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REVENUE RECOGNITION PRACTICES IN THE INDIAN TELECOM INDUSTRY

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ABSTRACT

India is the 2nd largest telecom player in the world for its large subscriber base and the industry, along with its massive size, plays a dominant role in the nation-building process. The industry is characterized by complex and one-of transactions and features like–very large number of customer contracts, frequent modifications to the customer contracts, activation income, income from post-paid and pre-paid cards, internet revenues, inter-connect revenues, income from indefeasible rights of use, subscription income etc. Owing to the size and importance of the industry, the author has chosen the industry to study the revenue recognition polices and their impact on accounting. AS-9, issued by the Institute of Chartered Accountants of India, is the standard on 'Revenue Recognition' followed by the Indian trade and commerce. In addition, companies that produce consolidated financial statements adopt the international standard IAS 18 on 'Revenue'. Per se there are differences between the two and hence the statements made using each of these cannot be compared on a line item basis. As India is progressing to implementing International Financial Reporting Standards (IFRS) in a phased manner, for those companies where IND AS is applicable, IND AS 18 is followed (equivalent of IAS 18). The standard IAS 18 was revised as it could not offer guidance on contract modifications etc. and hence the new standard IFRS 15 (applicable from 1st Jan 2018) has been released. The equivalent of the same is IND AS 115, which is yet to be notified in India. There are also certain differences between IND AS 18 and IND AS 115, thereby leading to a confusion and judgment, in some cases for the recognition of revenues. In addition to all these standards, Income Computation and Disclosure Standards-IV (ICDS) on 'Revenue Recognition', which does not have the principles of materiality and prudence, is also to be followed by organizations. This mandates two sets of books to be maintained for tax and accounting purposes. All these standards and stringent tax laws might create a tendency of tax-evasion by organizations, which may also be termed as 'revenuede-recognition'. To arrest all such un-healthy practices, having a uniform set of rule-based standards for revenue recognition will help the economy better, especially to the telecom industry with a wide range of customer contracts.

KEYWORDS: *Telecom Player, Disclosure Standards-IV, IFRS, ICDS, Pre-Paid Cards, Internet Revenues.*

Introduction

Revenue from operations is usually the single largest figure in any profit or loss account. It refers to the amount what a business house receives from its normal business activities. It is the total amount of monies received by the business house for the goods sold or services provided in an accounting year. Because "One cannot manage what one cannot measure", it is important that there be and followed certain recognition and measurement principles of revenue. In this article, the author has made an attempt to throw light on the available standards for recognizing and measuring revenue, especially in the highly dynamic telecom industry that witnesses several complex transactions.

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Why the Telecom industry?

I am sure those who are aware of this will certainly agree with me. Long ago, owning a telephone was a luxury and was a symbol of status. Gone are the days, when owner of a telephone was required to file an Income tax return under the ¼ scheme of the Income tax Act,1961 (Later on this scheme has been withdrawn).There was only one service provider in the field i.e. the one owned by the Government of India. Though it was a monopoly, it could not reach rural India. The Indian telecom industry has undergone tremendous and unprecedented growth and contributed to the national economy. Thanks to the telecom revolution, the Government perceived the need for such a revolution and in its new avatar, Indian Telephone Department has become BSNL (Bharat Sanchar Nigam Limited) and penetrated to the rural India. The private players like Airtel and Idea have also entered into the market and penetrated to the rural areas. It is now not an exaggeration to say that a mobile phone has become dire need of the day. India has a strong telecommunication infrastructure in terms of telecommunication ratings and ranks ahead of its peers in the West and Asia. It has the second largest subscriber base in the world with a subscriber base of nearly 1,210.71 million (as of July 2017) . India has the third-highest number of internet users with 431.21 million internet subscribers (as of June 2017). This rapid and unprecedented growth in the industry have not only transformed the nation but also paved way for the recently reforms taken by the Modi government, especially , the 'Make in India' and the 'Digital India'. Many basic amenities, like the LPG, are linked to a mobile phone, making it mandatory for every house hold to own a mobile phone. Also mobile based Internet has become quite common and is a key component of Indian Internet usage, with 7 out of 8 users accessing internet from their mobile phones.

