

CHAPTER V

Revenue shared by Reliance Communication Limited and Reliance Telecom Limited

5.1 Brief profile of Reliance Communication Limited and Reliance Telecom Limited

Reliance Communications Limited (RCL) and Reliance Telecom Limited (RTL) are the two arms of Reliance Communications (RCOM) providing telecommunications services across India. While RTL started operations as a GSM service provider by obtaining Cellular Mobile Telephone Service (CMTS) licences in 1995 for seven¹ licenced service areas (LSA), RCL, the erstwhile Reliance Infocomm Limited (RIC), first acquired licence for Basic Services (Basic licence) in Gujarat in 1997. In 2001, RCL acquired licences for eighteen² more service areas all of which were migrated to Unified Access Service Licence (UASL) in November 2003. In September 2004, RCL acquired UASL for Jammu & Kashmir service area also which enabled it to extend its foot print to 20 LSAs. RTL added one more LSA to its operations by acquiring CMTS licence for Kolkata in 2001. Thus, in the six LSAs of Bihar, HP, Kolkata, MP, Odisha and West Bengal both RCL and RTL hold licences.

Besides the licences mentioned above, RCL holds NLD and ILD licences acquired in 2002. While these licences support the telecommunication services of RCL, its internet services were provided through Reliance Communications Infrastructure Limited (RCIL) which held an ISP 'A' licence. RCIL is also the billing and collection agent for RCL. The ISP licence had expired in November 2013 and consequently the internet business has been merged with the UASL of RCL on a going concern basis. Approval of DoT for the above arrangement was awaited (June 2016)

5.1.1 Radio Frequency Spectrum held by RCL and RTL

In 2008 RCL obtained GSM spectrum and RTL was allotted CDMA spectrum which enabled these Companies to offer services with both the technologies. Spectrum held by these Companies is as shown below:

Table 5.1

RCL				
LSA	Technology		MW Access Spectrum	MW Backbone Spectrum
	GSM	CDMA		
			(in MHz) ³	
Andhra Pradesh	2 x 4.4 MHz	2 x 5	112	56
Bihar		2 x 5	56	56

¹ Assam, Bihar, HP, MP, NE, Orissa and WB.

² AP, Bihar, Delhi, Haryana, HP, Karnataka, Kerala, Kolkata, MP, Maharashtra, Mumbai, Orissa, Punjab, Rajasthan, Tamil Nadu, UP (E), UP (W) and WB.

³ One Carrier = 56 MHz.

Gujarat	2 x 4.4 MHz	2 x 3.75	112	112
Haryana	2 x 4.4 MHz	2 x 3.75	112	56
HP		2 x 2.5	112	56
J &K	2 x 4.4 MHz	2 x 2.5	0	0
Karnataka	2 x 4.4 MHz	2 x 5	112	112
Kerala	2 x 4.4 MHz	2 x 5	168	56
MP		2 x 5	112	56
Maharashtra	2 x 4.4 MHz	2 x 5	168	56
Odisha		2 x 3.75	112	56
Punjab	2 x 4.4 MHz	2 x 3.75	112	56
Rajasthan	2 x 4.4 MHz	2 x 3.75	112	56
Tamil Nadu	2 x 4.4 MHz	2 x 5	112	56
UP (West)	2 x 4.4 MHz	2 x 5	168	56
UP (East)	2 x 4.4 MHz	2 x 5	112	56
West Bengal		2 x 3.75	112	56
Kolkata		2 x 5	112	0
Delhi	2 x 4.4 MHz	2 x 5	112	0
Mumbai	2 x 4.4 MHz	2 x 5	168	0
RTL				
LSA	Technology		MW Access Spectrum	MW Backbone Spectrum
	GSM	CDMA	(in MHz)	
Assam	2 x 6.2 MHz	2 x 2.5	168	56
Bihar	2 x 8 MHz		112	56
HP	2 x 6.2 MHz		112	56
Kolkata	2 x 6.2 MHz		112	
MP	2 x 6.2 MHz		112	56
NE	2 x 6.2 MHz	2 x 2.5	112	56
Odisha	2 x 6.2 MHz		112	56
WB	2 x 6.2 MHz		112	56

RTL had procured spectrum in the auction conducted by DoT in March 2015 for the seven LSAs viz., Assam, Bihar, Himachal Pradesh, Madhya Pradesh, North East, Odisha and West Bengal in December 2015 whose licences were expiring in December 2015. Details of spectrum bought in auction was as under:

Table 5.2

Circle	900 MHz	1800 MHz
Assam	6.2	
Bihar	6.2	1.8
Himachal Pradesh	6.2	
Kolkata		6.2
Madhya Pradesh	6.2	
North East	6.2	1.8
Odisha	6.2	
West Bengal	6.2	1.8

