

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Financial Statement Presentation

The Company maintains its official accounting records in Korean won and prepares statutory financial statements in the Korean language (Hangul) in conformity with the accounting principles generally accepted in the Republic of Korea. 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. Certain information included in the Korean language financial statements, but not required for a fair presentation of the Company's financial position, results of operations, changes in shareholders' equity or cash flows, is not presented in the accompanying financial statements.

The Company prepared its financial statements as of December 31, 2007 in accordance with the revised Statements of Korea Accounting Standards ("SKAS") No. 16 "Income Taxes", new SKAS No. 21 "Preparation and Presentation of Financial Statements", No. 22 "Share-based Payment" and No. 23 "Earnings per Share", effective from January 1, 2007. Major changes compared with the standard applied in preparing the 2007 financial statements are as follows:

<u>Statements of Korea Accounting Standards</u>	<u>Major changes</u>
No. 16 Income Taxes	- To include additional income tax and income tax refunds in income tax expenses
No. 21 Preparation and Presentation of Financial Statements	- To prepare the statement of changes in shareholders' equity as a complete set of financial statements - To use accounts, 'Other non-current assets', and 'accumulated other comprehensive income' in preparing balance sheets
No. 23 Earnings per Share	- To present on the face of the income statement basic and diluted earning per share and disclose earning per share for profit or loss from discontinued operations

The Company restated the non-consolidated balance sheet as of December 31, 2006, and non-consolidated statements of income and cash flows for the year ended December 31, 2006, which are presented for comparative purposes, in accordance with the SKAS No.16, No.21 and No.23. Such restatement had no effect of net assets and net income of comparable period. Also, the Company did not prepare the statement of changes in shareholders' equity for the year ended December 31, 2006 for comparative purposes in accordance with the transition provision of SKAS No.21

The significant accounting policies followed by the Company in the preparation of its non-consolidated financial statements are summarized below.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and in banks and short-term financial instruments with original maturities of less than ninety days, which can be converted into cash and whose risk of value fluctuation arising from changes of interest rates is not material.

Allowance for Doubtful Accounts

The Company provides an allowance for doubtful accounts based on management's estimate of the

collectability of receivables and prior years' collection experience.

When interest rate and repayment period are changed unfavorably for the Company by a court imposition such as commencement of reorganization or by mutual agreements and the difference between nominal value and present value is material, the difference is presented as bad debt expenses.

Inventories

Inventories are stated at the lower of cost or net realized value. Cost is determined using the moving average method, except for materials in-transit for which cost is determined using the specific identification method. Quantities of inventories at year-end are determined based on physical counts. If the net realizable value of inventories is lower than cost, inventories are adjusted to net realizable value and the difference between cost and revalued amount is charged to current operations.

Investments in Securities Other than those Accounted for Using the Equity Method

Classification of Securities

At acquisition, the Company classifies securities into one of the three categories; trading, held-to-maturity or available-for-sale. Trading securities are those that were acquired principally to generate profits from short-term fluctuations in prices. Held-to-maturity securities are those with fixed or determinable payments and fixed maturity that the Company has the positive intent and ability to hold to maturity. Available-for-sale securities are those not classified as either held-to-maturity or trading securities. Trading securities are classified as current assets, whereas available-for-sale and held-to-maturity securities are classified as non-current assets, except for those whose maturity dates or whose likelihood of being disposed of are within one year from balance sheet date, which are classified as current assets.

Valuation of Securities

Securities are recognized initially at cost, which includes the market price of the consideration given to acquire them and incidental expenses. If the market price of the consideration is not reliably determinable, the market prices of the securities purchased are used as the basis for measurement. If neither the market prices of the consideration given nor those of the acquired securities are available, the acquisition cost is measured at the best estimates of its fair value.

After initial recognition, held-to-maturity securities are stated at amortized cost. The difference between their acquisition costs and face values of held-to-maturity securities is amortized over the remaining term of the securities by applying the effective interest method and added to or subtracted from the acquisition costs and interest income of the remaining period. Trading securities are valued at fair value, with unrealized gains or losses included in current operations. Available-for-sales securities are also valued at fair value, with unrealized gains or losses included in accumulated other comprehensive income (loss), until the securities are sold or if the securities are determined to be impaired and accumulated other comprehensive income (loss) is included in current income. However, available-for-sales securities that are not traded in an active market and whose fair values cannot be reliably estimated are accounted for at their acquisition costs. For those securities that are traded in an active market, fair values refer to those quoted market prices, which are measured as the closing price at the balance sheet date. The fair value of non-marketable securities are measured at the discounted future cash flows by using the discount rate that appropriately reflects the credit rating of issuing entity assessed by a publicly reliable independent credit rating agency. If application of such measurement method is not feasible, estimates of the fair values may be made using a reasonable valuation model or quoted market prices of similar debt securities issued by entities conducting similar business in similar industries.

