

1.3 Applied International Financial Reporting Standards platform

Standards and interpretations adopted by the IASB and EU which have entered into effect

In the opinion of the Parent Company's Management Board, the following standards have exerted a significant impact on these Consolidated Financial Statements:

IFRS 9 "Financial Instruments" – applicable to annual periods beginning on or after 1 January 2018. The key amendments introduced by the new standard pertain to:

1. Changes of the rules of classification and valuation of financial assets which are based on the entity's business model for managing the assets and the cash flow characteristics. The existing categories of financial assets have been replaced with new ones, i.e. carried out at:
 - amortized cost;
 - fair value through other comprehensive income;
 - fair value through profit or loss.The amended standard imposes an obligation to carry shares in unlisted companies in fair value and significantly reduces the existing possibility of carrying assets at cost.
2. Introduction of a new model for assessment of impairment of financial assets which replaces the concept of incurred losses with the concept of expected credit losses.
3. Hedge accounting model.

Impact on consolidated financial statements:

The entry of IFRS 9 into force has affected these Consolidated Financial Statements of the Group as described below.

CHANGE IN THE PRINCIPLES OF CLASSIFICATION AND MEASUREMENT OF FINANCIAL ASSETS

The Group has taken advantage of the IFRS 9 transition provisions allowing for refraining from the restatement of comparative data as regards the changes regarding classification and valuation and impairment of financial assets. Accordingly, it has restated its data as at the date of the first application of IFRS 9, that is 1 January 2018, which means that data for 2017 and 2018 are incomparable with each other, because they were prepared under different accounting policies. The change in the principles of classification has caused changes in the classification of financial assets in the Group's financial statements. Instruments previously classified into the loans and receivables category in accordance with the applicable business model are held for the purpose of collecting contractual cash flows. They satisfy the conditions of classification into assets carried at amortized cost, hence the entry of IFRS 9 into force has not caused a change in the principles of their valuation. Shares held by the Group in companies not listed on active markets were carried at purchase price less impairment losses, if any. In accordance with IFRS 9, investments in equity instruments are measured at fair value. As provided for by the adopted amendments to the accounting policy, the effect of measurement is recognized in other comprehensive income.

Presented below are the changes in the classification and measurement of financial assets in connection with entry of IFRS 9 into force.

IAS 39			IFRS 9			
Financial assets by category and class	Valuation method	31/12/2017	Financial assets by category and class	Valuation method	1/01/2018	Impact of the change
Hedging financial instruments			Hedging financial instruments			
Derivatives	at fair value through other comprehensive income	12.1	Derivatives	at fair value through other comprehensive income	12.1	-
Available-for-sale financial assets			Financial assets measured at fair value through other comprehensive income			
Shares in unlisted companies	at cost less impairment losses	7.3	Investments in equity instruments	at fair value through other comprehensive income	6.2	(1.1)
Loans and receivables			Financial assets measured at amortized cost			

IAS 39			IFRS 9			
Financial assets by category and class	Valuation method	31/12/2017	Financial assets by category and class	Valuation method	1/01/2018	Impact of the change
Trade receivables	at amortized cost	688.8	Trade receivables	at amortized cost	685.5	(3.3)
Receivables from sale of non-current assets	at amortized cost	0.1	Receivables from sale of non-current assets	at amortized cost	0.1	-
Loans granted	at amortized cost	1.1	Loans granted	at amortized cost	1.1	-
Bank deposits over 3 months	at amortized cost	253.8	Bank deposits over 3 months	at amortized cost	253.8	-
Cash and cash equivalents	at amortized cost	516.8	Cash and cash equivalents	at amortized cost	516.8	-

As at 31 December 2017 the Group, as part of shares in unlisted companies, presented mainly the value of the shares in Euroterminal Sławków Sp. z o.o. in the amount of PLN 6 million.

As a result of the first application of IFRS 9, the Group measured the fair value of shares in Euroterminal Sławków Sp. z o.o. The fair value of this shares was calculated as PLN 4.9 million.

In the statement of financial position, the effects of the measurement of investments in equity instruments are presented as other items of equity.

As at the date of the first application of IFRS 9, the Group restated the data resulting from the Consolidated Financial Statements for the financial year ended 31 December 2017 as follows:

- the effects of measurement of shares in Euroterminal Sławków Sp. z o.o. at fair value as at 1 January 2018 in the amount of PLN 1.1 million decreased other assets and other items of equity;
- the impairment loss on investment in equity instruments recognized in previous periods in the amount of PLN 11.8 million increased retained earnings and decreased other items of equity.