5.1.2 Revenue Reported and revenue share paid by RCL and RTL**Table 5.3****(₹ in crore)**

Year	Subscriber Base (in crore)	GR	Deductions	AGR	Percentage of AGR to GR	Revenue Share (LF + SUC)
2010-11	13.70	17,717.15	6,869.30	10,847.85	61.23	1,167.64
2011-12	15.43	16,692.31	5,934.96	10,757.35	64.45	1,160.05
2012-13	12.42	16,660.36	6,289.02	10,371.33	62.25	1,114.28
2013-14	11.21	17,185.76	6,093.12	11,092.65	64.55	1,215.98
2014-15	11.07	16,460.26	6,221.74	10,238.52	62.2	1,098.50
Total		84,715.84	31,408.14	53,307.70	62.93	5,756.45

5.2 Audit findings

Review of the accounting records of RCL and RTL along with the AGR statements furnished to DoT for the years from 2010-11 to 2014-15 revealed instances of non-conformities to the license conditions impacting the revenue share paid to Government as discussed in the succeeding paragraphs:

5.2.1. Avoidance of revenue share payment by passing on revenue earned from activities under UAS licence to ISP licence

Reliance Communications Infrastructure Limited (RCIL) was a subsidiary of RCL which held an 'A' category ISP licence. As per the conditions of the ISP agreement, the licence fee payable by RCIL was only Rupee One (₹ 1) *per annum*. The activities of RCIL included providing internet, miscellaneous applications, content and other allied services under the brand names R Connect⁴, R World⁵, 1234, 2345 and SMS content services. While 'R Connect' was an internet service provider to RCL subscribers 'R world' was a one-stop-shop for applications and content which included mobile TV, videos, games, cricket updates, music and ring tones, etc.

RCL, the UAS licensee, had agreements with RCIL whereby RCIL would provide all the above services to RCL's subscribers and RCL would provide the access support required to facilitate the same. As per the agreements between RCL and RCIL, revenue was to be shared between the Companies for 'R Connect' services and for applications and content services (including 'SMS' or 'MMS' based applications and content services).

Scrutiny of the accounting records of both RCL and RCIL, with reference to the licensed activities of both the entities, revealed that services which should have been normal activities of RCL under its UAS licence, were categorised as services under ISP licence and revenue

⁴ R Connect- Internet services provided to RCL subscribers by RCIL.

⁵ R World, 1234, 2345- Applications, content and other allied services.

from them were accounted in RCIL (ISP licensee) and not included in computation of GR for revenue share. Categories of revenue accounted in RCIL which had the impact of understatement of GR reported by RCL are discussed below:

5.2.1 (A) Gross value of end users revenue on account of VAS of R world and SMS content

As per an agreement between RCL and RCIL, internet, miscellaneous applications, content and other allied services under brand names “R World” and “SMS Content Service” to RCL subscribers would be provided by RCIL. The agreement provided that 25 *per cent* of subscription fees payable by the RCL subscriber for Applications and Content services & ₹ 1 per event/entry/message was to be paid by RCIL to RCL. Consequently, the end users revenue (revenue from subscribers) on account of R world and SMS content services were booked in the accounts of RCIL and a share of revenue was transferred to RCL. The revenue share was mainly the access charge for infrastructure support provided by RCL.

It was seen that revenue on account of R world and SMS content services recorded by RCIL declined rapidly in 2012-13 and 2013-14 with no revenue recorded in the year 2014-15 whereas the corresponding revenue in RCL accounts exceeded the revenue booked in RCIL accounts. The change in trend presumably was caused by the fact that the ISP license of RCIL expired in 2013 and hence all revenue was accounted in RCL.

Audit observed that an amount of ₹ 1036.87 crore was accounted as revenue from R world and SMS content services in the books of RCIL and an amount of ₹ 327.28 crore was transferred to RCL. Since the services provided by RCIL were in the nature of value added services (VAS) to RCL subscribers, the entire revenue generated on this account should have been included in the Gross revenue of the RCL. Due to non-inclusion of entire amount, GR of RCL was understated by ₹ 709.59 crore for the two years 2010-11 and 2011-12.

Management stated (September 2016) that its subscribers had signed Customer Acquisition Form (CAF) agreeing to avail the services of both RCL as well as RCIL. The voice services were provided by RCL and Internet, Content and data services were provided by RCIL to the subscribers. Since Data and Content services were provided by RCIL, revenue from data services was booked by RCIL. Revenue booked by RCIL as SMS content was on account of providing Content to the subscribers through RCL network. It was also informed that provision of providing Content Services do not require telecom licence or even registration. The VAS service was marketed and provided directly by the content providers/ content aggregators in respect of “Off Deck Model” which was a principle accepted by TRAI. It was further informed that the arrangement with RCIL was scrutinised by TRAI/DoT also and no adverse findings were reported by them.

The response of the Management was not accepted due to the following reasons

- The arrangement between RCL and RCIL was to facilitate the provision of service and the accounting between the entities. Subscribers availing the service was not a

party to it and hence the consent of subscriber obtained in the CAF by RCL, agreeing to avail services of RCIL, cannot be a justification for not offering VAS revenue for revenue share.