Securities are evaluated at each balance sheet date to determine whether there is any objective evidence of impairment loss. When any such evidence exists, unless there is a clear counter-evidence that recognition of impairment is unnecessary, the Company estimates the recoverable amount of the impaired security and recognizes any impairment loss in current operations. The amount of impairment loss of the held-to-maturity security or non-marketable equity security is measured as the difference between the recoverable amount and the carrying amount. The recoverable amount of held-to maturity security is the present value

of expected future cash flows discounted at the securities' original effective interest rate. For available-for-sale debt or equity security, the amount of impairment loss to be recognized in the current period is determined by subtracting the amount of impairment loss of debt or equity security already recognized in prior period from the amount of amortized cost in excess of the recoverable amount for debt security or the amount of the acquisition cost in excess of the fair value for equity security.

If the realizable value subsequently recovers, in case of a security stated at fair value, the increase in value is recorded in current operations, up to the amount of the previously recognized impairment loss, while for the security stated at amortized cost or acquisition cost, the increase in value is recorded in current operation, so that its recovered value does not exceed what its amortized cost would be as of the recovery date if there had been no impairment loss.

When transfers of securities between categories are needed because of changes in an entity's intention and ability to hold those securities, such transfer is accounted for as follows: trading securities cannot be reclassified into available-for-sale and held-to-maturity securities, and vice versa, except when certain trading securities lose their marketability. Available-for-sale securities and held-to-maturity securities can be reclassified into each other after fair value recognition. When held-to-maturity security is reclassified into available-for-sale security, the difference between the book value and fair value is reported in accumulated other comprehensive income (loss). Whereas, in case available-for-sale security is reclassified into held-to-maturity securities, the difference is reported in accumulated other comprehensive income (loss) and amortized over the remaining term of the securities using the effective interest method. If held-to-maturity securities are disposed or redeemed before the maturity date, any securities could not be categorized to held-to-maturity within 3 fiscal years after the disposal and redemption.

Investment Securities Accounted for Using the Equity Method

Equity securities held for investment in companies in which the Company is able to exercise significant influence over the operating and financial policies of the investees are accounted for using the equity method. Differences between the initial purchase price and the Company's initial proportionate ownership of the net book value of the investee are amortized over the reasonable periods within 20 years using the straight-line method. Under the equity method, the change in the Company's portion of an investee's net equity resulting from a change in an investee's net equity is reflected in the Company's net income (loss), retained earnings and accumulated other comprehensive income (loss), in accordance with the causes of the change, which consist of the investee's net income (loss), changes in retained earnings and changes in capital surplus, capital adjustments and accumulated other comprehensive income (loss). Unrealized profit arising from sales by the Company to subsidiaries of investor is fully eliminated. The Company's proportionate unrealized profit arising from sales by the equity method investees to the Company or sales between equity method investees is also eliminated.

If the amount recoverable from investment securities accounted for using the equity method is less than its carrying amount, impairment loss is recognized. The Company determines whether there is objective evidence that impairment loss has been incurred, and when such evidence exists, impairment loss is recognized as impairment loss. The recoverable amount is determined as the higher of value in use or expected amount of net cash inflows from disposal of the investment securities accounted for using the equity method. The amount of impairment loss is included in current earnings.

When applying the equity method by translating the financial statements of an investee operating overseas, the Company applies (a) the foreign exchange rate as of the Company's balance sheet date to the investee's assets and liabilities, (b) the foreign exchange rate as of the date on which the Company acquired its equity interest in the investee to the Company's share of the investee's equity interest, and (c) the foreign exchange rate as of each transaction date to the remaining equity interest in the investee after excluding any increase in retained earnings after the Company's acquisition of its equity interest in the investee. For the income statement items, the average rate for the pertinent period is applied in the translation. After translating into Korean won (KRW), from the difference between the total equity and the amount obtained by deducting liabilities from assets, the amount relating to the Company's share of the investee's equity interest is accounted for as accumulated other comprehensive income (loss).

Property, Plant and Equipment and Related Depreciation

Property, plant and equipment are stated at cost, (except for assets revalued upward in accordance with the Asset Revaluation Law of Korea), net of accumulated depreciation. The acquisition cost of property, plant, and equipment is comprised of its purchase price or manufacturing costs and any other directly attributable costs of bringing the asset to the working condition of its intended use. Any trade discounts and rebates are deducted in arriving at the purchase price.

