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Continuing with our revamped series of the Accounting and Auditing Update, this issue focusses on the telecommunication services sector.

The Indian Accounting Standards (Ind AS) are bringing about a paradigm shift in financial reporting which is going to potentially affect many key metrics of performance. For the telecommunication services sector, we highlight the impact of Ind AS on how revenue recognition would be impacted for a typical player in this sector upon adoption of Ind AS 115, *Revenue From Contracts with Customers*. We also discuss other important accounting issues such as capacity transactions, regulatory licences, impairment of assets, asset retirement obligations, etc.

This publication also carries an interview section with Mr. Anuraag Srivastava, Chief Financial Officer, Tata Teleservices Limited. His inputs help us to explore some of the key accounting and reporting as well as topical matters relevant to the sector.

In this issue, we also cover two important topics in the telecommunication sector: revenue assurance and risks due to fraud and cyberattacks. Revenue assurance is expected to help the telecommunication sector in achieving completeness and accuracy of revenue, and in turn help to enhance the same. Our article provides an overview on the concept of revenue assurance and highlights its need in this sector. In another article, we also throw light on key fraud risks/challenges in the area of mobile money services. We also discuss cybersecurity and the challenges arising on account of cyberattacks targeting service providers, customers and outsourced providers.

The telecommunication services sector is also affected by a number of developments in the areas of direct and indirect tax. Our article aims to summarise various tax issues such as the Income Computation and Disclosure Standards (ICDS), spectrum sharing and trading, royalty payments, withholding tax issues on the sale of SIM cards and prepaid vouchers, etc. Additionally, we also put forth the potential impact of the Goods and Services Tax (GST) requirements on this sector.

Our publication also carries a regular synopsis of regulatory updates.

As always, we would be delighted to receive any kind of feedback or inputs on the topics that we have covered.
Being one of the largest mobile markets, the Indian telecommunication sector has experienced an unprecedented growth in the past decade. The total telephone and mobile internet connections have crossed one billion and 300 million respectively, to make this sector the second largest mobile market in the world. It is amongst the top five sectors with the highest Foreign Direct Investment (FDI) at INR883 billion or 7 per cent of the total capital inflows in the country.

The regulatory and industry developments in the sector serve as catalysts for its growth and have helped it to scale exponentially. Communication services have received a major boost through the ‘Digital India’ initiative, while the ‘Make in India’ initiative is expected to enhance domestic equipment manufacturing. Expansion of fibre network and its constant upgrades are driving the quality of service while declining costs to customer is increasing subscriber growth and has massively improved rural coverage.

The growth in penetration of smartphones has spearheaded the move towards an app-based ecosystem, ushering the growth in Mobile Value Added Services (MVAS), especially Over-The-Top (OTT) m-services (including m-commerce, m-entertainment, etc.). Increasing convergence with other sectors such as financial services, healthcare, automotive, education, etc. has resulted in the development of telecommunication oriented cross-sector products/services. Spectrum sharing and trading arrangements are leading the industry towards consolidation. The expected spectrum refarming exercise of high value bands during the financial year 2016 can further enable service providers to expand their spectrum assets. Passive infrastructure providers (tower industry) too are moving towards consolidation through tower business hive-offs and sales.

Growth drivers
The launch of high speed services such as 3G (third generation) and 4G (fourth generation) has changed the way Indians access the internet. Though still minuscule, India’s mobile broadband base is expected to multiply, driven by nation-wide 4G launch, free public Wi-Fi projects and increasing use of OTT services. Additionally, affordable 3G and 4G smartphones are one of the major drivers of data growth.

Rural penetration has more than tripled in the last five years. With mere 13 per cent rural internet penetration and 48 per cent mobile penetration, rural India is seen as an important driver for future telecommunication growth. The investment by telecommunication operators to increase network coverage and capacity too has been beneficial for growth.

Revenue diversification, demand for enterprise mobility and the emergence of Small and Medium Enterprises (SMEs) have made the enterprise business a significant focus area for telecommunication players. Large scale adoption of emerging products/services such as Internet of Things (IoT), managed services, and cross-sector products/services shall also be a driving force.

1. Telecom Regulatory Authority of India (TRAI) performance indicators report for quarter ending June 2015
2. Quarterly Fact Sheet on FDI from April 2000 to September 2015, Department of Industrial Policy and Promotion, p9
**Business issues**

Despite astounding growth, the sector continues to fall short of achieving its full potential due to various issues. **High capital expenditure** and the resultant extensive **debt** have been a pressing issue since the first spectrum auction in 2010. **Right of Way (RoW) obligations**, network expenditure, power supply, etc. are some of the key reasons behind high infrastructure cost. **Network investments** continue to rise due to upgrades to make them **LTE** (**Long-Term Evolution**) ready. Additionally, though there is movement towards outsourcing to control **operating expenditure**, the outliers continue to affect profitability. The cluttered nature of the Indian telecommunication market with nearly 10 operators has been another roadblock. Competitive intensity has resulted in stressed balance sheets, margin pressures and constant price wars.

**Multiple tax levies** amounting to nearly 30 per cent of **Aggregate Gross Revenue (AGR)** has often been cited as a key factor for lack of investments. Currently, operators pay regulatory charges for spectrum usage, licence fees, **Universal Service Obligation Fund (USOF)** and other corporate taxes subjecting the Indian telecommunication market to a variety of taxes.

**Regulatory changes**

The **Telecommunication Regulatory Authority of India (TRAI)** has been in sync with global developments and has gained visibility on account of several regulatory aspects of telecommunication.

**Spectrum**

Spectrum sharing and trading norms have given a medium to unlock the financial value of the spectrum. Small scale operators can now realign their business operations. With the plans of another spectrum auction in works, 3G spectrum swap and spectrum harmonisation, operators are in a better position to plan their strategy.

**Net neutrality**

The **TRAI** has finally ruled in favour of net neutrality by releasing the **“Discriminatory Tariffs for Data Services Regulations”** prohibiting a telecommunication service provider to offer or charge discriminatory tariffs for data services on the basis of content. Initially effective for two years, these regulations are expected to be reviewed again either after two years or any earlier date as it deems fit.

**Telecommunication consumer protection**

Recent amendments to consumer protection regulations have mandated customer consent for data services activation. While this move prevents bill shocks, it has categorised mobile internet as a product rather than a utility. Additionally, telecommunication operators have recently been asked to financially compensate consumers in an event of a call drop.

**Other regulatory developments**

The **TRAI** has issued various other consultations such as the **BharatNet project implementation to lead digital revolution.** It has also published various recommendations such as **Mobile Virtual Network Operators (MVNOs)**, national broadband implementation as well as a revenue base definition for the calculation of fees liabilities. Besides this, the **Department of Telecommunications (DoT)** in India has also released a national policy road map for adoption of machine-to-machine communication technologies.

The Reserve Bank of India has granted payment bank licences to various telecommunication operators allowing them to further leverage their mobile money capabilities.

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4. TRAI performance indicators report for quarter ending June 2015  
5. Telecom Consumers Protection (Eighth Amendment) Regulations, 2015, TRAI, released on 7 August 2015  
6. TRAI mandates the mobile operators to compensate the consumers in the event of dropped calls, TRAI, released on 16 October 2015  
9. Recommendations on Definition of Revenue Base (AGR) for the Redimensioning of License Fee and Spectrum Usage Charges, TRAI, released on 1 January 2015  
The IFRS converged Indian Accounting Standards (Ind AS) have been notified by the Ministry of Corporate Affairs (MCA) in February 2015 under Section 133 of the Companies Act, 2013. This includes Ind AS 115, the new revenue standard which would impact many telecommunications companies significantly. While the equivalent IFRS 15, Revenue from Contracts with Customers, has been deferred by International Accounting Standards Board (IASB), the authoritative deferment of Ind AS 115 has been announced by MCA on 16 February 2016 and it has been proposed to be deferred up to 1 April 2018.

Ind AS 115 (equivalent standard for IFRS 15) creates a single source of guidance for revenue related accounting across all industries. The new revenue standard is a paradigm shift from the present “transfer of risk and rewards model” to a “five step model” which mainly focusses on timing of performing the obligations by an entity under a contract with its customers.

Though the standard is expected to be deferred on 1 April 2018, if practical expedients for transition to the new standard are adopted it would apply to all open revenue contracts as at 1 April 2018. The effective date of the standard may seem a long way off, decisions would need to be made soon - how to transition to the new standard. This article analyses the recognition principles laid down in Ind AS 115 and its related impact on the financial statements of telecommunication companies.

Apart from the sale of goods, the new standard also provides detailed guidance for recognising revenue from services providers, including construction contracts. It is expected that the additional application guidance provided in this standard requires increased judgement in recognising revenue.

Many believe that there is no major change between unbundling of multiple element arrangements under the existing IAS 18, Revenue, with that of recognising revenue based on performance of obligations agreed in a contract under this new standard. However, the devil actually lies in the details and many implementation issues are likely to crop up spreading across the five steps prescribed in the standard. In many cases, the new standard may impact the pattern and timing of revenue recognition by companies.

Considering these changes and the detailed guidance on determining performance obligations, the implementation of this standard by many telecommunication companies is expected to be much more challenging. This is mainly due to the variety of plans they offer and the frequency with which customers modify their plans. The accounting treatment prescribed for certain costs associated with obtaining and fulfilling a contract may also pose a significant challenge for companies in this sector.
Challenges in accounting for revenue recognition

Revenue generation is considered to be the core activity for any entity and in particular for the telecommunications sector, considering the number of IT systems involved and frequent changes in the service offerings. These factors make this area critical (at times) as well as a complex area in terms of accounting. With telecommunications companies foraying into internet and television besides mobile, fixed line telephony and value added services, and providing bundled package offers comprising handsets, prepaid minutes, messages, discounts, special offers and other incentives to their customers, the accounting for revenue in these companies has only added to the complexity. Demystifying different components of revenue recognition requires a careful analysis of the business transaction together with the understanding of the accounting principles. Certain aspects of revenue recognition that require consideration have been discussed in this article.

Key focus areas

It is expected that while applying the five step model prescribed in the standard, the following could be of key consideration which telecommunication companies need to focus on:

- Identifying the various performance obligations agreed upon under each tariff plan
- Identifying and accounting for variable considerations
- Adhering to recognition principles when a significant financing arrangement is included in the contract
- Accounting for modifications in contracts
- Determining whether the costs associated with obtaining/fulfilling a contract are to be capitalised, or expensed immediately.

Core principle and the five step model

The core principle of the standard is that revenue is recognised in the way that it depicts the transfer of goods or services to the customer at an amount to which the entity expects to be entitled. An entity implements the core principle by applying a five-step, contract-based model to recognise and measure revenue from contracts with customers.

This principle is applied using the following five steps:

1. Identify the contract with a customer
2. Identify performance obligations
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognise revenue

Source: Ind AS 115, Revenue Contracts with Customers
Implementation issues in the telecommunication sector

Ind AS 115 may lead to significant changes in the pattern of revenue and profit recognition. Telecommunication companies may have to consider and plan their implementation strategy to address key impacts resulting from the new standard, those issues that may arise in each step of the new model.

Step 1
Identify contracts with the customers

Combining and segmenting contracts

Under this standard, an entity is required to combine two or more contracts that it enters into at, or near, the same time with the same customer and account for them as a single contract, if they meet the specified criteria. Since revenue recognition is linked directly to the terms of the contract when the parties have present enforceable rights and obligations, it would be critical for companies to evaluate the terms of the contracts at inception and decide on combining/segmenting these contracts with a single customer.

A typical challenge for telecommunication companies starts with the sheer volume of contracts to be analysed considering the variety of plans, performance obligations agreed in the plans and the frequency with which plans can be modified by the customers. For example, if there is a plan under which handset is provided to customer for a period with a premature termination clause which requires the customer to pay the full consideration for the handset upon such termination, it is critical to assess as a first step as to whether it is only a contract for sale of services or it also contains a contract for sale of the handset and if so whether to combine these contracts. The existence of sufficient historical data to estimate the average customer life (also known as ‘churn period’ in the industry) may help companies to reach a conclusion for these types of contracts after exercising significant judgement.

Contract modifications

The sector is witnessing a highly competitive environment which necessitates the need to introduce progressive plans for its customers. Many companies provide their customers the right to add or remove certain services, switch over to a different data plan, add family members, as well as offer a flexible corporate plan which gives the right to add or remove new members at discounted rates, etc.

In assessing whether a contract modification is interdependent, the standard provides indicators which include whether the contracts being entered into are at a similar time, with a single commercial objective and being performed concurrently or consecutively. If these criteria are met with, accounting for the original contract is not affected by modification and revenue recognition for the original contract is not adjusted.

However, if the goods and services to be provided after contract modification are distinct from the goods and services provided on or before the modification, the entity accounts for contract modification as termination of the old contract and creation of a new one. The remaining portion of the original contract and modification are accounted for together on a prospective basis, by allocating the remaining consideration to the residual performance obligations.

Portfolio approach

Applying the principles of this standard to each and every individual contract entered into with the customer may be difficult and complex for telecommunication companies due to the volume of such contracts. The standard permits companies to account for a portfolio of similar contracts together, if the result is not materially different from the result of applying revenue recognition to each individual contract.

Step 2
Identify performance obligations

Under Ind AS 115, a performance obligation is a promise to deliver a good or service that is distinct. In other words:

- the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and
- the entity’s promise to transfer the good or service to the customer is separately identifiable from other goods or services in the contract.

An entity has to account for a series of distinct goods and services as a single performance obligation, if they are substantially the same and have a similar pattern of transfer.

In order to induce customers to sign up subscriptions agreements, many telecommunication operators frequently offer their new customers free handsets, free talk time, free usage of premium services for a few months, etc. Under Ind AS 115, these free services represent promised goods and services under the contract and need to be assessed to determine whether they represent separate performance obligations. And if it does, a portion of the transaction price will be allocated to these items. This could significantly differ from the present practice of treating them as marketing incentives.