- The content delivery to RCL subscribers was not over internet and hence was beyond the scope of ISP licence.

LF and SUC short paid by RCL due to understatement of GR on this account worked out to ₹ 57.85 crore and ₹ 25.48 crore respectively (**Annexure-5.01**).

5.2.1 (B) Charges for Caller Ring Back Tones

Caller Ring Back Tones (CRBT) was a VAS offered by RCL to its subscribers. But revenue amounting to ₹ 323.84 crore from CRBT services for the period from 2010-11 to 2012-13 was not booked in RCL accounts but accounted in RCIL. As these services were VAS availed by RCL subscribers, revenue on this account should have been included in GR of RCL in all the years for computation of revenue share. Understatement of GR by RCL owing to the above accounting treatment worked out to ₹ 323.84 crore.

Management replied (September 2016) that

- No telecom license or even registration was required for providing Content Services.
- RCIL was providing content services on standalone basis as separate legal entity. A subscriber when signs Customer Acquisition Form (CAF) agrees to avail the services of both RCL as well as RCIL. The voice services are provided by RCL and Internet and Content services are provided by RCIL to the subscriber. Hence, the revenue from data and content services are booked by RCIL.
- RCL and RCIL are issuing invoices to the customers for respective services i.e. RCL for voice and RCIL for data and content. RCIL was the billing and collection agent for RCL.
- The content provider leases the Access Services of the mobile operators on mutual agreement and is directly responsible to the customers for providing VAS services. The billing, collection and customer care are the other responsibilities of the VAS/ Content Providers. Thus, provision of VAS services by RCIL falls under the “Off Deck” Model.
- TRAI/DoT has also scrutinized the above arrangement of the Company in the past and no adverse findings have been reported by them.

The justification of the Management was not accepted for the same reasons as explained under Paragraphs 5.2.1 (A) above. LF and SUC short paid by RCL due to the above accounting treatment for period from 2010-11 to 2012-13 was worked out as ₹ 26.37 crore and ₹ 11.64 crore respectively. Details are in **Annexure-5.02**

5.2.1 (C) Revenue from Blackberry services of RCL

Revenue earned from the services availed by Blackberry subscribers of RCL for the period 2010-11 to 2013-14 was seen booked in RCIL accounts. Since such services were in the nature of value added services provided to RCL subscribers, income earned from them should have been considered by RCL for computation of revenue share. But it was observed that the above revenue was not offered for revenue share leading to understatement of its GR by ₹ 90.37 crore.

Management stated (September 2016) that the revenue booked in RCIL accounts was the income from internet/data services of Blackberry subscribers. Internet services were provided by RCIL and hence the revenue from them were booked under RCIL. The entire Voice revenue from Blackberry subscribers was booked in RCL and licence fee and spectrum fee were paid on the same. RCIL was a separate legal entity with all India ISP Licence and was providing internet services to subscribers under ISP Licence using infrastructure of RCL. As per terms of the ISP agreement, RCIL can lease or rent telecommunications resources from the other Telecom Service Providers for providing ISP services. As the revenue is pertaining to internet and Data services, RCIL has correctly recognized this revenue in its books of accounts and the same cannot be included in the revenue of RCL.

The above response was not accepted because as per the conditions of UASL, the provision of data services was part of the licenced activity and hence the revenue generated out of an activity falling under the ambit of the licence should form part of the GR of the licensee. Though the ISP licence permitted RCIL to lease or rent telecommunications resources from other telecom service providers for providing ISP services, the users of the service were essentially subscribers of RCL and not of RCIL. Revenue generated by the access licensee, by extending various services to its subscribers should form part of its GR.

Thus, non-inclusion of the revenue generated from data/internet services for computation of revenue share was not in compliance with the licence conditions leading to short payment of LF and SUC by ₹ 7.32 crore and ₹ 3.23 crore respectively. (Annexure-5.03)

5.2.1 (D) Revenue from R Connect services

Reliance Communications Limited (RCL), holding a UASL licence, entered into an agreement with Reliance Communications Infrastructure Limited (RCIL), a wholly owned subsidiary of RCL and having “Ä” category ISP Licence (April 2006) initially for three years which was subsequently extended up to 31.03.2012. As per the agreement, RCIL was to provide internet to RCL subscribers and pay to RCL Access charges at the rate of ₹ 0.16 per minute of usage.

From the records made available to Audit, it was noticed that revenue of ₹ 4179.55 crore was booked in the accounts of RCIL for the period from FY 2010-11 to FY 2013-14 as end users revenue (subscribers’ revenue) on account of R Connect services and ₹ 2925.96 crore was booked as Access charges on account of R Connect in the accounts of RCL.

In addition to the above, revenue of ₹ 612.61 crore was also booked in the accounts of RCIL as 'RGSM Data Administration charges' as Administrative Income towards 'Value Added Service-Data' and activation & deactivation charges for dongle services.

