THE INSTITUTE OF
CHARTERED ACCOUNTANTS OF INDIA
(Set up by an Act of Parliament)

PUNE BRANCH OF WIRC OF ICAI

NEWSLETTER

Issue NO. 06
June 2020

(Subscribers copy not for sale)

Chairman's Communique

CA. Abhishek Dhamne
Chairman
Pune Branch of WIRC of ICAI

Dear Members,

I hope you are taking good care of yourselves and nears and dear ones. We are transiting towards unlock phase of Corona Pandemic. But still the situation is not under control. People are already talking of New Normal and Living with Corona, however all these things are still are not comprehensive solution to the situation. We need to wait and watch and then cautiously decide further course of action even if unlock is rolled out.

Dear Members, in last month we had the honour of having Shri Devendra Fadnavis ji, Hon. Leader of Opposition and Ex-Chief Minister of Maharashtra as well as Shri. Rajendra Mirgane ji, Hon. Joint Chairman of Maharashtra Housing Development Corporation interacting with on various opportunities ushering in the Program 'Lockdown – New Dawn'. We also had the privilege of having Smt. Supriya tai Sule interacting with members of Pune ICAI on the topic of 'Role of Professionals on Rebuilding Economy'.

Friends, as you are aware Shri. Narendra Modiji, Hon. Prime Minister has recently rolled out blueprint of 'Atma Nirbhar Bharat', I am sure my all professional colleagues are geared to support and effectively implement self-reliant India. On these lines, your Branch has proactively conducted program on Atma Nirbhar Bharat having representatives from Banking, Economics, Industry sectors together on dais to deliberate and guide on the same.

We had carried out first ever German Language online classes for 15 days receiving fair good response from participants. Also, concurrently we are having Excel as well as Tally Courses which are sharpening skills of our Members and Students taking best advantage of available time.

In the month of May, we have organised various programs for Member and Students to get them future proof recognising the futuristic opportunities in the changing times.

We also had first ever online career counselling program having student participation across Pune district. Almost 300 colleges were joined online for the said program. Alongside various technical programs unique program of quiz competition named 'Kaun Banega Chatur Chankya' was organised for students.

Dear Colleagues, during the difficult times lingers, let us anticipate 3M problems viz Manpower, Mandays and Money. Manpower: Situation is challenging causing disruption for physical presence of our Office Staff. Mandays: Important 70 days have passed by wherein relatively less access to office data. Money: it is seen that, our routine fees cycle has been also been affected to a large extent. Let us all ponder upon how to tackle the situation effectively.

As you are aware June 27 is celebrated as International SMP Day, we plan to organise various programs on that occasion. We shall keep you posted with the same.

Friends, in these difficult times we should keep in mind that, "No matter how much falls on us, we have to keep ploughing ahead. That's the only way to keep the roads clear."

Please do write to us your suggestions, feedback and comments on **chairman@puneicai.org**

Happy to Serve,
CA Abhishek Dhamne,
Chairman Pune ICAI

June 1, 2020
जेष्ठ 10, 1942 (Saka)

List of recorded webinars available on Pune ICAI You Tube Channel

SR. NO.	DATE	TOPIC	SPEAKER	LINK
1	4th May, 2020	Interactive Session on 'Lockdown – New Dawn'	Shri. Rajendra Mirgane, Hon. Joint Chairman, MHDC and Shri. Devendra Fadnavis, Former CM of Maharashtra	https://www.youtube.com/watch?v=Pzu5-F43vLM&t=2s
2	9th May, 2020	Live Webinar on "Direct Tax- Concept of Deemed Income V/s Real Income in current Scenario & Recent Amendments in Income Tax Laws" Jointly with Akola, Nagpur, Nashik & Vadodara Branches of ICAI	CA Adv Kapil Goel	https://www.youtube.com/watch?v=1E-HcHz3fO8&t=6168s
3	11th May, 2020	Informative Webinar on CA Course Jointly with Pune WICASA	CA Jay Chhaira, CCM	https://www.youtube.com/watch?v=golbCdo-ZjQ
4	11th May, 2020	Live Webinar on "Everything about E-Way Bill" Jointly with Navi Mumbai ICAI Branch of ICAI	CA. Jugal Doshi	https://www.youtube.com/watch?v=MjQ6ecrLq7M&t=334s
5	22nd May, 2020	Webinar on "Write to Make it Right" Study Plan by Rankers for CA Students Jointly with Pune, Nashik, Aurangabad, Akola and Jalgaon WICASA	Mr. Gurram Naga Sri Krishna Praneeth & Mr. Dhawal Kapoorchand Chopda	https://www.youtube.com/watch?v=WtosF0Tk6kM
6	23rd May, 2020	Webinar on "Write to Make it Right" Study Plan by Rankers for CA Students Jointly with Pune, Nashik, Aurangabad, Akola and Jalgaon WICASA	Ms. Varada K P & Mr. Dhruv Kothari	https://www.youtube.com/watch?v=zlHLFquD-SQ
7	24th May, 2020	Webinar on "Write to Make it Right" Study Plan by Rankers for CA Students Jointly with Pune, Nashik, Aurangabad, Akola and Jalgaon WICASA	Mr. Abhay Bajoria & Mr. Suryansh Agarwal	https://www.youtube.com/watch?v=ldcrL2h9NQI https://www.youtube.com/watch?v=SMaF6QPCQ2Q