Under Indian GAAP, AS 9, Revenue Recognition, mentions with respect to sale of goods that, ‘revenue is to be recognised at the time of transfer of risks and rewards’ and for rendering of services it mentions that ‘revenue to be recognised when the service is performed, either by the proportionate completion method or by the completed service contract method.’

AS 9 does not give any particular guidance on how a separate component within an arrangement should be identified.
Step 3
Determine the transaction price

The transaction price is the amount of consideration which an entity expects to be entitled to in exchange for transferring the goods or services to the customer. In determining the transaction price, an entity considers the effects of variable consideration (including the constraint), whether there is a significant financing component in the arrangement, consideration payable to the customer and non-cash consideration.

Variable consideration

If the consideration promised in a contract includes a variable element, an entity would estimate the amount of consideration to which the entity would be entitled to in exchange for transferring the promised goods or services to a customer. The amount and timing of a portion of the transaction price could vary, due to discounts, rebates, refunds, credits, price concessions, incentives, bonuses, penalties or other similar items. Under Ind AS 115, these variable amounts are estimated and included in the transaction price using either the expected value method or the most likely amount method. The selected method should be applied consistently throughout the contract and update the estimated transaction price at the end of each reporting period. This requirement may pose a significant challenge for many telecommunication companies due to the sheer volume of contracts and the variety of options given under each tariff plan.

Significant financing arrangement

While determining the transaction price, an entity would need to adjust the promised amount of consideration for the effects of time value of money, if the timing of payments agreed upon by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In these circumstances, the contract contains a significant financing component, which may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed upon by the parties to the contract.

A typical example could be an interest free instalment plan offered for the handset when a customer enters into a contract for telecommunication service. Customers normally receive a price discount in relation to the services provided by the telecommunication operators in return for agreeing to an instalment plan for purchase of handsets from such telecommunication operators. Entities are required to unwind the implicit financing component as a separate performance obligation for revenue recognition.

As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service is one year or less.

Whether commission paid is indirectly passed onto the end customer

There could also be an added issue of determining the amount of revenue to be recognised. The standard requires that the consideration payable to a customer (or to other parties that purchase the entity’s goods or services from the customer) is treated as a reduction of the transaction price and, therefore, of revenue unless such payment to the customer is in exchange for a distinct good or service. Based on the fact pattern, a portion of the commission paid to the dealer is, in effect, passed on to the end customer. In such cases, such pass-through charges in the nature of discounts are netted against the revenue to be recognised.

Cashback offers

It is generally seen that telecommunication operators provide a ‘cashback’ offer to their customers on entering or at the time of renewal of a contract. It would be critical to consider whether this represents:

a. an interdependent pricing change or not
b. whether such a payment represents a rebate in relation to past performance or an upfront discount.

It may be worthy to note that the accounting treatment will differ in each of the above circumstances and companies have to review their existing contracts terms as well as evaluate the pricing strategy for future contracts.

Customer loyalty programmes

The costs involved in acquiring new customers is high and therefore telecommunication companies, as in many other industries, seek to reduce customer churn by offering retention incentives. For example, a telecommunication operator may award points for an amount spent on airtime and a customer could redeem those points for money off their monthly bill or obtain a handset upgrade.

An entity would account for a customer option to acquire additional goods or services as a performance obligation if the option provides the customer with a material right (customer loyalty programme). The new standard provides guidance on calculating the standalone selling price of a customer option.

If the stand-alone selling price for a customer’s option (customer loyalty programme) to acquire additional goods or services that is a material right is not directly observable, in such a case an entity would need to estimate it.

AS 9 does not give any particular guidance on how a separate component within an arrangement should be identified. According to the ‘Technical Guide on Accounting Issues in the Retail Sector’ issued by the Institute of Chartered Accountants of India (ICAI), two approaches are available:

- Provision approach
- Deferment approach.
The deferment model is on the lines of IFRIC 13, Customer Loyalty Programmes. In this model when a company grants loyalty points with a certain purchase e.g. airtime, the loyalty points are separated from the airtime and accounted for as a separate performance obligation (multiple element transactions). Under the provision model, sale is treated as a single element transaction and revenue is recognised for the entire transaction at the time of initial sale. However, since a further cost is expected to be incurred in the future with regard to the obligation to provide free/discounted goods or services, a provision is recognised towards the cost of such free/discounted goods or services as marketing expense at the time of initial sale. According to the guide, the deferment model being more refined is a preferred model, though it does involve complex workings to arrive at the fair value of the award credits/obligations to be fulfilled in the future. In case, reliable data is not available or the estimation of fair value of the award credits presents significant difficulties, the provision model may be used. In practice many entities with similar programmes, create a provision on an estimated incremental cost basis at the time of recognising revenue from the initial sale of its underlying products.

**Step 4**
Allocate the transaction price to the performance obligations in the contract

The transaction price is generally allocated to the performance obligations in a contract on the basis of relative standalone selling prices. Discounts and variable considerations would also be allocated to one or more specific performance obligations in certain circumstances.

Due to the limited guidance available in Indian GAAP for recognising revenue in respect of multiple-element arrangements, many telecommunication operators in India are presently using the U.S. GAAP model. Accordingly, under the present practice many companies may be using the ‘residual method’ for allocating the purchase consideration to various elements to be delivered under a contract. However, under Ind AS 115, the total transaction consideration has to be allocated to the identified performance obligations based on their relative standalone fair values. This may result in a change in the pattern and timing of revenue recognition of goods and services under a contract with the customer.

**Step 5**
Recognise revenue

Under Ind AS 115, an entity recognises revenue when (or as) it satisfies a performance obligation by transferring a good or service to a customer. An entity transfers a good or service to a customer when the customer obtains control of that good or service. Control may be transferred either at a point in time or over time.

**Prepaid mobile phone revenues**

In India, prepaid mobile services are the norm rather than post-paid contract-type services. While the average revenue per user typically may be lower than in the post-paid market, many telecommunication operators specifically target the prepaid market as it enables them to service customers who may not be able to obtain a post-paid contract due to concerns over creditworthiness. By receiving cash up front, telecommunication operators remove the credit risk in dealing with such customers.

Customers typically pay for ongoing services by purchasing cards, vouchers, or purchasing points a phone, online, or via other channels such as cash machines and customer payment terminals. Irrespective of the payment arrangement with the customer, an accounting issue which companies grapple with is when to recognise revenue in respect of services purchased in advance.

From an accounting perspective, revenue should follow performance rather than the timing of payment as telecommunication operators have an obligation to provide services to the end customer. This means that revenue should be recognised when calls are made. However, practical accounting difficulties arise when telecommunication operators cannot readily track the card or other forms of usage. In many cases, approximations, based on the expected usage and the life of the card or other credits, may be acceptable.

In addition to this, under the new standard entities would also consider whether it contains a significant finance model (especially a contract beyond a 12 months’ period) and discounting for time value of money received in advance may be warranted.

**Gross vs net presentation**

There are numerous examples in the sector in which the telecommunication operator is just one amongst many constituents involved in the provision of a service to an end user. Several issues arise in determining which party in a particular chain should report the transaction on a gross or net basis.

Specific guidance is provided by this standard to assess whether an entity is acting as an agent (net revenue presentation) or principal (gross revenue presentation) in a contract. The focus for such an assessment is shifted to a control model (which controls the delivery of goods or services to a customer) from the existing risk and rewards model (which takes the risks and rewards associated with the delivery of goods or services).

Many telecommunication companies use both the direct channel (through the operators’ own shops) and the indirect channel (through a dealer network) for servicing the customers. The question that arises is who is entering into the contract with the customer - the dealer or the telecommunication operator indirectly. A careful analysis of the facts and circumstances of an indirect channel arrangement is required to determine the appropriate accounting and presentation. The gross vs net presentation of revenue may significantly be impacted, if the payments made to a dealer represent a commission for sale of the service contract.

**Challenges surrounding interconnect revenue**

For many operators, interconnect charges represent one of the largest single operating cost and the second largest source of revenue. Mobile operators enter into a number of interconnect agreements with other operators, which agreements allow them to terminate a particular call or transit the traffic on another operator’s network. This, essentially, uses the network of contracting parties to facilitate and provide the wide-ranging connections required by the customers of agreeing parties. In certain cases, the rates may be regulated e.g. in India the rate is governed by the Interconnect Usage Charge (IUC) Guidelines issued by the Telecom Regulatory Authority of India (TRAI).
Even though interconnect agreements usually allow operators to settle revenues on a net basis, however as per market practices, interconnect revenues are accounted for on a gross basis since the operators are exposed to the gross risks of the transactions. For example, an operator may bear the gross credit risk for non-payment and be obliged to make payments under interconnect arrangements, irrespective of the level of reciprocal revenues due. Each arrangement should, therefore, be evaluated on a case-to-case basis. In transactions where products/services are of a similar nature, no revenue is recognised if the quantum of products/services is also the same. However, if the quantum exchanged is different, then revenue needs to be recognised.

Mobile content
The mobile phone is increasingly used for more than just making and receiving calls and text messages. Downloads of videos, ringtones, street directories, restaurant guides and similar content are now commonplace services. This could be another area of judgement in relation to the gross vs net presentation as it could involve third party content being provided by a telecommunication company to its customers (e.g. games, video on demand, etc.). Considering the risk and rewards model, many companies at present recognise revenue on a gross basis. Under the new standard, companies may have to ‘reassess’ their presentation of revenue if they do not control the delivery of such content.

Mobile payments
Mobile payments, or ‘m-payments’, are made using mobile services to either directly purchase or authorise payment for other goods and services. In emerging economies like India, m-payments are being used to provide currency exchange and cash transfer facilities to large parts of the population that previously did not have access to banking facilities. Although whether a telecommunication operator is acting as a principal or an agent in this chain, will vary depending on the contractual arrangements in place. However, typically, we would expect the telecommunication player to be an agent in such transactions.

Contract costs
The standard also includes guidance on accounting for:

- incremental costs to obtain, and
- costs to fulfil a contract that are not in the scope of another Ind AS.

Incremental cost to obtain a contract
An entity has to recognise as an asset the incremental costs of obtaining a contract with a customer if it expects to recover those costs.

Customer acquisition (or origination) costs are the directly attributable costs incurred in signing up a new customer. The costs of adding subscribers to a company’s customer base can be substantial and complicated by the type of costs involved, including incentives to retailers, commissions paid to external dealers or agents, and sales commissions to the telecommunication operator’s staff.

Many telecommunication operators are presently expensing the commission immediately while the standard would require companies to capitalise incremental costs of obtaining a contract which is a significant divergence from the current practice. The practical expedient provided in Ind AS 115 may help in these situations to some extent. The standard permits an entity to immediately recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less. This could be an accounting policy choice and should be applied consistently.

Cost to fulfil a contract
Some examples with respect to the cost of fulfillment of a contract could be the set-up, activation and installation costs incurred by telecommunication operators against a customer contract.

However, Ind AS 115 provides some specific guidance on capitalising such costs. The standard provide the following as examples of costs to fulfil a contract:

- a. direct labour (for example, the salaries and wages of employees who provide the promised services directly)
- b. direct materials (for example, supplies used in providing the promised services to a customer)
- c. allocations of costs that relate directly to the contract or to the contract activities (for example, costs of contract management and supervision, insurance and depreciation of tools and equipment used in fulfilling the contract)
- d. costs that are explicitly chargeable to the customer under the contract, and
- e. other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors).

Going by the above examples, companies may allocate direct labour, material and even supervision and depreciation costs towards the cost to fulfil a contract. This may broad base the present practice of capitalising only certain items of costs and have significant impact on financial statements.

Next steps

- Telecommunication companies would have to make an impact assessment of the new revenue recognition standard with their present accounting policy for revenue recognition.
- It may be important to note that the determination of performance obligations could significantly differ from the existing identification of multiple element arrangements.
- The new guidance and shift from the ‘risk and rewards’ model to the ‘control’ model has to be reviewed across all products and services being offered.
- Companies have to review the terms and conditions of existing contracts, especially long-term contracts which extend beyond one reporting period as well as those which are to be entered into in the future. In some cases, entities may choose to evaluate whether changes should be made to the underlying terms of contracts. Considering the highly competitive landscape of the telecommunication sector, such a review and evaluation on a timely basis may prove to be critical to avoid ambiguities and overcome the differences in the timing and amount of revenue to be recognised.

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As per the Ind AS adoption roadmap, Tata Teleservices (TTSL) would be adopting Ind AS from 1 April 2016, with date of transition being 1 April 2015. How are you addressing the challenges in the following areas?

i. Technical challenges
ii. Capacity and infrastructure challenges such as capacity building of the finance department and creating awareness both internal/external, changes to contracts/business practices, changes to IT systems/processes
iii. Non-technical challenges such as managing expectations and communication with stakeholders, both internal and external.

Ind AS, in the view of TTSL, is an essential element in enhancing the quality of financial statements and aligning Indian reporting with global reporting standards. This makes it easier for companies that have to raise capital in the global markets and have global lenders.

Every new reporting standard brings with it implementation challenges. The company is, at present, in the process of evaluating the transition provisions and their impact on its financial statements. Also, given the technical nature, the company is constantly engaged with experts and its own statutory auditors in firming up the interpretation of these standards.

We believe this is a great opportunity to enhance the skills of our internal finance teams. Training is part of our implementation strategy. Further, once we firm up our interpretation and conclude our impact analysis, this knowledge is being planned to be disbursed across the organisation in a targeted manner with a focus on impact on:
- How we budget for certain elements under Ind AS
- Our treasury operations
- Assessment of assets/components under Ind AS, etc., with telecommunication being a capital intense industry
- Revenue recognition with respect to Ind AS 115

TTSL’s financial accounting and reporting platform is SAP, through which, as part of the impact assessment phase, we have clearly laid down a road map to evaluate following:
  - The data input impact analysis within SAP and consequent data processing impact
  - Reporting requirements, and
  - Disclosure requirements.