Audit contends that the services covered under UAS licence include internet services also and so provision of internet services to RCL subscribers was part of the licensed activity of RCL. Therefore revenue from internet services, availed by RCL subscribers through R Connect should have been included in the Gross revenue of the RCL.

Thus, the arrangement between RCL and RCIL by which the revenue of RCL from internet services was limited to access charges alone was not consistent with the conditions of licence agreement wherein all revenue from UAS licence was required to be offered for revenue share by the operator holding the licence. Non-inclusion of entire revenue resulted in understatement of GR by ₹ 1866.20 crore.

Management, quoting the provisions of ISP licence agreement which permitted the licensee to take on lease/rent telecommunication resources from other telecom service providers for providing internet services and the conditions of CAF signed by RCL subscriber, stated (September 2016) that

- R Connect services are dial up internet services provided by RCIL under "A" Category (All India) ISP licence. This license was issued in 1998 and no license fee was payable for ISP service provided under this license. As per terms of the ISP agreement, RCIL can lease or rent telecommunications resources from the other Telecom Service Providers for providing ISP services.
- A subscriber by signing the Customer Acquisition Form (CAF) agrees to subscribe to the services of both the companies i.e. RCL and RCIL and hence revenue from internet and data services belong to RCIL.
- Since the Licensor has permitted the ISP licensees to have access for their subscribers from the access providers, it necessarily means that the ISPs have to enter into an agreement with the access providers for getting the access. As per agreement between RCIL and RCL in this regard, RCIL has agreed to pay @16 paise per minute as access charges to RCL for use of infrastructure. ISP licence is a non-facility based licence and almost all ISPs ride on infrastructure of Access Provider by wire line/wireless means or through cable service provider. Hence such revenue cannot be accounted as the revenue accrued to Access Provider. Only access charges are payable to Access Provider for use of network which have been included in revenue of RCL and due licence fee has been paid.
- The said Admin income was earned by RCIL from prepaid internet subscribers, mainly internet Dongle subscribers. RCIL was providing internet services through Dial up services. The data plan for internet services had certain component of Admin

charges, which was booked by RCIL. The Admin income pertains to internet Data plans, hence RCIL only has to book this revenue and it cannot be considered as revenue of RCL.

The above response was not accepted because:

- The UASL agreement permits an access service provider to offer internet services also. The internet services provided by an ISP licensee are dial up services which are offered through wire line. But the mobile phone subscribers of RCL latch on to internet using the capabilities of radio frequency spectrum allotted to it as a UAS licensee. Even if a subscriber becomes a subscriber of both RCL and RCIL by signing CAF, as stated by the Management, RCL in no way could share its spectrum with RCIL for providing internet services to RCIL subscribers as spectrum sharing between them was not permitted. So the agreement between RCL and RCIL which permitted the latter to use the infrastructure of the former could at best be for providing dial up internet access to RCL subscribers using physical connectivity.
- Since RCIL as ISP could offer only dial up connections using physical infrastructure of RCL its internet income cannot include revenue from mobile subscribers. Hence the whole revenue collected from the end users also should have been included in the GR of RCL. Access charges shown in the AGR of RCL was the payment received for permitting RCIL to use the infrastructure and hence cannot be substituted for end user revenue.
- Dongles provide access to internet using the same technology as mobile phones and hence data revenue from subscribers using dongle services cannot be construed to mean as revenue from dial up services and classified as revenue pertaining to ISP licence. Hence, the components of Administrative charges, Rent from VAS-Data, activation/deactivation charges etc. should form part of the GR of RCL.

Thus non-considering of revenue earned from R Connect services by RCL despite the fact that services were availed by its wireless subscribers was not in compliance with UAS licence conditions and led to understatement of the GR by ₹ 1866.20 crore. Consequently, LF and SUC were short paid by ₹ 151.07 crore and ₹ 66.79 crore respectively. **(Annexure-5.04)**

5.2.1 (E) Revenue from installation of Fixed Wireless Phone/ Terminal (FWP/T) in subscriber's premises

Telephone instruments/Terminal equipment are integral to provision of fixed wireless services. As such, income from their installation and other upfront charges collected from the subscribers of the service would come under the ambit of GR as defined in clause 19.1 of licence agreement. But it was observed that “non- refundable upfront payment” of ₹ 23.16 crore received from the subscribers of RCL for installation of FWP/T in subscribers' premises was accounted in the books of RCIL and not considered for computation of GR by RCL.