MODEL FOR THE ASSESSMENT OF IMPAIRMENT OF FINANCIAL ASSETS

The new financial asset impairment model implemented by the Group is based on an analysis of the expected credit losses on trade receivables. The determined amount of the additional impairment loss on trade receivables resulting from implementation of IFRS 9 amounts to PLN 3.3 million.

The implementation of IFRS 9 has not affected the impairment of other financial instruments of a debt nature.

Changes resulting from the application of IFRS 9 in respect of the model for the assessment of impairment of financial assets are reflected as at 1 January 2018 as follows:

- trade receivables decreased by PLN 3.3 million;
- deferred tax assets increased by PLN 0.6 million;
- retained earnings decreased by PLN 2.7 million.

Impairment losses on trade receivables were determined in accordance with IFRS 9, as described in [Note 5.4](#).

Other financial assets of a debt nature are characterized by low credit risk. Moreover, because the calculation of impairment revealed an insignificant amount of the impairment loss, the Group chose not to recognize it.

Hedge accounting

The changes in hedge accounting in the case of the Group pertained mainly to documentation issues and hence the entry of IFRS 9 into force in this area has not impacted the Group's asset or financial standing.

The effect of implementation of IFRS 9 as at the day of its first application, i.e. as at 1 January 2018, is presented in [Note 1.5](#).

IFRS 15 "Revenue from Contracts with Customers" – applicable to annual periods beginning on or after 1 January 2018. This standard has replaced IAS 18 "Revenues" and IAS 11 "Construction Contracts" and the related interpretations. The fundamental principle of the new standard provides for recognition of the revenues in the financial statements in such a way as to show the transfer of goods or services to customers in the amount that reflects the amount of the remuneration (i.e. payment) which the Group expects to receive in return for such goods or services. In accordance with the new regulations a revenue occurs at the time when control over the goods or services passes on to the customer. The standard has introduced a 5-step approach to revenue recognition:

1. Identify the contracts with customers, which are understood as parties which concluded a contract with the entity to purchase goods or services, resulting from ordinary activity of the entity, in exchange for consideration.
2. Identify the performance obligations in the contract.
3. Determine the transaction price. Determining the transaction price, in addition to the base consideration, one should consider such other components as: variable consideration, non-pecuniary consideration which should be carried at fair value, factors associated with financing the price (by the seller or buyer) e.g. discount resulting from a time difference between the performance of the obligation and the payment for its performance or amounts paid in connection with performance of the obligations of the contract.
4. Allocate the transaction price to the performance obligations in the contract. The best basis to determine the individual price is the price for which the entity may separately sell the given good or service.
5. Recognize revenue when (or as) the entity satisfies a performance obligation. The performance obligation is recognized as satisfied upon transfer of the control over the goods or services subject to the agreement to the customer.

Impact on consolidated financial statements

IFRS 15 "Revenue from Contracts with Customers" – since the Group generates revenues primarily from the provision of rail transport services, the entry of IFRS 15 into force has chiefly affected transportation agreements. As a result of completed works, it has been concluded that the commercial agreements contain a variable consideration component resulting from:

- the possibility of imposing penalties on the client in connection with its failure to meet the contractual provisions pertaining to transportation of a specified freight volume during the term of the agreement,
- the possibility of imposing a penalty on the Group by the client in the event of failure to transport the ordered freight volume.

Previously, these penalties have been presented as other operating revenues or other operating expenses depending on the nature of the penalty. According to the new standard, these penalties are treated as a component of contracts with customers. Based on IFRS 15 Annex C item 3a the Management Board of the Parent Company has decided that the standard will be implemented retrospectively in accordance with the requirements of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, with the possibility of taking into account the instructions contained in clause C5. The application of this approach did not result in an adjustment of the Group's equity as at the date of its first application of IFRS 15. In accordance with the previously applied accounting principles, the following items were recognized in the period from 1 January 2017 to 31 December 2017:

- in other operating revenues, debit notes and provisions for penalties imposed on clients in the amount of PLN 2.1 million,
- in other operating expenses, provisions for penalties charged by the customer in the amount of PLN 5.6 million.

In line with the aforementioned changes, the Group has restated its comparative data. Presented in [Note 1.5](#) is the restatement of comparative data. Information disclosed in the additional explanatory notes to the Consolidated Financial Statements was restated as appropriate.

Clarifications to IFRS 15 "Revenue from Contracts with Customers" – applicable to annual periods beginning on or after 1 January 2018. The improvement has provided additional clarifications concerning certain requirements and has introduced an additional exemption for entities introducing IFRS 15 "Revenue from Contracts with Customers".

