)	-
KNOC Kamchatka Petroleum Limited	Loans to affiliates	41,255	27,713
Fosco B.V.	Loans to affiliates	17,989	11,343
KC Karpovsky B.V.	Loans to affiliates	12,935	11,158
KNOC Nigerian West Oil Company Limited	Loans to affiliates	46,845	42,660
	Valuation allowance	(7,356)	-
KNOC Nigerian East Oil Company Limited	Loans to affiliates	52,451	48,243
	Valuation allowance	(6,845)	-
KNOC Aral Ltd.	Loans to affiliates	6,922	1,958
KNOC Kamchatka Co., Ltd.	Loans to affiliates	118,761	37,795
	Valuation allowance	(77,108)	-
KNOC Kazakh B.V.	Loans to affiliates	39,847	2,052
	Total loans to affiliates	₩ 424,665	₩ 237,086
	Total valuation allowance	₩ (103,566)	₩ -

Outstanding balances with related parties other than those entities accounted for using the equity method as of December 31, 2008 and 2007 are as follows (Korean won in millions):

<u>Related parties</u>	<u>Account</u>	<u>2008</u>	<u>2007</u>
Employees	Short-term loans	₩ 203	₩ 190
	Other non-current assets (Long-term loans)	12,056	10,400
		₩ 12,259	₩ 10,590

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7. Related party disclosures (cont'd)

The Company has provided the following guarantee for a related party as of December 31, 2008:

Guarantee provided to	Guaranteed amount (US\$ in thousands)	Description
Yemen LNG Company Ltd.	<u>\$ 32,831</u>	Guarantee for project financing for Maribe LNG wells

8. Property, plant and equipment

Details of property, plant and equipment as of December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008		
	Cost	Accumulated depreciation	Net book value
Land	₩ 201,222	₩ -	₩ 201,222
Buildings	94,090	(20,000)	74,090
Structures	1,643,303	(318,708)	1,324,595
Machinery and equipment	396,626	(306,793)	89,833
Vehicles	2,154	(1,653)	501
Furniture and fixtures	30,306	(23,072)	7,234
Oil prospecting vessels	50,305	(40,459)	9,846
Construction-in-progress	258,955	-	258,955
	<u>₩ 2,676,961</u>	<u>₩ (710,685)</u>	<u>₩ 1,966,276</u>

	2007		
	Cost	Accumulated depreciation	Net book value
Land	₩ 194,922	₩ -	₩ 194,922
Buildings	90,629	(17,677)	72,952
Structures	1,238,361	(275,131)	963,230
Machinery and equipment	348,502	(273,577)	74,925
Vehicles	2,093	(1,555)	538
Furniture and fixtures	27,340	(19,210)	8,130
Oil prospecting vessels	46,974	(37,667)	9,307
Construction-in-progress	593,067	-	593,067
	<u>₩ 2,541,888</u>	<u>₩ (624,817)</u>	<u>₩ 1,917,071</u>

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8. Property, plant and equipment (cont'd)

Changes in the net book value of property, plant and equipment for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008					December 31,	
	January 1, 2008	Additions	Disposals	Depreciation	Others	2008	
Land	₩ 194,922	₩ -	₩ (136)	₩ -	₩ 6,436	₩ 201,222	
Buildings	72,952	7	(95)	(2,356)	3,582	74,090	
Structures	963,230	49,780	-	(43,578)	355,163	1,324,595	
Machinery and equipment	74,925	2,650	-	(37,986)	50,244	89,833	
Vehicles	538	270	(5)	(302)	-	501	
Furniture and fixtures	8,130	3,067	(1)	(4,025)	63	7,234	
Oil prospecting vessels	9,307	2,210	-	(2,793)	1,122	9,846	
Construction-in-progress	593,067	82,498	-	-	(416,610)	258,955	
	<u>₩ 1,917,071</u>	<u>₩ 140,482</u>	<u>₩ (237)</u>	<u>₩ (91,040)</u>	<u>₩ -</u>	<u>₩ 1,966,276</u>	

	2007					December 31,	
	January 1, 2007	Additions	Disposals	Depreciation	Others	2007	
Land	₩ 194,815	₩ -	₩ (6)	₩ -	₩ 113	₩ 194,922	
Buildings	78,032	2,171	(15)	(2,253)	(4,983)	72,952	
Structures	1,003,454	125	(55)	(42,008)	1,714	963,230	
Machinery and equipment	98,008	2,112	(40)	(26,033)	878	74,925	
Vehicles	622	277	(3)	(358)	-	538	
Furniture and fixtures	6,062	5,166	(72)	(3,793)	767	8,130	
Oil prospecting vessels	11,169	779	-	(2,641)	-	9,307	
Construction-in-progress	444,055	149,046	-	-	(34)	593,067	
	<u>₩ 1,836,217</u>	<u>₩ 159,676</u>	<u>₩ (191)</u>	<u>₩ (77,086)</u>	<u>₩ (1,545)</u>	<u>₩ 1,917,071</u>	

The value of the Company's land, as determined by the Government of the Republic of Korea for tax administration purposes, was ₩400,075 million and ₩391,143 million as of December 31, 2008 and 2007, respectively.