Management stated (September 2016) that

- RCIL provided services of installation and recovery of FWP/Ts. The FWTs/Ps were not sold to the subscribers. They were only given on “for use” basis. Hence RCIL retained upfront charges received from FWP/T subscribers and the receipt by RCIL was not on behalf of the RCL. Therefore, in computation of AGR, such revenue was not liable to be included.
- RCIL provided services of installation of the instruments at subscribers’ premises for which RCIL received charges directly from the subscriber. Therefore, revenue accrued belonged to RCIL.
- The Hon’ble TDSAT in its judgment dated 28 May 2010 had held that the installation charges were given back to the person who did the installation work and hence it would not come in the purview of the AGR of the licensee.
- Installation of telecom equipment is a non-licence activity. It is possible for a UAS Licence holder to transfer out activities that do not require a UAS Licence to any other entity, in which case the revenues earned from the transferred services would not be included in the UAS Licence holder’s licence fee computation. The Hon’ble Supreme Court of India had also held that *it was open to the licensees not to undertake activities for which they do not require licence under Clause (4) of the Telegraph Act and transfer these activities to any other person, firm or company.*

The justification offered by the Management was not accepted for reasons given below:

- In terms of UASL agreement, GR of the licensee would include revenue from installation of terminal equipment (FWP/T). The fact that FWP/Ts were the property of RCL and it had only requested RCIL to install them was evident from the correspondence between RCL and RCIL. RCIL was only performing the role of an installation agency and hence charges paid to it should be expenditure to the Company. Non-inclusion of installation revenue tantamounts to setting it off against installation expenditure.
- TDSAT judgment of May 2010 referred in Management reply was not related to telecom operators but related to Direct to Home (DTH –related to TV broadcast) operators.
- Audit accepts that installation of telecom equipment was an activity which does not require a telecom licence. But the charges collected from the subscribers towards installation charges should form part of the GR as per the terms of the licence agreement. Expenditure on installation i.e., payment made to RCIL should have been a cost to RCL.

LF and SUC short paid by RCL on account of the above worked out to ₹ 1.89 crore and ₹ 0.84 crore respectively. (**Annexure-5.05**)

5.2.1 (F) Sale value of SIM cards

SIM cards supplied to the customers are integral part of mobile telecom service. As such, the value of the SIM cards sold should form part of the GR of the telecom service provider. The importance of income from sale of SIM was also confirmed by Hon'ble Supreme Court of India when it held (August 2011) that the amount received by the cellular telephone company from its subscribers towards SIM card will form part of the taxable value for levy of service tax because SIM cards are never sold as goods independent from services provided confirm that revenue. But it was observed that revenue of ₹ 36.94 crore earned through the sale of SIM cards in the years 2010-11 and 2011-12 was shown as the revenue of RCIL leading to understatement of RCL GR to that extent and short payment of Revenue share of ₹ 4.34 crore comprising of ₹ 3.01 crore as LF and ₹ 1.33 crore as SUC. (Annexure-5.06)

Revenue for the years 2012-13 to 2014-15 was not traceable either in the accounts of RCL or in RCIL and the Management did not provide information on how revenue from sale of SIM cards has been accounted in those years. In the absence of information Audit could not work out under statement of revenue for the above period.

Reply of the Management on the above audit observation was awaited (November 2016).

5.3 Related expenditures netted off from Gross Revenue

As per clause 19.1 of the licence agreement between DoT and the telecom service providers, the Gross Revenue of the operators shall be inclusive of installation charges, late fees, sale proceeds of handsets (or any other terminal equipment etc.), revenue on account of interest, dividend, value added services, supplementary services, access or interconnection charges, roaming charges, revenue from permissible sharing of infrastructure and any other miscellaneous revenue, without any set-off for related item of expense, etc. It was observed in Audit that the GR recorded under many revenue account heads in the books of accounts of RCL and RTL were net off the expenditures. Instances are discussed below:

5.3.1 Booking of Prepaid Revenue net of Free Air Time by RCL/RTL

Free talk time/free airtime provided to the subscribers were not accounted in the accounting systems of RCL and those Minutes of Usage (MoU) were eliminated in the billing cycle. RCL held the view that free talk time/free airtime were provided to subscribers along with product and/or tariff without any charges and hence were not rated and valued in the system. As the free talk time/free airtime were filtered at the Mediation level⁶ itself, they were not captured in the system and hence not considered as revenue for the purpose of revenue share.

Management also stated (September 2016) that free talk time/free air time/free minutes offered to subscribers were not in the nature of any discount or rebate. Since no revenue was

⁶ A mediation device is a network component in Telecom network that receives, processes, reformats and sends information to other formats between network elements and is commonly used for Billing and Customer Care Systems.

generated from the free minutes, they were not included in the bills issued to subscribers and so not included in the AGR statements.

In this connection, Audit opines that airtime is the actual talk time offered to a subscriber by using a natural resource (RF Spectrum). As the Government has a legitimate claim to share the worth derived out of the use of the natural resource, it is imperative that the free talk time/air time are valued and rated by the Company. This was significant because free talk time/air time need not always be given to subscribers alone but could be given to franchisees/distributors also in lieu of discount/commission which in turn would have been amortized by them. In a situation where the value of free talk time/airtime was not captured Audit could not confirm its impact on the GR.

5.3.2 Understatement of prepaid revenue of RCL due to set-off of commission/discount

As per the marketing agreement between RCL and RCIL, RCIL was an agent and authorized person for selling the product of RCL. As per the agreement, RCL would sell the prepaid vouchers to RCIL at the rate as agreed from time to time and RCIL would sell the same to its distributors at the same net price.

