

A Ventyx Whitepaper:

The Path to IFRS Compliance

The competitive implications of transitioning to International Financial Reporting Standards in asset intensive industries



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Executive Summary

Compliance with the International Financial Reporting Standards (IFRS) will become a requirement for all publically traded companies in the US, Canada, and many other nations in the near future, as it already has in over 100 countries throughout Europe and elsewhere. The motivation for this significant change is to create a consistent, global approach to financial accounting that better enables investors to compare the performance of corporations irrespective of what countries they operate in.

The implications of the transition to IFRS vary widely depending on what business a company is in, and the specifics of its current financial practices and processes. Asset intensive industries such as mining, oil and gas, public infrastructure (including transportation and utilities), etc. face particular considerations, as outlined below.

For many, compliance with IFRS is likely to mean major changes to internal accounting processes and associated IT systems; such as those for financial management, human resources, and enterprise asset management (EAM). While some organizations will view these business process changes as a one-time technical challenge to address as expediently as possible, others will take the opportunity to make fundamental business transformations that can drive greater operating efficiency and competitive advantage both domestically and internationally.

This whitepaper outlines the competitive implications of IFRS compliance for Asset intensive businesses as they relate to the maintenance of assets and EAM software solutions.

IFRS Implications for Asset Intensive Businesses

In contrast to rules-based standards like the US Generally Accepted Accounting Principles (GAAP), the IFRS is principles-based and is intended to be interpretive rather than prescriptive. As such, the task of interpreting and applying it is likely to be an ongoing effort rather than a one-time problem to be resolved.

For asset intensive businesses, there are some particular issues of interpretation and application of the IFRS. Mining operations, for example, entail significant upfront investments in exploration with low success rates and long time-to-value. Dealing with the cessation of operations and corresponding decommissioning of assets, environmental mitigation and site rehabilitation, and so on is likewise open to differing interpretations and introduces new complexities under IFRS.

The greater subjectivity of IFRS is a compelling reason for new adopters in asset intensive businesses to implement flexible business processes. These processes provide a strong foundation for analyzing and reporting on operational data, as needs for reports and supplemental information required for compliance might be difficult to predict precisely and could change over time as new accounting practices evolve.

Opportunities and Risks

Moving towards IFRS compliance requires investments in new processes and technology without the promise of an immediate return. IFRS compliance is more appropriately seen as a strategic transition, with a longer-term payback. From this perspective many companies will see that the benefits of moving to IFRS can clearly outweigh the costs, particularly if the transition is accompanied by other process improvements. Some benefits of IFRS compliance might include reduced costs of capital and credit, greater attractiveness to investors, and an improved ability to finance operations abroad.

On the other hand, the costs of not moving to IFRS in a timely manner could be catastrophic. Failure to comply would eventually lead to significant fines, negative impacts on the valuation of the business by potential investors, and lost investment and partnering opportunities.

While privately held companies are not generally mandated to comply with IFRS, market forces will compel many to adopt the standard as current and potential investors and partners seek comprehensive, well-structured financial disclosure.

Impacts of IFRS on Asset Management

The IFRS specifies more than thirty accounting policies, many of which relate to the valuation of assets. Overall, the intent is for companies to represent assets and inventories in a consistent way that accurately reflects their actual business value. EAM and other enterprise systems will need to support these changes. In particular:

- Inventories must be described using first-in-first-out (FIFO) or average weighted cost methods, not last-in-first-out (LIFO).
- Valuations for property, plant, and equipment must be based on historical costs; ongoing expenses such as maintenance must be reflected in the carrying costs.
- Asset depreciation must accurately and systematically reflect how the asset is being consumed and its residual value.
- When the carrying cost of an asset exceeds its value through sale or disposal, an impairment cost must be recognized.