Emerging Trends in Telecom Industry

In addition to the above, the landscape of the industry is witnessing several trends as below:

- **Green Telecom:** Aimed at reducing carbon footprint of the telecom industry through lower energy consumption.
- **Expansion to Rural Markets**: There are over 62,443 uncovered villages in India; these would be provided with village telephone facility with subsidy support from the government's Universal Service Obligation Fund.
- **Emergence of Broadband Wireless Access (BWA) Technologies**: 4G service launched by Airtel in 2015 ; then by BSNL; Reliance-Jio launched its 4G services pan-India at free of cost.
- **Internet of Things**: This concept of electronically interconnected and integrated machines is quite vital in the development of smart cities.
- **Outsourcing Non-core Activities:** As part of the recent outsourcing trend, operators have outsourced functions such as network maintenance, IT operations and customer service.
- **Rising Investments:** Giants like Vodafone and Docomo have made investments in the order of a few hundreds of millions in technology.
- **Mobile Banking:** Recently, the number of mobile banking transactions ticked more than a billion and the government aims to multiply this 25-fold.[1]

That the telecom industry and infrastructure play a dominant role in the nation-building process, needs no mention. In view of the size and the number of transactions in the industry and being an ardent believer of the statement "Accountancy is a profession in the public interest", I would discuss the revenue recognition standards applicable (AS-9, IAS-18 or IND AS 18, IFRS 15 or IND AS 115 which is yet to be notified) in conjunction with the Income Computation and Disclosure Standards -IV (ICDS-IV).

Revenue Recognition

A revenue policy is a policy that is consistently followed by an organization in recognizing its revenues. Owing to the complexities of the telecom sector, the sector witnesses several types of incomes and expenses. Broad range of incomes in the industry include activation income, income from post-paid and pre-paid cards, internet revenues, inter-connect revenues, income from indefeasible rights of use, subscription income etc. The guidance that is offered in recognizing these incomes is given by AS-9 ("Revenue Recognition") as per the accounting standards issues by the Institute of Chartered Accountants of India (ICAI), IND AS 18 ("Revenue") which is the equivalent of IAS 18 and the IND AS -115 ("Revenue from Contracts with Customers" -yet to be notified and the equivalent of IFRS -15), as per the Indian GAAP . AS-9 and IND AS 18 however, offer limited guidance and does not offer guidance in respect of all kinds of transactions in the telecom industry. This brings in judgmental factors and leaves the treatment of certain incomes to the organization's ease. This creates differences in the treatment of same items of income for two different organizations, and hence the income tax paid by them. It is to be borne in mind that India is converging towards International Financial Reporting Standards (IFRS) in a phased manner and the organizations implementing the AS-9 would shortly (3 to 4 years) move to IND AS. Hence the current GAAP of India includes AS for certain companies and IND AS for certain companies. IFRS 15 or IND AS 115 is a standard that has emerged out of the deficiencies of the present standards and is yet to be notified. As is the importance of recognition of revenue, so is its de-recognition. In jurisdictions of tough tax regimes and stringent tax laws, organizations also resort to 'de-recognition' of income using creative accounting and other methods. Tax evasion methods are practiced and this means a lower income tax paid to the department. Hence lowering the revenue earned by the department.

Overview of IND AS-18 and Comparison with other Standards

According to IAS-18, revenue is the gross inflow of economic benefits during the period arising from the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants. Definition of 'revenue' given in the IAS AS 18 is broad compared to the definition of 'revenue' given in existing AS 9 because it covers all economic benefits that arise in the ordinary course of activities of an entity which result in increases in equity, other than increases relating to contributions from equity participants. While, as per the existing AS 9, revenue is gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise. After the difference in definition, here are a few further differences between IND AS 18 and AS 9.

