9. Basis of preparation of the consolidated financial statements

These consolidated financial statements were prepared in accordance with the International Financial Reporting Standards (“IFRS”) and the IFRS endorsed by the European Union which were in effect as at December 31st 2011.

The IFRS include the standards and interpretations approved by the International Accounting Standards Board (“the Board”, “IASB”) and the International Financial Reporting Interpretation Committee (“IFRIC”).

As at the date of approval of these financial statements for publication, taking into account the ongoing process of implementation of the IFRS in the EU and the business activities conducted by the Group, as far as the accounting policies applied by the Group are concerned, there is no difference between the IFRS that have become effective and the IFRS endorsed by the EU.

The Parent and LOTOS Petrobaltic S.A., LOTOS Exploration and Production Norge AS, LOTOS Asfalt Sp. z o.o., LOTOS Oil S.A., LOTOS Paliwa Sp. z o.o., LOTOS Kolej Sp. z o.o., LOTOS Tank Sp. z o.o., LOTOS Serwis Sp. z o.o., AB LOTOS Geonafta and UAB Minijos Nafta maintain their accounting books in accordance with the accounting policies prescribed by the International Financial Reporting Standards. The other Group companies maintain their accounting books in accordance with the accounting standards defined in the Polish Accountancy Act of September 29th 1994 and the accounting policies and standards applicable at their foreign locations. These consolidated financial statements include adjustments which are absent from the accounting books of the Group’s entities applying standards other than IFRS, and which have been introduced to ensure consistency of the entities’ financial information with the IFRS.

The following new standards, amendments to the existing standards and interpretations which have been adopted by the European Union are effective in periods beginning after January 1st 2011:

- Amendments to IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction: Prepayments of a Minimum Funding Requirement (effective for periods beginning on or after January 1st 2011),
- Revised IAS 24 Related Party Disclosures (effective for annual periods beginning on or after January 1st 2011),
- Amendments introduced as part of the improvements to IFRSs published in May 2010 (IFRS 1, IFRS 3, IFRS 7, IAS 1, IAS 27, IAS 34 and IFRIC 13) – some changes are effective for annual periods beginning on July 1st 2010, some for annual periods beginning on January 1st 2011,
- Amendments to IFRS 7 Financial Instruments: Disclosures: Transfers of Financial Assets (effective for annual periods beginning on or after July 1st 2011).

The Group has reviewed the new interpretations, standards and amendments to the existing standards. The new interpretations, standards and amendments to the existing standards which are in effect and have been adopted by the European Union, have no material impact on the accounting policies applied by the Group.

9.1 New standards and interpretations

The following new standards, amendments to existing standards and interpretations have been issued by the International Accounting Standards Board or the International Financial Reporting Interpretation Committee, but have not been adopted by the European Union:

- IFRS 9 Financial Instruments: Classification and Measurement (effective for periods beginning on or after January 1st 2015),
- Amendments to IAS 12 – Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after January 1st 2012),
- Amendments to IFRS 1 – First-Time Adoption of International Financial Reporting Standards: Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (effective for periods beginning on or after July 1st 2011).
- IFRS 10 Consolidated Financial Statements (effective for periods beginning on or after January 1st 2013),
- IFRS 11 Joint Arrangements (effective for periods beginning on or after January 1st 2013),
- IFRS 12 Disclosure of Interests in Other Entities (effective for periods beginning on or after January 1st 2013),
- IFRS 13 Fair Value Measurement (effective for periods beginning on or after January 1st 2013),
- Amendment to IAS 19 Employee Benefits (effective for periods beginning on or after January 1st 2013),
- Amendment to IAS 1 Presentation of Financial Statements – Presentation of Items of Other Comprehensive Income (effective for periods beginning on or after July 1st 2012),

- IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine (effective for periods beginning on or after January 1st 2013).
- Amendments to IFRS 7 – Financial Instruments: Disclosures: Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1st 2013),
- Amendments to IAS 32 Financial Instruments: Presentation: Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1st 2014),
- Amendments to IFRS 1 – First-Time Adoption of International Financial Reporting Standards: Government Loans (effective for annual periods beginning on or after January 1st 2013).

The Group has not decided to choose the option of early application of any of the above standards, interpretations, or amendments which have been published but have not yet become effective.

By the date of approval of these consolidated financial statements, the first phase of IFRS 9 Financial Instruments: Classification and Measurement (effective for annual periods beginning on or after January 1st 2015), had not been endorsed by the European Union. During the next phases, the International Accounting Standards Board will focus on hedge accounting and impairment. Implementation of the first phase of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets. The Group will analyse this effect along with the effect from the other phases of the project after their publication, in order to present a coherent picture.

The Management Board is assessing whether the introduction of the new standards and interpretations specified above will have any material impact on the accounting policies applied by the Group.