Though we believe that more importantly it is also a review of the chart of accounts (COA) and certain other minor configurations which may need to be reviewed accordingly.
What learnings or insights are you developing as you gear up to meet these challenges, especially with regard to the new revenue standard which is significantly impacting the telecommunication sector?

Within the telecommunication sector, revenue streams are generally defined reasonably well, though there are always elements to revenues which are constantly evolving due to:

- Either technological reasons
- Evolution in the delivery of service
- The tariff packages to customers, bundling, etc.
- Revenue recognition with respect to Ind AS 115
- Technological platforms at customer’s end.

These new standards, in fact, provide us an opportunity to segment some of these elements in a structured way and align our billing and compliance norms accordingly. These could more so affect the enterprise customers who avail various products and services that are delivered across geographies.

The adoption of the Income Computation and Disclosure Standards (ICDS) is expected to significantly alter the way companies compute their taxable income. What are the key implementation challenges of ICDS that you foresee? Do you believe that adequate implementation time and guidance has been provided by the government?

There are various ways to view the advent of ICDS. We, as a country, do have a fairly comprehensive tax act and rules. In spite of comprehensive tax act and rule, there are numerous litigations. A fresh set of standards may add another level of complication.

The new standards could entail an overlap of the law with accounting, hence we believe that the law can be all pervasive and does not need fresh standards. Rather, the focus should be on ensuring that the law gets simplified and clearer so as to reduce litigation.

The Companies Act, 2013 (2013 Act) has introduced Section 134(5) (e) which requires the directors’ responsibility statement to state that the directors, in the case of a listed company, have laid down Internal Financial Controls (IFC) to be followed by the company, and that such controls are adequate and operate effectively. How have you approached this area, and what have been your key considerations related to the implementation of IFC reporting?

IFC enhances the assurance process in a company, and we welcome any initiative which does so around internal control as well as provides assurance to all stakeholders in this regard. Being a Tata Group company, we believe in a continuous improvement process in all our assurance programmes, and subscribe to a higher standard of assurance.

We have been one of the early movers in this space and, in the previous financial year itself, we set out to implement an IFC framework and review the control design within our organisation. We have initially used this as a peripheral layer on all our other assurance programmes and, in the near future, we will integrate this in our existing assurance programme. In fact, we enabled the complete IFC process this year with a design and control effectiveness evaluation. We also constantly engage with our statutory auditors and seek their inputs to make this process extremely robust and effective.

Have there been other areas, such as related party transaction approvals required under the 2013 Act, that have been challenging to implement?

From financial year 2014-15, the company has successfully implemented an effective related party transactions framework with an underlying process which ensures full compliance with these requirements. Our company does have many transactions with others in the group, however, we have used the related party transactions process in the past to further enhance our transparency and governance in this regard.

We have an independent governance process with regard to related party transactions, which reports into the audit committee, and have our own policy up on our website, apart from enabling tagging of the same in our ERP platforms.

What has been your overall evaluation of the 2013 Act? How should such a significant economic legislation be implemented in the country?

As economies or businesses evolve and get globally integrated, the statute has to also develop and imbibe the accepted practices in itself. We believe that the 2013 Act is a step in the right direction. Companies can debate on the speed of applicability of various provisions - given that it takes a while to upgrade skills, bring internal IT platforms and processes to speed without any business disruption - but the intent is always welcome and should be implemented. It is important to lay down a medium-term road map of legislation, such as the 2013 Act, as it impacts every element of an organisation. This will enable corporates to plan their efforts and implement the standards within a defined time frame, while also carrying out skill upgrade, etc.
Despite the setback so far in the Parliament, the general view is that GST will soon become a reality. Viewed from this perspective, how are you framing your plans in order to achieve significant efficiencies of business, yielding a competitive edge in the market?

GST will happen; it is just a matter of time. Its implementation worldwide has had a positive effect on economies over a longer term. We believe it is transformational and hence are very closely watching the political developments in this regard. We have begun to meet experts and engage with them to comprehend the proposed law and evaluate prima facie impact areas. We are shortly going to initiate an organisation-wide project in this regard as well.

We believe that GST will significantly enhance and, hopefully, simplify the customer process, while also bringing about clarity in terms of its compliance.

What are your views on the impact of GST on the telecommunication sector in India?

While framing the law, the government needs to give specific consideration to the telecommunication sector, keeping in view the complexities involved here. There is a requirement of separate and specific place of supply rules, with specific resolution to circle vs state disparity, since GST is destination-based.

Yes, initially there is going to be a steep change in the tax rate, impacting the top line, if tariffs are not revised. Hence, it is being represented from all sectors to keep the initial rate low.

What were your key considerations while implementing the Corporate Social Responsibility (CSR) requirements in the 2013 Act for the first time? Please elaborate on the CSR programmes being undertaken by the company?

Irrespective of legislation, the Tata group strongly believes in giving back to the society. Our areas of focus for CSR are employability, creating a livelihood for people, volunteering in case of natural disasters, and skill development.

As you focus on new product development as well as technology upgrades, what changes do you anticipate in the company in the areas of research and development costs, finance function, and automation?

We are always ahead in terms of automation or hi-speed technology, and keep our technology upgraded to provide better service to customers. All our systems are well connected internally and any issues are sorted in least amount of time.

The telecommunication industry is a technology-oriented industry. In our company, within finance, practically every team is made aware of products and services, along with underlying technological developments – be it in revenue assurance, or business finance.

What are the new learning initiatives that TTSL is undertaking as a capacity building exercise in order to equip its finance department/internal auditors/stakeholders/board of directors to build their knowledge base in areas of change?

We have a well defined learning and development plan for our people. We identify individual training needs and customise learning programmes accordingly. The learning interactions include technical and functional training (SAP, Ind AS, taxation) as well as behavioural training. We also have a well-developed management trainee programme in finance where we hire fresh graduates from CA Institutes and groom them to be future leaders.

How do you see spectrum trading as a big game changer for the telecommunication industry, despite lack of clarity on spectrum cap, calculation of trading fee as Adjusted Gross Revenue (AGR), and determination of market fees?

Spectrum trading/sharing will act as a significant catalyst for not only improving the economies of telecommunication, but for providing service quality to the end customer. This policy would also allow small chunks of spectrum to consolidate through sharing which would at the same time also help in making the spectrum available for next generation services.
What key steps is your company taking in dealing with cybersecurity, especially when your company has presence in different geographies?

Cybersecurity is an area of concern for every company. Our management understands the risks associated with it and, to show our commitment to it, we have an appropriate governance structure in place. We have a dedicated team with well-defined roles and responsibilities for those looking after information and cybersecurity. To address the risks, we also build capabilities in critical areas such as prevention, detection and response.

We are working on preparing a comprehensive cybersecurity response plan that will cover most of the known scenarios and actions in case of a threat.

The views and opinions expressed herein are those of the interviewee and do not necessarily represent the views and opinions of KPMG in India.
The telecommunication sector is developing a vast ecosystem surrounding itself expanding rapidly across a broad swath of product, technology and services companies.

A key focus area of the sector in the recent past has been technological development, specifically over data business than the voice business. Considering that there are frequent regulatory changes, availability of new services in the sector, such as 4G and Long Term Evolution (LTE), continuously increasing teledensity and internet penetration, the sector still continues to be in the evolution phase. In the wake of such transition, the industry faces significant accounting and business challenges due to complexities in the schemes offered to customers, capacity transactions, accounting and amortisation of intangibles, etc. Intermediately, the Institute of Chartered Accountants of India’s (ICAI) Expert Advisory Committee (EAC) has also issued relevant guidance on certain critical aspects of the telecommunication sector.

Capacity transactions

Framework for deciding if an Indefeasible Right to Use (IRU) is a lease

Telecommunication companies operate in a capital-intensive industry in which significant costs are incurred, such as those used to set-up mobile towers and laying fibre optics in respect of operation of the network infrastructure. It makes commercial sense for such telecommunication companies which own excess network capacity to enter into arrangements whereby they convey to another telecommunication company the ‘right to use’ equipment, fibre or bandwidth (capacity) for an agreed period of time for an agreed payment. In respect to such a capacity transaction, a telecommunication company could either be a seller, buyer, or both, or there could be capacity swaps. The excess capacity holder usually retains the ownership of the network asset and allows an IRU to the customer. An accounting issue relating to IRU is the timing of revenue recognition. Determination of the timing of revenue recognition requires understanding of all facts and circumstances of the arrangement and generally relates to two basic questions: Is the IRU a lease or a service contract.

### Important accounting issues

This article aims to:
- Highlight important accounting issues faced by the telecommunication operators.

#### Capacity transactions

Is there a lease?

**Yes**

- Apply lease accounting
- Operating lease

- Finance lease
- Sale of services
- Sale of goods

**No**

- Apply revenue recognition principles

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1. KPMG IFRG Limited’s publication: Accounting under IFRS: Telecoms - January 2010

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1. KPMG IFRG Limited’s publication: Accounting under IFRS: Telecoms - January 2010
Often, IRU contracts are complex and lease arrangements are not explicitly mentioned in the contracts. Thus, one should evaluate the substance of the agreement to understand whether the arrangement contains a leasing arrangement or not. Other than AS 19, Leases, Indian GAAP does not have any specific guidance on evaluating whether an arrangement has a lease in it or not. However, under IFRS, IFRIC 4, Determining Whether an Arrangement contains a Lease, mentions the basic criteria for such an evaluation. The IFRIC 4 lays down the following two criteria to evaluate whether an arrangement contains a lease:

a. does the provision of a service depend on the use of one or more specific assets, and
b. does the arrangement convey the right to use.

Although IFRIC 4 does not define the term ‘specific asset’, it does state that if the entity has the right and ability to provide services using other assets not specified in the arrangement, then fulfillment of the arrangement is not dependent on the specified asset and the arrangement does not contain a lease.

In determining whether an IRU is a lease, it is generally not difficult to determine that a ‘right of use’ is being conveyed under the agreement. However, difficulties do arise in identifying whether a specific asset is being used. As such, the arrangement should have explicitly or implicitly identified the specific path or wavelength which may be used to transmit data for and on behalf of the customer.

The following framework helps in deciding if there is a lease component under the IRU transactions:

```
Is a specific asset or are specific assets being used?
  Yes

Is a right to use being conveyed, i.e.:
  Does the customer have the ability or right to operate the asset, including to direct how others should operate the asset, and at the same time obtain or control more than an insignificant amount of the asset’s output?
    No
      Yes
    Yes

  Does the customer have the ability or right to control physical access to the asset, while obtaining or controlling more than an insignificant amount of the asset’s output?
    No
      Yes
    Yes

  Is the possibility that another party will take more than an insignificant amount of the asset’s output during the term of the arrangement remote?
    No
      Yes
    Yes

  Does the customer pay a contractually fixed price per unit of output?
    Yes
    No

  Does the customer pay market price per unit of output?
    Yes
    No

There is no embedded lease

There is an embedded lease
```

Source: KPMG IFRG Limited’s publication: Accounting under IFRS: Telecoms January 2010
Upon being identified as a lease arrangement, it would then have to be classified either as an operating lease or a finance lease based on the criteria given in IAS 17, Leases. An operating lease is a lease other than a finance lease. Based on the analysis, if the arrangement is classified as a finance lease, it would result in the asset being derecognised from the books of the lessee.

**Capacity swaps**

Generally, telecommunication operators often exchange network cables or swap capacity based on requirement, with or without any cash flow movement. There is no specific accounting guidance given for such swaps other than AS 10, Accounting for Fixed Assets under Indian GAAP. When a fixed asset is acquired in exchange or in part exchange for another asset, the cost of such an asset acquired should be recorded either at the fair market value or the net book value of the asset given up, adjusted for any balance payment or receipt of cash or other consideration. For these purposes, the fair market value may be determined by referring either to the asset given up or to the asset acquired, whichever is more clearly evident.

The key issues in respect of exchange transactions is to help ensure there is an appropriate commercial basis for the transaction and to determine the relevant fair value at which the transaction is to be recorded. If there is no commercial rationale, no accounting recognition should be given to the transaction.

**Intangible assets – Regulatory licences**

Telecommunication operators are required to acquire licences to operate and access the parts of the spectrum to enable delivery of their services. The auction of 4G, 3G, LTE and Broadband Wireless Access (BWA) licensees in India by the Department of Telecommunications (DOT) is a recent example, wherein many telecommunication operators had tendered their bids and were awarded spectrums, which involved significant costs. Hence, accounting for intangible assets becomes especially pertinent in this sector. Under the Indian GAAP, AS 26, Intangible Assets deals with the accounting relating to intangible assets.

The following aspects may be relevant in accounting for regulatory licences.

- **Whether the licencees should be capitalised or not?** If yes, what should be the amount of capitalisation?
  - Intangible assets are recognised when they meet the conditions such as a) it is probable that future economic benefits that are attributable to the asset will flow to the entity and b) the cost of the asset can be measured reliably.
  - Thus, considering these, such regulatory licences should be capitalised as intangible asset. The amount of other directly attributable expenses such as legal charges, tender fees, etc. would also be capitalised along with the amount of licence fees paid.

- **What should be the period of amortisation/useful life?**
  - Under Indian GAAP, AS 26 prescribes the period of amortisation of intangibles to be 10 years. However, the period of amortisation is rebuttable if persuasive evidence is available for longer useful life than 10 years. The useful life of an intangible asset may be very long but it is considered to be finite under Indian GAAP. In case of regulatory licences, the period of a licence allotted by the regulatory authority would be relevant for determining the period of amortisation.

- **When should the licences be capitalised and commencement of amortisation begin?**
  - The amortisation of licence commences when they are available for use. Generally, capitalisation and amortisation of the licences coincides with each other. However, there could be two different viewpoints about the date of commencement of the amortisation.
  - Either, the licencees are capitalised and amortised from the date of allotment by the regulatory authority or the licencees are capitalised and amortised from the date on which the operator actually starts rolling out the services by using the awarded licence. In this case, the licences are amortised over the balance useful life commencing from the date of rolling out of the services. The decision would be based on the circumstances in each case and one should evaluate the point of availability of intangible for use to consider the starting point amortisation. Considering the nature of the industry, such licences at times, take significant time to be deployed and start generating revenue.