Routine maintenance and repairs are expensed as incurred. Expenditures that result in the enhancement of the value or extension of the useful lives of the facilities involved are treated as additions to property, plant and equipment. The interest incurred on borrowings to finance the purchase of construction of property, plant and equipment and manufacture of inventories are charged to current income.

Depreciation is computed using the straight-line method, based on the estimated useful lives of the assets as described below.

	<u>Useful lives (years)</u>
Buildings and structures	20
	– 40
Machinery and equipment	10
Ships	12
Vehicles	5
Tools, furniture and fixtures	5

The Company assesses any possible recognition of impairment loss when there is an indication that expected future economic benefits of a property, plant and equipment is considerably less than its carrying amount as a result of technological obsolescence or rapid decline in market value. When it is determined that a property, plant and equipment may have been impaired and that its estimated total future cash flows from continued use or disposal is less than its carrying amount, the carrying amount of a property, plant and equipment is reduced to its recoverable amount and the difference is recognized as an impairment loss. If the recoverable amount of the impaired asset exceeds its carrying amount in subsequent reporting period, the amount equal to the excess is treated as reversal of the impairment loss; however, it cannot exceed the carrying amount that would have been determined had no impairment loss been recognized.

Intangible Assets

Intangible assets, such as development costs and usage rights for the donated properties, are stated at cost, net of accumulated amortization, which is computed using the straight-line method based on the estimated service lives of the intangibles assets as described below.

	<u>Service lives (years)</u>
Development costs	5
Usage right for donated properties	20 - 40

Development costs are incurred in respect of particular development activities and directly related to new products or technology. The Company's management believes that the value of development costs will be recovered through their future economic benefits.

Discounts on Debentures

Discounts on debentures are amortized over the redemption period of the debentures using the effective interest rate method. Amortization of discounts is recognized as interest expense on the debentures.

Foreign Currency Translation

The Company maintains its accounts in Korean won. Transactions in foreign currencies are recorded in Korean won based on the prevailing exchange rates on the transaction date. Monetary accounts with balances denominated in foreign currencies are recorded and reported in the accompanying financial statements at the exchange rates prevailing at the balance sheet dates. The balances have been translated using the Seoul Money Brokerage Service Ltd. Basic Rate, which was ₩938.20 and ₩929.60 to USD1.00 at December 31, 2007 and 2006, respectively, and translation gains or losses are reflected in current operations.

Provision for Foreseeable Losses from Construction Contracts

When a loss on construction is expected based on cost estimates, the expected loss is charged to current operations and is included in the balance sheet as a provision for foreseeable losses from construction contracts.

Provision for Construction Warranty

The Company generally provides a warranty within the contract on rectification of defects after the contract's completion and accrues the rectification expense on defects based on actual claims history as provision for construction warranty.

Provision for Product Warranty

The Company generally provides a warranty relating to product defects for a specified period of time after sales and accrues estimated costs as provision for product warranty, which may occur due to product liabilities suits.

Accrued Severance Benefits

Employees and directors with more than one year of service are entitled to receive a lump-sum payment upon termination of their services with the Company, based on their length of service and rate of payment at the time of termination. Accrued severance benefits that would be payable assuming all eligible employees were to terminate their employment amount to ₩1,190,834,067 thousand and ₩1,135,188,486 thousand as of December 31, 2007 and 2006, respectively (see Note 10). Accrued severance benefits are funded approximately 87.6% and 79.3% as of December 31, 2007 and 2006, respectively, through certain insurance plans with Kyobo Life Insurance Co., Ltd. and other insurance companies. The unused portion of severance insurance deposits for these insurance plans is deducted from accrued severance benefits.

Revenue Recognition

Revenues from long-term contracts, including shipbuilding contracts, are recognized using the percentage-of-completion method, measured by the units of work performed. Revenues from other sales are recognized upon delivery of goods.

Under the percentage-of-completion method, revenues are recognized based on the percentage of costs incurred (including man hours and raw material costs) over total estimated costs for each contract. As a result, the timing of revenue recognition of which the Company reports may differ materially from the timing of actual contract payments received. The Company's estimates reflect information during construction activities. In addition, since most contracts are completed over several months, the timing of the recognition of related revenues could have a significant impact on quarterly operating results. The revenue recognized in excess of the payment received by the Company is reflected as accounts receivable, while the payments received in excess of the revenue recognized by the Company are reflected as advances from customers. The expenditures incurred before the construction contract is entered into are recognized as prepaid construction costs, if they are directly related to making a contract, separately identifiable and reliably

measurable, and an agreement to construction is probable. The prepaid construction costs are transferred to construction cost at the commencement of the construction.