Details of insurance coverage of the Company as of December 31, 2008 are as follows (Korean won in millions):

Description	Insured	Korean won in millions	Insurance company
Center fire and Others	Buildings, machinery and equipment	₩ 20,034	Lotte Non-Life Insurance Co., Ltd. and others
Property all risks	Buildings, structures, machinery, supplies and oil stockpile	14,365,482	LIG Insurance Co., Ltd. and others
Terror	Facilities on land and sea (except for seabed)	2,772,469	Samsung Fire & Marine Insurance Co., Ltd. and others
BUOY	BUOY and pipelines	39,693	Lotte Non-Life Insurance Co., Ltd. and others
Drillship at all risks	Drillship (shipbody and equipment)	68,748	Lotte Non-Life Insurance Co., Ltd. and others
Donghae-1 gas fields	Machinery and fixtures	293,136	Hyundai Marine & Fire Insurance Co., Ltd. and others
Directors' liability	Main directors' & officers' liability for reparation	50,000	Samsung Fire & Marine Insurance Co., Ltd. and others

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9. Intangible assets

Intangible assets as of December 31, 2008 and 2007 consist of the following (Korean won in millions):

	2008	2007
Oil interests:		
Exploration	₩ 644,801	₩ 331,132
Development	318,635	274,643
Production	<u>2,220,668</u>	<u>919,665</u>
	3,184,104	1,525,440
Other intangible assets	<u>5,504</u>	<u>7,697</u>
	<u>₩ 3,189,608</u>	<u>₩ 1,533,137</u>

Changes in the net book value of oil interests for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

2008							
	Jan. 1, 2008	Increase	Decrease	Amortization	Impairment loss	Other changes (*)	Dec. 31, 2008
Oil interests in exploration	₩ 331,132	₩ 327,619	₩ (8,253)	₩ -	₩ (5,697)	₩ -	₩ 644,801
Oil interests in development	274,643	43,992	-	-	-	-	318,635
Oil interests in production	<u>919,665</u>	<u>1,417,937</u>	<u>(504)</u>	<u>(195,705)</u>	<u>-</u>	<u>79,275</u>	<u>2,220,668</u>
	<u>₩ 1,525,440</u>	<u>₩ 1,789,548</u>	<u>₩ (8,757)</u>	<u>₩ (195,705)</u>	<u>₩ (5,697)</u>	<u>₩ 79,275</u>	<u>₩ 3,184,104</u>

2007							
	Jan. 1, 2007	Increase	Decrease	Amortization	Impairment loss	Other changes (*)	Dec. 31, 2007
Oil interests in exploration	₩ 280,414	₩ 55,254	₩ -	₩ -	₩ (4,536)	₩ -	₩ 331,132
Oil interests in development	262,095	12,548	-	-	-	-	274,643
Oil interests in production	<u>920,756</u>	<u>185,507</u>	<u>-</u>	<u>(128,631)</u>	<u>-</u>	<u>(57,967)</u>	<u>919,665</u>
	<u>₩ 1,463,265</u>	<u>₩ 253,309</u>	<u>₩ -</u>	<u>₩ (128,631)</u>	<u>₩ (4,536)</u>	<u>₩ (57,967)</u>	<u>₩ 1,525,440</u>

(*) Change due to increase or decrease in provision for restoration costs.

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9. Intangible assets (cont'd)

Changes in the net book value of other intangible assets for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

2008						
	Jan. 1, 2008	Increase	Decrease	Amortization	Other changes	Dec. 31, 2008
Industrial property rights	₩ 2	₩ -	₩ -	₩ (2)	₩ -	₩ -
Development costs	5,224	160	-	(2,325)	-	3,059
Others	2,471	1,001	-	(1,027)	-	2,445
	<u>₩ 7,697</u>	<u>₩ 1,161</u>	<u>₩ -</u>	<u>₩ (3,354)</u>	<u>₩ -</u>	<u>₩ 5,504</u>

2007						
	Jan. 1, 2007	Increase	Decrease	Amortization	Other changes	Dec. 31, 2007
Industrial property rights	₩ 5	₩ -	₩ -	₩ (3)	₩ -	₩ 2
Development costs	3,867	4,412	-	(1,290)	(1,765)	5,224
Others	2,476	383	-	(1,388)	1,000	2,471
	<u>₩ 6,348</u>	<u>₩ 4,795</u>	<u>₩ -</u>	<u>₩ (2,681)</u>	<u>₩ (765)</u>	<u>₩ 7,697</u>

10. Other non-current assets

Other non-current assets as of December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
Loans to employees (see Note 7)	₩ 12,056	₩ 10,400
Others	<u>22,667</u>	<u>2,694</u>
	<u>₩ 34,723</u>	<u>₩ 13,094</u>

11. Short-term borrowings

Short-term borrowings of the Company as of December 31, 2008 and 2007 are as follows:

Lender	Description	Interest rate (%)	2008		2007	
			US dollars in thousands	Korean won in millions	US dollars in thousands	Korean won in millions
BNP Paribas Bank	General operations	6M LIBOR+3.3	\$ 250,000	₩ 314,375	\$ -	₩ -
BNP Paribas Bank	General operations	6M LIBOR+3.3	<u>200,000</u>	<u>251,500</u>	-	-
			<u>\$ 450,000</u>	<u>₩ 565,875</u>	<u>\$ -</u>	<u>₩ -</u>

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12. Long-term borrowings

Long-term borrowings denominated in Korean won as of December 31, 2008 and 2007 are as follows (Korean won in millions):

Lender	Annual interest rate	2008		2007	
SAER for petroleum business	4.75% ~ 5.25%	₩	1,317,277	₩	1,486,528
Less: current portion			(208,056)		(193,826)
		₩	1,109,221	₩	1,292,702

Long-term borrowings denominated in foreign currencies as of December 31, 2008 and 2007 are as follows (Korean won in millions):

Lender	Annual interest rate	2008		2007	
		US dollars in thousands	Korean won equivalent	US dollars in thousands	Korean won equivalent
SAER for loan to 3rd party:					
Borrowings for exploration and production	(*)3.5%	\$ 797,949	₩ 1,003,421	\$ 656,129	₩ 615,581
Borrowings for general operations	2.5% ~ 4.75%	125,324	157,595	156,750	147,063
Less: current portion		(35,469)	(44,603)	(31,426)	(29,484)
		887,804	1,116,413	781,453	733,160
SAER for KNOC:					
Borrowings for exploration and production	(*)3.5%	644,221	703,715	511,021	518,935
Borrowings for general operations	3.5% ~ 4.5%	167,085	210,110	208,279	195,407
Less: current portion		(40,968)	(51,517)	(41,194)	(38,648)
		770,338	862,308	678,106	675,694
BNP Paribas Bank:					
Borrowings for general operations		-	-	11,000	10,320
Less: current portion		-	-	(11,000)	(10,320)
		-	-	-	-
Korea Development Bank:					
Borrowings for general operations	1M Libor + 0.17%	250,000	314,375	-	-
Less: current portion		(250,000)	(314,375)	-	-
		-	-	-	-
		\$ 1,658,142	₩ 1,978,721	\$ 1,459,559	₩ 1,408,854

(*) The principal amount of these borrowings is to be repaid on an installment basis dependent on the successful commercial production of oil. The Company's obligation to repay the principal amount will be exempted if the exploration is proven to be unsuccessful and withdrawn without any commercial production in accordance with the policy of the Ministry of Commerce, Industry and Energy ("MCIE") (No. 2001-27) on loans.

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12. Long-term borrowings (cont'd)

A summary of the repayment schedule of long-term borrowings as of December 31, 2008 is as follows (Korean won in millions):

Year	Korean won denominated borrowings	Foreign currency denominated borrowings	Total
2009	₩ 208,056	₩ 410,495	₩ 618,551
2010	226,679	93,953	320,632
2011	149,932	75,711	225,643
2012	166,930	20,354	187,284
2013 and thereafter	565,680	81,567	647,247
	₩ 1,317,277	₩ 682,080	₩ 1,999,357

Borrowings of ₩1,707,136 million that are dependent on the successful commercial production of oil as described above are not included in the above repayment schedule of long-term borrowings.

13. Asset-backed securitization ("ABS") liabilities

During 2006, the Company entered into a contract to borrow money in exchange for transferring future trade receivables from Vietnam 15-1 oil interests to be generated for the next five years with an overseas resources investment company under the Overseas Resources Development Business Act. ABS liabilities as of December 31, 2008 and 2007 are as follows (Korean won in millions):

	Description	2008	2007
Vietnam 15-1	ABS liabilities	₩ 94,066	₩ 145,755
	Less: current portion	(43,612)	(51,688)
		₩ 50,454	₩ 94,067

14. Severance and retirement benefits

Changes in net carrying amount of the liability for severance and retirement benefits for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
As of January 1,	₩ 44,570	₩ 33,786
Provision during the year	9,702	12,383
Payments during the year	(4,704)	(1,600)
	49,568	44,569
Less: operational assets for pension plan	(39,367)	(28,996)
As of December 31,	₩ 10,201	₩ 15,573

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14. Severance and retirement benefits (cont'd)

Under the defined benefit plan as described in Note 2, the Company has partially funded its liability for severance and retirement benefits at 79% as of December 31, 2008 (65% as of December 31, 2007) and the funds contributed are administered by the Samsung Life Insurance Co., Ltd. and others. The Company accounts for the funds contributed as a deduction from the liability for severance and retirement benefits. The details of the contributed funds as of December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008		2007	
Short-term and long-term financial instruments	₩	32,559	₩	24,537
Investment securities		5,406		4,048
Loans		618		69
Others		784		342
	₩	<u>39,367</u>	₩	<u>28,996</u>

15. Assets and liabilities denominated in foreign currencies

Assets and liabilities denominated in foreign currencies as of December 31, 2008 and 2007 are as follows:

	2008				2007			
	Foreign currencies (in thousands)		Korean won equivalent (in millions)		Foreign currencies (in thousands)		Korean won equivalent (in millions)	
Assets:								
Cash and cash equivalents	US\$	85,561	₩	107,593	US\$	50,664	₩	47,533
	CAD	479		497	CAD	476		456
	SGD	9		8	SGD	-		-
	PEN	4,269		1,709	PEN	-		-
Trade accounts receivable	US\$	74,258		93,404	US\$	153,172		143,706
Short-term and long-term loans (*)	US\$	923,334		1,161,093	US\$	812,941		762,701
Other current assets	US\$	18,119		22,785	US\$	27,380		25,668
	AUD	573		499	AUD	573		472
Other accounts receivable	US\$	18,165		22,843	US\$	32,916		30,882
Total assets	US\$	1,119,437	₩	1,410,431	US\$	1,077,073	₩	1,011,418
	AUD	573			AUD	573		
	CAD	479			CAD	476		
	SGD	9			SGD	-		
	PEN	4,269			PEN	-		
Liabilities:								
Other accounts payable	US\$	336,109	₩	422,657	US\$	111,366	₩	104,483
	GBP	35		64	GBP	161		302
	EUR	-		-	EUR	535		738
	SGD	1,314		1,151	SGD	1,150		746
	AUD	-		-	AUD	304		250
	CAD	1,969		2,044	CAD	58		55
Short-term borrowings	US\$	450,000		565,875	US\$	-		-
Current portion of long-term borrowings	US\$	326,437		410,495	US\$	83,620		78,453
Long-term borrowings (*)	US\$	1,658,142		1,978,721	US\$	1,459,559		1,408,854
Total liabilities	US\$	2,770,688	₩	3,381,007	US\$	1,654,545	₩	1,593,881

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15. Assets and liabilities denominated in foreign currencies (cont'd)

2008		2007	
Foreign currencies (in thousands)	Korean won equivalent (in millions)	Foreign currencies (in thousands)	Korean won equivalent (in millions)
GBP	35	GBP	161
EUR	-	EUR	535
SGD	1,314	SGD	1,150
AUD	-	AUD	304
CAD	1,969	CAD	58

(*) Translation gains (losses) on loans and borrowings denominated in foreign currencies associated with exploratory oil fields are not recognized until the development of oil fields is proven to be a success (see Note 2).

16. Valuation of receivables and payables at present value

The present value and related discounts on short-term and long-term receivables and payables arising from long-term installment transactions or with unfavorable credit terms as of December 31, 2008 and 2007 are as follows (Korean won in millions):

		2008			
	Interest rate (%)	Maturity	Nominal amount	Present value	Present value discount
Short-term and long-term loans denominated in foreign currencies	5 ~ 7	2009 ~ 2012	₩ 3,191	₩ 2,841	₩ (350)
Long-term borrowings, including current portion, denominated in foreign currencies	4 ~ 6	2009 ~ 2012	3,191	2,800	(391)
Long-term trade accounts receivable	Floating rates reset quarterly	2010 ~ 2012	61,468	51,089	(10,379)
Long-term trade accounts payable	Floating rates reset quarterly	2010 ~ 2012	55,014	46,519	(8,495)
Trade accounts receivable	Floating rates reset quarterly	2009	15,343	15,343	-
Trade accounts payable	Floating rates reset quarterly	2009	13,570	13,570	-

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16. Valuation of receivables and payables at present value (cont'd)

	2007				
	Interest rate (%)	Maturity	Nominal amount	Present value	Present value discount
Short-term and long-term loans denominated in foreign currencies	5 ~ 7	2008 ~ 2012	₩ 3,664	₩ 3,185	₩ (479)
Long-term borrowings, including current portion, denominated in foreign currencies	4 ~ 6	2008 ~ 2012	3,664	3,129	(535)
Long-term trade accounts receivable	Floating rates reset quarterly	2009 ~ 2012	61,677	52,088	(9,589)
Long-term trade accounts payable	Floating rates reset quarterly	2009 ~ 2012	54,832	47,102	(7,730)
Trade accounts receivable	Floating rates reset quarterly	2008	16,204	16,204	-
Trade accounts payable	Floating rates reset quarterly	2008	14,436	14,436	-

The collection schedule of loans to SK Incheon Oil Co., Ltd., for which the Company borrowed from the SAER under the policy of the MCIE and made loans, was rescheduled from the period 2001 to 2005 to the period 2005 to 2012 as a result of court receivership determination on March 25, 2003. As such, the repayment schedule for the Company's borrowings from the SAER was rescheduled accordingly. SK Incheon Oil Co., Ltd. was merged with SK Energy Co., Ltd. on February 1, 2008.