8	22nd May, 2020	Virtual CPE Meeting on "Internal Team Communication and Effective Communication with Clients and Making Professional Impact – Preparing & Presenting Effective Advisory Reports, Consultation & Training'"	Ms. Nandita Khaire & CA Meghnand Dungarwal	https://www.youtube.com/watch?v=0G68sQdirJA&t=4057s
9	23rd May, 2020	Virtual CPE Meeting on "Interview – FAQs and Faceless Assessments & Ideal Way of Drafting"	CA Murtuza Kachwala & CA Neelesh Khandelwal	https://www.youtube.com/watch?v=PNdK8iru0Uk&t=1302s
10	24th May, 2020	Virtual CPE Meeting on "Insurance in times of Covid19, Value Added Service and Income Tax Settlement Commission - Procedure and Practice"	CA Bhupendra Bhandari & Shri. H. C. Jain	https://www.youtube.com/watch?v=NrllHgs91aw&t=6814s
11	28th May, 2020	Virtual CPE Meeting on "Exploring New Avenues"	CA Priti Savla & CA Arpit Kabra	https://www.youtube.com/watch?v=dVUpoKK_4o4&t=2715s
12	29th May, 2020	Interactive Session "Post COVID 19-Role of Professional in Rebuilding Economy"	Smt. Supriya Sule, Hon. Member of Parliament, Lok Sabha	https://www.youtube.com/watch?v=Nw5EvHQSe9g&t=4546s
13	29th May, 2020	Virtual CPE Meeting on "Recent Incentives Schemes by GOI"	• Shri. Amit Ghaisas • Dr. Apoorva Javadekar • Shri. Sanjay Rudra • CA Maheshwar Marathe	https://www.youtube.com/watch?v=0fAqgxM5TQ8&t=7863s

Yours Proactively,
Team Pune ICAI

MANAGEMENT TOOLS

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This article enumerates the importance of connecting different functions of any organisation with varying Management Tools and how it can help to **Work Remotely** as well as **Efficiently.**

Nationwide lockdown due to COVID-19 has created sudden compulsion to look for options to manage all business functions remotely or working from home. Technology has played a vital role in these times to enable the same. Various CEO and CFO from start-up entities to large enterprise has suddenly started looking at all their business functions differently and analysing where technology can help them to efficiently run the business remotely. Platform Service Providers or technology enablers may have never seen such a spurt in demand. But choosing the right service or technology is never an easy thing after all.

Productivity and Collaboration across functions get impacted in the short term and it even curates one to find long term solution to meet the current requirement. It's not just now a question of single function or process it's about the entire business and which can drag it downwards to an unsustainable level. Competitors will take away the business if originations fall short of right technology as the enabler.

Disclaimer: This isn't** a **promotion or marketing of any services or website listed here. Sequences provided is purely coincidental and has no relevance of preference over others. This article is just to provide education and curate to look at the various options technology has made available to us.

How these technological tools can help to achieve desired results and provide flexibility to different conducts of business functions. There is a significant need that our fraternity understands the usage of different tools and how it can help to scale up the business. We The Chartered Accountants are the best professional who came across various technological solutions throughout our tenure right from articleship to career path be it into practice or industry. We can certainly become a guiding light for connecting different dots within an organisational function.

The complexities of writing and maintaining programs have caused software costs to outstrip computer hardware costs. Because of such skyrocketing costs, software tools and techniques are emerging that facilitate the development efforts through streamlined procedures or automation of some of the tasks. Many tools and techniques have been developed that offer significantly improved management control and reduced costs if properly applied. The number of new tools and techniques continues to grow. There are various software or solution tools available for all types of organisational functions, this article attempts to provide a glossary of the most common types of tools available in the market.

In the tech space, we often come across the terms **"tool"** and **"solution"** being used interchangeably. But there is a massive difference between the two, with vastly different business impacts. Therefore many tech companies have started calling their offering "software as a service" rather than just "software."

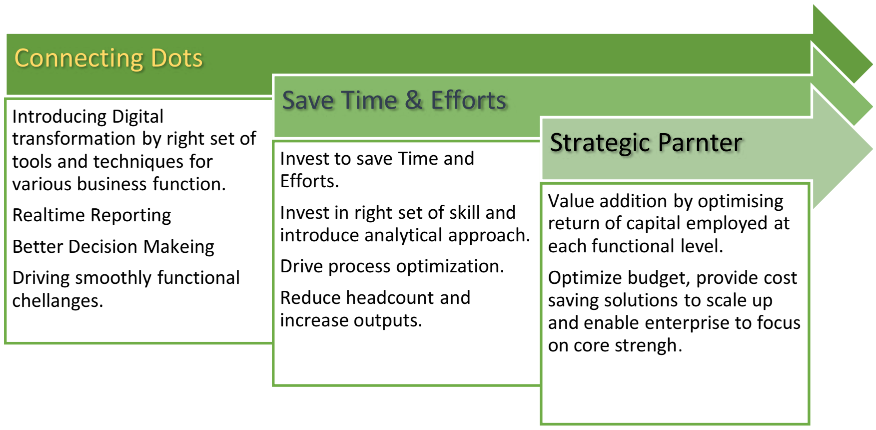
By Definition: A tool does one specific task well no matter who is using it. They're usually part of a larger system set of tools that help a particular part of the business operate properly.

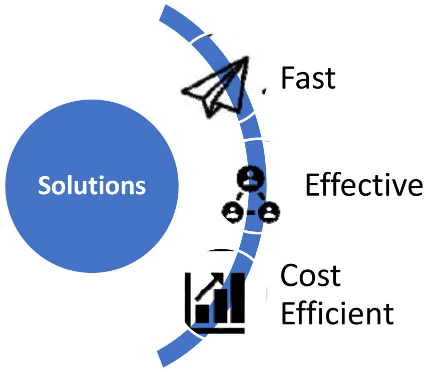
By Definition: Solutions are often the application or implementation of a set of tools to solve a larger business problem

Tools	**Solutions**
Pros	**Pros**
>> Specialised to the specific task. >> Fast and easy to implement. >> Typically, less expensive.	>> It doesn't solve one problem; they introduce new business processes to fundamentally change the way it operates. >> Far more sophisticated and comes with dedicated support.
Cons	**Cons**
>> Not easy to customize to your business needs. >> Don't come with support.	>> More expensive and consumes more resources. >> It can take a lot longer to implement.

How to know if you need a Tool or a Solution? If a tool is a screwdriver, a solution is a team of carpenters using the screwdriver and other tools to build a home.

Today a Finance function or a role of a Chartered Accountant is no longer being seen a person who collates data and provides MIS or Reports, it has much more significant expectations of becoming strategic business partner, connecting functions and drive organisations to add value at each level of functional activity. Value additions have become of immense importance in the industry either from an in-house chartered accountant or from practicing chartered accountants. One can provide complete transformation by becoming a key business partner and driving overall strategy.





