

## MS IN FINANCE CAPSTONE PROJECT

### Summary

Stabilization after transition

Reporting, Cost allocation and Currency risk

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This dissertation is a reflection of my interest in the methodologies multinational organizations follow nowadays in terms of taking prompt decisions due to the dynamics of the market. The topic has been chosen after my MSc in Finance Program, and because from a personal level, being an entrepreneur myself, I am aware of the different practices large organizations develop with the market flow as a challenge. To be able to expose these practices, I have taken the occasion to use AGCO Corporation as a case of example. Within the large number of finance functions that organizations have, two have been selected to address the purpose of my research:

1. Financial reporting and Cost Allocation issues
2. Currency Risk Management

After having the chance to take part of AGCO financial team within the frame of my MSc Program, I have considered the results of my professional experience strong enough to use them as a point of reference for this present dissertation around the two concepts exposed above.

In the present dissertation, I will firstly present the problem that AGCO is facing currently, which is essentially that in terms of ROI, it is lower compared to its principal peers. Aiming to address this problem, I will suggest a solution based in reporting and cost allocation, as it is demonstrated that helps to determine which profit center is bearing better results in a comparative context. For this purpose, the reporting standards that AGCO maintains for both Financial and managerial will be exposed, as well as further information of the cost allocation methodology followed by the company. In addition, those issues related to reporting and cost allocation in AGCO will be described, and also the way the company decides to manage its currency risk will be a point of research, taking in consideration that it contributes to higher profits. Finally, I will take the occasion to present some suggestions for improvement based on my empirical observation as in data retrieved during my own experience being part of the company, combining those with the present research results and the skills learnt in my MSc.

To shortly locate and identify the Client Organization of AGCO Corporation, I describe the characteristics of the company and the targeted collaborators and customers. The Company provides High-tech solutions for farmers around the world, through its wide range of products. Products are distributed through multiple brands, furthermore, the operations and the finance team are distributed per regions on a global scale, which is headed by a CFO for a region. CFO leads the team of Finance directors who are responsible for their own brands. Cost is allocated primarily to brands, and where there is not clear where to allocate the cost to a certain brand, the cost is allocated to AIG, which is represented simultaneously through AIG or NO brand. Regions are responsible for mainly Accounting, and Financial accounting, financial functions such as financial risk and pension funds management is done centrally in US. Brands and products: Challenger, FENDT, GSI, Massey Ferguson, VALTRA, etc.

## Research topic

As I mentioned in the introduction the topics of my research, here I would like to further elaborate the need and importance of the topic of my choice. As recommendations to the exposed problematic, I support Reporting and Cost Allocation Issues, through means of accounting that ascertain the health and performance of a company. Financial statement provides information necessary for the interested persons to make their decision about the company. Though it is important for the investors to know that how their money is spent, it is also vital for managers to protect that information for the benefit of the company. Through business practices, laws regulations or ethical conduct it is ensured that which information must be made public, there are standards such as US GAAP or IFRS which a company maintains as per the jurisdiction to be made the mandatory information available for everyone. However for the managerial decisions such regulations barely exist. This can give an advantage and capability to the management to make decisions what they may deem fit for the performance of the business. We may break down the reporting to Financial and Managerial to understand the issues better, and to see that how the company responds to them. Like any public limited company, AGCO corporation Financial Reporting is done for public and for the managerial purpose. The company mainly uses GAAP, and as it is listed in US market, it complies with all the relevant laws and procedures laid down by US Government and market.

## Reporting Issues

As it discloses the information discussing its revenues and expenses, Financial Reporting may satisfy the reporting for the taxation purposes, that is why we do not discuss taxation accounting separately, though in some cases the information made available to tax authorities and to investors may differ. Management/managerial accounting: Unlike Financial reporting the management reporting is not done for following any certain rules or guidelines, but to make optimal decisions for business. For the reason Sox and Soc controls are placed. these controls largely impact the managerial accounting as well as the Financial reporting activities.

It is through managerial reporting the company can make effective and timely decisions. Focus of the reporting is the business and operations of the company, so that falls outside the scope of the research. In AGCO corporation the management accounting has budget and forecast periods, unlike yearly and quarterly reports in financial accounting. Budget is prepared from the upcoming year, based upon the data collected from marketing sales and manufacturing departments, which is reviewed in subsequent forecasts.