- Revenue arising from agreements of real estate development is specifically scoped out from IND AS 18. Existing AS 9 does not exclude the same.
- As per existing AS 9, revenue is recognized at the nominal amount of consideration receivable. IND AS 18 requires the revenue to be measured at fair value of the consideration received or receivable.
- IND AS 18 specifically deals with the exchange of goods and services with goods and services of similar and dissimilar nature. In this regard specific guidance is given regarding barter transactions involving advertising services. This aspect is not dealt with in the existing AS 9.
- IND AS 18 provides guidance on application of recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. Existing AS 9 does not specifically deal with the same.[1]
- Existing AS 9 requires the recognition of revenue from interest on time proportion basis. IND AS 18 requires interest to be recognized using effective interest rate method.
- Existing AS 9 specifically deals with disclosure of excise duty as a deduction from revenue from sales transactions. IAS AS 18 does not specifically deal with the same.

Because of the above differences, those companies that follow AS – 9 for reporting in India and IAS 18 for reporting the consolidated figures, there are a few differences mentioned above in the way revenue is measured and recognized. So to say, IND AS 18 provides guidance more than AS-9 but is still deficient in certain transactions. For example, customers might pay at a time different from that when they receive goods or services, and an entity might provide the promised goods and services over many reporting periods. There may be many bundled transactions with multiple-elements etc. There is no guidance for these kinds of transactions in the existing GAAP.

IFRS 15 or IND AS 115

Though the Generally Accepted Accounting Principles (GAAP) has put fourth prescription of several practices in the form of standards, different entities have been adapting different methods in recognizing revenue. Since there are diverse set of practices as per the standards, the entities follow them conveniently to adapt and practice as per the transactions of business entity. Thus, recognition is not purely based on the principles, but also transacted situations which help in judging the issue. This obviously makes things different. Especially in the telecom industry, where the volume of bundled transactions is high, judgment is resorted to by companies, turning down a common platform for comparison. Hence came the IFRS–15–Revenue from Contracts with Customers, which is to be yet notified and followed as Indian GAAP as IND AS 115.

So, in a nutshell, IND AS 115 contains guidance for transactions not previously addressed (service revenue, contract modifications), improves guidance for multiple-element arrangements and requires enhanced disclosures about revenue.

Impact of IFRS-15 on Telecom Industry

IFRS-15, the standard on "Revenue from contracts with customers" impacts the telecom industry in the following ways:

- Significantly affects the timing of recognition of revenue and profits
- Current accounting systems and processes need a sea change – as the standard is more a conceptual approach. The concept of applying this approach and of producing the detailed disclosures required by the new standard in an industry typified by vast numbers of contracts and a multitude of product offerings may be so great as to compel entities to develop new systems.[1]
- The new standard requires the revenue from a contract be allocated to each distinct good or service provided on a relative standalone selling price basis, while the previous standards paved way for judgment for allocation of the same.
- Telecom operators usually witness customers modifying their contracts for increase or decrease of minutes or addition or removal of services. The current standard also guides the operators as how to account the change and whether to affect it retrospectively or prospectively.

IFRS 15 follows a five step framework as given below.

Five step Model Framework of IFRS-15

- Step-1 : Identify the contract with a customer
- Step-2 : Identify the performance obligations in the contract
- Step-3: Determine the transaction price.
- Step-4: Allocate the transaction price to the performance obligations in the contract
- Step-5 : Recognize revenue when the entity satisfies a performance obligation

Below is the illustration differentiating the accounting treatments between AS -9 (also IAS 18) and IFRS-15:

For example ABC Ltd, a telecom company gives free handset and 12 month network services at the cost of Rs. 5,000 p.m. Network Services package is Rs.4, 500 p. m and the handset cost is Rs.10, 000. Say the contract started on 01.10.2016. Revenue recognition as per IND AS-18 and IFRS -15 are as follows:

Particulars	**AS-9**	**IFRS-15**
Handset	0.00	4,686 (Refer Note-1)
Network Services	30,000 (5000*6)	25,314 (Refer Note-1)
Total	**30,000**	**30,000**

Note-1: Calculation of Revenue as per IFRS-15

Performance Obligation	**Stand Alone Selling Price**	**% on the total**	**Revenue**
Handset	Rs.10,000	15.62% (10000/64000)	Rs.9, 372 (60000*15.62%)
Network Services (12 months)	Rs.54,000 (4500*12)	84.38% (54000/64000)	Rs.50, 628 (60000*84.38%)
Total	**Rs**.64**,000**	**100.0%**	**Rs.60,000**

Revenue to be recognized for Network Services per month equals to Rs. 4,219 (i.e.; Rs. 50,628/12). Revenue to be recognized for Handset per month equals to Rs.781. (i.e.; Rs. 9,372/12). Under IFRS-15, Journal entries to be passed will be as follows:

- **When Handset is given:**

Unbilled Revenue a/c	…Dr	9,372	
To Revenue from sale of goods a/c			9,372

- **Providing Network Services:**

Receivable a/c	….Dr	5,000	
To Revenue from Network Services a/c (50,628/12=Rs.4, 219)			4,219
To Unbilled Revenue a/c (9372/12=Rs.781)			781

Thanks to the developments on the accounting side. International accounting standards in 1977 and subsequent accounting standards in our country have brought sea change in the accounting. Various standards were implemented to promote uniformity, harmony and convergence among the various practices of accounting.

ICDS-IV

In addition to the above, the ICDS are the applicable tax accounting standards for the purpose of income tax. ICDS-IV deals with revenue recognition. For sale of goods, ICDS is identical to AS – 9 but when it comes to the revenue from services, ICDS only mandates the percentage completion method where as the AS-9 allows completed contract method also. Most of the organizations recognize service income as per the completed contract method. The same is not included in ICDS and this might cause companies to maintain tax books as per percentage completion method for income tax purpose.[1] The criteria of ability to reliably measure the revenue for recognition of revenue is conspicuous by its absence in most circumstances under this ICDS IV. This is a direct impact of omission of 'prudence' as a factor to be taken into consideration while selecting accounting policies. As a result, wherever this ICDS becomes applicable. Recognition of revenue cannot be postponed on account of the inability to measure the revenue reliably except in cases where specific provision has been made by ICDS. ICDS also clarifies that in an agency relationship it is not the gross inflow of cash that is to be considered as revenue but only the amount of commission will be considered as the revenue. ICDS does not define interest. So the definitions in the Act (IT Act, 1961) shall prevail.

Differences between the Standards

Reading all the three in Conjunction, the following Major Differences may be observed:

Particulars	AS-9	IAS AS-18 Or IND AS 18	ICDS –IV	IFRS 15 Or IND AS 115
Revenue Recognition for service transactions	Allows Completed Service Contract Method & Proportionate Completion Method	Only Percentage of completion method	Only Percentage of completion method	Based on the contract and performance obligations
Measurement of revenue	Based on the consideration received or receivable.	Fair value of consideration received	Based on the consideration received or receivable.	Five-step model
Recognition of interest income	accrual basis	Effective interest method	Accrual basis	Based on the contract

Because of the differences in the concepts given above, it goes without saying that two sets of books have to be maintained by organizations–one for accounting and the other for tax purposes. With ICDS, the difference between the accounting income and taxable income is only going to widen. For small service providers, say courier services etc., the application of percentage completion method would be quite difficult practically. Moreover, ICDS do not have the concept of materiality or prudence, which would be that an organization, for example, capitalizes a stapler that is buys for its stationery. This will result in some companies coming under MAT since in the year in which expected loss from service transactions is booked in accounts, it will not be allowed for computing the taxable income. On the other hand, when for tax purposes such loss is allowed, the company may have book profit which may become taxable under section 115JB of the Act.