Let us now run through some of the tools or solutions that can help to automate or run the task effortlessly.

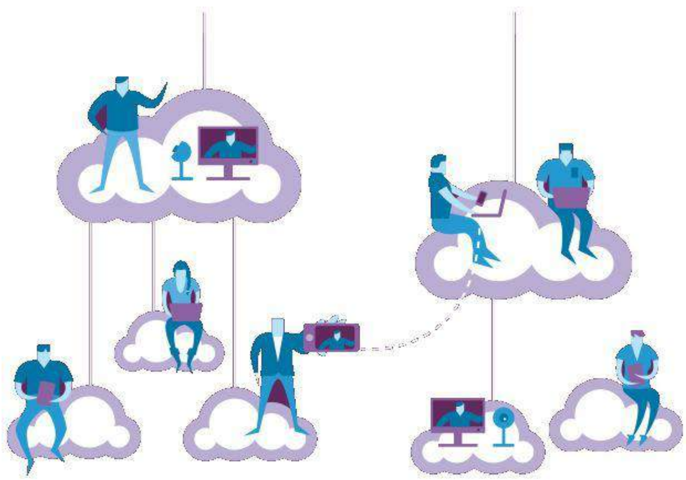
The key is to find the right **tool/solution, right from the phase of being** a start-up **to large scale enterprise.**

Business Function	**Popular Names**	**Website**	**Brief Description**
Expense Management	Happay	www.happay.com	It makes employee expense / reimbursement easy to process and track. For both enterprise and employees, it can even automate accounting if integrated with accounting software.
	Fyle	www.fylehq.com	
	Keka	www.keka.com	
	Zoho	www.zoho.com	
	Expensify	use.expensify.com	

Payroll Management	Paybooks Greythr ADP Zoho	www.paybooks.in www.greythr.com www.adp.in www.zoho.com	It's the most critical function. This payroll management software also takes care of many related statutory compliances across different states. Additionally, it can also work as outsourced HR if required.
Interactive or Collaborative Platforms	Slack Skype Zoom Ryver G Suite	www.slack.com www.skype.com www.zoom.us www.ryver.com www.gsuite.com	It gives a huge platform with various productivity tools to manage enterprise-wide collaboration or communication. It empowers the workplace by connecting teams and tools.
Vendor / Supplier Management	Zycus Tipalti Ivalua Intelex Procurify Coupa	www.zycus.com www.tipalti.com www.ivalua.com www.intelex.com www.procurify.com www.coupa.com	It can provide flexibility to manage Procure to Pay cycle with various features like e-Invoicing, Project/Contract Management, e-procurement etc. Depending upon volume and efforts one can choose the service provider.
Social Media Management	Buffer Tailorbrands Hootsuite Coschedule	www.buffer.com www.tailorbrands.com www.hootsuite.com www.coschedule.com	Social media management is the process of managing your online presence on social media platforms and engaging with users on those platforms.
Sales and Marketing Management	Hubspot pipedrive Panjiva	www.Hubspot.com www.pipedrive.com www.panjiva.com	Many among these offers a full stack of software for Sales, Marketing, Customer Service, Inside Sales etc.
Analytics	Tableau Clari Datahug 6sense	www.tableau.com www.clarii.com www.datahug.com www.6sense.com	It provides a perfect tool to harness the power of your data. It's a smart approach to Analytics. It also provides a dashboard for actionable items to drive the business efficiently.
Payment Gateways	Razor Pay Insta Mojo Stripe CC Avenue Payapl Timepay	www.razorpay.com www.instamojo.com www.stripe.com www.ccavenue.com www.paypal.com www.timepay.co.in	Effortlessly accepts payment from your Customers and make payments to Vendors. Faster, Easier and Safer, a must if you're having good volume of transactions. It can also resolve admin efforts and reconciliation issues.

Technology Solutions in Credits and Verifications	Perfios	www.perfios.com	It leverages the power of technology and digital platform for credit scoring, verification, onboarding, connecting lenders and borrowers etc.
	CreditMantri	www.creditmantri.com	
	Lenddo	www.lenddo.com	
	CreditVidya	www.creditvidya.com	

Once you decide which tools / solutions you may have to choose another challenge is to upgrade your team to use the same, however given the user-friendly interface and easy to adopt models, it's really not much of a concern. Changeover can be done quickly and seamlessly at any time with concentrated efforts. There are still many options available like cloud servers, data storage, virtual phone numbers, data analytics, dashboard management, customer support and many others which may suit specific needs.



As a CA we can advise our clients or management on various such technology and choose to become a person who adds value to the organisation. **This road is less travelled, but it can provide a journey to** A **whole new career.** Cost savings or reducing dependency over headcounts is the most important Value-addition to any enterprise. All these technological tools can enable functions with minimum headcounts and maximum output. Introducing the right technology at a certain level of company or volume is very imperative and challenging as well. Whether it is economic boom or recession, technology can help in both situations to manage the process in ever changing environment.

WE ALL NEED SMALL BUSINESSES. DON'T LET THEM DIE

Contributed by :- CA Govind M Chandak

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- A sad fact of the economy in recent decades has been that **far too many people have been relegated to economic positions that are even less secure than a small business.**
- By the time the corona virus crisis ~~is~~ will be over, we might emerge from our homes only to find some of our favorite shops, gyms and restaurants permanently shuttered down. It doesn't need to be that way.
- While some of the harm has already been done, we can still prevent much of the long-lasting damage.

- Consider a hypothetical neighborhood restaurant that, until this crisis, was flourishing.
- Business was brisk, the employees worked well together, and customers enjoyed the feeling of being "regulars" at a place where everyone knew their names.
- Then the corona virus hit and suddenly business dried up.
- Earlier there was some takeout revenue, but even that seemed to be disappearing. The bills keep coming.
- The restaurant owner no longer needs to buy meats, vegetables or liquor, but it is still on the hook for its biggest cost—rent.

