

## Executive Summary

### 1. Revenue share model in Indian Telecom Sector

The New Telecom Policy (NTP-99), which came into effect in April 1999, introduced the revenue sharing model in the Indian telecom sector. Under this system telecom licensees were required to share a percentage of their Adjusted Gross Revenue (AGR) with the Government as annual License Fee (LF). In addition, mobile telephone operators were also required to pay Spectrum Usage Charges (SUC) for the use of radio frequency spectrum allotted to them. The license agreements between the Department of Telecommunications and the service providers defined the components of the GR of the licensee company and the AGR was computed after allowing for certain deductions spelt out in the license agreements. The annual accounts of the service provider, audited by their Auditors appointed under Section 224 of the Companies' Act, 1956, are relied upon by DoT for assessing the revenue share due to the Government.

### 2. Audit by CAG on the correctness of revenue share paid by private telecom Service Providers

The revenue shared by Private Telecom Service Providers (PSPs) with the Government of India (GOI) as LF and SUC forms part of the Consolidated Fund of India. Section 16 of Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 make it obligatory on the part of CAG to satisfy himself that the Government of India has received its complete and correct share. Further, the 'Telecom Regulatory Authority of India, Service Providers (Maintenance of Books of Accounts and other Documents) Rules, 2002', promulgated by the Government in November 2002 contains enabling provisions for verification of all the accounting records and documents maintained by the service providers that has a bearing on the Gross Revenue (GR) of the service providers by the CAG of India. CAG had presented a report on the Sharing of Revenue by PSPs during the years 2006-07 to 2009-10 to the Parliament in March 2016 and the Report is under the consideration of the Public Accounts Committee. The current Report presents the audit observations emanating from the verification of the accounting records of six operators, five of whom were covered in the first phase. The accounting years covered were from 2010-11 to 2014-15 except for the new operator included in the Report for whom the coverage was for the years from 2006-07 to 2014-15.

### 3. Structure of the Report

This report consists of seven chapters and annexures. Chapter 1 gives an overview of the salient features of the revenue sharing regime and the arrangements in Department of Telecommunication (DoT) for collection of LF and SUC and their final assessment. It also

explains the audit scope, methodology. Audit findings are narrated, operator wise in Chapters II to VII.

#### **4. Summary of important audit findings**

##### **(i) Gross Revenue (GR)/AGR understated by all the PSPs by the amount of commission/discount paid to their distributors/dealers/agents/franchisees**

PSPs employ distributors/dealers/agents/franchisees to sell their prepaid products and for customer acquisition and pay commission/discounts etc. to them. All the PSPs whose accounts were verified had their GR/AGR reduced by the amount of commission/discounts etc. paid to distributors/dealers/agents/franchisees. However, the operators had adopted different methods for accounting these transactions. While Airtel, Vodafone and SSTL had booked the amount of commission/discounts etc. as a debit entry to revenue, Reliance, Idea and Aircel have booked the revenue after netting of discounts/commission.

Since commission/discounts etc. paid to distributors/dealers/agents/franchisees were in the nature of business expenses (marketing expenses), netting off or reducing it from revenue for the purpose of reporting GR/AGR was not in line with the conditions of license agreements. Amount of discount/commission etc. netted off from revenue worked out by audit was ₹16862.22 crore resulting in short payment of LF and SUC by ₹ 1394.89 crore and ₹ 842.05 crore respectively.

*(Paragraphs 2.2.1(A), 3.2.1(A), 4.2.1 (A), 5.3.2, 6.2.1, 7.2.1)*

##### **(ii) GR/AGR understated by all the PSPs by the amount of promotional schemes like Free Talk Time/Free Air Time**

Audit noticed that PSPs provide various offers like Free Talk Time/Free Air Time (FTT/FAT) to their prepaid subscribers on different occasions which were basically promotional schemes under various names. Unified Access Service Licence(UASL) agreements provide that operators should show service revenue (amount billable) gross and details of discount/rebate indicated separately. It was noticed that promotional offers were not recognised as revenue by the PSPs.

In the books of accounts of Airtel, Vodafone, Idea, Aircel and SSTL amount of promotional FAT/FTT given to subscribers were accounted as debit entries to revenue heads. But no such information could be obtained from the account of Reliance as the Company had eliminated the promotional FAT/FTT in the billing cycle without reflecting it in the financial systems and the books of accounts.

Since such promotional offers were in the nature of business expenses, in accordance with UASL agreements, they should be recognised as revenue for the purpose of GR/AGR for computation of revenue share to GOI. Audit worked out understatement of GR/AGR on this account at ₹ 7049.61 crore resulting in short payment of LF and SUC by ₹ 587.70 crore and ₹ 370.00 crore respectively.

