Effect on the statement of financial position

Estimated effect of implementation of IFRS 16 on the recognition of additional financial liabilities and related right-of-use assets:

	January 1st 2019
Right-of-use assets	
Land	626.5
Buildings and structures	9.9
Service stations	141.0
Vehicles	314.2
Total right-of-use assets	**1,091.6**
Lease liabilities	
Non-current liabilities	885.6
Current liabilities	206.0
Total lease liabilities	**1,091.6**

Effect on equity

The implementation of IFRS 16 will have no effect on retained earnings or equity as at January 1st 2019 due to the fact that the right-of-use assets and lease liabilities will be recognised in the same amount.

Effect on financial ratios

Given the fact that practically all lease contracts will be recognised in the consolidated statement of financial position, the implementation of IFRS 16 by the Group will affect its balance sheet ratios, including the debt to equity ratio. In addition, the implementation of IFRS 16 will result in changes to the profits metrics (e.g. operating profit, EBITDA) and to cash flows from operating activities. The Group has analysed the implications of these changes for the fulfilment of covenants contained in its credit facility agreements. No risk of default has been identified.

5. Use of accounting assumptions, estimates and judgements

The preparation of financial statements in accordance with the International Financial Reporting Standards requires a number of assumptions, judgements and estimates which affect the value of items disclosed in these financial statements.

Although the assumptions and estimates are based on the management's best knowledge of the current and future events and developments, the actual results might differ from the estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Any change in an accounting estimate is recognised in the period in which it was made if it refers exclusively to that period, or in the current period and future periods if it refers to both the current period and future periods. Material assumptions used in making the estimates are described in the relevant notes to these financial statements.

While making assumptions, estimates and judgements, the Company's Management Board (Management Board) relies on its experience and knowledge and may take into consideration opinions, analyses and recommendations issued by independent experts.

Critical assumptions and estimates

Employee benefit obligations

Employee benefit obligations are estimated using actuarial methods. For information on the actuarial assumptions and valuation of employee benefit obligations, see Note 24.3.

Depreciation and amortisation

Depreciation and amortisation of the assets of onshore and offshore oil and gas extraction facilities is calculated (using the units-of-production method) based on 2P hydrocarbon reserve estimates (proved and probable reserves), evaluated, revised and updated by the Group, as well as forecast production volumes from the individual oil and gas fields based on geological data, test production, subsequent production data and the schedule of work adopted in the long-term strategy.

Depreciation and amortisation charges on refining and other non-current assets are determined based on the expected useful lives of property, plant and equipment and intangible assets. The Group reviews the useful lives of its assets annually, based on current estimates. The relevant estimate update which had an effect on the Group's financial statements for 2018 applied in the first place to the Parent, which recorded a PLN 0.6m decrease in depreciation or amortisation of these assets.

Fair value of financial instruments

The fair value of financial instruments for which no active market exists is determined by means of appropriate valuation methods. In selecting the methods and assumptions appropriate for these objectives, the Group relies on professional judgement.
For more information on the assumptions adopted for the measurement of fair value of financial instruments, see Note 7.20.

Deferred tax assets

The Group recognises deferred tax assets if it is assumed that taxable income will be generated in the future against which the assets can be utilised. If taxable profit deteriorates in the future, this assumption may prove invalid. The Parent's Management Board reviews its estimates regarding the likelihood of recovering deferred tax assets taking into account changes in the factors on which such estimates were based, new information and past experience.

For information on deferred tax assets, see Note 10.3.

Impairment of cash-generating units, individual items of property, plant and equipment, and intangible assets

If there is any indication of impairment, the Group estimates the recoverable amounts of assets and cash-generating units. While determining the recoverable amount, such key variables as discount rates, growth rates and price indices are taken into account.

As at December 31st 2018, following an analysis of cash flows for individual cash-generating units and the required impairment tests for assets, the Group made necessary adjustments to assets and disclosed detailed information on the test assumptions and results in Note 13.