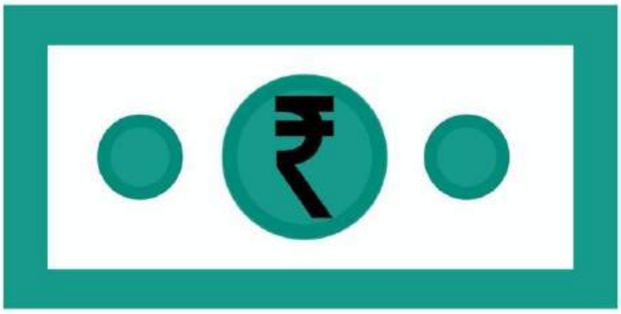
- And it faces an ethical dilemma: Should it use its scant savings to continue to pay its workers?
- It has little money in cash reserve; operating margins are thin in a restaurant, and its savings had already been spent on expanding the cramped kitchen.
- What was a thriving enterprise before the pandemic will emerge—if it emerges at all — as a hobbled business, which may fail shortly thereafter.

Reduce Business Costs

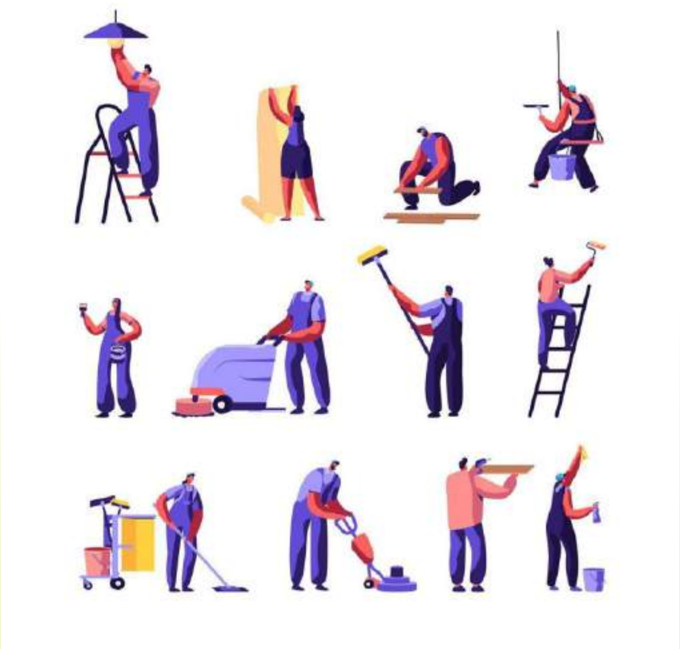
- The government can **unilaterally freeze commercial rent and mortgage payments for small businesses.**
- The policy can be targeted to businesses that use less than a certain square footage.
- This would shift the loss to the owners of those properties and mortgages.

Send cash where it is needed most

- Beyond freezing rents and mortgage payments, the government can **infuse cash into these businesses.**
- That need not be a transfer—it can be an investment.
- While government agencies cannot easily take equity in small businesses, they can give credit.
- It makes sense to offer zero-interest loans with long maturities for the sole purpose of paying the staff.



Many workers need help, too



- A sad fact of the economy in recent decades has been that far too many people have been relegated to economic positions that are even less secure than a small business.
- **All those people — hourly workers, gig economy workers, off-the-books cleaning and day care workers — face a sudden drop in income**
- **Wise policies can prevent this.**

Take it personally

- Though, a lot of business may not have succumbed to the changing times, it may not be the case for the hundreds of thousands of businesses that were flourishing just two weeks ago.
- **The businesses affected by the corona virus may face a different kind of sadness: the anguish of an unexpected disaster when everything was going well.**
- That is a tragic end we must act to prevent.

REAL OPTIONS [BASICS AND VALAUTIONS]

Contributed by :- CA Nitin Pahilwani
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Pointers
1.Introduction
2.Financial Options versus Real Options
3.Use of Real Options
4.Factor affecting Real Options Valuation
5.Types of Real Options
Real options Valuation [with example and analysis

INTRODUCTION

Traditional approaches of capital budgeting discounted cash flows is based on a set of static assumptions related to the project payoff and one-time decision making process, whereas the payoffs in the real scenario are uncertain and probabilistic. Most projects involve contingent decisions, where senior management can change the course of the project by deciding whether to defer the investment for a while; abandon, expand, or contract the project; maintain the status quo; and so on.

There is great strategic value imbedded in these multistaged decisions, which can be taken advantage of only if management recognizes it and is willing to exercise the options and the value of such options must be quantified and captured.

Investment strategies with high risks and uncertainty or irreversible corporate decisions coupled with managerial flexibility provide the best candidates for real options.

In other words, the company should apply the notion of options, as conceived in financial options, to their own business situation.

Example:
You have a chance to invest INR 100,000 in a project today that is estimated to yield a return of INR 125,000 one year from now with a 50-50 chance that it may go up to INR 170,000 (good case) or down to INR 80,000 (bad case). But you also have the choice to defer the decision for a year, by which time the uncertainty about the payoff is expected to clear. Discount Rate 15%

Time = 0	Time = 1
-1,00,000	125,000
Discount Rate	15%
DCF	$\frac{125{,}000}{\{1+0.15\}^{1}}$ =INR 1,09,000
NPV	INR 9,000 [109,000-1,00,000]

As mentioned, there is also a mutually exclusive alternative of deferring the decision until one year from now, by which time the uncertainty of the cash flows is expected to clear.

The expected NPV for the good case is

Time=0	Best Case	Bad Case
Discounted Revenue	128,544	60,491
Discounted Investment	86,957	86,957
Profits	41,588	(26465)
Probability	0.5	0.5
Expected NPV	20,794	(13,233)

In summary, the expected NPVs for the good and bad cases are 20,794 and -13,233, respectively. Therefore, after one year, if it turns out to be the good case, you will invest in the project, but if it turns to be the bad case, you will not. Thus the decision to defer for one year is worth 20794 today. However, the decision to invest now is worth only 9,000, as shown by the DCF method. Therefore, the value added because of the option to defer is the difference between the two alternatives: 20794 – 9,000 = 11,794.