Each telecommunication operator has to exercise judgement to decide the preoperative period as well as the expenses incurred under such a period. Sometimes, operators are allotted separate licences for geographical areas such as circles. In such cases, commencement and amortisation would need to be evaluated for each area for which a licence is awarded.

- **Method of amortisation:** Intangibles are required to be amortised over the useful life using the method which reflects the pattern in which the asset’s economic benefits are consumed by the enterprise. This aspect requires consideration as the operators incur a high cost initially and the returns from such an investment may not reflect the actual pattern of utilisation of the asset. This is particularly relevant in the case of intangibles, where high licence fees are paid and the capacity may not be fully utilised initially. Hence, deciding the method of amortisation is a matter of judgement and is determined based on facts and other relevant factors. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, diminishing balance method and the unit of production method.

**Capitalisation of interest during pre-operative period**

Telecommunication operators often construct networks from borrowed funds for expansion or start-up. These networks are generally constructed in phases one after another depending on the market demand, operational practicability, availability of the channel and environmental situation.

Normally, there is a time lag between the availability of the network and connecting the first customer. Irrespective of whether the customer is available or not, the interest liability starts when the company gets funds. During the start-up phase, there are operational hurdles and several test runs may be required. Interest costs incurred until the time that a sizeable customer base is created could be significant for the operators. Hence, the question that now arises is how and for which period should the preoperative interest be capitalised.

1. The EAC opinion no. 1 on capitalisation of interest during the preoperative period in cable and telecommunication industry – 16 March 2011

© 2016 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
The EAC\(^2\), of ICAI has clarified the matter by way of an opinion on capitalisation of interest during the preoperative period in the telecommunication sector. The EAC mentioned that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset and that the capitalisation of borrowing cost should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore, interest should be capitalised, if it is directly related to the qualifying asset. The company may use the weighted average cost formula to the extent that borrowed funds are used. Interest may be capitalised till the time the facility is technologically and commercially ready for distribution to the end-customers and not till the time the customer base is created, as the subsequent activities do not add any value to the asset under consideration. Consolidation of business and getting a sizeable number of customers is not a criterion for determining the commercial readiness to estimate the substantial period of time.

### Optimisation costs

Like in any capital intensive industry in the telecommunication industry as well, there is a continuous need for significant maintenance or overhaul required for maintaining the assets standard performance or to maintain the asset as per current technology, in the telecommunication sector as well there is an need to incur cost which may increases the standard of performance of the asset. For example, the company may incur additional maintenance charges for enhancing the current network’s standard of performance by either increasing the coverage of the network or reducing the call drop rate. This cost may be incurred by the telecommunication operator through internal means or through an outsourced manner. Thus, such costs should be carefully evaluated, whether they need to be expensed or capitalised. AS 26 and AS 10 provide guidance on accounting of subsequent expenditure on an intangible asset and a fixed asset respectively, after their purchase or completion is recognised. Such an expenditure would recognised as an expense when it is incurred, unless:

- it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance, and
- the expenditure can be measured and attributed to the asset reliably.

If these conditions are met with, the subsequent expenditure should be added to the cost of the intangible asset. A telecommunication operator should exercise judgement to evaluate if subsequent expenditure should be capitalised. Costs which are purely in nature of maintenance of the assets and do not improve the standard of performance should be expensed as incurred.

### Impairment of assets

The significant technology innovations in the telecommunication sector from the second generation to 4G and LTE, required the telecommunication operators to invest significantly to deliver such products to the end customer. This investment is in the form of capital assets as well as intangibles. Impairment testing is required when there are indicators of impairment. In a scenario where companies are investing heavily on intangibles at an extremely high prices, one may encounter a triggering factor more likely than not.

An important aspect to consider while evaluating the impairment of a telecommunication company is to ascertain the Cash Generating Unit (CGU). AS 28, *Impairment of Assets* defines CGU as the smallest identifiable group of assets that generates cash inflows from continuous use that is largely independent on the cash inflows from other assets or groups of assets. A CGU should be identified consistently unless a change is justified.

While identifying whether cash inflows from assets or CGUs are largely independent of the cash inflows from other assets or CGUs, various factors, including the manner in which the management monitors operations and makes decisions about continuing or disposing off the assets and/or operations, should be considered. However, the identification of independent cash inflows is a key consideration.

For telecommunication operators identifying CGUs is further complicated in the current environment of network convergence and stiff competition, as a result of which telecommunication companies are increasingly providing bundled products and services. Many telecommunication operators operate on the basis of the type of customer i.e. enterprise or retail customers as opposed to the type of network e.g. wireline or wireless. This interdependency of the revenue stream has the effect of increasing the size of the CGU because the assets at the lower level do not generate largely independent cash inflows.

A telecommunication company’s network is often common across many of its product lines or businesses, and might need to be viewed as a single geographic country or on a regional basis e.g. circle. Monitoring and management of the business may be on a product basis e.g. distinct billing for distinct range of products. However, the product may use the same underlying network. While the use of the network is monitored, independent cash inflows may not be identifiable for individual parts of the physical network and hence, it is a challenging area as far as identification of CGUs is concerned.

The EAC opinion\(^2\) on the telecommunication sector has mentioned that CGUs of the enterprise should be identified on the basis of a detailed and in-depth study of the assets of the enterprise keeping in view various factors, including those stated in AS 28.

### Asset retirement obligation

Telecommunication operators often construct assets to build their networks for their mobile and fixed line operations. The land or premises on which such networks are constructed are generally taken on lease, whereby the operators are obligated (like under the lease agreement) to reinstate the land or premises at the end of the agreed term. A provision for such costs is required under Indian GAAP as per AS 29, *Provisions, Current Liabilities and Current Assets* as Asset Retirement Obligations (AROs). The provision for ARO is made at the cost estimate involving in dismantling the network assets and reinstating the land of the premises on which the networks are built and reviewed at every reporting date till the time the obligations are met with. The complexity involved in accounting for AROs is that often it may not be evident from the contractual terms that a legally enforceable obligation exists. It may also be that the contract is unclear or silent on the restoration requirements at the end of the contract period. Even in such circumstances, entities would need to make their ‘best estimate’ of the cost involved based on prior experience. This provision is remeasured at each reporting date on the best estimate of the dismantling and asset removal costs.

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\(^2\) The EAC opinion no. 21, Applicability of AS 28 to telecom industry - finalised on 17 August 2005.
Revenue assurance

This article aims to:
- Provide an overview on the concept of revenue assurance
- Highlight the need for revenue assurance in the telecommunication sector.

Revenue assurance is a series of cross-functional activities designed to provide support to the management of a company to achieve completeness and accuracy of revenue, with the aim of enhancing the same, along with the cash inflow. Activities undertaken to reach this level include:

- Thorough review of all processes under the revenue cycle
- Performing preventive and detective checks (analytics/configuration reviews/test calls, etc.)
- Identification of revenue leakage, revenue exposure, revenue enhancement, as well as direct cost reduction opportunities.

Need of revenue assurance

Revenue assurance, as an organisational function, is required for protection against revenue and customer losses. It enables the timely identification and correction of errors which otherwise can damage the reputation and financials of the organisation. The function is more useful for organisations having multiple transactions with varied data type (customer records, usage records and service records) and operational reference data (dial-codes, rate cards, offers, promotions and rules). It is the involvement of complex processes and infrastructure with multiple points of information generation, movement across systems and output that make the presence of an effective revenue assurance function necessary.

Revenue assurance in other sectors

Revenue assurance is majorly useful for sectors having high number of transactions and complex system configuration. Some of the emerging sectors where the function is emerging are:

- Transport industry (Railways and airlines)
- Value Added Services (VAS) service providers
- Banking and financial services
- E-commerce
- Satellite TV service provider.

Basic revenue assurance operating principles

Although revenue assurance practices could vary, the main areas of operational focus include:

- **System Configurations**: Subscriber provisioning, tariff and billing system configurations.
- **System integration**: Transitioning from switch to mediation, to billing system.
- **Subscriber usage**: Monitoring all forms of usage, in-line with business rules.
- **Subscription**: Examining the additional services subscribed.
- **Partner settlement**: Executing timely and error-free partner settlements.
- **Fraud**: Providing timely identification of fraud alarms.
Key revenue assurance controls across functions

Revenue assurance covers all processes across the revenue cycle for all revenue streams existing within the telecommunication company. It also covers checks across billing, product configuration, network and customer service related elements. Listed broadly below are key revenue assurance controls which are performed across revenue streams and what they include:

- **Network configuration validation**: Subscriber configuration, B-table and routing checks, monitoring of network utilisation, compliance to network key performance indicators, and network migration and updates.
- **Rating and billing**: Product/plan configuration, billing/rating completeness, bill run checks, dunning and collection.
- **Roaming and Interconnection Usage Charges (IUC)**: Roaming partner configuration, roaming and IUC Call Detail Records (CDR) validations, IUC billing system, interconnect rate validation and trunk group reconciliations.
- **Partner settlements**: Channel partner validations, VAS vendor settlements, interconnect invoices validation, roaming partner and clearing house settlements.
- **Fraud management system**: Out-roamer usage monitoring, long distance call monitoring, SIM-box monitoring, recharge and usage monitoring.

The need for change

A telecommunication company faces a dynamic environment of increased competition, downward pressure on margins, increasing usage volumes, and new and potentially complex business models. Faced with these complexities, it is imperative that the revenue assurance and billing control functions be geared towards proactively managing a telecommunication company’s revenue.

As the operating environment is changing rapidly, with huge number of transactions, products and plans becoming more complex, the introduction of new technologies (4G/LTE), fast changing infrastructure and changing relationships with content providers, have made revenue assurance a constantly evolving function.

Over a period, a drastic shift - from reactive and manual to a proactive and automation - can be seen in existing revenue assurance approaches. Telecommunication companies have started using fully automated revenue assurance tools which have capabilities to work on high number of transactions on a real-time basis. Any leakages/errors in the systems get identified in real-time and the issue is closed without major damage, e.g. software can build alarms into the systems so that errors can be detected as and when they occur.

Systems are also getting integrated with monitoring mechanisms, which can provide insights by using trend analysis and can catch errors in the system proactively so that the management can take action before they move downstream to leak revenue or cause customer dissatisfaction.

As the telecommunication environment is very dynamic in nature, companies have adopted an approach to perform a periodic risk assessment to identify existing high-risk areas. Basis the outcome of risk assessment, focus of revenue assurance controls are also prioritised towards the high-risk areas.

Source: KPMG in India’s analysis, 2016

The past: Usage based voice charging

The present: Recurring charge multi service bundles incorporating content and exponential increases in mobile data

The future: New business models including value added services, cloud, MVNO1 / RSP2, media and content

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1. Mobile Virtual Network Operator
2. Routing Switch Platform
**Myths and realities**

There are certain misconceptions associated with the scope and purpose of revenue assurance and billing controls. The following table highlights the same with respect to reality scenarios:

<table>
<thead>
<tr>
<th>Myths</th>
<th>Realities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue assurance is only about plugging revenue leakage</td>
<td>Revenue assurance has evolved into a margin enhancement function which identifies cost optimisation and revenue enhancement opportunities apart from minimising revenue leakages</td>
</tr>
<tr>
<td>Revenue assurance only focusses on CDRs, billing and financial reporting related risks</td>
<td>Revenue assurance has a much wider purview assessing service provisioning, network operations, product development and various other systems and process such as customer relationship management (CRM), sales and distribution, etc.</td>
</tr>
<tr>
<td>Anybody with a background in finance can perform revenue assurance</td>
<td>Revenue assurance function demands a collaboration of diverse skill-sets (IT, networks, finance) to effectively deliver value to the organisation</td>
</tr>
<tr>
<td>The revenue assurance department is responsible for independently rectifying issues and safeguarding revenue</td>
<td>Revenue assurance acts as a facilitator and requires organisation wide support to investigate, escalate and resolve issues hence requires a cross functional team to ensure effectiveness</td>
</tr>
<tr>
<td>All you need for revenue assurance is a revenue assurance tool</td>
<td>Tools are critical enablers for effectiveness of revenue assurance operations. However, investments in a strong technical team is required to decipher the indicators highlighted by revenue assurance tools and evaluate controls that are outside the tool for an extensive coverage</td>
</tr>
</tbody>
</table>

Source: KPMG in India's analysis, 2016
Revenue assurance maturity levels

A mature revenue assurance unit seeks to prevent previous mistakes leading to revenue leakage from occurring in the future, and not just detect existing leakages. Although difficult to quantify, this future focus has the potential to make large savings for businesses. This model can lead to fewer revenue issues to react to, and also lead to a faster reaction to revenue leakage identified by the model.

**Five stages of revenue assurance maturity**

**Level 5 | Optimised**
- Revenue intelligence - capitalise on the wealth of data to promote growth
- Measures and controls implemented become subject matter matter for continual improvement
- Decentralised ownership
- Continuous improvement
- Key contributing member of product conceptualisation and innovation

**Level 4 | Managed**
- Quantitative measurement of revenue risk through key performance indicators' definitions
- Processes provide measures that drive planning and control of revenue assurance activities
- Automated analytics of standardised controls and processes through effective robust tools
- Assurance of over 70 per cent across revenue streams

**Level 3 | Standardised**
- Control points understood by revenue assurance
- Revenue assurance processes begin to be embedded in organisational processes
- Resource allocation to revenue assurance indicates organisational focus on revenue assurance

**Level 2 | Basic**
- Some revenue assurance processes and activities
- Project level or product level revenue assurance activities undertaken

**Level 1 | Ad Hoc**
- Reactive – Queries resolved as and when stumbled upon

Source: KPMG International publication: “Revenue Assurance on Telecommunications – Progressing or Preserving” issued in 2010
Conclusion
The telecommunication environment is continuously evolving due to which revenue leakage is likely to keep increasing, however, deployment of a robust revenue assurance system can curtail this and can have a striking impact on the bottom line numbers. In case the concerns regarding leakage are not addressed proactively in this dynamic environment, telecommunication companies may let go of the stakeholder’s money and investors may perceive this risk and move elsewhere. The companies should make sure that they are deploying advanced and flexible technology to handle the ‘As-Is’ and ‘To Be’ business to help ensure their survival and growth in the future.
Frauds in the telecommunication sector

This article aims to:
- Summarises key fraud risks/challenges that need significant attention of telecommunication operators.