From the books of accounts of RCIL for the period from 2010-11 to 2014-15, it was found that the discount/commission received by RCIL from RCL amounting to ₹ 1284.27 crore for selling its product was shown as “Billing Income” which was in turn the commission paid to the distributors by RCIL. However, RCL had netted of the commission/discount paid to RCIL on sale of prepaid cards and only the net realized value was accounted as revenue that was considered for AGR.

The value of commission/discount given to distributors/agents for sale of pre-paid products (SIM cards/recharge vouchers) was to be treated as business expenses by RCL and the gross value of the prepaid cards i.e. the value of the telecommunications service being provided by the operator (RCL) was required to be considered as revenue without any set off.

RTL, the other UAS licensee of the Reliance Group had its own franchisees/distributors unlike RCL which had a selling and marketing arrangements with the subsidiary company RCL. It was observed that the revenue earned by RTL on sale of prepaid cards and recharge vouchers was accounted net of discounts given to distributors/dealers instead of their gross value. As the rate at which the discounts were offered by the Operator was not made available to Audit, based on the ratio between the prepaid revenue of RCL and discount allowed by it, Audit computed that the prepaid revenue of RTL for the period covered in audit was understated by ₹ 680.92 crore.

Management stated (September 2016) that

- RCL had appointed RCIL as billing and collection agent and RCIL had not paid any commission to distributors. It was discount amount which was offered to distributors

on prepaid vouchers. The relationship between the RCIL and Distributor was of **Principal to Principal** and not of Principal to Agent. Therefore, amount allowed to Distributors was discount and not commission and the same cannot be included in the AGR for the purpose of the Licence Fee and Spectrum Charges. Revenue was booked from prepaid vouchers net of discounts.

- The sale by RCL was on a stated/agreed price, invoiced at that agreed price and booked under the revenue in the profit and loss account without netting off any discount, the actual selling price would be the revenue and the difference between the MRP and this selling price cannot be added to gross revenue. This practice was in line with the TDSAT judgement of April 2015 which held that if the sale is on a stated/agreed price, invoiced at that agreed price and booked under the revenue in the profit and loss account accordingly, without netting off any discount, the actual selling price would be the revenue and the difference between the MRP and this selling price cannot be added to “gross revenue”.
- AS-9 recognizes revenue which flow in form of cash/receivables. Notional income is not recognized as revenue. Discount offered to distributors is not accrued as revenue to the company and no cash inflow arises to the company hence the same cannot be construed as revenue of the Company.

The above responses were not acceptable due to reasons given below:

- RCIL was the billing and collection agent of RCL and not a reseller of RCL services. The role of RCIL was that of distributor acting on behalf of RCL and the products sold on MRP by RCIL had no intrinsic value and all its value was provided by RCL on the strength of its UAS licence. In other words, the SIM cards/recharge vouchers etc., sold by RCIL would not have any value if dissociated from the service to be provided by RCL. Service cannot be sold but only provided. The distributors only perform the role of agents in the chain of delivery of services to the end users. Therefore, Audit is of the view that the relationship between RCL and RCIL was only that of Principal to Agent and not Principal to Principal.
- The TDSAT judgement of April 2015 has been challenged by the DoT in the Hon'ble Supreme Court of India and hence cannot be considered as final.
- Audit is not questioning the accounting in accordance with AS-9 but contends that netting off of discount/commission was not in accordance with the conditions of Licence Agreement.

Thus, GR of both RCL and RTL were understated by ₹ 1284.27 crore and ₹ 680.92 crore respectively during the years 2010-11 to 2014-15. Consequently, LF of RCL was short paid by ₹ 103.77 crore and SUC by ₹ 45.95 crore while the short payment of LF and SUC by RTL was ₹ 51.32 crore and ₹ 31.49 crore respectively. (**Annexure 5.07**)

5.4 Incomes not offered for revenue share

The licence agreement, while prescribing certification of the accounts of the licensee companies by their Auditors in accordance with the provisions of the Companies' Act, 1956, also specified that reconciliation should be done between the revenue appearing in the revenue share statements and the annual accounts of the Company as certified by their Auditors.

Review of the reconciliation statements with the Trial Balances, Audited AGR statements and Notes on Accounts prepared by the Statutory Auditors submitted along with Auditors Report and comparing them with primary accounting records of RCL and RTL for the years 2010-11 to 2014-15 showed that income/revenue under certain categories, appearing in the Company's accounts, were not considered for computation of GR/AGR and payment of revenue share. These revenues which should have been a part of AGR were not included in the AGR statements. Moreover, the reconciliation statements also did not disclose the above income fully. Incomes thus excluded are discussed below:

5.4.1 Interest income not offered for revenue share

As per clause 19.1 of the license agreement, interest income was to be included in the GR of the licensee for computation of licence fee payable.