FINANCIAL OPTIONS VS REAL OPTION

POINT	FINANCIAL OPTIONS	REAL OPTION
Period	FO have short maturity, usually in months	RO have longer maturity, usually in years
Underlying Asset	Underlying variable driving its value is equity price or price of a financial asset [i.e. Index or commodity]	Underlying variables are free cash flows, which in turn are driven by competition, demand, management
Control	Cannot control option value as	Can increase strategic option

	its price depends on underlying assets	value by management decisions, timing & flexibility
Terms	The Financial option has clearly defined terms and conditions	There is no clearly defined terms and condition
Risk	Amount of risk values are usually small	Amount of risks values are high in lakhs and crores
Market Risk	Competitive or market effects are irrelevant to its value and pricing	Competition and market drive the value of a strategic option
Marketability	Marketable and traded security with comparables and pricing info.	Not traded and proprietary in nature, with no market comparables
Management Decision	Management assumptions and actions have no bearing on valuation	Management assumptions and actions drive the value of a real option
Competition	There is no competition in financial options, it gives you right and obligations	In real option, your competitors can expand first and makes your project unviable

USE OF REAL OPTIONS

Real options have strategic value only when

- There is uncertainty.
- Uncertainty drives project value.
- Management has flexibility.
- Flexibility strategies are credible and executable.
- Management is rational in executing strategies.

Real Option is most valuable when there is high uncertainty with the underlying asset value and management has significant flexibility to change the course of the project in a favourable direction and is willing to exercise the options.

Real options are useful not only in valuing a firm through its strategic business options but also as a strategic business tool in capital budgeting decisions.

Real Options Valuation offers valuable information for go/no-go decisions based on evaluation of projects not only for their own merit but also for their relative merit against other competing projects in a portfolio. When the option value is significant, less attractive projects ranked lower based on DCF alone can move higher on the ranking scale and receive approval for investment, bumping other projects. ROV can become a "tie breaker" where two or more competing projects have similar NPVs.

The real options analysis can be used in a variety of settings, including pharmaceutical drug development, oil and gas exploration, e-commerce, start-up valuation, venture capital investment, research and development, mergers and acquisitions, e-commerce and e-business, intellectual capital development, technology development, facility expansion, business project prioritization, enterprise-wide risk management, business unit capital budgeting, licenses, contracts, intangible asset valuation

FACTOR AFFECTING REAL OPTION VALUATION

Financial Options	Real Options
Time to expiry	Period for which opportunity is valid
Exercise price	Present value of fixed costs
Stock price	Present value of expected cash flows
Dividends	Value lost over duration of option
Uncertainty	Unpredictability of expected cash flows

Apart from the above factors, one needs consider following factors also

1. Assumption for Cash Flows, NPV, Risks etc.
2. Management Decision & Timing
3. Competition and Market Risk

TYPES OF REAL OPTIONS

1. Option to defer
2. Option to expand
3. Option to contract
4. Option to abandon
5. Option to choose
6. Parallel compound option
7. Sequential compound option
8. Learning option
9. Rainbow option

VALUATION OF REAL OPTIONS

The DCF valuation captures a base estimate of value, the option valuation adds in the impact of the positive potential uncertainty. Real options valuation [ROV] will help you evaluate possible alternatives, so you can take advantage of the potential project payoff while minimizing the downside. ROV is not a substitute for but rather an extension of the DCF method.

There remain a few challenges with option valuations. First, it is hard to find good input variables which the model requires [i.e. inputs, historical numbers or volatility of innovative project]. Financial options use volatility derived from historical prices of share or index. Second, even if he company succeed in finding good proxies for the input variables, they remain vulnerable to a major conceptual error. In the present scenario in option valuation, high volatility in profits, leads to higher valuation. Similarly, in case of duration, longer duration will result in higher valuation. We have to make suitable adjustments in valuation methods. For eg Financial options, Real options are also valued using one of the following valuation models:

- Black-Scholes-Merton Model (BSM Model)
- Binomial Model
- Monte Carlo Simulation

The elegant, Nobel Prize winning Black-Scholes-Merton model, the first complete formula for pricing so-called European-style options, was designed to value an option that was exercisable only at the end of its life and whose underlying share paid no dividends.

Binomial model uses algebra, which is a practical advantage over the calculus based BSM Model, It can also be more easily customized to reflect changing volatility, early decision points, and multiple decisions. Their relative transparency and flexibility mean that you can tinker with a binomial model you have created until it closely reflects the project you wish to value. It is true that building a customized binomial model for each real option involves more work than plugging numbers into a Black-Scholes-Merton formula, but most company evaluating major projects using NPV analysis prefer to create their own spreadsheets anyway rather than rely on generic models.

Binomial model captures the contingencies of real options and addresses nearly all of the most commonly voiced criticisms of using option theory to manage those contingencies.

To determine a project's volatility, then, we must first develop a financial model of the business using the most likely values for all the factors that drive costs and revenues. We use these to compute the expected total costs and revenues for the DCF component of the project's total value. Then for each factor, we specify the range of possible values. These ranges (whose widths reflect their associated uncertainties) are put into a Monte Carlo simulation, from which we extract the means and standard deviations of total profits, total revenues, and total costs. The standard deviations of profits, revenues, and costs are used in the calculation of adjusted volatility and this adjusted volatility is then used in the option valuation. The mean of the project value, discounted back at a risk-adjusted rate, becomes the proxy for the current price of the underlying asset.

Example

N Pahilwani Consulting, a leading enterprise resource planning Software Company with an established market share, is contemplating the development of a software product that would complement its existing products. Based on its experience with existing similar products, it can wait for a maximum of five years before releasing the new product without experiencing any substantial loss of revenues. The DCF estimate using an appropriate risk-adjusted discount rate shows that the present value of the expected future cash flows for the new product will be INR 1.60 Lakhs, while the investment to develop and market it is INR 2.00 Lakhs. The annual volatility of the logarithmic returns of the future cash flows is estimated to be 30% and the continuous annual risk-free rate over the option's life of five years is 5%. What is the value of the option to wait?

