THE FINANCIAL EXPRESS
Read to Lead

Is CAG audit of telcos a good idea?

Posted online: Friday, May 09, 2014 at 0000 hrs

A recent Supreme Court judgment on the subject of CAG audit requirement has raised many eyebrows. It is expected to have a far-reaching impact on investors who avail of government-auctioned natural resources, in general, and an immediate impact on telecom operators, in particular, in whose context the Supreme Court order permitting CAG audit has come.

The CAG initiated the audit after the Telecom Regulatory Authority of India (Trai) alleged that some operators were under-reporting the government's revenue share. In response to a petition by the operators, the Delhi High Court held that the CAG's constitutional powers are wide. Specifically in relation to the question of audit of telecom companies, it held that the CAG audit has to pertain to revenues and not all aspects such as 'wisdom and economy in expenditures', thereby restricting the scope of audit.

The Supreme Court, modifying the High Court order, held that it is not the statutory audit under the Companies Act or the special audit function as prescribed under the terms of the agreement between the licensor (the government via the Department of Telecommunications —DoT) and the licensee (the operator), but an inherent power of the CAG as the constitutional authority under Article 149 of the Constitution which comes into play.

The Supreme Court, however, provided a caveat to its order by saying that the CAG examination should be confined to statement of accounts for ascertaining that there is no loss to the exchequer. In coming to the conclusion, the Supreme Court didn't agree with the operators' association that the commencement of the CAG audit would depend on 'the formation of opinion' by the government or DoT that the statement of accounts submitted by it (operators' association) are inaccurate or misleading. The Supreme Court distinguished the power of the government derived from the licensing agreement and the power of the CAG as an independent constitutional authority.

To buttress its opinion, the Supreme Court relied upon established jurisprudence in the context of the importance of natural resources, in general, and the spectrum, in particular, as a scarce and finite resource belonging to the people of the country. The obiter sounded similar to the earlier judgments of the Supreme Court in the 2G spectrum allocation and Reliance natural gas matters.

A plain reading of the judgment reveals that it shall have a far-reaching impact and its consequences could be wide, encompassing all forms of natural resources such as minerals, hydrocarbons, etc, and spread across a wider range of industries including airlines, roads, etc. While businesses would grapple with this judgment, it seems that the Supreme Court, in coming to the conclusion on the telecom matter, merely interpreted the agreement between the licensee and licensor and hence has limited impact. Its obiter ideally should not impact all forms of auctionable natural resources. However, this judgment seems to give wider empowerment to the CAG to perform such audit on private or public or public-private partnership (PPP) models.

What is possible is an outcome similar to the 2G verdict, wherein the obiter of the Supreme Court suggested that the government shall have to pursue an auction policy for all forms of natural resources irrespective of executive powers. Thankfully, in a Presidential reference made by the government, this aspect was clarified. A similar situation has arisen and the recent judgment needs clarity insofar as its reach is concerned to avoid unintended consequences.

Mukesh Butani
The author is managing partner, BMR Legal. Views are personal

It would be simplistic to oppose the Supreme Court's decision that the Comptroller and Auditor General of India (CAG) is within its rights to audit the accounts of telecom companies.

The CAG's responsibility is to ensure that the collection and expenditure of government money complies with rules. It may not be cost-effective to track every paise spent by or owed to the government. However, revenues of the telecom sector last quarter were over R52,000 crore ($8.5 billion) and corresponding government receipts about R4,000 crore. Given these numbers, their scrutiny can hardly be termed overzealous, especially if the government's receipts are proportional to revenues.

The problem is real. The Department of Telecommunications (DoT) claims that private operators under-report revenues to escape fees. In 2012, it issued notices to almost all private operators and penalised some. The Telecom Regulatory Authority of India (Trai) wants new licensing norms to prevent losses to the exchequer.

However, the audit role of the CAG is not a solution. The audit will severely burden the operators and the CAG. The task is complex. The large fees paid by telecom companies depend on the types of licences, services provided and on the amount and type of spectrum they hold. There are nearly 200 licences, around 12 distinct players, and diverse services and tariff plans. The 2G, 3G, 4G spectrum currently in use have varied fees. Further, the operators also pay each other for connecting to each other and for sharing infrastructure like towers and optical fibre. There is little basis or precedent to rule out 'creative accounting', fraud, mischief, and from any source.

The fact is rules for telecom licensing and spectrum encourage under-reporting of revenues. Like it is for taxation, there is an incentive for the payer to hide revenues and income. This hurts government collections and rewards inefficient companies. However, there is an additional disadvantage. The company might be holding a scarce and precious resource like spectrum, thus denying its use to others, especially competitors. This is unforgivable in a country like India where over 90% of the sector's revenues are generated by wireless technologies that depend on the availability of spectrum.

The solution lies in computing government levies differently. A ready option is to link fees to the revenues of the sector, instead of those of an individual operator, as at present. So, if the government was to set fees at, say, 8% of sector revenues, for last year's revenues of R50,000 crore, it could collect the same R4,000 crore in proportion to the amount of spectrum it holds. Thus, if operator X holds 10% of spectrum, it would pay R400 crore as fees. This makes eminent regulatory sense and promotes much-needed efficiencies in the use of spectrum.

Some fine-tuning may be necessary to accommodate different types of spectrum. For example, 3G and 4G spectrum have better propagation characteristics than 2G. The regulator is qualified to evolve reasonable 'weighting factors' to accommodate these differences. Yes, the 8% and above is arbitrary, but less than the many different percentages that apply today to different types of licences and spectrum. The government could ask Trai to suggest an appropriate number to reflect revenue targets and policy goals. Trai can also recommend one-off corrections to bring the various licences and services at par, to operate the new rules from a set date.

Linking fees to sector revenues is logical and straightforward and can resolve many current disputes. It will eliminate the reasons why the Supreme Court and the government think the CAG needs to embark on the complex, costly and thankless task of auditing telecom companies.

Mahesh Uppal

The author is a telecom consultant