With the evolution of data and value added services through improvements in telecommunication technology that is aiding convergence on the mobile, the telecommunication ecosystem is becoming increasingly complex and consequently more susceptible to fraud.

One stellar example of this convergence is the introduction of mobile money services. With mobile phones outnumbering bank account holders many fold in India and in almost all the developing countries, mobile money is being universally accepted as an effective approach to help achieve financial inclusion of the masses and for taking banking/payment services to the hitherto unbanked population.

As mobile money services in India expand and its adoption grows exponentially on the back of an ease in regulations (from half wallet to full wallet and the introduction of payments banks), innovation in services and acceptability, the operating environment is becoming increasingly complex with a multitude of stakeholders - telecommunication operators, banks, sales agents/merchants, technology enablers, customers, etc.

This exponential growth requires a proactive approach to be adopted towards fraud risk as mobile money services have a higher fraud vulnerability and disruption due to the financial nature of transactions.

This article summarises key fraud risks/challenges that need significant attention of telecommunication operators.

Situations of difference between business rules and system configuration of telecommunication operators

- **Transaction failures**: Definitions in the ‘Functional Design’ (FD) documents relating to successful transactions, exception/rollback of transactions, etc. and protocols for response could be inadequate or there could be a mismatch between the FD, agreement with banks and system configuration. Consequently, all transaction failures may not be captured in the reports. This could lead to delayed detection and root cause analysis of transaction failures.

- **Transfers (of money) completed before balance validation**: In certain situations, remittance is made and confirmed to the transaction initiator as well as the recipient, prior to balance validation of the initiator. This would lead to ‘negative’ balance in the initiating customer’s wallet and consequently, the remittance transaction would be require a roll-back. This situation could be exploited by a customer to make continuous transfers that would get rolled back while the recipients withdrawing money immediately (pseudo e-value generation).

- **Mismatch in tariff configuration**: In certain situations, there could be mismatch in tariff configuration between the approval document vis-a-vis the charging table, due to ineffective change management.
Joint and thorough User Acceptance Testing (UAT) may not be conducted prior to service introduction/changes by the telecommunication operator

Due to competitive pressures service introductions/changes are made without a thorough UAT/adequate testing of transactions. Such scenarios could lead to fraud vulnerability in the following ways:

- All scenarios of success/failure/delays/exception handling of transactions and related protocols may not be simulated
- Volume stress testing may not be performed by all stakeholders within the organisation to validate volume of simultaneous transactions that can be handled by the platform
- No archive of test results maintained to provide an audit trail of failures and corrections/modifications to the system flow
- Joint UAT may not be performed by all the stakeholders, including banks, to help ensure that each component of the platform is working as per the design.

Unauthorised PIN resets and SIM swaps

- Unauthorised PIN resets and SIM swaps performed through the backend/customer care leads to withdrawal/transfer of the balance in the target customer wallets. A periodic review of such PIN resets and SIM swaps may not be performed
- Abuse of weak system validation e.g. the system does not restrict PIN reset before the ‘cooling off’ period of SIM swap.

Know You Customer (KYC)/customer identity verification

- Given the challenges that telecommunication operators have faced due to non-compliance with customer verification” (AV/CV) mismatches, and verification documents accepted which are not as per the criteria, strict compliance with KYC prior to provision of mobile money services is of vital importance. This situation is further complicated as KYC requirements of both the Telecom Regulatory Authority of India (TRAI) and the Reserve Bank of India (RBI) need to be harmonised.

Weak monitoring of transaction reversals and roll back of transactions

- A transaction initiator may fraudulently demand ‘roll back’ of an amount transferred, despite having knowledge that the amount transferred has been withdrawn by the recipient
- A reversal process may allow multiple reversals against single request via multiple concurrent logins
- Periodic reports may not capture details of all exceptions/transaction failures.

Reconciliation between customer e-wallets, settlement account and trust account bank reconciliation may not be adequate

- Reconciliation could be performed on an overall value basis and not for each transaction
- MSISDN and bank account linkage reconciliation may not be performed.

Customer authentication for cash outs and agent float allocation

- With ease of RBI’s regulation enabling cash outs through mobile money service kiosks or agents, customer authentication has become a high risk area with significant fraud implication.

Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) monitoring

- AML limits are not imposed on a category of customers; only an overall transaction limit has been imposed without restricting the per-day transaction limit/daily transaction limit or vice versa.
- Transaction monitoring is not being performed.

Further, mobile banking and wallet apps can be exposed to several threats due to device level security challenges that exist in the end user handsets (which usually belong to employees on account of BYOD policies). Apps which allow employees to remember internet and mobile wallet passwords, make the cybercrime risk even more complex to manage.

Effective measures to combat such fraud risks would require a combined approach – well coordinated platform development and change management coupled with increased awareness amongst the stakeholders on one hand and a robust response mechanism built on real time transaction data analytics with a well-defined alarm system on the other.

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2. AV – Address Verification, CV- Customer Verification
3. MSISDN - Mobile Station International Subscriber Directory Number
4. BYOD - Bring your own device
Cybersecurity

Telecommunications continue to be one of the prime candidates for cyberattacks. With an ever growing demand for bandwidth and content, the variety and scale of cybercrime targeting telecommunications soon poses to be untamable.

The massive penetration of mobile phones and the proliferation of mobile applications pose a challenge viz. the privacy of its customers. Further, the outsourced nature of telecommunication operations bring its own challenges.

Attacks on service providers

In our experience, internet service providers have seen a huge rise in Distributed Denial of Service (DDoS) attacks, usually perpetrated by hacktivist groups and state sponsored players. Further, telecommunication companies have been under fire in recent times over breaches that have led to the leakage of customer details.

Attacks on customer data

Attackers are increasingly targeting Customer Relationship Management (CRM) and online self-service systems through multiple attack vectors.

Breaches into customer data (personal and financial information) are on the rise. Additionally, in a few instances it is also noted that key customer databases are encrypted using ransomware.

Under threat of contract violation, privacy violation and exposing a company to the risk of legal penalties attackers force victims to pay ransom in order to unencrypt the data and keep the same confidential.

Outsourced providers

As companies move towards cost cutting and green data centres, third party vendors are also increasingly being seen as vulnerable to cyberattacks. In our experience, some trends that are seen globally:

- Compromises of administrator privileges leading to mass data wipe outs; network outages on account of compromise of data centre level network devices
- Centres do not maintain/activate security logs (such as Firewall Logs, Active Directory logs, DHCP logs), audit logs for the database and other applications to foster an adequate audit trail
- Poor user access management.

Cybersecurity unlike IT security, is not limited to IT systems. Awareness about the threats as well as preventive measures plays a key role in prevention of cybercrime. Organisations should, therefore, continue cybercrime awareness campaigns for their staff and customers with renewed fervour.

5. Dynamic Host Configuration Protocol
Telecommunication spectrum, essentially air waves to carry signals, is a scarce resource. The procedure for spectrum allocation to telecommunication companies has undergone a change over the years and is presently allocated through an auction process as against an administrative allocation procedure prior to 2010. During the term of 20 years for which spectrum is generally allocated, there may be a few operators having sufficient subscribers to utilise the spectrum while other operators may not. This results in a spectrum crisis for some operators while others may have unutilised spectrum.

To this effect, the government approved the long pending guidelines for spectrum sharing and spectrum trading in 2015. Spectrum sharing allows only two operators having in the same band to pool their individual spectrum for usage in a specific geographical area. Spectrum sharing should result in an increase of in spectrum usage charges by 0.5 per cent of the ‘aggregate gross revenue’ for both the licences.

Spectrum trading norms, on the other hand, allow one telecommunication company to outrightly transfer its spectrum acquired through auction together with all the rights and obligations to another telecommunication company, subject to the prescribed spectrum caps. The original validity period of the spectrum should not be altered. An administrative fee of 1 per cent of the transaction amount or 1 per cent of the prescribed market price, whichever is higher, would be imposed by the government on the buyer of the spectrum.

Spectrum sharing and trading between telecommunication companies is expected to allow greater flexibility and efficient usage, leading to improved quality of service.

The sector has started responding positively to the guidelines and as per news reports several leading operators have commenced discussions Reliance Jio and Reliance Communications for spectrum sharing, as have Idea and Videocon and some other telecom operators. Despite the positive sentiments of the sector, there are certain embedded tax issues in these transactions which should be clarified upfront.

Whether indirect tax on spectrum trading is chargeable to Valued Added Tax (VAT), service tax or both

Currently there is lack of clarity on the applicability of indirect taxes on spectrum trading transactions i.e. whether it is liable to service tax, VAT or both. The courts have expansively interpreted the definition of ‘goods’ under VAT laws, to include even incorporeal and/or intangible properties which can potentially include spectrum trading transactions. The service tax laws defines ‘service’ as any activity carried out by a person for a consideration unless specifically exempted or excluded under the ‘negative list’ which does not include spectrum sharing and trading. Thus, there is a possibility of levy of service tax on the consideration paid towards spectrum trading. An argument in favour of the industry is that there is no levy of service tax on purchase of spectrum through auctions; therefore, spectrum trading in the secondary market should also not be subject to service tax. But whether spectrum qualifies as a good or a service is yet to be explicitly established in the law.

Further, while telecommunication companies can get a credit of service tax payment, no such relief would be available in the case of VAT, thereby compounding the problem. The matter may get resolved once the Goods and Services Tax (GST) comes in.

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1. Paid to Government of India through Department of Telecommunication.
2. a. Synopsis of Chairman’s comments at the 11th Annual General Meeting of Reliance on 30 September 2015
b. The Economic Times - Vodafone India in talks to buy Tikona Digital Networks 4G spectrum, 30 December 2015.
c. The Economic Times - Telenor ahead in race to snap up Videocon 4G; deal talks confirmed by Videocom, 27 December 2015.
d. Bharti Airtel acquires 100 per cent stake in Augere Wireless, 31 December 2015.
Whether spectrum trading is chargeable to capital gains or royalty?

A relevant issue from a purchaser’s perspective is whether a spectrum trading transaction qualifies as ‘royalty’ under the provisions of the Income-tax Act, 1961 (IT Act) and subject to withholding tax at 10 per cent. The determining factor serves to be whether spectrum trading is essentially the transfer of a right to use the spectrum by one operator to another or whether it is an outright transfer of the intangible asset akin to a capital gains transaction and would not be subject to withholding tax.

The definition of royalty under the IT Act includes a consideration for ‘transfer of rights in respect of’ or ‘use or right to use’ of equipment, process, design, trademark, etc. One finds it difficult to envisage spectrum trading payments to fall under any of the above categories. However, the tax authorities may still adopt an aggressive stance by terming spectrum trading transactions as ‘royalty’, especially considering that spectrum trading guidelines have specifically used the term ‘outright transfer of right to use the spectrum’. The spectrum buyer may prefer to withhold tax to avoid any adverse tax consequences, which may result in cash flow challenges for the spectrum seller.

A parallel issue is with respect to the taxation of the consideration in the hands of the seller. Tax treatment should depend on the position taken by the seller with respect to the spectrum charges paid at the time of acquisition i.e. whether depreciation has been claimed or the charges paid over the life of the spectrum have been amortised. In case depreciation has been claimed, any gain arising from spectrum trading would be assessable as short-term capital gains. In case of amortisation, the consideration should be bifurcated into business income and capital gains based on the amount of consideration received and the amortisation amount that has been claimed. Such a distinction in tax treatment may lead to varying tax liability and may also impact the set-off and carry forward of tax losses of the spectrum seller.

To realise the benefits associated with spectrum sharing and trading, it is important that the government clarifies the related tax issues to provide certainty to telecommunication companies. Any litigation on account of uncertain tax issues would adversely impact the implementation of the guidelines for spectrum sharing and trading.
On the tax front, the telecommunication sector faces certain challenges such as tax controversies as well as aggressive stance adopted by tax authorities over the years. The present government has repeatedly affirmed its commitment towards a non-adversarial tax regime seeks to further improve the ease of doing business in India. However, time bound action needs to be taken to resolve the legacy tax issues that are plaguing this sector. It is imperative for the government to provide more clarity on outstanding tax issues and help settle protracted litigation which is pending before various courts in the country.

Some of the tax issues affecting the telecommunication sector are elucidated below:

**Characterisation of telecommunication services as ‘royalty’**

One of the contentious tax issues adversely impacting the telecommunication sector is the controversy around tax characterisation of telecommunication payments towards provision of bandwidth, leased line, inter connect usage, roaming charges, etc. as ‘royalty’ under the Income-tax Act, 1961 (IT Act) post the retrospective amendments. Though the controversy is prevalent in both domestic and international transactions, the impact is more severe in the case of international transactions. This is on account of the fact that a ‘royalty’ characterisation grants the tax authorities a right to levy tax on payments on a gross basis even if a foreign service provider does not have any presence in India.

The retrospective amendments in the IT Act have touched two important aspects:

- **Process:** The amendments have increased the scope of the term ‘process’ in the definition of royalty by including ‘transmission by satellite, cable, optical fibre or by any other similar technology’.
- **Equipment royalty:** The amendments have dispensed the requirement of actual possession and control of an equipment by the payer while determining whether a right to use of the equipment has been granted.

With the above retrospective amendments in the definition of royalty, the tax authorities are taking a position that the payments for transmission of signals (voice and/or data) is towards the use of an equipment (essentially the underlying telecommunication infrastructure) or a process (the transmission of signals) and therefore, is liable to withholding tax.