Income Tax Expense

The Company recognizes income tax expenses determined by adding or deducting changes in deferred income tax assets (liabilities) to or from total income tax and surtaxes to be paid by tax law for the current period. The deferred income tax assets or liabilities will be charged or credited to income tax expense in the period each temporary difference (the difference between the tax basis of assets or liabilities and the book value) reverses in the future. The Company recognizes deferred tax liabilities basically for all taxable temporary differences, but recognizes deferred tax assets for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized. Also, the Company recognizes deferred tax assets for all deductible temporary differences arising from investments in subsidiaries and associates to the extent that it is probable that the temporary difference will be reversed in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized. In addition, current tax and deferred tax is charged or credited directly to equity if the tax relates to items that are credited or charged directly to equity in the same or different period. Deferred tax assets and liabilities are classified as current or non-current based on the classification of the related assets or liabilities for financial reporting.

Derivative Instruments

All derivative instruments are accounted for at fair value with the valuation gain or loss recorded as an asset or liability. If the derivative instrument is not part of a transaction qualifying as a hedge, the adjustment to fair value is reflected in current operations. The accounting for derivative transactions that are part of a qualified hedge based both on the purpose of the transaction and on meeting the specified criteria for hedge accounting differs depending on whether the transaction is a fair value hedge or a cash flow hedge. Fair value hedge accounting is applied to a derivative instrument designated as hedging the exposure to changes in the fair value of an asset or a liability or a firm commitment (hedged item) that is attributable to a particular risk. The gain or loss both on the hedging derivative instruments and on the hedged item attributable to the hedged risk is reflected in current operations.

Cash flow hedge accounting is applied to a derivative instrument designated as hedging the exposure to variability in expected future cash flows of an asset or a liability or a forecast transaction that is attributable to a particular risk. The effective portion of gain or loss on a derivative instrument designated as a cash flow hedge is recorded as an accumulated other comprehensive income (loss) and the ineffective portion is recorded in current operations. The effective portion of gain or loss recorded as an accumulated other comprehensive income (loss) is reclassified to current earnings in the same period during which the hedged forecasted transaction affects earnings. If the hedged transaction results in the acquisition of an asset or the incurrence of a liability, the gain or loss in accumulated other comprehensive income (loss) is added to or deducted from the asset or the liability.

Cumulative Effect from Change in Accounting Policy

The Company accounted the investment securities in Hyundai Samho Heavy Industries Co., Ltd. ("HSHI") using the equity method based on the financial statements provided by HSHI, where the investments of Hyundai Mipo Dockyard Co., Ltd. ("HMDC", the subsidiary of HSHI) in the Company's share were included as available-for-sale securities. However, according to the new accounting interpretation (2007-08) announced by Financial Supervisory Service of Korea, the Company has changed its accounting policy from the above method to accounting for as a treasury stock on the HMDC's investment securities in the Company's shares.

As a result, the Company's investment securities accounted for using the equity method decreased by ₩350,772,853 thousand, deferred income tax liabilities decreased by ₩93,401,606 thousand, accumulated other comprehensive income decreased by ₩212,000,650 thousand and net income decreased by ₩45,370,597 thousand as of and for the year ended December 31, 2007, compared to the previous accounting method. In addition, the accompanying non-consolidated balance sheet as of December 31, 2006 and the non-consolidated statements of income and cash flows for the year ended December 31, 2006, which are presented for comparative purposes, were restated in accordance with the new interpretation above.

The effect of the change in the accounting policy on using the equity method on the Company's financial statements for the preceding three years is as follows:

Description	Korean won (In thousands)					
	2004		2005		2006	
	Before	After	Before	After	Before	After
Investment securities accounted for using the equity method	₩ 1,023,448,611	₩971,735,381	₩1,150,538,105	₩1,008,772,609	₩ 1,716,810,918	₩ 1,499,146,077
Deferred income tax assets (non-current)	-	-	-	28,937,557	-	-
Deferred income tax liabilities (non-current)	-	-	10,047,955	-	141,229,492	81,371,661
Changes in equity arising from application of the equity method	40,880,035	-	82,766,836	14,201,449	143,828,856	13,486,566
Negative changes in equity arising from application of the equity method	-	(10,833,195)	(15,203,288)	(49,417,886)	(22,366,243)	(49,830,963)