Black - Scholes Merton Model

1. Identify the input parameters:

    So(Current asset value) = 1.60 Lakhs

    X (Strike price) = 2.00 Lakhs

    σ (Volatility) = 30%

    r (Risk free rate) = 5%

    T (Time to expiration) = 5 years

d1 = [ln (So/X) + (r + 0.5σ^2)T]/(σ√T) d1 = [ln (1.60/2.00) + (0.05 + 0.5x0.3^2)5]/(0.3√5) d1 = 0.375	d2 = d1 − σ√T d2 = 0.375 − 0.3√5 d2 = −0.295
N(d1)=0.646 [from excel formula =NORMSDIST(0.375)] N(d2)=0.384 [from excel formula =NORMSDIST(-0.295)]	
C = N(d1)So − N(d2)X exp (−rT) C = 0.646 x 1.60 − 0.384 x 2.00 exp (−0.05x5) Value of Call Option = 0.435 mean43,500	

Binomial Method

Identify the input parameters:

So = INR 1.60 Lakhs

X = INR 2.00 Lakhs

T = 5 years

σ = 30%

r = 5%

TI = 1 year

$U = \exp(\sigma\sqrt{TI})$ $U = \exp(0.30\sqrt{1})$ [Excel Formula =exp(0.30)] $U = 1.350$	$D = 1/U$ $D = 1/1.35$ $D = 0.741$
$Pu = \dfrac{Rf - D}{U - D}$ $Pu = \dfrac{1.05 - 0.741}{1.35 - 0.741}$ $Pu = 0.51$	$Pd = 1 - Pu$ $Pd = 0.49$

Year	0	1	2	3	4	5
						7.17 $S_0.U^5$ 5.17
					5.31 $S_0.U^4$ 3.42 [Note 1]	
				3.94 $S_0.U^3$ 2.13		3.94 $S_0.U^4D^1$ 1.94
			2.92 $S_0.U^3$ 1.28		2.92 $S_0.U^3D^1$ 1.02	
		2.16 $S_0.U^1$ 0.75		2.16 $S_0.U^2D^1$ 0.53		2.16 $S_0.U^3D^2$ 0.16
	S0= 0.43		1.60 $S_0.U^1D^1$ 0.28		1.60 $S_0.U^2D^2$ 0.08 [Note 2]	
		1.19 $S_0.D^1$ 0.14		1.19 $S_0.U^1D^2$ 0.04		1.19 $S_0.U^2D^3$ 0
			0.88 $S_0.D^2$ 0.02		0.88 $S_0.U^1D^3$ 0	
				0.65 $S_0.D^3$ 0		0.65 $S_0.U.D^4$ 0
					0.48 $S_0.D^4$ 0 [Note 2]	
						0.36 $S_0.D^5$ 0

Start with *S.0* and multiply it by the up factor and the down factor to obtain upside and downside respectively for the first time step and continue in a similar manner for every node of the binomial tree until the last step. For example, *S0U1* = 1.60 * 1.350 = 2.16; *S0D1* = 1.60 * 0.741 = 1.19. Moving to the right, continue in a similar fashion for every node of the binomial tree until the last time step.

Start with the terminal nodes representing the last time step first. At node *S0U5,* the expected asset value is INR 7.17 Lakhs if you invested INR 2.00 Lakhs for the new product; therefore, the net asset value is: INR 5.17 Lakhs

Next, move on to the intermediate nodes, one step away from the last time step. Starting at the top, at node SOU4, calculate the expected asset value for keeping the option open. This is simply the discounted (at the risk-free rate) weighted average of potential future option values using the risk-neutral probability. That value at node S0u4 is: INR 3.41 Lakhs

Note: 1

$$Value\ S.U^4 = \frac{[Pu(S.U^5) + Pd\ (S.U^4D^1)]}{1.05}$$

$$Value\ S.U^4 = \frac{[0.51(5.17) + 0.49\ (1.94)]}{1.05}$$

$$Value\ SOU^4 = 3.42$$

If the option is exercised at this node by investing INR 2.00 Lakhs, the payoff would be INR 5.31 Lakhs (the asset value at S0U4), resulting in a net asset value of INR 3.31 Lakhs. Since keeping the option open shows a higher asset value (INR 3.41 Lakhs), you would not exercise the option but instead continue to wait; the option value at this node becomes INR 3.41 Lakhs.

Similarly, at node S0.U2D2, the expected asset value for keeping the option open, taking into account the downstream optimal decisions is:

Note: 2

$$Value\ S.U^2D^2 = \frac{[Pu(S.U^2D^3) + Pd\ (S.U^1D^4)]}{1.05}$$

$$Value\ S.U^2D^2 = \frac{[0.51(0.16) + 0.49\ (0)]}{1.05}$$

$$Value\ S0.U^2D^2 = 0.08$$

If the option is exercised by investing INR 2.00 Lakhs, the payoff at this node is INR 1.60 Lakhs (the asset value at S0.U2D2), showing a net loss of INR 0.40 Lakh. Therefore, the decision would be to keep the option open and where the value of open option is INR 0.08 Lakh

Analysis

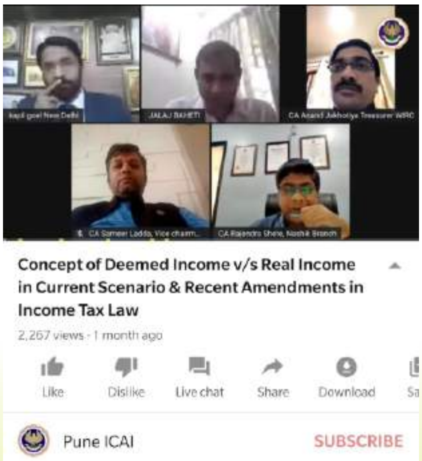
As the calculations show, the Black-Scholes solution simply involves inserting the numbers into the equation and solving it, which makes it the easiest model. However, there is no transparency with this model in the sense that the logic behind the solution is not clear.

The binomial method offers transparency by showing the project values in the future for the given expected payoffs and the rational decisions management would make. The idea is that as the uncertainty clears in the future, management can make appropriate decisions at that time by comparing the expected payoff with the investment cost. The binomial method provides a strategic map to facilitate that process.