Generally, a foreign service provider is eligible for benefits under the applicable tax treaty which are usually beneficial as compared to the IT Act. While the term ‘royalty’ would be defined in the tax treaties, however most of them have neither defined the term ‘process’ nor have expressly dispensed with the requirement of actual possession or control by the payer. Therefore, despite the treaty benefit being available in several cases, the tax authorities tend to take a contrary view and treat the payments as royalty even if they fall in the scope of a tax treaty. This has led to protracted litigation over the matter1 and several cases are pending resolution by the Apex Court.

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1. Verizon Communications Singapore Pte Ltd. vs Income-tax Officer (International Taxation) [361 ITR 575], Vodafone South Limited vs. DDIT [53 taxmann.com 441], Income-tax officer Vs. Cognizant Technology Solutions India Private Limited [47 taxmann.com 409], Asia Satellite Telecommunications Co. Ltd vs DIT [332 ITR 340]
The potential impact of this controversy on the sector could be threefold:

i. The tax authorities can hold an Indian telecommunication company as an ‘assessee in default’ for non-withholding of tax and seeking to recover the taxes not withheld.

ii. The tax authorities can disallow deduction of the expenditure incurred by Indian telecommunication companies on account of non-withholding of tax, and

iii. The foreign telecommunication companies can potentially be subject to audit by the authorities and assessed to tax in respect of the receipts for telecommunication services.

In the absence of clarity on this matter, foreign business partners of Indian telecommunication players have raised concerns over possible withholding of tax and are increasingly inclined to negotiate net of tax contracts. This could adversely impact the cost of operations of an Indian telecommunication company which could be ailing due to various other business reasons. Given that the matter may take some time to reach a final resolution, in the case of intragroup transactions, it is imperative to assess the overall tax risks while adopting a tax position around withholding of taxes.

**Withholding tax on distributors’ margin on the sale of SIM cards and prepaid recharge vouchers**

It is an industry practice to sell SIM cards and prepaid recharge vouchers to end customers through independent aggregators, distributors and retailers. The SIM cards and prepaid recharge vouchers are typically sold at a discount to the aggregators/distributors who further sell it to retailers and/or end subscribers at the market price. The tax characterisation of the margin left with the distributors/intermediaries as well as the applicability of tax withholding obligations is the core of the tax controversy in this transaction.

The telecommunication sector treats the margin as a discount and not in the nature of a commission, since the distributors are not considered as agents of telecommunication companies and the sale of SIM cards is akin to sale of goods. Generally, sale of goods do not attract withholding tax provisions.

On the other hand, tax authorities have adopted a contrary position regarding the sale of SIM cards and prepaid recharge vouchers. They believe that a discount given to the distributors is in the nature of commission and therefore, should be subject to tax withholding.

There have been several conflicting judgements2 on this matter, which is presently pending resolution before the Apex Court.

There is an urgent need to resolve the controversy and end protracted litigation over this matter. This is expected to help in preventing a compliance challenge for telecommunication players and might also address a cash flow issue at the end of the distributors. With the evolution of technology around recharge business (from paper vouchers to electronic aggregation and transfer of talk time), one needs to evaluate the relevance of the controversy in current times.

**Carry forward/set-off of business losses on amalgamation of telecommunication passive infrastructure service providers**

The Indian tax law prescribes certain specific cases (stated in Section 72A of the IT Act) where accumulated business losses of an amalgamating company are allowed to be carried forward and set off by the amalgamated company provided that such an amalgamating company is a specified ‘industrial undertaking’.

The term ‘industrial undertaking’ has been defined to include companies providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services.

However, the term ‘industrial undertaking’ does not specifically mention ‘telecommunication infrastructure service providers’ in its definition. Therefore, a claim of benefit by telecommunication infrastructure service providers for carry forward/set-off of business losses on amalgamation may be subject to significant challenges and could lead to litigation.

It would be worth noting that when the benefits of this provision were extended to the telecommunication sector in 2002-03, the concept of separate and independent telecommunication infrastructure services were not envisaged. Owing to advancement in technology and evolution of business models, telecommunication infrastructure companies are now the backbone and a vital element of the telecommunication sector and have also been granted ‘infrastructure status’ by the government.

In keeping with the spirit and intent of Section 72A of the IT Act, there is a need for a specific clarification/amendment to permit the benefit of carry forward of business losses, in case of amalgamation within tower infrastructure service providers. If clarified, it would address a long standing demand of the sector and go a long way to improve the ease of doing business and avoid needless litigation on this issue.

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Historically, taxable income for taxpayers in India has been computed based on the accounting books after considering the adjustments specified in the Income tax Act, 1961 (IT Act). With notification of the Income Computation and Disclosure Standards (ICDS), this has changed. To help ensure consistency in tax matters, reduce tax related disputes and facilitate the implementation of Ind AS, the finance ministry introduced 10 standards (referred to as ICDS) for computing taxable income effective from the previous year beginning 1 April 2015. These ICDS have been notified after multiple rounds of public consultation and changes.

While, the first tax reporting in the ICDS era would fall due after 31 March 2016, impacted taxpayers should have ideally paid the advance taxes of the June, September and December quarter of 2015 using the ICDS principles. Since the ICDS principles are very much aligned to the current accounting framework (Indian GAAP), currently there are not too many significant differences between the accounting and taxable profit under ICDS. However, these differences are going to increase significantly on implementation of Ind AS from the financial year 2016-17 for phase 1 companies.

There still remains a need for clarity on various aspects of the practical application of ICDS. On the basis of several representations received from multiple stakeholders, it was observed by the Central Board of Direct taxes (CBDT) that certain provisions of ICDS may need further clarification for its effective implementation. Subsequently, the CBDT has requested all concerned taxpayers to write to them with issues which may require further clarification or additional guidance from the regulators for effective and efficient implementation of the provisions. The CBDT in turn will raise these issues to a committee of experts comprising departmental officers and professionals. This seems to be the same committee formed by the CBDT to suggest a framework for Minimum Alternate Tax (MAT) for Ind AS compliant companies.

While the 10 notified ICDS provide a direction to the Indian regulators to plan and deal with direct tax issues, significant efforts are still required on part of the regulators. Some of the notable ones would be the definition of book profit for computation of MAT, placeholder for disclosures and reconciliation required by the ICDS, impact of Ind AS on Tax Deducted at Source (TDS), new ICDSs for some specific transactions such as leases, share-based payments, financial instruments, etc.

Based on the 10 notified ICDS, highlighted below are some of the key areas of impact for telecommunication companies.
**Revenue recognition**

ICDS IV on revenue recognition lays down the criteria for revenue recognition for sale of goods, services and the use of entities resources by others, i.e. interest, rentals, etc. However, unlike the exposure draft on Ind AS 18, Revenue, ICDS IV does not prescribe any specific guidance for multiple element transactions. Telecommunication companies routinely offer bundled arrangement to customers, for example, voice and data services, activation and subscription, cellular and hardware (mobile, data card), etc. Ind AS requires the revenue earned in each transaction to be split up for multiple elements using fair value principles; while under ICDS, companies may continue to account for revenue based on the legal form of contract. Under IFRS, there is a diversity in practice with respect to accounting for customer acquisition costs. Under Ind AS, in case any company chooses to recognises customer acquisition costs as an intangible asset (provided it meets the recognition criteria as an intangible asset), there could be a potential difference between accounting and ICDS since under tax laws deduction for such costs may be allowed in entirety in the year in which they are incurred.

**Borrowing costs**

With regard to borrowings costs, ICDS IX excludes the term ‘substantial period of time to get ready for intended use or sale’ while defining qualifying assets. Only in case of inventory, a period of twelve months is indicated. With an omission of this term, telecommunication companies may end up capitalising borrowing costs on fixed assets (for example, tower assets) for tax purposes. Considering the difference in accounting of borrowing costs on spectrum, telecommunication companies should evaluate the impact of ICDS on the capitalisation of borrowing costs on spectrum fees. Further, the ICDS prescribes a specific formula for capitalisation of general borrowings costs, which is different from the requirements under Ind AS. Unlike ICDS, under Ind AS, borrowing costs also include exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. Accordingly, companies may need to maintain separate calculations for computation of capitalised general borrowing costs for accounting and tax purposes.

**Derivatives and hedges**

ICDS requirements are significantly different when it comes to accounting for derivatives and hedging transactions. ICDS primarily does away with the concept of prudence. All mark to market adjustments, gains or losses, would be allowed to be recognised for tax purposes only on settlement; unlike in Ind AS, wherein all mark to market adjustments are required to be recorded in every reporting period. With derivatives used to hedge on balance sheet exposure being the only exception (for example, forward contracts for debtors, creditors, etc.), for such derivatives, ICDS requires the premium to be amortised over the life of the contract and spot exchange differences taxable at each period end. Considering that telecommunication companies commonly use derivatives to hedge their exposure to foreign exchange or interest rate risks, this area will require significant attention while drawing out the tax computation under ICDS.

**Provisions**

Accounting for provisions and contingent assets is also different in ICDS as compared to Ind AS. As per Ind AS, provisions are recognised when a ‘probable’ outflow of resources is expected. However, ICDS allows recognition of provisions when the outflow of resources is ‘reasonably’ certain. Telecommunication tower companies generally make a provision for restoration of their tower sites post completion of its useful life. Under Ind AS, such asset retirement obligations are required to be capitalised as a cost of the fixed asset at a discounted value. Since under ICDS, discounting of provision is not permitted, this is likely to result into a difference between Ind AS and ICDS. Under ICDS, there is continuous assessment of contingent assets and when it becomes reasonably certain that inflow of an economic benefit will arise, the asset and related income are recognised in the year in which the change occurs. Under Ind AS, contingent assets are recognised only when realisation of income is virtually certain. Virtual certainty under Ind AS is a higher recognition threshold compared to reasonable certainty under ICDS.

Another area of concern under ICDS are transition adjustments on implementation of Ind AS. On implementation of Ind AS for the first time in India, entities will make cumulative adjustments to the reserves and surplus on the transition date (i.e. 1 April 2015 for phase 1 companies). Currently, there is no clarity in ICDS regarding the taxation or deduction of such transition adjustments. However, this is an area which the regulators are actively looking to address. Considering that the gap between accounting and taxable profit under ICDS is going to widen with implementation of Ind AS, companies would need to consider the changes in systems and processes to maintain parallel records under both frameworks.
Goods and Services Tax

Impact on the Indian telecommunication sector

This article aims to:
- Highlight key areas of impact under GST towards the telecommunication operators, handset manufacturers, and passive infrastructure providers
- Suggest areas of preparation/steps to be undertaken for effective implementation and transition into the GST regime

Goods and Services Tax (GST) is a broad indirect tax regime proposed to be introduced in India, with its prime objective being to combine all taxes and create a single market. The concept of GST revolves around creating an efficient and harmonised consumption tax system in the country. Particularly, since it is aimed at eradicating the cascading effect of indirect taxes and allow seamless flow of credits, it is expected to be a more transparent mode of administering taxes.

The GST regime is expected to introduce a common market for goods and services, help ensure their seamless movement as well as provide an environment wherein business decisions are tax neutral. GST which would be a destination-based consumption tax would bring about a paradigm shift in the present indirect tax regime by subsuming many taxes such as excise duty (levied on manufacture of goods), service tax (levied on provision of services), Value Added Tax (VAT) on intrastate sale of goods, Central Sales Tax (CST) on interstate sale of goods, etc. These taxes would be replaced by the Central Goods and Services Tax (CGST) and State Goods and Services Tax (SGST) on intra-state supply of goods/services and Integrated Goods and Services Tax (IGST) to be levied on interstate supplies (a combination of SGST and CGST).

The sector broadly comprises three major segments telecommunication service providers, telecommunication equipment and mobile handset manufacturers and passive infrastructure providers.

The government needs to take into account the complex nature of transactions in the telecommunication sector and the necessity of telecommunication services while formulating the GST framework. In the ensuing paragraphs, we have discussed the impact of GST on the three segments of the telecommunication industry in detail.
Impact on telecommunication operators

I. Key impact on prepaid business

Prepaid vouchers are sold by telecommunication operators to distributors/aggregators, who further sell it to retailers (who are largely unorganised) for onward sale to the end customer. Currently, service tax at 14.5 per cent1 is levied on the Maximum Retail Price (MRP) of the vouchers (i.e. the full value at which it is sold to the end customers which is inclusive of service tax) which is discharged by the telecommunication service provider at the time of sale of voucher to the distributor.

Under the GST regime, CGST and SGST which would be applicable on supply of prepaid vouchers is expected to be around 18 per cent. Therefore, such an increase in tax would lead to an increase in tax costs. In such a scenario, telecommunication operators may choose to either increase the MRP or reduce the talk-time provided to customers. Depending upon the prevalent competitive practices, the telecommunication operators may decide to embrace one of these practices to combat the adverse impact on its prepaid business. However, given the importance and necessity of prepaid telecommunication services, it is important to represent to the relevant authorities that these services should be taxed at a lower rate at GST of 12 per cent2.

Under the GST regime, since there is a single levy of indirect tax on telecommunication services i.e. service tax which is paid to the central government, there is little relevance of determining the situs of telecommunication services or the place of supply of services except in case of cross-border transactions.