RCL had included ₹ 2093.02 crore as Interest income during 2011-12 to 2014-15 in the accounts but the said income was not included in the GR of the company for payment of revenue share. Interest income not offered for revenue share in the years 2010-11 to 2014-15 by RTL was ₹ 27.61 crore. Thus the total interest income excluded from the AGRs of both RCL and RTL worked out to ₹ 2120.63 crore.

Exclusion of interest income from the AGR meant short payment of LF amounting to ₹168.61 crore and SUC of ₹ 74.43 crore by RCL. Short payment of LF and SUC by RTL on this account worked out to ₹ 2.04 crore and ₹ 1.29 crore respectively. (**Annexure 5.08**)

5.4.2 Other income not offered for revenue share

It was observed that RCL and RTL had accounted ₹ 941.37 crore as other income in the years 2010-11 to 2014-15. Income classified as other income included 'miscellaneous income, rent received, sale of scrap, etc. However, this income was not seen included in the AGR for the above period leading to understatement of revenue.

RCL Management responded (September 2016) stating that:

- RCL has not paid Licence fee on interest income from Q4 of FY 2008-09 onwards in line with the TDSAT Judgment of August 2007. As TDSAT had pronounced that only Income related to Telecom activities was liable for Licence Fee, no licence fee was paid on interest income.

- UAS Licence Agreement talks about Revenue and not about income for Licence Fee purpose. Income” and “Revenue” are not analogous. Revenue essentially refers to that received from operation of a business whereas income is of much wider import than revenue.
- Further only interest and/or dividend income with direct nexus to provision of telecom services merits inclusion in computation of the “adjusted gross revenue”. In the case pointed out by Audit, this would essentially include – a) interest earned on/from debtors and interest and/or dividend earned from investments in telecom activities.

Response of the Management was not accepted on account of the following:

- Definition of GR in licence agreement expressly provides for inclusion of interest income for GR/AGR for computation of revenue share.
- The August 2007 ruling of TDSAT had been set aside by the Hon’ble Supreme Court in October 2011 and hence the definition of revenue as contained in the UASL agreement remain unaltered.

Non-inclusion of incomes categorized as other income for payment of revenue share led to short payment of LF and SUC by RCL by ₹ 67.66 crore and ₹ 29.40 crore respectively while the same by RTL was ₹ 8.23 crore and ₹ 4.94 crore respectively. (**Annexure 5.09**)

5.4.3 Income from Forex gains

In terms of definition of Gross Revenue defined under clause 19 of Licence Agreement as stated above, all the revenues are to be taken into consideration for calculation of Gross Revenue for the purpose of payment of Revenue Share to DoT. Since Licence Agreement do not provide for set off or related expenses all gains arising from the exchange differences are to be included in the GR.

It was seen from the Annual Accounts for the years 2011-12, 2012-13, 2013-14 and 2014-15 that Forex gains under the relevant revenue accounts were seen set-off against Forex losses recorded under different expense accounts. Consequently the gains were netted off against losses making the GL balances NIL. Forex gains thus not included in the AGR worked out to ₹ 754.05 crore comprising ₹ 635.44 crore in respect of RCL and ₹118.61 crore for RTL.

Management stated (September 2016) that

- RCL paid Licence fee on realized Forex gain amounting to ₹ 500.96 crore till Q3 of FY 2008-09. From Q4 of FY 2008-09, RCL started paying Licence Fee in accordance with the TDSAT Judgment of August 2007. The said judgment was made applicable to RCL also vide TDSAT judgement of March 2009 and the Company has claimed refund from DoT of the Licence fee paid on such non-telecom revenue items.

- Further, Exchange Gains could only reduce the liability towards payment for capital goods. Since the cost of equipment had no impact on the licence fee, gains arising out of decrease in cost of capital goods cannot be treated as revenue.
- Telecom companies are obliged to comply with AS 9 which is also recognized and accepted by the Courts. AS 9 does not recognize Forex gain as revenue and thus, the Company was not liable to pay any Licence Fee to DoT.
- Hon'ble Supreme Court in its judgment dated 11 October 2011 permitted the Hon'ble TDSAT to decide as to which components/heads can be included in the company's AGR by the DoT. Accordingly, the Hon'ble TDSAT in its judgment of April 2015 had ruled that Forex gains were not liable for Licence Fee.
- The fluctuation of Forex accounted in the GL codes of similar nature of transactions the result should on net basis.
- Only RTL had realized Forex Gain of ₹ 13.29 crore in the year 2010-11 and in all other years it has been realized Forex Loss for RCL as well as RTL. Hence, the amount cannot be added back to the AGR.

Audit comments on the Management response are:

- TDSAT judgment of August 2007 was set aside by the Hon'ble Supreme Court in October 2011 and hence payment of LF and SUC based on a judgment which had become null and void was not justifiable
- Forex gain/loss results from individual transactions. Individual transactions cannot be clubbed.
- Recognising Forex gains after netting off for losses would be a deviation from the condition of licence agreement which stipulates that GR should be recorded without any set-off for related expenditure.