Let us now compare the decisions you would make strictly based on DCF results versus ROV results. The DCF method shows a payoff of INR 1.60 Lakhs for the new product, which is expected to cost INR 2.00 Lakhs for development and marketing. This means the NPV of the project is INR -40 Lakh (INR 1.60 Lakhs - INR 2.00 Lakhs), which does not favour the investment. The additional value created by the option is the difference between the ROV of INR 0.43 Lakhs and the DCF-based NPV of INR – 0.40 Lakhs, which equals INR 0.83 Lakhs.

With such substantial additional value created by the option, N Pahilwani Consulting may want to explore alternatives other than abandonment of the project at this time. For example, it may simply wait until the market uncertainty clears by itself (passive learning), at which time it would re-estimate the project payoff. If the payoff

It should be evident from the above calculations and discussion that ROV is a supplement to rather than an alternative to DCF based NPV. If N Pahilwani Consulting's project has either an extremely high positive or extremely high negative NPV, the project may be accepted or rejected for investment respectively, irrespective of the option value. ROV quantifies the value of waiting and provides a strategic road map for future contingent decisions. Since the NPV is not highly negative and the project has a high option value, senior management may want to consider alternative decisions related to passive or active learning and keep the project "alive."

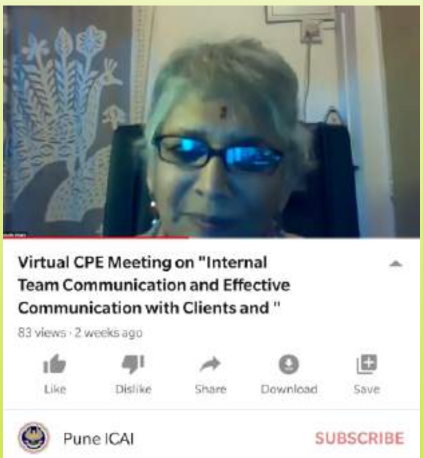


CA Adv Kapil Goel - Speaker

CA Jay Chhaira - Speaker

CA Arpit Kabra - Speaker

CA Meghnand Dungarwal - Speaker



Ms. Nandita Khaire - Speaker

CA Neelesh Khandelwal - Speaker

VALUE ADDITION…..A NEED OF THE DAY.

Contributed by :- CA. Vijay Ashtekar

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The Concept

Value, the consideration for an article or service may or may not be commensurate with the benefits derived from the article or service. As far as an article is concerned to certain extent the accuracy of the value can be measured. But it is practically impossible to measure the correct value of a service sometimes it may be overvalued but most of the times it is undervalued.

The question may arise how one can make such a statement that a particular service is undervalued, what is the base or proof for it. Theoretically proving the statement is bit difficult however one can experience it practically.

As a professional one always provide the services as agreed upon or mutually decided. Those services can be classified broadly into two classes. First the compliance service and another need based or supplementary to compliance service. I don't have to explain here what Are compliance services and what are non-compliance services as we all know them very well.

Usually need based or supplementary services are well defined with terms and conditions, scope, fees, etc. needless to say anything about compliance service.

There is A third category of service neither it is defined nor it is expressed. Most of the time it is implied service. We call this as Value Addition Service. Over seventy five years as An official service provider we are rendering compliance and non compliance services to the industry, society and the nation. At the same time, a large amount of value added services are also being provided. To a large portion of the period referred above the compliance service was the dominance of our profession. However, after the beginning of globalization, the industry grew up phenomenally. The MNCs established their manufacturing plants and also service units in India. The professionals were being expected to provide global standard services. Value addition services become the dire need of the hour and also handsomely rewarded. It is necessary to understand why it became the dire need of an hour. The businesses were expanding like anything crossing the boarders. The widespread large scale of operations required effective control which was possible only with brilliant ideas and handsome skills. These were well possessed by the Chartered Accountants and professionals from other streams including information technology. A large number of tools and applications were required to ensure the accuracy, integrity and authenticity of the data including financial. The business needs were increasing beyond the conventional compliance. They wanted professionals to come forward with great ideas and solutions to problems, situations, complexities and make value addition to the business. They were asking for more and more inputs to run the business smoothly and profitably whether small scale or large scale. Indirectly they started expecting professionals to become a partner to their business and contribute as much as possible and also to take back the rewards. Value addition can be in different manners like reduction in cost of the product, services, expenditure, increase in the gains, incomes, reduction in losses, increase in profits, etc. The value addition may also have indirect impact like efficient internal control systems, increase in efficiency, productivity not necessarily the plant or workers' productivity. Reduction in duplication of work, synchronization of the series of activities, well established co-ordination among the employees, the benefits derived from various government schemes. There could be n number of avenues open to a smart professional to think, work and execute so that the business gets value addition and the professional too. He has to look beyond the framework, have the initiative, take some extra efforts, prepare a scheme, present it smartly to the businessman and execute effectively so that the direct and / or indirect benefits come forward may be immediately or in due course of time.

The process

Probably who will better understand the value addition service than a Chartered Accountant? A businessman may or may not understand however the Chartered Accountant knows better how to make a businessman aware of value addition service and the real direct and indirect benefits derived out of it.

To implement the process effectively we should understand the business of the client to the micro level. The macro and micro environment, the competition, the industry, the global standards, the legal requirements, the benefits available to the industry should be studied thoroughly. For this, we need to find extra time and take extra efforts. At the same time without compromising with the compliance service we have to find out such opportunities. It is not the case that the value addition services can be rendered in altogether different areas. The compliance and non compliance services both have sufficient room for value addition services. It requires out of the box thinking. It requires reading between the lines and looking beyond the things.

Sometimes the circumstances may provide the opportunity or sometimes the events happening externally or internally may provide such opportunity. The professional has to grab that opportunity, explore it, and draw the attention of the businessman to it and the benefits those can be derived by executing that service.

Regular interaction with the client and continuous review of the business transactions help us to identify such areas where cost cutting and profit maximization is possible. As stated earlier the value addition process will have mutual benefits. However to make it a success we have to be constantly updated and continuous improvement is essential. We have to take extra efforts, make more analytical study, do research about the industry and the economy at national and global levels. Compliance and non compliance services are very much structured and have limited scope for extra efforts and extra results as far as business is concerned.