Since Daehan Oil Pipeline Co., Ltd. ("DOPCO"), previously a government-controlled corporations, was privatized, the Company provided a loan to DOPCO through borrowings from the SAER under the policy of the MCIE. In 2002, original collection schedule for the period 2002 to 2007 was rescheduled to the period 2007 to 2012. The collection schedule for the Company's borrowings from the SAER was also rescheduled accordingly. As a result, the Company accounted for other bad debt expense of ₩12,232 million and ₩3,404 million for the years ended December 31, 2008 and 2007, respectively. Further, the Company recorded gains from liabilities exempted of ₩3,021 million and ₩2,812 million for the years ended December 31, 2008 and 2007, respectively.

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17. Provision for restoration costs

The Company accounts for the present value of restoration costs relating to oil fields, structures, and machinery and equipment as a provision (see Note 2). As of December 31, 2008, the Company's provision for restoration costs for the Peru 8 and Donghae-1 properties amounted to ₩3,933 million and ₩82,192 million, respectively. For the Vietnam 15-1, Vietnam 11-2, England Captain and Taylor properties, the Company's provision for restoration costs amounted to ₩9,660 million, ₩14,708 million, ₩19,007 million and ₩59,374 million, respectively, as of December 31, 2008.

Changes in the net carrying amount of the provision for restoration costs during 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
As of January 1,	₩ 116,367	₩ 183,750
Provision during the year (*1)	8,216	5,010
Adjustments during the year (*2)	64,291	(72,393)
As of December 31,	188,874	116,367
Less: deposits for restoration costs	(2,004)	-
	<u>₩ 186,870</u>	<u>₩ 116,367</u>

(*1) Provision for restoration costs for the England Captain property is accounted for as non-operating expense from oversea oil fields.

(*2) Adjustments include changes in estimated restoration costs and additional obligations assumed from acquisitions of oil fields.

18. Commitments and contingencies

As of December 31, 2008, the Company is a defendant in three pending lawsuits with total claims amounting to ₩2,215 million and a plaintiff in one pending lawsuit against the two individuals amounting to ₩555 million. The outcomes of these pending lawsuits and their impact on the Company's financial statements cannot presently be determined as of December 31, 2008.

The Company has obtained guarantees of US\$548,178 thousand in total from BNP Paribas Bank and Standard Chartered Bank and of ₩1,233 million from Seoul Guarantee Insurance Co., Ltd. associated with purchasing oil interests, exploration of OPL 321/323 and restoration of Donghae-1 gas fields as of December 31, 2008.

In November 2007, a consortium led by the Company and including SK Energy Co., Ltd. entered into an agreement for exploration and production in Bazian oil fields, located in Iraq, with the Kurdistan regional government, in accordance with the local Kurdish oil exploration laws. In January 2008, the Company and other participating companies were notified by the Iraqi federal government that such agreement, without obtaining proper approval from the federal government, would be invalid. The oil interests in exploration of ₩50,879 million are accounted for as intangible assets as of December 31, 2008. The Company was advised by legal consultants in England and in Iraq that there is no legal basis on the above alleging nullity of the agreement.

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18. Commitments and contingencies (cont'd)

Under a Joint Operating Agreement, Korea Captain Company Limited ("KCCL"), which is an investee of the Company and participates in the Captain oil fields as a non-operator, is liable for its proportionate share of any amounts paid out by the operator with respect to the operator's liability under Offshore Pollution Liability Association Limited ("OPOL"). KCCL's risk is restricted to incidents arising in the Captain oil fields in the North Sea. The operator's liability for each accident or occurrence under OPOL capped at US\$120,000 thousand and KCCL's share is therefore capped at US\$18,000 thousand.

19. Derivative financial instruments

Commodity swaps

The Company entered into commodity swaps as of December 31, 2008 for the purpose of hedging the exposure to changes in the fair value of and the variability in future cash flows of petroleum inventories and the details are as follows (Korean won in millions, BBL: Barrels):

Hedged asset	Objective	Counter-party	Due date	Sell or buy	Quantity (BBL)	Contract price	Fair value	Valuation loss
Oil stockpile	Fair value hedge	JP. Morgan and others	2009.1.31	Buy	2,000,000	₩ 221,324	₩ 107,944	₩ (113,380)
Commodity oil	Cash flow hedge	Barclay Capital and others	2009.12.31	Sell	1,000,000	61,942	68,043	(6,101)

In connection with valuation loss of ₩113,380 million from fair value hedge accounting on oil stockpile inventory, the Company recognized an equal gain from the corresponding firm commitment of future purchase.

Zero-cost collar option

The Company purchased a zero-cost collar option for the purpose of hedging exposure to variability in future cash flows of oil to be produced in the Taylor properties located in the United States and details of the contract are as follows (Korean won in millions):

Hedged asset	Objective	Counter-party	Due date	Sell or buy	Quantities (BBL)	Contract price	Fair value	Valuation gain (*)
Crude oil	Cash flow hedge	Morgan Stanley	2009.12.31	Sell	2,300,000	₩ 523,497	₩ 340,437	₩ 184,761
			2010.12.31	Sell	2,300,000			

(*) Gain on valuation from the options above consists of an intrinsic value component of ₩183,060 million and a time value component of ₩1,701 million as of December 31, 2008.