The understatement of GR of the above operators due to exclusion of forex gain led to short payment of ₹ 51.54 crore towards LF ₹ 22.82 crore as SUC by RCL and ₹ 8.83 crore and ₹ 5.56 crore towards LF and SUC respectively by RTL. (**Annexure-5.10**)

5.4.4 Revenue from lease of bandwidth not considered for SUC

UASL agreement provides that “while calculating AGR for limited purpose of levying spectrum charges based on revenue share, revenue from wireline subscribers shall not be taken into account”. The format of statement of revenue and licence fee (AGR Statement) prescribed for the UASL agreement depicts items which are to be classified as wireline income and hence it was evident that DoT had envisaged that all items of revenue which are outside the category mentioned as wireline income should be considered for payment of SUC.

In the AGR Statements of RCL for the years 2010-11 and 2011-12 revenue from sale/lease of bandwidth links, R&G cases, turnkey projects, etc., were not classified as exclusive wireline revenue. Yet revenue earned from the above amounting to ₹ 1053.38 crore was not considered while calculating the SUC payable by the Company leading to short payment of SUC by ₹ 37.97 crore (**Annexure- 5.11**)

Management stated (September 2016) that

- Licence Agreement very clearly mentioned that Spectrum fee shall be payable on AGR earned from wireless subscribers only. As Lease line revenue is not wireless revenue and no spectrum is used to provide Lease line services, the inclusion of lease line revenue in AGR for spectrum fee does not arise.
- DoT vide its letter dated 08 January 2013 has raised demand of Spectrum charges on Lease line revenue, which was challenged by the Company in the Hon'ble Madras High Court and has obtained a stay on the demand of Spectrum charges on lease line revenue raised by DoT amounting to ₹ 219 crore vide order dated 23 June 2016

The above response of the Management was not accepted because as per the format of AGR statement (Appendix II to Annexure –II of UASL agreement) only those revenue falling under line item 1A thereof were to be treated as revenue from wireline services. DoT had not classified revenue from sale/lease of bandwidth links, R&G cases, turnkey projects etc., as an item which is exclusive to land line services. Further, the stay granted by the Hon'ble Madras High Court on the demand raised by DoT cannot be interpreted as the final judicial pronouncement on the issue.

5.5 Disclosures in the Statement of Revenue and Licence fee (AGR statements)

The UASL Agreement stipulated that the accounts of the operator Company should be certified by its Statutory Auditor. Concurrently, the Agreement also provided distinct and specific norms/guidelines for recognition and reporting of revenue by the licensees from the licenced activity. These norms, detailed in the Annexure –III of UAS Licence agreement, stipulated disclosure of important information to facilitate DoT for easy assessment of the GR reported by the licensees. The norms/guidelines read along with Clauses 20.2 and 20.6 of licence agreement would clearly indicate that while it was the prerogative of the licensee company to prepare their accounts complying with the provisions of the Companies Act, acceptable Accounting Standards etc., the AGR of the licensee company, for the purpose of payment of revenue share, would be computed as per the definition of revenue adopted in the UAS Licence.

The Statutory Auditor of the licensee, preparing the accounts in accordance with the provisions in the Company's Act/ relevant Accounting standards etc., should also give a confirmation to the effect that the Statement of Revenue and Licence Fee has been *prepared*

in accordance with the norms/guidelines contained in the Licence agreement (Appendix -I to Annexure -II).

Instances of understatement of revenue as brought out in the report would confirm that the revenue recognised for payment of licence fee and SUC by RCL and RTL were not in line with the licence conditions nor the preparation of accounts was fully in compliance with the norms prescribed by DoT. Though it was stated by the Management that revenue was booked net of discounts its details were never seen indicated in the Annual Accounts of RCL and RTL as required by the licence agreement. The Management also informed that that billable revenue was shown as Gross in line with AS-9 and no discount was offered on the billable amount. The stand of the Management was not in line with the licence agreement because as per the guidelines the service income of the licensee had to be shown gross and details of discount/rebate indicated separately.

5.6 Interest on revenue share short paid

On issues raised above (from paras 5.2 to 5.4) short/non-payment of LF and SUC worked out to ₹ 709.52 crore and ₹ 363.16 crore, respectively. The interest on this short/non-payment of LF and SUC was ₹ 839.09 crore (**Annexure 5.12**). The calculation of interest was based on the rate prescribed in the Licence agreement (i.e. 2 *per cent*) above the Prime Lending Rate of State Bank of India existing as on the beginning of the financial year) and the period considered for the calculation was from the end of the concerned financial year up to March 2016.

5.7 Response of DoT

Preliminary audit findings were communicated to DoT in the form of a draft audit report in September 2016 for eliciting response, with copy to Reliance Management. Response of the management to DoT, copy of which was endorsed to Audit was received in October 2016. The responses on the observations presented in this report generally reiterated the stance of the management on them communicated during the audit. The replies have been appropriately considered in this Report. DoT reply is as mentioned in the para 2.4.