9.2 Changes in accounting policies and correction of errors

The accounting policies and calculation methods adopted by the Group in the preparation of these consolidated financial statements are the same as those used in the preparation of the consolidated financial statements for the year ended December 31st 2010, except to the extent that:

- As of January 1st 2011, the Group changed its accounting policies as regards the exchange rates used to translate business transactions denominated in foreign currencies. As of January 1st 2011, such business transactions will be recognised as at the transaction date (i) using the exchange rate actually applied on that date due to the nature of the transaction – in the case of sale or purchase of foreign currencies, and (ii) using the mid-exchange rate quoted for a given currency by the National Bank of Poland for a day preceding the transaction date – in the case of payment of receivables or liabilities where there is no rationale for using the actual exchange rate, and in the case of other transactions. Application of the new accounting policies will not affect the Group's total net result, but will affect the values presented in the operating and financial parts of the statement of comprehensive income. Accordingly, in the statement of comprehensive income for the year ended December 31st 2010, cost of sales fell by PLN 298,039 thousand, finance income decreased by PLN 199,400 thousand, and finance expenses grew by 98,639 thousand.

Furthermore, starting as of January 1st 2011, the Company introduced cash flow hedge accounting with respect to foreign-currency denominated borrowings used to finance the 10+ Programme, designated as hedges of future USD-denominated petroleum product sales transactions, as described in more detail in Note 10.30 (/en/financial-data/consolidated-financial-statements-2011/notes-to-the-financial-statements/10.-accounting-policies#10-30) to these consolidated financial statements. In the period January 1st – December 31st 2011, foreign exchange loss recognised in the cash flow hedging reserve amounted to PLN 517,631 thousand, before the PLN 98,350 thousand adjustment for a tax effect.

As of January 1st 2011, the Group changed the rules for the presentation of measurement and settlement of financial instruments. The effect of measurement and settlement of financial instruments is presented on a net basis in finance income or expenses. As a result of this change, both finance income and finance expenses for the year ended December 31st 2010 declined by PLN 3,112 thousand.

As at December 31st 2010, in its statement of financial position the Group reclassified certain items which had earlier been presented as restricted cash and cash equivalents into interest-bearing current borrowings. These items included the PLN 8,665 thousand (January 1st 2010: PLN 9,928 thousand) deposits securing the repayment of interest and principal payments under the borrowings used to finance the 10+ Programme. Furthermore, in the cash flow statement, restricted cash as at December 31st 2010 and cash flows from operating activities for the year ended December 31st 2010, changed by PLN (8,665) thousand and PLN 1,263 thousand, respectively. For the current presentation policy, see Note 34 (http://raportroczny.lotos.pl/en/financial-data/consolidated-financial-statements-2011/notes-to-the-financial-statements/34.-interest-bearing-borrowings-and-other-debt-instruments/).

For the year ended December 31st 2010, the Group adjusted its revenue from sales of goods for resale and cost of goods for resale sold. For the year ended December 31st 2010, sales revenue and cost of sales in the statement of comprehensive income decreased by PLN 17,729 thousand.

The Group has analysed the expected time of realisation of interest rate risk hedges (IRS) and has classified them as current or non-current assets and liabilities, based on the related cash flows. Previously, the Group classified interest rate risk hedges according to their expiry dates. The Group has adjusted the comparative data. As at December 31st 2010, the value of current and non-current interest rate risk hedge (IRS) assets and liabilities amounted respectively to PLN 10,259 thousand, PLN 18,828 thousand, PLN 148,253 thousand and PLN 79,644 thousand.

As at January 1st 2011, the amount of cash and cash equivalents in the statement of cash flows changed by PLN 10,463 thousand in connection with an overdraft facility which is not classified as cash equivalents. In the statement of cash flows for the year ended December 31st 2010, cash flows from financing activities changed by PLN 10,982 thousand.

For the year ended December 31st 2010, the Group reclassified some of the general and administrative expenses (perpetual usufruct charges, property insurance, licence charges). As a result of the adjustment, general and administrative expenses fell by PLN 24,025 thousand, selling costs rose by PLN 1,092 thousand, and cost of sales increased by PLN 22,933 thousand.

As at December 31st 2011, the Group recognised the calculated contributions to the decommissioning fund under non-current liabilities (previously under current liabilities). As a result of this change, non-current liabilities as at December 31st 2010 increased by PLN 21,668 thousand. Furthermore, as of January 1st 2012, the Group recognises the relevant provision under long-term provisions. The decommissioning of gas and oil facilities is scheduled to start no sooner than in 2016. As a result of this change, long-term provisions as at December 31st 2010 increased by PLN 2,400 thousand.

In the statement of financial position as at December 31st 2010, under Assets held for sale, the Group recognised Assets held for sale of PLN 7,911 thousand, which were previously recognised under Non-current assets held for sale in the amount of PLN 6,018 thousand and Current assets held for sale in the amount of PLN 1,893 thousand.

The Group reclassified certain items previously recognised under investment commitments to other liabilities. As at December 31st 2010 and January 1st 2010, other liabilities increased by PLN 866 thousand and PLN 2,560 thousand respectively. Therefore, in the statement of cash flows for the year ended December 31st 2010, cash flows from operating and investing activities changed by PLN 1,694 thousand.