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20. Paid-in capital

The Company's paid-in capital is allowed to be invested solely by the Korean government in accordance with the Korean Oil Corporation Act and the authorized paid-in capital is W10 trillion as of December 31, 2008.

The changes in paid-in capital during the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

	<u>2008</u>
As of January 1, 2008	₩ 4,684,913
Increases during 2008:	
February 15 (increase for oil stockpiling business)	45,000
February 19 (increase for oil stockpiling business)	100,000
June 30 (increase for oil stockpiling business)	112,032
August 6 (increase for oil stockpiling business)	33,338
August 6 (increase for exploring and developing oil fields)	64,700
September 5 (increase for oil stockpiling business)	25,000
September 29 (increase for exploring and developing oil fields)	200,000
November 3 (increase for exploring and developing oil fields)	600,000
November 14 (increase for oil stockpiling business)	14,762
December 18 (increase for oil stockpiling business)	<u>35,070</u>
	<u>1,229,902</u>
As of December 31, 2008	<u>₩ 5,914,815</u>
	<u>2007</u>
As of January 1, 2007	₩ 3,964,542
Increases during 2007:	
March 20 (increase for oil stockpiling business)	24,180
March 28 (increase for oil stockpiling business)	85,000
April 24 (increase for oil stockpiling business)	34,522
June 29 (increase for oil stockpiling business)	130,096
June 29 (increase for exploring and developing oil fields)	97,218
December 28 (increase for oil stockpiling business)	91,873
December 28 (increase for exploring and developing oil fields)	<u>257,482</u>
	<u>720,371</u>
As of December 31, 2007	<u>₩ 4,684,913</u>

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21. Retained earnings

Retained earnings of the Company as of December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
Appropriated retained earnings:		
Legal reserve	₩ 537,966	₩ 446,096
Reserve for business expansion	536,523	444,653
	1,074,489	890,749
Unappropriated retained earnings	119,493	125,996
	₩ 1,193,982	₩ 1,016,745

Legal reserve

In accordance with the Korean Oil Corporation Act, an amount equal to at least 20% of net income for each accounting period is required to be appropriated as a legal reserve until the reserve equals 50% of paid-in capital after having offset an accumulated deficit with net income for the current year. The legal reserve may be transferred to the paid-in capital.

Reserve for business expansion

The Korean Oil Corporation Act requires the Company to appropriate, from retained earnings, an amount equal to at least 20% of net income for each accounting period as a reserve for business expansion until the reserve equals paid-in capital after having appropriated for the legal reserve. This reserve may be used to offset an accumulated deficit.

22. Accumulated other comprehensive income (loss)

Details of accumulated other comprehensive income (loss) of the Company as of December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
Gain on valuation of available-for-sale securities (Note 5)	₩ 206	₩ 1,187
Capital adjustment arising from equity method investments (Note 6)	1,223	232
Exchange differences on translation of foreign operations (Note 2)	245,098	(7,818)
Gain on valuation of derivative instruments (Note 19)	135,871	-
	₩ 382,398	₩ (6,399)

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23. Comprehensive income

The details of comprehensive income for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
Net income	₩ 200,193	₩ 166,740
Other comprehensive income (loss):		
Gain (loss) on valuation of available-for-sale securities, less tax effect of ₩185 million in 2008 and ₩450 million in 2007	(981)	1,187
Capital adjustment arising from equity method investments, less tax effect of ₩283 million in 2008 and nil in 2007	991	232
Exchange differences on translation of foreign operations, less tax effect of ₩63,201 million in 2008 and nil in 2007	252,916	1,899
Gain on valuation of derivative instruments, less tax effect of ₩41,087 million in 2008	135,871	-
	388,797	3,318
Comprehensive income	₩ 588,990	₩ 170,058

24. Dividends

The dividend rates for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
Cash dividends (A)	₩ 25,138	₩ 22,956
Paid-in capital (B)	5,914,815	4,684,913
Dividend rate (A/B)	0.425%	0.490%

The dividend payout ratios for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007 (*)
Cash dividends (A)	₩ 25,138	₩ 22,956
Net income (B)	200,193	166,740
Dividend payout ratio (A/B)	12.56%	13.77%

(*) The dividend payout ratio as of December 31, 2007 is restated and the dividend payout ratio before restatement was 11.11%.

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25. Selling and administrative expenses

Details of selling and administrative expenses for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
Salaries	₩ 37,432	₩ 28,611
Provision for severance and retirement benefits	4,837	5,389
Other employee benefits	6,875	8,265
Travel	919	997
Communications	278	237
Utilities	380	373
Taxes and public dues	3,036	2,491
Supplies	231	280
Clothing	113	104
Books and printing	190	232
Rent	61	74
Depreciation	2,625	2,680
Amortization	3,179	2,508
Maintenance	1,034	870
Vehicle maintenance	703	644
Insurance	64	26
Commissions and fees	3,280	3,854
Entertainment	162	110
Advertisement	634	775
Training	1,974	1,758
Research	4	5
Rewards	74	86
Registry and legal fees	459	684
Association	238	77
Development expense	9,169	3,379
Miscellaneous	624	677
	<u>₩ 78,575</u>	<u>₩ 65,186</u>

26. Income taxes

For the financial year ended December 31, 2008, the Company is subject to corporate income taxes, including resident surtax, at the aggregate rates of 12.1% on taxable income up to ₩200 million and 27.5% on taxable income in excess of ₩200 million (in 2007, at the aggregate rates of 14.3% on taxable income up to ₩100 million and 27.5% on taxable income in excess of ₩100 million). The aggregate tax rate will be reduced to 24.2% for 2009 and 22% for 2010 and thereafter on taxable income in excess of ₩200 million.