IFRS also mandates more precise and consistent handling of currency exchange rates when they impact business transactions. For asset intensive businesses operating in multiple countries, this makes it vitally important that the EAM system supports these new reporting requirements and is able to capture data on differing exchange rates, as needed for balance sheet and income statements.

Making IFRS Compliance a Value-Add Program

Forward-looking organizations will take opportunities to make value-added enhancements to business processes as they implement IFRS. Some options include:

- Rationalizing and improving reporting processes
- Consolidating and simplifying IT systems
- Streamlining financial management and operations business processes

For example, key business processes can be reviewed in combination with the Chart of Accounts to identify opportunities for efficiency gains. Similarly, the determination of new reporting requirements can encompass operational as well as financial requirements, with an eye toward eliminating redundancies.

Regarding operations and specifically asset management, IFRS conversion is an ideal time to incorporate ad hoc systems based on Excel spreadsheets into the ERP or EAM system. An asset management strategy can be revisited to leverage IFRS-related changes. Maintenance policies for critical assets (failure-based, use-based, condition-based) can be further optimized. Some organizations may even work with the new demands of IFRS to move toward reliability-centered maintenance (RCM) and root cause analysis (RCA) for critical assets, to optimize asset lifecycle costs.

Basic Requirements for IFRS-Compliant EAM Systems

For asset intensive businesses, the EAM system must support IFRS to make the transition to new accounting practices straightforward and to maximize the benefits of IFRS-related changes.

Among the most important capabilities that the EAM system must support are:

- An asset/equipment/component/part hierarchy, so that components of a complex asset can be depreciated separately (component-based depreciation)
- Multiple asset valuation methods (original, impaired, fair value) so that asset and maintenance costs can be capitalized and depreciated in today's terms, and so an asset's current condition can be accurately reported
- Fixed asset accounting, including multiple registers
- Lifecycle costing for assets
- Condition-based maintenance
- A high degree of configurability across both processes and interfaces
- Very flexible reporting
- Ability to work with multiple currencies
- Adaptability to multiple books (IFRS, local currency or standard, etc.)

In general, the EAM system must be flexible and configurable enough to evolve in response to changing interpretations of IFRS as it relates to unique business situations. EAM systems that cannot support these critical features and provide the required level of flexibility should be considered candidates for replacement.

Ventyx Ellipse: A Fully IFRS-Capable EAM Solution

Adapting to IFRS is an ideal opportunity to simultaneously implement operations and maintenance best practices. However, a flexible EAM system with appropriate features, supported by a knowledgeable and experienced EAM vendor/partner, is vital to achieving rapid time-to-value.

Ventyx Ellipse is a market-leading EAM solution reflecting Ventyx's thirty-plus years of experience across its global, asset intensive customer base. Ellipse offers comprehensive visibility and management of assets enterprise-wide. Ventyx has been successfully supporting its Ellipse customers to navigate the planning and execution of IFRS compliance since 2005, and fully understands the unique challenges faced by mining, energy, and oil and gas companies in this regard.

Key IFRS-Related Features in Ventyx Ellipse

Ventyx Ellipse provides the specific data processing and reporting capabilities that enable asset intensive businesses to quickly achieve and smoothly maintain IFRS compliance. Existing customers can look to Ellipse to deliver an even greater return on their EAM investment by providing low-cost, low-effort IFRS compliance across EAM business processes, including:

Impairments

Impairment is an accounting concept based on economic factors that determine the value of assets within individual organizations. Impairment can apply to any asset, whether valued at cost or fair value. Under IFRS, companies will "test" using valuation calculations whether any of their fixed assets are subject to impairment; that is, whether an asset's recoverable value is less than its recorded value. Ventyx Ellipse can track impairments, reversal of impairments, and impairment of assets subject to revaluation.