Provision for decommissioning of the upstream segment's facilities and site restoration

As at the end of each reporting period, the Group analyses the costs necessary to decommission oil and gas extraction facilities and the expenditure to be incurred on future site restoration. As a result of those analyses, the Group adjusts the value of the site restoration provision recognised in previous years to reflect the estimated amount of necessary future costs. Any changes in the estimated time value of money are also reflected in the amount of the provision. For information on the rules for recognition of those provisions and information on provisions disclosed in these financial statements for 2018, see Note 7.24.1 and Note 25.1, respectively.

Professional judgement in accounting

Joint control of an investee or operation

The Group and two or more investors jointly control an investee when they must act together to direct the relevant activities. In such cases, because no investor can direct the activities without the cooperation of other investors, no investor individually controls the investee. The Group assesses whether it shares control of an arrangement, which – in accordance with IFRS 11 *Joint Arrangements* – may be defined either as a joint venture or a joint operation, taking into consideration whether all parties to the arrangement have control of it, whether they share exposure, or rights, to variable returns from their involvement with the investee, and whether they have the ability to jointly use their power over the investee to affect the amount of their returns.

As at the end of the reporting period, the Group was involved in joint operations under projects carried out in the Heimdal fields in Norway, and in joint ventures (see Note 14), as defined in IFRS 11, and in that respect, considering all facts and circumstances, it had joint control.

As at December 31st 2018, the Group also held interests in the Sleipner gas fields in Norway. Upon their acquisition in December 2015 (see Note 13.1.3 in the consolidated financial statements for 2015), the Group entered into an agreement with the other holders of the Sleipner, Gungne, Loke, Alfa Sentral and PL046D licences. Considering the IFRS 11 criteria, the Group's operations in those fields do not constitute joint arrangements as defined in the standard, and the Group does not have joint control of the operations, as there is more than one combination of parties that can agree to decisions about the relevant activities. Therefore, for the purpose of correct recognition and measurement of transactions related to the operations in the Sleipner fields, the Group applies other relevant IFRSs taking into account its interest in the fields, which ensures that there are no material differences in the accounting recognition and measurement of transactions related to these operations and the manner of recognising operations which are carried out jointly with the Heimdal licence interest holders and meet the definition of joint operations within the meaning of IFRS 11.

Classification of lease contracts

The Group classifies its lease contracts as finance leases or operating leases based on the assessment of the extent to which the risks and rewards incidental to asset ownership have been transferred from the lessor to the lessee. Such assessment is in each case based on the economic substance of a given transaction. At the inception of a lease, the Group assesses all facts, circumstances and conditions, and specifies the objectives and intentions concerning the contract, in order to determine if substantially all the risks and rewards of ownership have been transferred to the lessee. In the event of material amendments to a lease, the Group performs a reassessment of the lease classification, applying the same rules as in the initial classification of the lease contract.

Classification of natural gas and crude oil assets in financial statements

The Group classifies its natural gas and crude oil assets as exploration and evaluation assets, development assets or production assets, relying on its professional judgement.

Once the size of a deposit is confirmed and its production plan is approved, the expenditure on natural gas and crude oil assets is transferred from exploration and evaluation assets to appropriate items of property, plant and equipment or intangible assets classified as development or production assets.

The decision to present natural gas and crude oil assets in the financial statements under development assets or production assets is made taking into account all conditions and circumstances related to the upstream project and the subsequent production from the field.

For information on accounting policies concerning natural gas and crude oil assets, see Note 7.11. For presentation and details of those assets in these financial statements, see Note 13.2.

6. Change of information presented in previous reporting periods and change of accounting policies

The Group recorded no material changes of estimated amounts reported in prior periods, where such changes would have a material effect on the current reporting period.

7. Accounting policies

These consolidated financial statements have been prepared in accordance with the historical cost principle, with the exception of those financial instruments which are measured at fair value.

The key accounting policies applied by the Group are presented below.

7.1 Consolidation

These consolidated financial statements have been prepared on the basis of the financial statements of the Parent and financial statements of its subsidiaries and jointly-controlled entities, prepared as at December 31st 2018.

All significant balances and transactions between the related entities, including material unrealised profits on transactions, have been eliminated in their entirety. Unrealised losses are eliminated unless they are indicative of impairment.