Monthly reports consist of actuals and comparison with variable, with previous year and the budget or forecast. Once the input for the actuals is completed. All the Balance sheet items, and the Income state per brand and per region is reported, which is followed by a presentation to the regional CFO and after to the Global CFO.

The corporation uses the following tools for data management and process:

Cost allocation is a method used by the company to allocate its tax to the company where the tax rate is higher to keep their profit low.

### Cost allocation and issues:

AGCO corporation also allocates its cost to the countries where the tax rate is higher, the cost centers are created in country to keep the profit of the company on optimal level, this is also done through, having manufacturing and assembling units or through services in the high tax rate countries.

Cost Allocation Structure: The Company operated under many of its brands and subsidiaries, which are headed by the Finance directors, who lead the team of managers and controllers. Finance directors are led by CFO for the region, who in turn report to the vice president who is also the CFO for the corporation, and to the Board of directors.

As per the budgeting report the cost are allocated to the regional CFO, who allocate the cost to the cost centers by region. Directors are responsible to keep a check on these allocated costs, through managers and controllers.

The company faces lot of cost allocation issues, though each brand is responsible for their own manufacturing and sales, but almost none of them is totally independent,

Intracompany trade profit is balanced of in the monthly AS allocation report, and it is ensured that the profit and loss remain at a par.

so it is very complicated to determine the actual profit a specific brand or product is generating.

### Currency Risk

The company's operations are distributed across the world, which exposes it to currency risk. Company uses hedging to minimize its exposure to currency risk, for the reason company through experts first determine that what amount of risk it is exposed to, as in many cases the company's revenues and expenses are in the same currency, which limits the exposure or in other words balances out the risk. The company manages its risk in 4 currencies namely, Euro, GBP and Brazilian Real and Canadian dollars.

The companies incurred gains and losses on derivatives for the year 2017, is net USD 6.7 million, which is 1.6% of the total operating profit of the company. As the currency exposure is calculated considering only 4 main currencies, accumulated cost of currency is more than 2%. I am unable to determine that what is the threshold of the cost of currency risk exposure, but I believe if it can be limited to 1% the rest can contribute to the overall profitability of the company.

### Project outcomes

Finally I would like to summarize the outcome of my research project, I would like to share my observations and learnings and furthermore I would like to present the suggestions based upon my research.

I had the opportunity to research the reporting and cost allocation issues the company is facing, and how the company manages its currency risk, I also had the opportunity to discuss in details with leadership and decision makers, and to understand the limitations and the challenges they face, I would summarize my understanding and outcome briefly hereunder

**Reporting:** There are not any improvement which I can suggest at this stage in both Financial and managerial accounting, the issues the company facing is the outcome of the global presence and the size of the company. In fact I was very impressed by the standards of reporting company is keeping and from my understanding the reporting issues are dealt in an excellent manner.

**Cost allocation:** The company faces lot of cost allocation issues, and there is a clear need and room for improvements, though each brand is responsible for their own manufacturing and sales, but almost none of them is totally independent, for intra company sales the it is insured that there is no profit, which actually contribute to the profit of another brand or products, so it is very complicated to determine the actual profit a specific brand or product is generating. In my opinion this may affect the decision making when it comes to investment based upon rate of return.

The company allocates the cost of head count basis, in my opinion the cost allocation should be done on the basis of profit. No brand collectively determines if the cost allocation issue cannot be resolved by any of the brand, which put the cost on all of the brands collectively, which also includes the brands which do not use any of the services of the costs in dispute.

**Currency Risk management:** Currency risk management is mainly done on the basis on a single currency per region, which effectively leaves the currency risk management to mainly three currencies. The currency risk exposure is limited to this currency from the company's point of view. Company manages its risk mainly in US and a small group is completely responsible for the said reason. Management believes that widening the scope of currency risk management would increase the cost, which are not otherwise justified. I have suggested that company may outsource the currency risk management in that case, or can have an assessment to ascertain the currency risk it is exposed to.

Finally, I would like to finish my report, with the suggestion that for attaining better results the company should review its cost allocation structure, and the currency risk management, though not limited to this, but any improvement in these would result in positive contribution to the income of the company.