As of now there is no clarity on the point of taxation/valuation for the purpose of levying GST. Some of the key scenarios along with their challenges have been discussed in the table below:

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>Valuation</th>
<th>Point of taxation</th>
<th>Place of supply</th>
<th>Challenges</th>
</tr>
</thead>
</table>
| 1      | On MRP   | Sale of paper voucher/ SIM cards by the telecommunication operator to the distributor (for onward sale to retailers/end customers) | • Location of pre-payment  
• Location of sale of voucher | • Location of pre-payment - location of customer is not known at the time of sale of voucher to the distributor and thus, would lead to a delay in payment of taxes.  
• Location of sale of voucher - if the ultimate consumer is located in a state other than the distributor's state, the destination-based principle would be violated. |
| 2      | On MRP   | Sale of recharge vouchers to distributors/aggregators for onward sale through e-recharge | Location of service recipient | Telecommunication operators may be need to determine the customer's location (by tracking them on real-time basis) and deposit CGST/SGST or IGST at such locations. The data base of telecommunication operators with respect to the address of the customers might also need to be updated. |
| 3      | On the transaction value (sale price) | Sale of paper voucher/ SIM cards by the telecommunication operator to the distributor (for onward sale to retailers/end customers) | Location of pre-payment or location of sale of voucher | If the ultimate consumer is located in a state other than the distributor's state, the destination-based principle would be violated. |

Source: KPMG in India analysis, 2016

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2. Report of the Committee headed by the Chief Economic Adviser Dr. Arvind Subramanian on Possible Tax rates under GST dated 4 December 2015 and other news articles
II. Key impact on post-paid business
In terms of the draft model GST law, the place of supply for post-paid connections has been proposed to be the billing address of the service recipient. Generally, when a post-paid connection is in the name of the company/employer, the connection is used by the employee. In certain situations, the registered address of the company may be different from the state where the employee uses such a connection. In such a scenario, the destination principle would be violated as the billing address would be of the company/employer, and usage of the same is by an employee in an other state.

III. Key impact on accounting and compliance
Another peculiar issue with respect to telecommunication services is where a telecommunication circle extends beyond one state or there are more than one telecommunication circles operating within a state. The regulatory authorities which govern the telecommunication industry such as the Telecom Regulatory Authority of India (TRAI) require telecommunication companies to maintain their accounting on a circle-wise basis i.e. as per the defined telecommunication circles which may comprise more than one state or only a part of a state. Currently, since there is a single central levy of service tax on telecommunication services, the circle-wise accounting requirements prescribed by the regulatory authorities are not perturbed. However, due to levy of SGST, the circle-wise reporting requirements will come into conflict with the requirement of maintaining state-wise records under the GST regime. Therefore, this would create practical challenges with respect to accounting/reporting requirements prescribed by regulatory and tax authorities.

Impact on equipment manufacturers
The manufacturing segment of the telecommunication sector comprises telecommunication equipment and handset manufacturing companies. In tune with the ‘Make in India’ initiative, manufacturers of mobile handsets are currently subject to a central excise duty at a subsidised rate of 2 per cent (levied on 65 per cent of the MRP). Further, sale of mobile handsets is subject to state VAT either at a concessional rate of 5 per cent or 14 per cent which is generally dependent on the value of the mobile phone. The effective rate of taxes on domestic manufacture of mobile handsets currently range between 7 to 16 per cent.

On the other hand, in the case of importing mobile handsets, while the Basic Customs Duty (BCD) is exempted, there is a countervailing duty (CVD) of 13.5 per cent (approximately) and the sale of imported handsets is subject to VAT at the rate of 5 or 14 per cent (approximately) depending on the value of the mobile phone.

Thus, the effective rate of taxes currently applicable on import of mobile handsets ranges between 18.5 - 28 per cent. Thus, there is a competitive advantage given to domestic manufacturers of mobile handsets vis-à-vis importers under the current regime due to a difference in rate of excise duty and CVD and also by restricting credit of CVD paid by the importer.

Under GST, it is expected that mobile handsets would be liable at a lower GST rate which would lead to a potential increase in rate of tax from the current range of 7 to 16 per cent to a GST of 12 per cent.

However, the effective tax rate on imported mobile handsets may get reduced from 18.5 to 28 per cent to 12 per cent. Further, the importer may become eligible to claim credit of import GST paid. Thus, the competitive advantage (arising on account of a higher rate of CVD and restriction of credit of CVD to the importer) to the domestic manufacturers would hopefully dilute significantly.

From a compliance stand point, due to imposition of SGST, state-wise registrations would be required (on the basis of determination of place of supply of services) vis-à-vis centralised service tax registrations available under the current tax regime. This may also lead to an increase in compliances on account of requirement of state-wise records/ registrations, accounting, invoicing, deposition of tax, filing of returns, etc.

In order to achieve a smooth transition to GST, telecommunication companies should actively undertake the assessment and upgradation of their IT systems and other key processes.

In light of the above mentioned complexities, the telecommunication industry is anticipating that the government would frame appropriate law/rules so as to adequately cater to the ambiguities and peculiarities in the sector.

3. S No. 263A of Notification No. 12(2012-Central Excise, dated 17th March, 2012 (as amended) and Section 122 read with 12th Schedule to the Finance Act, 2005 (as amended)
4. On comparison of various State VAT schedules
5. This is only an indicative range upon a sum total of various taxes namely excise duty, National Calamity Contingent Duty and VAT
6. Chapter 85 (tariff entry 851712) of the Central Excise Tariff Act, 1985 and Section 122 read with 12th Schedule to the Finance Act, 2005 (as amended)
7. This is only an indicative range upon a sum total of various taxes namely CVD, National Calamity Contingent Duty and VAT

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Passive infrastructure providers play a pivotal role by allowing telecommunication operators to share such sites, since building and operating such an infrastructure involves a significant cost for telecommunication operators. Currently, the passive infrastructure providers are plagued with the issue of non-availability of credit of duties paid on parts of towers/shelters either as ‘capital goods’ or as ‘inputs’ as per the CENVAT Credit Rules, 2004.

It has been argued by service providers that the credit of the said goods should be allowed since such towers and parts are critical components of the telecommunication sector for provision of telecommunication services. However, the courts have held that such parts including towers, shelters, etc. constitute as ‘immoveable property’ and since such parts neither qualify as ‘capital goods’ nor ‘inputs’, credit on such parts should not be allowed. As a result, this has led to a significant increase in the tax cost for passive infrastructure providers.

Under GST, the intention of the government is to have free flow of credit of CGST, SGST and IGST paid on procurement of goods and services. Therefore, since the taxable event under GST would be the supply of goods and services, the current ambiguity of classification of procurements into ‘inputs’, ‘capital goods’ and ‘input services’ for availing CENVAT credit is likely to go away. Thus, the GST regime is likely to have a positive impact on the current hurdles in the credit chain for passive infrastructure providers.

Presently, infrastructure providers have availed of centralised registration with the service tax authorities and are not required to comply with state level compliances. However, the same may undergo change under the GST regime (depending upon the place of supply rules), since the state governments would also have the right to tax services and accordingly, there could be a requirement to obtain state wise registration instead of a single centralised registration. The same can result in increased compliances such as returns, payment of taxes, maintenance of records, accounting, invoicing, etc. which requires revamping/upgrading the accounting and IT systems.

While GST is likely to have a beneficial impact on many sectors of the economy, its proposed framework in the current form seems to have an adverse impact on certain segments and poses key operational challenges. Given the radical development that the telecommunication industry has undergone in terms of its offerings through electronic payments and mobile wallets, lawmakers should help ensure that the GST framework is clear and unambiguous.

For a smooth transition to GST, it is imperative for the telecommunication companies to become upbeat and undertake a GST impact assessment on an ‘as-is basis’. Such an analysis would help the companies to assess the following key areas:

- Fiscal impact of GST on business
- Impact on the companies’ IT systems, and
- Impact on business segments, products, locations, cash flow, procurement and logistics.

Identification and analysis of these key areas that are likely to have an adverse impact on the business might help the sector in urging the government to implement an appropriate GST policy. Moreover, it would also aid companies in developing an action plan for implementation of GST.

While the industry awaits the passage of the GST bill, the sector should analyse its impact on various business functions for an effective transition to the new regime. Further, in tune with the ‘Digital India’ initiative and in light of the contribution of the telecommunication sector to the Indian economy, the government should consider the needs of this sector while framing GST laws which is critical for achieving socio-economic development.
Draft Companies (Indian Accounting Standards) (Amendment) Rules, 2016

Background
The MCA through its notification dated 16 February 2016 issued 39 Indian Accounting Standards (Ind AS) that have been converged with the International Financial Reporting Standards (IFRS). Through this notification, the IFRS converged standards are expected to bridge significant gaps that exist in the current accounting guidance in India. Amongst those notified by the MCA on 16 February 2015 is Ind AS 115, Revenue from Contracts with Customers which is based on IFRS 15, Revenue from Contracts with Customers.

New development
The MCA on 16 February 2016 issued the draft Companies (Indian Accounting Standards) Amendment Rules, 2016. The draft rules proposed deferment of Ind AS 115.

Ind AS transition facilitation group (ITFG) clarification bulletin 1

Background
The Institute of Chartered Accountants of India (ICAI) on 11 January 2016 formed ITFG in order to provide certain clarifications on issues arising due to applicability and/or implementation of Ind AS.

The ITFG is expected to address:
• Issues which need clarifications on the application/implementation of Ind AS
• Issues pertaining to interpretation of Ind AS.

New development
The ITFG held its first meeting on 16 January 2016 and has issued its first bulletin (Bulletin I) which provides guidance on five issues relating to the application of Ind AS.

These issues relate to following topics:
• The year from which a company would be required to comply with Ind AS based on the thresholds of net worth as defined in the Ind AS road map i.e. if a company meets the threshold of net worth in a particular financial year, then Ind AS would be applicable to such a company immediately in the next financial year.
• In case of a group with subsidiaries, if a subsidiary ceases to be the subsidiary (of a parent that is covered under the Ind AS road map) before the date of adoption of Ind AS then depending on the subsidiary’s net worth threshold, the subsidiary would fall in the road map of Ind AS. Additionally, if a subsidiary is sold off after the adoption of Ind AS, then the subsidiary would continue to prepare financial statements under the Ind AS road map.
• Application of the option under Ind AS 101, First-time Adoption India Accounting Standards to continue with the accounting policy under para 46A of the AS 11. The Effects of Changes in Foreign Exchange Rates would be available for those long term foreign currency loans which were taken before the beginning of the first Ind AS reporting period i.e. 1 April 2016 for a company falling in phase I of the Ind AS adoption road map.
• When the functional currency of a company changes from INR to any other currency (e.g. USD) then any loans taken in functional currency (USD) would not be considered as long-term foreign currency monetary items under para 46A of AS 11 even though the company could be recognising such loans under para 46A of AS 11 under the current Indian GAAP.
• A company would have to determine its functional currency retrospectively on application of Ind AS in light of no specific exception or exemption provided in Ind AS 101 First-time Adoption of Indian Accounting Standards.

New steps
Companies should consider the interpretations issued by the ITFG while transitioning to Ind AS.

(Source: ICAI - ITFG clarification bulletin 1 dated 11 February 2016)
The RBI issues directions to banks on Ind AS implementation

On 11 February 2016, the Reserve Bank of India (RBI) issued a circular RBI/2015-16/315 requiring scheduled commercial banks to comply with the Indian Accounting Standards (Ind AS) for accounting periods beginning from 1 April 2018 onwards, with comparatives for periods ending on or after 31 March 2018. Ind AS would be applicable to both standalone financial statements and consolidated financial statements. This circular reiterates the timeline for Ind AS implementation by banks that was issued by the MCA in its press release dated 18 January 2016. It also provides further direction on critical issues that banks need to consider in their Ind AS implementation plan.

Background

The MCA notified the Companies (Indian Accounting Standards) Rules, 2015 on 16 February 2015. On 29 September 2015, RBI recommended a road map to MCA for implementation of Ind AS from 2018-19 onwards for banks and non-banking financial companies (NBFCs). Further, in October 2015, RBI issued a report of its Working Group on implementation of Ind AS by banks in India, which provided recommendations on key areas with a focus on financial instruments, as well as formats for financial statements.

The MCA's press release on 18 January 2016 and the recent RBI circular now provide certainty on the timing and manner of Ind AS implementation by banks in India.

Overview of the recent circular

This circular requires all scheduled commercial banks (excluding Regional Rural Banks (RRBs)) to implement Ind AS for accounting periods beginning 1 April 2018 onwards, with early adoption being disallowed. It also draws attention to MCA's press release which states that, notwithstanding the Ind AS road map for companies (issued by MCA on 16 February 2015), the holding, subsidiary, joint venture or associate companies of banks would also prepare Ind AS financial statements for accounting periods beginning 1 April 2018 onwards.

In addition, RBI has advised banks to set up a Steering Committee headed by an official of the rank of an Executive Director (or equivalent) and comprising members with cross-functional experience, to plan and initiate the implementation process. The strategy for this implementation has to be disclosed in the annual report from the financial year 2016-17 onwards. The Audit Committee should oversee the Ind AS implementation process and provide quarterly reports to the bank's board on this subject.

The RBI has identified the following critical issues that should be considered by banks in their Ind AS implementation plan:

- Technical accounting issues
- Evaluation of changes to systems and processes
- Determining business impacts
- Evaluation of resources
- Project management.

Please refer our issue of IFRS Notes dated 12 February 2016 which summarises key issues addressed in RBI circular.

(Source: RBI circular RBI/2015-16/315 dated 11 February 2016 and KPMG in India IFRS Notes: The RBI issues directions to banks on Ind AS implementation dated 12 February 2016)
The ICAI issues a guidance note on accounting for depreciation in companies in the context of Schedule II to the Companies Act, 2013

**Background**
Schedule II to the Companies Act, 2013 (2013 Act) specifies useful lives for the purpose of computation of depreciation.

On 10 April 2015, ICAI issued an Application Guide (AG) to address certain practical issues arising in the implementation of Schedule II to the 2013 Act in respect of depreciation related provisions. In May 2015, ICAI issued a revised version of the AG which provided an updated guidance for computing depreciation for assets working in double/triple shift.

**New development**
The ICAI on 11 February 2016 issued a Guidance Note (GN) on accounting for depreciation in companies in the context of Schedule II. This GN has been issued with the objective of providing guidance on certain significant issues that may arise when companies practically implement Schedule II. Further, use of the GN would help to establish consistent practice with respect to accounting for depreciation.

The GN will be applicable for accounting periods beginning on or after 1 April 2016, earlier application is encouraged.

The GN provides new guidance such as multiple shift depreciation, revaluation of assets, component approach, estimation of the residual value, etc.