Sometimes we may take the help of other professionals like engineers, valuers, IT experts, etc. to prepare a plan or scheme and implement. For example in cost reduction programs an engineer is essentially required to contribute technically when the cost of production per unit is required to be reduced. The current requirement of a large business organization is data analytics, business intelligence, business analytics where you need many more tools and applications which are basically designed and developed by IT professionals. Compliance and supplementary to compliance services are to certain extent static and periodical. Value addition services are always changing and continuous. The external environment, the economic development of the country, the other countries, the increasing competition, the environmental changes, and many more things become the cause for creation of the opportunities and instances of value addition service. I remember in one seminar a CFO of a well known company who happens to be a Chartered Accountant openly said that if the statutory requirement of Internal Audit is removed by the law then he will be the first person to close the services of the Internal Auditor i.e. a Chartered Accountant to his organization.

Let's take another example today the Tax Audit limit is Rs. 1 cr. or 2 cr. of turnover with certain conditions. A practicing CA is having ten clients whose turnover ranges from Rs. 1 cr. to Rs. 10 cr. If the law amends the provision and makes the Tax Audit limit of Rs. 10 cr. how many out of those ten clients will wish to continue the services of the Chartered Accountant not as auditor but as a business consultant with the same amount of fees. I doubt many of them will look for a tax consultant who will prepare and file the returns are will ask the in house people to carry out the work. In such a situation the businessman will review the services of the Chartered Accountant whether those are really making value addition to his business if so will continue the association.

The effects

Value addition services have inherent direct and indirect benefits. The term itself indicates the purpose and the result of the service. It is been experienced by many professionals that sometimes the monetary value of the service is numerous. Most of the time those services are rewardless because they have not been properly defined, discussed and valued in advance. That is the reason that we should identify such services in advance and challnelise them properly so that there won't be revenue loss on our part. The indirect benefit to the client is limitless. If we look at the example given above (auditor of ten clients) it is the perfect situation where a value addition service makes difference. We have many such experiences where the clients whether manufacturing, services like banks have invited the Chartered Accountant on the board of the organization to contribute their best and it is being done by them.

It not only helps to maintain the perpetual association with the client but also to develop i.e. increase the work by way of reference by the client. Value addition is not only to the client's business but also to the professional's revenue.
An example can be given a person starting his business is being asked to maintain accounts right from the beginning, to prepare new worth statement i.e. balance sheet every year as on 31st march, to file the Income Tax Return even the income is not taxable. These things prove to be very useful in future. A private limited company is to prepare cash flow statement even if not required by law to have better understanding and control over finances. To get the credit rating from a certified agency even though the bank has not required in view of improving ratios, the financial health and eventually to get better pricing for loans.

I would like to share some experiences.
A company was having term loan of Rs. 24.00 cr at interest rate of 11.25 % pa. The company was having regular exports generating handsome amount of forex every month. We asked the banker to convert the term loan into FCNRB category where the interest rate was labor linked. The effective rate came down from 11.25 % to 3.75 % p.a. saving 7.50 % p.a. This resulted into saving of interest in monetary terms Rs. 1.80 cr for the first year. There are many such instances of value addition services which are over and above the basic standard services. As I mentioned earlier these value addition services definitely fetch good amount of benefits to the client directly and indirectly. Also for professionals they bring more rewards and improve the image of the profession in the business world.
Two companies under the same management and ownership were having different lines of business. One company was incurring huge losses y-o-y due to high fixed costs and tough completion in the market. The losses were piling up. The other company being very straight forward business was making huge profits due to low fixed cost and having high value addition product. It was paying sizeable taxes on account of high income. A Chartered Accountant who was newly appointed as consultant but not as the Statutory Auditor to the loss making company took various measures in co-operation with the management. And he turn around the company to profit making in the first year itself. Secondly he advised for merger of profit making company with the loss making company to take the advantage of optimum use of resources, save taxes and reduce the cost of duplication.

A partnership firm doing manufacturing business was incurring losses y-o-y. The firm was paying interest and salary to the partners despite having business losses in the firm every year. The result was piled up losses in the hands of the firm and cash outflow on account of income tax in the hands of the partners where practically there was no cash flow on account of interest and salary from the firm to the partners. This was being followed year after year and the owners or partners being technical persons were not aware of the implications. The reason being the balance sheet was always prepared in the last week of the due date, it was signed on the last but one day of the due date hence there was no sufficient interaction between the auditor and the partners to understand financials. The first action taken by the new auditor was to stop paying interest and salary to the partners. The second was the financial statements were being prepared in the month of June or before every year and thoroughly discussed with the partners and then signed. With the other lot of measures the firm could turn around in profit after two years and it could absorb all the losses in the next two years.

Concluding value addition is the basic need of any business today rather than a compliance service especially for the MSME category of businesses.

CA Maheshwar Marathe - Speaker

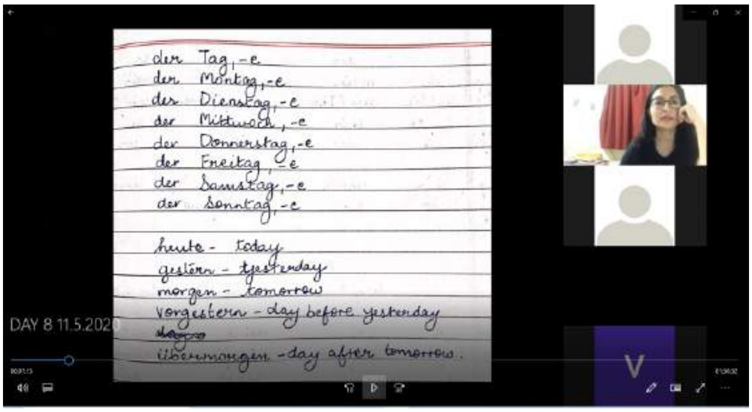
Shri. Sanjay Rudra - Speaker

Dr. Apoorva Javadekar - Speaker

Shri. Amit Ghaisas - Speaker

Shri. H. C. Jain - Speaker

CA Bhupendra Bhandari - Speaker



German Online Class - Ms. Vidhi Daryanani (Trainer)

CA Jugal Doshi - Speaker

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