Plant, Property and Equipment (PP&E)

Relative to some other accounting practices, IFRS requires the application of different depreciation methods or rates, or the separate depreciation, of significant components of PP&E. Asset intensive businesses can no longer depreciate entire complex assets (e.g., a haul truck) as single items, but instead must depreciate and value the major components of the asset separately. In Ventyx Ellipse, fixed assets can be broken down into sub-assets with asset values, depreciation rates, and amounts being held at the sub-asset level. Also important, Ellipse tracks the full history of any adjustment made to a fixed asset, and can distinguish between system entries and manual entries.

Asset Residual Value Calculations

IFRS requires that the depreciation of an asset must accurately reflect how it is being consumed, and its residual value. For some asset intensive businesses, such as mining companies, this could potentially require depreciation of some assets using a usage statistic approach (e.g., over what percentage of overall production an asset is used, or the number of trips made and tons hauled by a truck). Ventyx Ellipse is capable of capturing production statistics for both mobile and fixed plant equipment. Thus, Ellipse enables companies to tailor depreciation calculations to specific operating environments. Ellipse can maintain three different written-down values (historical cost or original value, impaired value, and fair value) in two currencies (local, secondary) for process and disclosure purposes.

Foreign Currencies

For many organizations the conversion to IFRS also presents an opportunity to review the chart of accounts (COA) structure and design, in conjunction with conformance to the foreign currency calculations and reporting requirements mandated by IFRS. Embedded in the Ventyx Ellipse chart of accounts is the code/rules for translation and re-measurement, along with the determination of functional currency. For each transaction, Ellipse automatically creates local currency equivalents for foreign currency balances, thus allowing the correct re-measurement for any number of foreign currency sub-balances held with respect to a single account. The re-measurement process identifies accounts subject to currency fluctuation, and utilizes the method and rules specified for each general ledger account holding an open balance. Once all balances have been re-measured, the resulting accrual journals will be automatically updated. After re-measurement, accounts may be translated into any other presentation currency (principally required for consolidation of foreign Entities). Foreign currency exchange rates can be recorded on a daily or periodic basis. Ellipse can handle all the foreign currency calculation and reporting requirements mandated by IFRS, including the use (i.e., translation) of a presentation currency other than the functional currency.

Reporting

Ventyx Ellipse can handle all reporting requirements mandated by IFRS, including complex dual reporting requirements seen in Latin America and Canada during their transitions to the new standard. Ventyx Ellipse Reporting (MER) provides a report portal that enables users to create, receive, and schedule reports in a secure, organized, and personalized view. Ellipse Reporting Developer provides query and analysis tools that allow users to access the Ellipse data with minimal knowledge of the underlying data structure — providing the most powerful web query, reporting, and analysis capabilities available. These features are delivered via a “thin client” solution that enables users to easily track, understand, and manage organizational data over intranets and extranets, while maintaining tight security over data access.

Conclusion

The impending transition to IFRS is significant for many asset intensive businesses. Organizations contemplating these changes should look to realize ongoing business benefits from their technology and process investments around IFRS compliance. Key to achieving these benefits will be solutions that offer rapid time-to-value, and that provide the flexibility and features necessary to support evolving interpretations of the new standard.

Ventyx has an in-depth understanding of how IFRS impacts its customers in asset intensive businesses like mining and oil and gas, and has the expertise to assist its customers with their IFRS transformations. The Ventyx Ellipse EAM solution is proven in production use to fully support all IFRS processing and reporting requirements.

Contact Ventyx to learn how we can support your organization's IFRS transformation.

About Ventyx

Ventyx, an ABB company, is the world's leading supplier of enterprise software and services for essential industries such as energy, mining, public infrastructure and transportation. Ventyx solutions bridge the gap between information technologies (IT) and operational technologies (OT), enabling clients to make faster, better-informed decisions in both daily operations and long-term planning strategies. Some of the world's largest private and public enterprises rely on Ventyx solutions to minimize risk, enhance operational and financial performance, and execute the right strategies for the future.

To learn more about Ventyx solutions visit www.ventyx.com or contact a Ventyx sales representative today.