*(Paragraphs 2.2.1(B), 3.2.1(B), 4.2.1(B), 6.2.2, 7.2.1)*

**(iii) Understatement of GR/AGR by netting-off of discounts/waivers given to post-paid subscriber**

Discounts/waivers given to post paid subscribers over and above tariff plans submitted to TRAI which were in the nature of business expense were seen deducted from revenue in the accounts of Airtel, Vodafone, Idea and Aircel. This practice was a deviation from the license agreement which stipulated recording of revenue without setting off related expenditures. This deviation led to understatement of ₹ 417.60 crore in GR/AGR reported by these companies resulting in short payment of LF and SUC by ₹ 34.21 crore and ₹ 17.20 crore respectively.

*(Paragraphs 2.2.2 and 4.2.2)*

**(iv) Understatement of GR/AGR by netting of discounts from revenue pertaining to roaming services**

PSPs have arrangements with other International Operators for roaming services. It was observed that the Inter Operator traffic (IOT) discounts paid/credited to the accounts of these Operators were debited/deducted from the roaming revenue by Airtel, Vodafone and Idea. Having roaming arrangement with other national/ international operators is a matter of mutual agreement between two operators and giving discounts over and above the agreed charges for roaming is part of overall commercial strategy to enhance business between the two operators. As such, these discounts were in the nature of expenses and hence, in terms of license agreements, they are not permitted to be deducted from revenue. Audit worked out understatement of GR/AGR for computation of revenue share on this account as ₹ 889.85 crore resulting in short payment of LF and SUC by ₹ 76.20 crore and ₹ 48.19 crore respectively.

*(Paragraphs 2.2.3, 3.2.2, 4.2.3)*

**(v) Understatement of GR/AGR by netting of revenue from infrastructure sharing**

UASL agreements provide that GR shall be inclusive of revenue from infrastructure sharing without setting off of any related item of expenses. PSPs have arrangements with other PSPs for sharing of their passive infrastructure. Audit has noticed that amount received towards infrastructure sharing in the case of Airtel, Vodafone, Idea, and Aircel has not been taken to revenue in full, instead, part of it has been credited to expenses. This has resulted in understatement of revenue from infrastructure sharing for computation of GR/AGR for the purpose of revenue share. Understatement of GR/AGR on this account was worked out by audit as ₹ 1090.07 crore resulting in short payment of LF and SUC by ₹ 87.17 crore and ₹ 55.25 crore respectively.

*(Paragraphs 2.2.4, 3.2.3, 4.2.4, 6.2.3)*

**(vi) Understatement of GR/AGR due to short/non-inclusion of forex gain in GR**

In terms of definition of GR, forex gain was to be a component of the GR for computation of revenue share. We observed that forex gains were either excluded completely or only partially included in GR by the PSPs. The exclusion of forex gain in GR of all the PSPs worked out to ₹ 2174.19 crore leading to short payment of LF and SUC by ₹ 176.54 crore and ₹ 78.15 crore respectively.

*(Paragraphs 2.2.5, 3.2.4, 4.2.7, 5.4.3, 6.2.4, 7.2.2)*

**(vii) Understatement of GR/AGR by all PSPs by non- inclusion of interest income**

License agreements expressly provide that interest income of the licensee company should be included in its GR for computation of revenue share payable. Audit observed that the PSPs either did not include interest income in GR/AGR or only partially included it in their GR leading to short payment of revenue share paid. Understatement of revenue reported by the PSPs during the period of audit coverage was ₹ 10207.46 crore and consequent short payment of LF and SUC was worked out at ₹ 880.19 crore and ₹ 467.99 crore respectively.

*(Paragraphs 2.2.6, 3.2.5, 4.3.1, 5.4.1, 6.3.1, 7.3.1)*

**(viii) Understatement of GR/AGR by all PSPs by non-inclusion of profit from sale of investment**

License agreements provide that income from investments should be included in GR/AGR for computation of revenue share. Audit noticed that Airtel, Idea, and Aircel have not included income earned from investments in GR/AGR for computation of revenue share. Audit worked out amount of non-inclusion of income from investments in GR/AGR as ₹ 5276.24 crore resulting in short payment of LF and SUC by ₹ 424.27 crore and ₹ 235.71 crore respectively.