In the opinion of the Parent Company's Management Board, the standards and interpretations mentioned below did not result in any major amendments to the Accounting Policy applied by the Group:

Standard / Interpretation	Effective date
Amendments to IFRS 2 "Share-based payments"	1 January 2018
Amendments to IFRS 4 "Insurance contracts"	1 January 2018
Amendments to IFRS (cycle 2014-2016) - IFRS 1 and IAS 28	1 January 2018
IFRIC 22 Interpretation - Foreign currency transactions and advance consideration	1 January 2018
Amendments to IAS 40 "Investment property"	1 January 2018

Standards and interpretations adopted by the IASB and endorsed by the EU which have not yet entered into effect

In the opinion of the Parent Company's Management Board, IFRS 16 "Leases", applicable to annual periods beginning on or after 1 January 2019, will have a significant impact on the Consolidated Financial Statements of the PKP CARGO Group. In accordance with the new standard, the lessee recognizes the right to use an asset and lease liability. The right to use an asset is treated like other non-financial assets and amortized accordingly. Lease liabilities are initially carried at current value of the lease payments payable during the lease term, discounted by the lease rate, if it is not difficult to determine it. If such rate cannot be easily determined the lessee applies the marginal interest rate.

IMPACT ON CONSOLIDATED FINANCIAL STATEMENTS:

IFRS 16 "Leases" – The Group has conducted a preliminary analysis of the impact of IFRS 16 on the accounting principles used. The analysis has shown that the Group's financial statements will have to recognize material assets and liabilities resulting from operating leases, lease or rent and perpetual usufruct rights to land.

The most significant lease contracts pertain to real properties serving as rolling stock repair points and cargo loading points, considered by the Group as strategic for its operations. Other lease contracts for the most part pertain to those rolling stock components and other buildings and real properties that are not considered strategic by the Group. Moreover, presented as lease contracts under IFRS 16 will also be those contracts that pertain to the right of perpetual usufruct of land in the case of which the Group pays fees in return for their use.

The Parent Company's Management Board plans to implement the standard retrospectively in accordance with IFRS 16 Annex C item 5b, by presenting as at 1 January 2019 the combined effect of the application of this standard by adjusting the opening balance of retained earnings, without restating the comparative data. The Group chose not to apply the standard earlier. Applying IFRS 16 for the first time, the Group plans to apply the following practical solutions permitted by the standard, including:

- application of a single discount rate to the measurement of the portfolio of leases with relatively similar characteristics;
- adjustment of the value of the right to use assets by the amount of the provision for onerous contracts recognized in accordance with IAS 37 directly before the date of first application of IFRS 16;
- the use of post-factual knowledge and experience in determining the term of the lease if the contract contains options for renewal or termination;
- not recognizing the right to use assets and liabilities for short-term lease contracts. Agreements for which the remaining term of the lease as at 1 January 2019 is shorter than 12 months;
- exclusion of initial direct costs from the measurement of assets on account of rights to use assets as at 1 January 2019.

The following are additional simplifications that will be applied by the Group to contracts to which it is the lessee party:

- not recognizing the right to use lease assets and liabilities for contracts pertaining to assets of low initial unit value (IT equipment, furniture, office equipment, etc.);
- not separating leasing and non-leasing components for lease contracts for selected classes of the underlying asset.

The Group intends to present its rights to the use of assets in a separate statement of financial position. This line item will also include assets used under current finance lease agreements in accordance with IAS 17 and the perpetual usufruct right to land. Moreover, the Group will recognize lease receivables arising from sublease contracts providing for the use of assets that are recognized as finance lease contracts.

SUMMARY OF THE EXPECTED IMPACT

The effect of the implementation of IFRS 16 as at 1 January 2019 is presented below:

	31/12/2018	Impact of the changes	1/01/2019
ASSETS			
Rolling stock	3,997.0	(165.4)	3,831.6
Other property, plant and equipment	949.9	(50.0)	899.9
Right to use assets	-	1,009.7	1,009.7
Lease receivables	-	7.4	7.4
Other assets	56.7	(9.4)	47.3

	31/12/2018	Impact of the changes	1/01/2019
Deferred tax assets	135.6	(0.2)	135.4
Total non-current assets	5,187.2	792.1	5,979.3
Lease receivables	-	0.4	0.4
Total current assets	1,619.1	0.4	1,619.5
TOTAL ASSETS	6,806.3	792.5	7,598.8
EQUITY AND LIABILITIES			
Retained earnings	584.4	0.8	585.2
Total equity	3,483.5	0.8	3,484.3
Debt liabilities	1,156.5	707.6	1,864.1
Other provisions	20.5	(1.3)	19.2
Total long-term liabilities	1,969.1	706.3	2,675.4
Debt liabilities	270.5	101.5	372.0
Trade payables	499.4	(13.7)	485.7
Other provisions	56.9	(2.4)	54.5
Total short-term liabilities	1,353.7	85.4	1,439.1
Total liabilities	3,322.8	791.7	4,114.5
TOTAL EQUITY AND LIABILITIES	6,806.3	792.5	7,598.8