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26. Income taxes (cont'd)

The components of the provision for income taxes for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

	2008	2007
Current income taxes	₩ 177,776	₩ 158,381
Deferred income taxes arising from tax effect of temporary differences	98,346	(13,200)
Current and deferred income taxes recognized directly to equity	(104,757)	(450)
Provision for income taxes	<u>₩ 171,365</u>	<u>₩ 144,731</u>

A reconciliation of the provision for income taxes applicable to income before income taxes at the Korea statutory tax rate to the provision for income taxes at the effective income tax rate of the Company is as follows (Korean won in millions):

	2008
Income before income taxes	<u>₩ 371,558</u>
Tax at the statutory income tax rate of 27.5%	₩ 102,178
Adjustments:	
Expenses not deductible for tax purposes (₩176,959 million)	48,664
Income not subject to tax purposes (₩99,614 million)	(27,394)
Income taxes from overseas investees	83,944
Change in statutory tax rate and others	(36,027)
Provision for income taxes	<u>₩ 171,365</u>
Effective income tax rate	<u>46.12%</u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for corporate income tax reporting purposes. Significant changes in cumulative temporary differences and deferred income tax assets and liabilities for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

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26. Income taxes (cont'd)

2008								
	Jan. 1, 2008	Change in tax filing	Net increase (decrease)	Dec. 31, 2008	Deferred income tax assets (liabilities)	Current	Non-current	
Accrued income	₩ (2,222)	₩ (491)	₩ (2,765)	₩ (5,478)	₩ (1,326)	₩ (1,326)	₩ -	
Severance & retirement benefits	28,970	-	-	28,970	6,373	-	6,373	
Deposits for severance & retirement benefits	(28,970)	-	-	(28,970)	(6,373)	-	(6,373)	
Impairment loss on available-for-sale securities	6,037	-	-	6,037	1,328	-	1,328	
Equity in earnings of equity method investments	(613)	143	(2,057)	(2,527)	(556)	-	(556)	
Equity in earnings from overseas oil interests (KNOC USA)	-	-	(38,297)	(38,297)	(8,425)	-	(8,425)	
Capital adjustment from overseas oil interests (KNOC USA)	-	-	(219,532)	(219,532)	(48,297)	-	(48,297)	
Capital adjustment arising from equity method investments	(14,712)	17,507	(71,825)	(69,030)	(15,187)	-	(15,187)	
Depreciation	8,771	-	-	8,771	1,930	-	1,930	
Amortization	6,515	(465)	(2,064)	3,986	877	-	877	
Present value discount	(8,265)	-	(621)	(8,886)	(2,150)	(2,150)	-	
Oil interests in production	(59,919)	-	(2,930)	(62,849)	(13,827)	-	(13,827)	
Provision for restoration costs	97,581	-	12,912	110,493	24,308	-	24,308	
Impairment loss on oil interests	39,777	-	5,697	45,474	10,004	-	10,004	
Depreciation - Peru (*1)	(13,812)	-	2,894	(10,918)	(3,275)	-	(3,275)	
Restoration costs - Peru (*1)	1,638	-	(994)	644	193	-	193	
Gain on foreign currency translation	-	-	139,356	139,356	33,724	33,724	-	
Gain on valuation of firm commitments	-	-	(306,331)	(306,331)	(67,393)	-	(67,393)	
Gain on valuation of derivatives	-	-	113,380	113,380	27,438	27,438	-	
Gain on valuation of derivatives (capital adjustment)	-	-	(176,960)	(176,960)	(41,087)	(23,720)	(17,367)	
Others (*2)	46,888	81	38,175	85,144	18,732	-	18,732	
Total	₩ 107,664	₩ 16,775	₩ (511,962)	₩ (387,523)	₩ (82,989)	₩ 33,966	₩ (116,955)	
Tax rates	27.5%			24.2%, 22%				
Deferred income tax assets (liabilities), net	₩ 15,356			₩ (82,989)				

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26. Income taxes (cont'd)