*(Paragraphs 2.2.9, 4.3.2, 6.3.2)*

**(ix) Evasion of revenue share payment by Reliance Communications Limited (RCL) through an arrangement with its subsidiary**

RCL a Unified Access Service (UAS) Licensee had agreement with its wholly owned subsidiary Reliance Communications Infrastructure Limited (RCIL) holding Category “A” ISP license for providing Value Added Services (VAS) to its subscribers and selling/marketing products of RCL. RCIL was also the billing and collection agent for the services provided by RCL. Internet services including services with dongles availed by RCL customers were provided by RCIL under its ISP license and access was provided RCL. In accordance with the agreements between RCL and RCIL, revenue from services like VAS, Caller Ring Back Tunes, internet services availed by RCL subscribers etc., were accounted in the books of RCIL and only a portion of the total revenue was passed on to RCL. In addition

the revenue earned towards sale of handsets, SIM cards and installation charges from subscribers which should have been accounted in the GR of RCL, was booked in RCIL accounts. Thus revenue which should have been the revenue of the UAS licensee were accounted in the books of the ISP licensee. Since the ISP licensees were required to pay only a nominal license fee RCL, we observed, through the arrangements with RCIL, passed on revenue to RCIL and avoided payment of revenue share. Total understatement of GR/AGR by RCL owing to its arrangement with its subsidiary (RCIL) came to ₹ 3050.10 crore. Its impact on short payment of LF and SUC was worked out to ₹ 247.51 crore and ₹ 109.31 crore respectively.

*(Paragraphs 5.2.1 (A) to 5.2.1 (E))*

**(x) Understatement of GR/AGR due to non-inclusion of miscellaneous revenue and profit on sale of fixed assets**

Definition of revenue in the license agreements stipulates that GR of the licensee company should include miscellaneous revenue without any set-off for related item of expense, etc. Audit noticed that the PSPs did not include miscellaneous income like profit on sale of fixed assets in their GR leading to its understatement. The GR understated totalled to ₹ 2131.60 crore resulting in short payment of LF and SUC by ₹ 172.94 crore and ₹ 81.55 crore respectively.

*(Paragraphs 2.2.10, 2.2.11, 3.2.7, 3.2.8, 4.3.3, 4.3.4, 5.4.2, 6.3.3, 6.3.4, 7.3.1)*

**(xi) Non-inclusion of dividend income in GR**

The GR of the PSPs, as stipulated in the license agreement should include the component of dividend income also. We observed that the GR reported by Airtel, Vodafone and Aircel during the years 2010-11 to 2014-15 did not include income accrued as dividends. This deviation from the license agreement led to understatement of ₹ 4531.12 crore in the GR of the above PSPs. The short payment of LF and SUC on account of the omission was ₹ 367.98 crore and ₹ 219.63 crore respectively.

*(Paragraphs 2.2.8, 3.2.6, 7.3.1)*

**(xii) Understatement of AGR by amount of bad debts written off, claimed as deduction**

The license agreements permit only three items of revenue to be deducted from GR to arrive at the AGR of service providers. Bad debts written off were not eligible to be claimed from GR to arrive at AGR. However, Airtel, Vodafone, Idea, and Aircel claimed deduction of bad debts written off from their GR to arrive at AGR. A total of ₹ 1984.65 crore was seen deducted which led to short payment of LF and SUC of ₹ 175.34 crore and ₹ 105.12 crore respectively.

*(Paragraphs 2.2.12, 3.2.9, 4.4.1, 6.4.1)*

**(xiii) Understatement of AGR for computation of SUC**

In terms of UASL agreements, revenue from sale/lease of bandwidth should be considered in AGR for computation of SUC. Audit noticed that Airtel and Reliance did not include revenue from sale/lease of bandwidth for computation of SUC though the same was included for computation of LF. No such exclusion, however was made by PSPs providing only wireless services. Revenue not included in AGR for computation of SUC worked out to ₹ 2671.02 crore which had the impact of short payment of SUC of ₹ 131.44 crore.

*(Paragraphs 2.2.13, 5.4.4, 7.3.2)*

**(xiv) Compliance to license conditions**

The Gross Revenue of the licensee operator, as per the license agreement with DoT prohibits any set-offs of related expenditure from revenue and norms for preparation of the accounts for payment of revenue share are built into the license agreement. We observed non-conformities with conditions of license agreement in the accounts prepared by all the six operators covered in audit due to which their GR computed for sharing revenue with the Government was understated. Even though computation of the GR was not in compliance with the licence agreement, the Statutory Auditors had always certified that the accounts were prepared in accordance with the guidelines/norms contained in the Licence Agreement and the companies always presented an affidavit to DoT affirming that their GR was as defined in the license agreements. These statements submitted by the operators appeared to be only a perfunctory practice as they consistently departed from the stipulations in the UASL agreements while computing GR/AGR. DoT on its part did not take any proactive steps to ensure that the licensees disclosed their revenue as stipulated in the licence agreements.