The application of IFRS 16 will also affect the structure of the statement of profit or loss and other comprehensive income in 2019 and in subsequent years. Based on its analysis, the Group estimates that in 2019 its operating result will increase by PLN 17 million, EBITDA by PLN 118 million and the profit before tax will decrease by PLN 12 million. This analysis has been prepared on the basis of contracts effective as at 31 December 2018 and is based on certain assumptions that are material on that date, in particular with respect to:

- the actual period of validity of the agreements concluded for an indefinite term and the resulting useful life of the right to use assets;
- discount rate used for the measurement of the lease liabilities;

The lease periods applied for the purposes of estimation of the value of lease liabilities, broken down into underlying asset classes, were as follows:

Strategic real properties	14 – 17 years
Other real properties	4 – 15 years
Means of transport	2 – 5 years
Other	2 – 5 years

The lease period in contracts for the perpetual usufruct right to land is defined as the period remaining until the date to which these rights have been granted unless the circumstances require the adoption of a longer or shorter period. The lessee's marginal rates applied for the purposes of estimation of the value of lease liabilities ranged from 1.16% to 4.29%. The diversification of the rates was a result of the following factors having been taken into account:

- currency of the contract,
- term of the contract.

The weighted average lease rate accepted for the measurement of liabilities was 3.83%.

Presented below is an explanation of the key differences between the amounts of future payments, as described in [Note 7.2](#) to these Consolidated Financial Statements, and the value of lease liabilities to be additionally recognized due to the application of IFRS 16:

Amount of future minimum lease payments under non-cancellable operating leases	190.7
Operating lease liabilities recognized as at 31 December 2018 as trade payables	10.4
Finance lease liabilities recognized as at 31 December 2018	95.2
Adjustments	866.6
Extension and termination options which the Group is highly likely to exercise	816.6
Exemptions for short-term leases and leases of assets with a low initial value	(24.3)
Perpetual usufruct right to land	74.2
Other	0.1
Lease liabilities recognized as at 31 December 2018, adjusted	1,162.90
Discount	(258.6)
Lease liabilities as at 1 January 2019	904.3
including the effect of recognition under IFRS 16	809.1

The main differences are due to the fact that the period of adopted lease payment projections in accordance with IAS 17 applies only to non-cancellable lease periods, which the Group considers to be the termination notice periods. Meanwhile, in accordance with IFRS 16, the lease period over which lease liabilities should be recognized also includes any periods resulting from an extension or early termination of the contract if any scenario leading to such an outcome is sufficiently certain in the Group's opinion. In the case of contracts with an extension option and contracts entered into for an indefinite term for which the Group has estimated the lease period, the lease liability is correspondingly higher.

In order to calculate the amount of lease liabilities to be recognized in accordance with IFRS 16, the total amounts of future minimum fees arising from the executed operating lease contracts as at 31 December 2018 have been adjusted to the current value by applying the pertinent discount rate.

In the opinion of the Parent Company's Management Board, the standards and interpretations mentioned below will not result in any major amendments to the Accounting Policy applied by the Group:

Standard / Interpretation	Effective date
Amendments to IFRS 9 "Financial Instruments" - Prepayment features with negative compensation	1 January 2019
Interpretation of IFRIC 23 - Uncertainty over income tax treatments	1 January 2019
Amendments to IAS 28 "Investments in associates and joint ventures"	1 January 2019
Amendment to IAS 19 "Employee benefits"	1 January 2019

Standards and interpretations adopted by the IASB but not yet endorsed by the EU which have not entered into effect

IFRS as approved by the EU do not currently differ materially from the regulations adopted by the International Accounting Standards Board (IASB), with the exception of the following standards, their amendments and interpretations, which as at 31 December 2018 have not yet been approved by the EU and have not entered into effect: In the opinion of the Parent Company's Management Board, the EU's endorsement of the following standards will not trigger the need to modify significantly the accounting policies applied by the Group:

Standard / Interpretation	Effective date
Amendments to IFRS (cycle 2015-2017) - IFRS 3, IFRS 11, IAS 12 and IAS 23	1 January 2019
Amendments to references to the IFRS Framework	1 January 2020
Amendments to IFRS 3 "Business combinations" - Definition of a business	1 January 2020
Amendments to IAS 1 "Presentation of financial statements" and IAS 8 "Accounting policies, changes in accounting estimates and errors"	1 January 2020
IFRS 17 "Insurance contracts"	1 January 2021