Study of RR Practices of Airtel and BSNL

In light of the complexity of the industry and various standards, suggesting different methods of recognition leaving judgment to the management and stringent tax laws, the corporate resort to adopting deceitful and willful practices or frauds. An attempt is made by the author to study the various methods of revenue recognition by two industry majors namely BSNL and Airtel and compare them with respect to certain important line items of revenue:

- Income received from the prepaid services provided by the company is recognized on the cash basis by BSNL i.e.., they recognize it as an income as soon as they receive cash for the prepaid services. According to the Airtel revenue recognition treatment, they recognize the income from prepaid services as per actual usage basis i.e..; they recognize the income so generated over the period of usage.

- The income generated from the installation of new connection will be recognized in the first year of billing as per the BSNL revenue recognition treatment whereas the installation charges will be recognized over the estimated customer relationship in the case of Airtel.
- The treatment of unbilled revenue in books of BSNL is they record it as accrued revenue during the period in which services are provided. In the case of Airtel, they are billed in subsequent periods based on the terms of billing plans/ contractual arrangement.
- For providing the bad debts BSNL considers the debts outstanding for more than two years whereas in the case of Airtel they consider the amounts outstanding for more than 90 days from date of billing for providing for bad debts.

From the above it is evident that the companies follow different methods of revenue recognition, not just as an accounting policy but also including judgmental decisions. The recognition is discretionary because of accounting flexibility. These different recognition methods impact the following areas of Sales from operations, Income from other operations, Profit & Profitability, Assets, Liabilities and financial Performance etc. It is needless to say that the financial statements of an entity reflects numbers and behind the numbers, the financial performance of the entity. The numbers speak income, expenses, assets and liabilities. Investors, shareholders, funders, credit agencies, creditors, employees, financial institutions, revenue departments namely Income Tax and GST and many end users will eye on all the numbers, remember them, use them, quote them and keep them in their memory. The financial statements are made well within the accounting standards.

De-recognition Practices in Telecom Industry

As mentioned earlier, in territories of tough tax regimes and stringent tax laws, organizations seek to minimize the tax expense. While world over sincere attempts are made for revenue recognition, unfortunately efforts are made for de-recognition of revenues by certain organizations. While fraud is a universal truth, the favorite playground for fraudsters is Telecom Industry. There are the various methods to de- recognize the revenues adopted by many corporate which fall under the umbrella of creative accounting. To mention some usual methods to deal with the numbers are Wrong numbers, Accounting red flags, Difference between gross and net revenues, Accounting frauds, Camouflage accounting, Sales manipulation game, Tax evasion, Material accounting manipulations, Characterization of income, Invoice Accuracy, Deferment, Postponement, Judgment, Concealment, Window dressing, Painting green or painting red or painting invisible, rapid accounting, False accounting, Misrepresentation or pushing at the boundaries of law, Innovative or aggressive or artificial or omission or not reporting or adapting unsuitable or recasting or restatement regrouping or re-classification or re-arrangement. Some companies often manipulate their inflating revenue, assets, cash inflow and understate expenses, liabilities and cash outflows. Inflation of earnings, understating expenses, red flags, frequent changes in accounting policies are resorted to. Hence it is needed that there be uniform accounting practices for accounting and taxation, without paving way for much judgment by the organizations.

Conclusion

Telecom Industry is large industry with wide operations and inherent complexities. The players give stiff competition to each other. The daily price war with daily innovative schemes is order of the day. Different standards failed to bring uniformity and harmony in recognizing revenue. Fraudsters resort to creative accounting. The culmination of all these reasons, are resulting to financial irregularities and cause harm to individuals, companies and society. Investors, employees, Banks, Lenders, Vendors and public are demoralized. This leads to destabilizing the economy. Efforts should be made to bring uniform accounting and reporting of financials by the regulators. Industry should not have flexibility in accounting except to go for uniform accounting.

Limitations of the Study

The present study is limited to analyze the revenue recognition practices of two Telecom industry majors. The exact amount of impact on account of different policies couldn't be ascertained for want of data.

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