**5. Consolidated statement of non-realisation of revenue noticed by Audit:**

Short/non-payment of LF as per the licence agreements is given in the following table:-

Audit Observations	Non realisation of LF (₹ in crore)					
	Airtel	Vodafone	Idea	Reliance	Aircel	SSTL
Revenue netted off by the amount of commission/ discount etc. paid to distributors/ dealers/ agents/ franchisees	462.01	351.77	285.95	155.10	125.31	14.75
Promotional Free Airtime given to subscribers not recognized as revenue for revenue share	195.17		234.65	-		11.23
Revenue netted off by the amount of waivers/discount given to post paid subscribers	20.01	116.66*	14.20	-	29.99*	-
Roaming revenue netted off by discount given to other operators	40.32	24.92	10.96	-	-	-
Infrastructure sharing revenue netted off	19.75	27.75	34.92	-	4.75	-

Non-inclusion of forex gain	42.65	13.55	21.30	60.37	38.12	0.55
Non/short inclusion of interest income	47.13	525.48	24.30	170.65	91.03	21.60
Non -inclusion of profit on sale of investment	368.95	-	48.02	-	7.3	-
Revenue booked in subsidiary's accounts instead of its own books of accounts by RCL	-	-	-	247.51	-	-
Non-inclusion of miscellaneous revenue and profit on sale of assets	35.09	54.49	2.78	75.89	4.5	0.19
Non-inclusion of Dividend Income	181.67	186.31	-	-	-	-
Ineligible deduction on account of bad debts written off claimed	117.74	44.48	9.09	-	4.03	-
Other issues	46.63	-	22.75	-	164.95	-
<b>Total</b>	<b>1577.12</b>	<b>1345.41</b>	<b>708.92</b>	<b>709.52</b>	<b>469.98</b>	<b>48.32</b>

\* Promotional Free Airtime/ waivers/discount offered to Pre-paid and Post paid subscribers could not be segregated.

Short/non-payment of SUC as per the licence agreements is given in the following table:-

Audit Observations	Non realisation of SUC ( ₹ in crore)					
	Airtel	Vodafone	Idea	Reliance	Aircel	SSTL
Revenue netted off by the amount of commission/ discount etc. paid to distributors/ dealers/ agents/ franchisees	312.85	213.52	174.92	77.44	59.02	4.30
Promotional Free Airtime given to subscribers not recognized as revenue for revenue share	133.33		147.44	-		3.34
Revenue netted off by the amount of waivers/discount given to post paid subscribers	8.39	70.95	8.81	-	14.94	-
Roaming revenue netted off by discount given to other operators	26.86	15.00	6.33	-	-	-
Infrastructure sharing revenue netted off	13.23	16.12	24.03	-	1.87	-
Non inclusion of forex gain	22.25	6.58	10.97	28.38	9.82	0.15
Non/short inclusion of interest income	25.50	307.67	13.19	75.72	40.37	5.54
Non-inclusion of profit on sale of investment	205.76	-	26.70	-	3.25	-

Revenue booked in subsidiary's accounts instead of its own books of accounts by RCL	-	-	-	109.31	-	-
Non-inclusion of miscellaneous revenue and profit on sale of assets	13.21	30.49	1.64	34.34	1.82	0.05
Non- inclusion of Dividend Income	98.98	120.65	-	-	-	-
Ineligible deduction on account of bad debts written off claimed	72.20	26.56	6.21	-	0.15	-
Revenue included in AGR for LF but not for SUC	92.56	-	-	37.97	-	0.91
Other issues	0	-	7.13	-	69.63	-
<b>Total</b>	<b>1025.12</b>	<b>807.54</b>	<b>427.37</b>	<b>363.16</b>	<b>200.87</b>	<b>14.29</b>

Short/non-payment of LF, SUC and interest due thereon as on 31 March 2016 as per the licence agreements is depicted in the following table:-

	Short/non-payment of LF, SUC and interest (₹ in crore)						
	Bharti Airtel	Vodafone	Idea	Reliance	Aircel	SSTL	Total
LF	1577.12	1345.41	708.92	709.52	469.98	48.32	4859.27
SUC	1025.12	807.54	427.37	363.16	200.87	14.29	2838.35
Total (LF+SUC)	2602.24	2152.95	1136.29	1072.68	670.85	62.61	7697.62
Interest	1245.91	1178.84	657.88	839.09	555.80	54.10	4531.62
Total (LF+SUC+ Interest)	3848.15	3331.79	1794.17	1911.77	1226.65	116.71	12229.24

To sum up the verification of records of six PSPs by audit indicated total understatement of AGR of ₹ 61064.56 crore for the period from 2010-11 to 2014-15 (for five operators except SSTL for which the period is from 2006-07 to 2014-15) and consequent short payment of revenue share to Government of India to the tune of ₹ 7697.62 crore. The interest due on the short paid revenue share, for the period up to March 2016 was ₹ 4531.62 crore.

## 6. Response of DoT and the PSPs to the audit observations

Audit observations on the sharing of revenue by the six selected PSPs were communicated to DoT during August/September 2016 with copies endorsed to the PSPs concerned. PSPs had submitted their replies to DoT copies of which were submitted to Audit also. Responses of the Ministry and PSPs on various audit observations were received in February 2017 and September 2016 respectively. Same has been appropriately included in this Report.