	2007					
	Jan. 1, 2007	Net increase (decrease)	Dec. 31, 2007	Deferred income tax assets (liabilities)	Current	Non-current
Accrued income	₩ (2,335)	₩ 113	₩ (2,222)	₩ (611)	₩ (611)	₩ -
Severance & retirement benefits	20,272	8,698	28,970	7,967	-	7,967
Deposits for severance & retirement benefits	(20,272)	(8,698)	(28,970)	(7,967)	-	(7,967)
Equity in earnings from overseas oil interests	(37,246)	(27,104)	(64,350)	(17,696)	-	(17,696)
Impairment loss on available-for-sale securities	6,037	-	6,037	1,660	-	1,660
Equity in earnings of equity method investments	(452)	(161)	(613)	(168)	-	(168)
Depreciation	8,988	(217)	8,771	2,412	-	2,412
Amortization	6,515	-	6,515	1,792	-	1,792
Present value discount	(8,376)	111	(8,265)	(2,273)	(2,273)	-
Oil interests in production	(139,566)	79,647	(59,919)	(16,478)	-	(16,478)
Provision for restoration costs	166,238	(68,657)	97,581	26,835	-	26,835
Gain on valuation of derivatives	(3,719)	3,719	-	-	-	-
Impairment loss on oil interests	40,695	(918)	39,777	10,939	-	10,939
Depreciation - Peru	(13,307)	(505)	(13,812)	(3,798)	-	(3,798)
Restoration cost - Peru	1,649	(11)	1,638	450	-	450
Capital adjustment arising from equity method investments	(12,915)	(1,797)	(14,712)	-	-	-
Others (*2)	20,097	26,791	46,888	12,292	-	12,292
Total	₩ 32,303	₩ 11,011	₩ 43,314	₩ 15,356	₩ (2,884)	₩ 18,240
Tax rates	27.5%		27.5%			
Deferred income tax assets, (liabilities), net	₩ 3,135		₩ 15,356			

(*1) Deferred income tax assets and liabilities arising from these temporary differences in Peru as of December 31, 2008 are calculated based on the expected local income tax rate of 30.0%.

(*2) The effect of change in accounting policy prior to 2008 was adjusted as of January 1, 2008.

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27. Value added information

In accordance with SKAS 21 *Preparation and Presentation of Financial Statements*, the “value added” items as defined by the standard, which are required to be disclosed by the Company for the years ended December 31, 2008 and 2007, are as follows (Korean won in millions):

	2008	2007
Salaries	₩ 82,611	₩ 72,845
Severance and retirement benefits	10,103	12,383
Employee benefits	14,559	19,063
Rental expense	2,358	1,149
Depreciation	91,040	77,086
Amortization	199,059	131,312
Taxes and dues	10,616	10,139

28. Environmental consideration

The Company established environmental objectives from mid-term to long-term and detailed strategies to meet its objectives. This is due to the potential safety problems and the Company’s inherent business risks, including contamination or pollution of water, soil and sea that may occur during construction of stockpiling facilities, development of petroleum resources or preservation of oil in reserve stock.

To ensure both systematic implementation of environmental policies and efficiency of allocation and investment of resources, the Company adopted ISO 14000 in 1998 and has been operating under the system.

29. Employee welfare, contributions to society and human resources development

For employee welfare, the Company maintains a refectory, an infirmary, athletic facilities, a scholarship fund, workmen’s accident compensation insurance, medical insurance, and other benefits. The expenses incurred for welfare programs during the years ended December 31, 2008 and 2007 were ₩14,559 million and ₩19,063 million, respectively.

The Company donated ₩536 million and ₩511 million to the internal labor welfare fund related to oil development and others for the years ended December 31, 2008 and 2007, respectively.

Expenditures associated with development of specialization in human resources during the years ended December 31, 2008, 2007 and 2006 are as follows (Korean won in millions):

	2008	2007	2006	Total
Training	₩ 2,748	₩ 2,412	₩ 1,705	₩ 6,865

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30. Segment information

The Company engages in the following major businesses, and sales by the business segment for the years ended December 31, 2008 and 2007 are as follows (Korean won in millions):

Segment	Main goods (or services)	
Oil resource development	Exploration and development of domestic and overseas oil resources	
Stockpiling of oil	Imports and exports of crude oil and petroleum products; lending and sales of oil stockpile; management, operation and lending of oil stockpiling facilities	
Financing	Financing for companies operating in energy and natural resources industries	
Drillship chartering	Drillship chartering business	
Other	Incidental income from the above businesses	

	2008	2007
Oil resource development	₩ 1,115,162	₩ 829,287
Stockpiling of oil	130,959	58,723
Financing	382,100	127,028
Drillship chartering	108,242	36,895
Other	11,017	17,402
	<u>₩ 1,747,480</u>	<u>₩ 1,069,335</u>

31. Acquisition of Petro-Tech properties

The Company acquired Offshore International Group Inc. ("OIG") on February 5, 2009 jointly with Ecopetrol S.A., which is a government-owned company in Columbia. The Company and Ecopetrol S.A. have a 50% of ownership interest in OIG, respectively. OIG owns Petro-Tech Peruana S.A. which is located in Peru and has one oil producing well and ten exploratory wells.

32. Approval of 2008 financial statements

The accompanying financial statements for the year ended December 31, 2008 are scheduled to be approved at the Board of Directors' meeting to be held on February 25, 2009.