(Source: ICAI guidance note on accounting for depreciation in companies in the context of Schedule II to the Companies Act, 2013 dated 6 February 2016)

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The ICAI issues a revised Guidance Note on reporting of frauds under Section 143(12) of the 2013 Act

**Background**
Section 143(12) of the Companies Act, 2013 (2013 Act) requires statutory auditors of companies to report to the central government about any fraud/suspected fraud committed against the company by the officers or employees of the company. This Section read with the corresponding Rule 13 of the Companies (Audit and Auditors) Rules, 2014 requires the reporting of every fraud to the central government irrespective of the amount of fraud.

On 2 March 2015, the ICAI issued a guidance note on reporting on a fraud under Section 143(12) of the 2013 Act to provide guidance to the members on this new reporting requirement.

The MCA on 26 May 2015 issued the Companies (Amendment) Act, 2015 that amended the provisions of Section 143(12) of the 2013 Act. Additionally, vide notification dated 14 December 2015, MCA issued the Companies (Audit and Auditors) Amendment Rules, 2015 that amended Rule 13 of the Companies (Audit and Auditors) Rules, 2014. The amended provisions require, inter alia, the following points:

- Reporting by a statutory auditor to the central government only for frauds which involve/are expected to involve individually an amount of INR1 crore or above.
- In case of a fraud involving lesser than INR1 crore, the statutory auditor is to report the matter to the audit committee/board of the company instead of the central government.

- The amended provisions have also made certain other changes in the procedure and particulars of reporting under Section 143(12) of the 2013 Act.

**Recent development**
In light of the amendment to the 2013 Act, ICAI issued a revised guidance note on reporting of frauds under Section 143(12) of the Companies Act, 2013 (revised GN). This revised GN aims to provide guidance to auditors on matters that may arise pursuant to the reporting requirements on fraud.

(Source: ICAI guidance note on reporting of frauds under Section 143(12) of the Companies Act, 2013 dated 12 February 2016)

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© 2016 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
RBI revises the threshold for reporting of frauds by NBFCs

Background
The RBI on 2 July 2012 issued a master circular which laid down a broad framework to be followed by Non-Banking Financial Companies (NBFCs) while reporting frauds. The circular provided guidelines with respect to classification of frauds, reporting of frauds to the RBI, filing of quarterly returns, reports to the board and guidelines to be followed for reporting frauds to the police.

New development
The RBI through its circular dated 18 February 2016 has decided to:
- Revise the threshold limit for reporting of frauds and submission of quarterly progress reports on frauds to the Central Fraud Monitoring Cell, RBI, Department of Banking Supervision, from INR25 lakh as on date to INR1 crore with immediate effect.
- As regard reporting of frauds and submission of quarterly progress reports on frauds below the revised threshold, NBFCs will have to furnish the same to the Regional Office of the RBI, Department of Non-Banking Supervision, under whose jurisdiction the Registered Office of the NBFC falls.

(Source: RBI circular RBI/2015-16/327 dated 18 February 2016)

Report of the Companies Law Committee

Background
The Companies Law Committee (CLC) was constituted on 4 June 2015 to examine and to make recommendations on the issues arising out of implementation of the Companies Act, 2013 (2013 Act) as well as the recommendation received from the Bankruptcy Law Reforms Committee, the High Level Committee on Corporate Social Responsibility (CSR), the Law Commission and other agencies. The CLC submitted its report to the government on 1 February 2016.

In making its recommendations, the CLC conducted extensive consultations with stakeholders including all industry chambers, professional institutes, law firms, financial sector and other regulators. The consultation process resulted in more than 2,000 suggestions.

Recommendations of the CLC
The CLC has recommended amendments to both the 2013 Act and the Rules to the 2013 Act (Rules). It has proposed changes in 78 sections of the 2013 Act, which along with consequential changes, would result in about 100 amendments to the 2013 Act. It has proposed approximately 50 amendments to the Rules. The recommendations cover significant areas of the 2013 Act, including definitions, raising of capital, accounts and audit, corporate governance, managerial remuneration, companies incorporated outside India and offences/penalties.
### Report of the Companies Law Committee

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<td>Definitions revisited</td>
<td>Changes recommended to definitions of subsidiary, associate, joint venture, financial year, holding company, net worth and interim dividend, debenture, nominee director, related party, turnover, etc.</td>
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| Funding concerns and investment restrictions eased | • Companies may give loan to any other person in whom the director is interested, subject to a prior approval of the company by a special resolution. Further, loans extended to persons, including subsidiaries, falling within the restrictive purview of Section 185 should be used by the subsidiary for its principal business activity only, and not for further investment or grant of a loan.  
• Interest rate benchmarked to yield on Government of India Securities.  
• Removal on layers of investment companies.  
• Right issues of ‘body corporates’ to be excluded from limits on investment. |
| Revised approval requirement for related party transactions to prevent abuse | • All related parties to be prohibited from voting on any related party transaction with the exception to be given to the related parties of joint venture companies/closely held public companies.  
• In case a related party transaction was entered without an audit committee approval, the audit committee may ratify the same within three months of such transactions subject to an upper threshold of INR1 crore.  
• Responsibility of the audit committee clarified. |
| Responsibility of the board reinforced    | • Responsibility on Internal Financial Controls continues to lie with the board.  
• Board’s responsibility for compliance with applicable laws reiterated. |
| Corporate Social Responsibility (CSR)    | • Composition of the CSR committee for ‘companies not required to appoint independent directors’ should be prescribed as ‘having two or more directors’.  
• For determining the threshold of the specified net worth, turnover, or net profit to constitute a CSR committee, the words ‘any financial year’ should be replaced by words ‘preceding financial year’.  
• The inconsistency between Rule 2(1)(f) of the Companies (Corporate Social Responsibility) Rules, 2014 and the provisions of the 2013 Act should be removed by providing prescriptive powers to exclude certain sums from net profit in Section 135(1) of the 2013 Act. |
| Incentivising individuals to be directors | • Introduce a test of materiality, for the purpose of determining whether pecuniary relationships could impact the independence of an individual for becoming an independent director.  
• Section 149(6)(d) to be amended with respect to the scope of restriction on a ‘pecuniary relationship or transaction’ entered into by a relative should be made more specific by clearly categorising the types of transactions as provided under Section 141(3)(d). |
| Eligibility criteria for independent directors eased | Currently, an individual is restricted to be appointed as an independent director in case his relative is a Key Managerial Personnel (KMP) or an employee in the company, its holding, subsidiary or associate company during any of the preceding three years. The CLC recommended that the scope of the restriction should be modified. For the preceding years, the restriction should be for relatives holding Board or KMP/one level below a Board position similar to that contained in Section 141(3)(f). The scope of restriction after appointment is to be retained. |
| Enhance auditors independence             | • No requirement of annual ratification by shareholders.  
• Existing rotation rules retained.  
• Definition of relative for determining auditors’ disqualification to be suitably modified. |
| Consolidated Financial statements (CFS)   | • Clarification/relaxation relating to financial statements of overseas subsidiaries/associate/joint ventures  
• Local GAAP financial statements can be used for filing requirements  
• CFS of such subsidiaries, etc. where available, would suffice for filing compliances. |

Please refer our issue of First Notes dated 6 February 2016 which summarises key recommendations of the CLC.

(Source: Companies Law Committee report dated 1 February 2016 and KPMG in India First Notes Report of the Companies Law Committee dated 6 February 2016)
Draft Companies (Auditor’s Report) Order 2016

Background
Section 143(11) of the Companies Act, 2013 (2013 Act) requires that the auditor’s report of specified class of companies should include a statement on the prescribed matters. These reporting requirements have been prescribed under the Companies (Auditor’s Report) Order, 2015 (CARO 2015) issued by MCA on 10 April 2015.

New development
The MCA had set-up a committee on 16 September 2015 to examine and recommend matters that should form part of the statement. This statement would be attached with the auditor’s report under Section 143(11) for the Financial Year (FY) 2015-16 and thereafter.

The committee made recommendations on the matters to be included in the statement and on the basis of its recommendations, MCA issued draft Companies (Auditor’s Report) Order, 2016 (CARO 2016) on 9 February 2016.

The MCA has relaxed the scope/application of CARO on the private companies by increasing applicability thresholds, thus, it would be applicable to less number of private companies. CARO 2016 would not be applicable to the auditor’s report on consolidated financial statements.

CARO 2016 enhances the reporting requirements and thereby, would increase the reporting responsibility of the auditors relating to following important clauses:
- Utilisation of public issue/follow-on-offer/term loans (including, debt instruments)
- Compliance of Section 42 (offer or invitation for subscription of securities on private placement)
- Lender wise details in case of default of payment of dues to banks and financial institutions
- Loans given to related parties covered under Section 2(76) (i.e. section defining related party) instead of Section 189 (i.e. Section on register of contracts or arrangements in which directors are interested)
- Related party transactions (all transactions) under Section 188 and 177 of the 2013 Act
- Loans, investments and guarantees comply with Section 185 and 186 of the 2013 Act
- Nature and amount of frauds by officers and employees
- Non-cash transactions with directors or persons connected with him under Section 192 of the 2013 Act
- Managerial remuneration has been paid/provided in accordance with the requisite approvals mandated by the provisions of Section 197 read with schedule V to the 2013 Act.

Please refer to our issue of First Notes dated 19 February 2016 for a detailed analysis of CARO 2016.

(Source: MCA notice dated 9 February 2016 and KPMG in India’s First Notes dated 19 February 2016)

Draft Companies (Accounting Standards) Rules, 2016

The MCA is in the process of revising the existing Accounting Standards (ASs), as it intends to upgrade the ASs as notified under Companies (Accounting Standards) Rules, 2006 and seek alignment with the Indian Accounting Standards.

Accordingly, MCA on 16 February 2016 issued the draft Companies (Accounting Standards) Rules, 2016 to upgrade these standards on the following standards:
- AS 2, Valuation of Inventories
- AS 4, Contingencies and Events Occurring After the Balance Sheet Date
- AS 10, Property, Plant and Equipment
- AS 13, Accounting for Investments
- AS 14, Accounting for Amalgamations
- AS 21, Consolidated Financial Statements
- AS 29, Provisions, Contingent Liabilities and Contingent Assets

The draft Companies (Accounting Standards) Rules, 2016 are available on the website of MCA, and public comments on the same are sought through email at cas@mca.gov.in, until 1 March 2016.

(Source: MCA notice dated 16 February 2016)
Draft Schedule III for financial statements as per Ind AS

Background
Section 129 of the 2013 Act requires that the financial statements should provide a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under Section 133 and should be in the form(s) as may be provided for different class or classes of companies in Schedule III.

Schedule III provides general instructions for preparation of the balance sheet and statement of profit and loss of a company in compliance with the accounting standards prescribed under the 2013 Act.

New development
The MCA on 9 February 2016, issued a draft on the revised Schedule III to the 2013 Act for a company whose financial statements are drawn up in compliance with the Companies (Indian Accounting Standards) Rules, 2015 and as amended from time to time. The draft revised Schedule III is available on the MCA website and the period to seek comments from the public closed on 23 February 2016.

(Source: MCA notice dated 9 February 2016)

Draft Companies (Incorporation) Second Amendment Rules, 2016

Background
Section 18(1) of the Companies Act, 2013 (2013 Act) provides that a company of any class registered under 2013 Act may convert itself as a company of an other class under the 2013 Act by alteration of the memorandum and articles of the company in accordance with the provisions of this chapter. The Companies (Incorporation) Rules, 2014 as amended from time to time lays down the procedure to be followed by newly formed companies.

New development
The MCA on 17 February 2016 issued the draft Companies (Incorporation) Second Amendment Rules, 2016. These amended rules issued a draft notification upon conversion of an unlimited liability company to a limited liability company. The main features of the draft rules are as follows:

• Within seven days of passing of such a special resolution, the company should publish a notice of such a proposal in newspapers.
• Within 60 days of passing of a special resolution, an application should be filed with the Registrar of Companies (ROC) in the prescribed form.
• A declaration from all the directors of the company that no complaints are pending against the company from members or investors should be provided for.
• The draft rules also prescribe the conditions to be complied with, subsequent to conversion.
• There are certain conditions when an unlimited liability company shall not be eligible for conversion to a limited company.

The draft rules are available on MCA website and public comments on the same are sought until 2 March 2016.

(Source: MCA notice dated 17 February 2016)
KPMG in India’s IFRS institute
Visit KPMG in India’s IFRS institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

IFRS Notes
Ind AS Transition Facilitation Group issues clarifications on matters relating to Ind AS (ITFG Bulletin I)

26 February 2016
Background
With the impending Ind AS convergence that will be applicable to large corporates, the Institute of Chartered Accountants of India (ICAI) on 11 January 2016 formed the Ind AS Transition Facilitation Group (ITFG) in order to provide certain clarifications on issues arising due to applicability and/or implementation of Ind AS.

New developments
The ITFG held its first meeting on 16 January 2016 and has issued its first bulletin (Bulletin I) on 11 February 2016 which provides guidance on five issues relating to the application of Ind AS.

Missed an issue of Accounting and Auditing Update or First Notes?

26 February 2016
Draft Companies (Auditor’s Report) Order 2016
19 February 2016

Background
Section 143(11) of the Companies Act, 2013 (2013 Act) requires that the auditor’s report of specified class of companies should include a statement on the prescribed matters. These reporting requirements have been prescribed under the Companies (Auditor’s Report) Order, 2015 (CARO 2015) issued by the Ministry of Corporate Affairs (MCA) on 10 April 2015.

New developments
The MCA had set-up a committee on 16 September 2015 to examine and recommend matters that should form part of the statement. This statement would be attached with the auditor’s report under Section 143(11) for the financial year 2015-16 and thereafter. The committee made recommendations on the matters to be included in the statement and on the basis of its recommendations, MCA issued draft Companies (Auditor’s Report) Order, 2016 (CARO 2016) on 9 February 2016.

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Our issue of IFRS notes provide an overview of issues clarified by ITFG.

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