

### **Query No. 13**

**Subject: Recognition of gross receipt as revenue.<sup>1</sup>**

#### **A. Facts of the Case**

1. In June 1972, Government of India (GOI) constituted the Space Commission (SC) and established the Department of Space (DOS) to formulate and implement space policies and programmes in the country.
2. The Indian Space Research Organisation (ISRO) is the research and development (R&D) organisation of the DOS and is responsible for executing the programmes and schemes of the DOS in accordance with the directives and policies laid down by the SC and the DOS through ISRO centres/ units and the grant-in-aid institutions.
3. A company (hereinafter referred to as 'the company') was incorporated on 28<sup>th</sup> September, 1992 under the Companies Act, 1956 as a private limited company and is a wholly owned Government of India company under the administrative control of DOS.
4. The company is the commercial arm of ISRO and is mandated to promote and commercially exploit products and services emanating from the Indian space programme by utilising the capabilities, capacities, infrastructure and manpower of ISRO.
5. The company *per se* does not own any space based assets or manufacturing facilities except its corporate office. In the year 2008, the company was awarded 'Mini Ratna' status.
6. The major business areas of the company currently are:
  - (i) Provisioning of communication satellite transponders to Indian users;
  - (ii) Providing satellite launch services to domestic and international customers;
  - (iii) Marketing of direct downlinking of data from Indian Remote Sensing (IRS) satellites to International Ground Stations (IGS) and data products to Indian and international customers;
  - (iv) Building and marketing of satellites and satellite sub-systems for international customers and related services;
  - (v) Building satellites and establishing associated ground infrastructure for Indian strategic users;
  - (vi) Mission support services for foreign satellites.
7. The querist has stated that over the years, DOS/ ISRO has developed and launched the Indian National Satellite (INSAT) and Geosynchronous Satellite (GSAT) series of communication satellites; with transponders operating in C, Extended-C, Ku, UHF and S bands; for broadcasting (TV, DTH, DSNG) and communication applications (VSAT); and established the INSAT system. As and when the INSAT system's transponder capacity was found to be inadequate to meet the user demands, the company is directed to identify suitable transponder capacities from foreign satellite operators to augment the INSAT capacity by leasing. Such leased capacities provided to users are also considered to be part of INSAT's transponder capacity.
8. In the financial year 2014-15, the company earned about INR 1171.23 crores as revenue by providing capacities from the INSAT system. Out of this, the revenue from

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<sup>1</sup> Opinion finalised by the Committee on 9.6.2017.

providing INSAT/GSAT transponders to users is INR 487.07 crores (42%) and revenue from providing foreign satellite capacity to users is INR 684.16 crores (58%).

9. The querist has further stated that the statutory auditor, while auditing annual accounts of the company for the financial year 2014-15, requested the company to obtain the opinion of Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI), as to whether the existing practice of “recognising the gross receipt of ‘Space Segment Charges (SSC)’ in respect of INSAT/ GSAT transponder capacity (other than receipts in respect of foreign satellites capacity) as revenue in the books of the company”, is in order.

*Technical Background:*

10. Every communication satellite that is used for transmission of signals will contain devices called ‘transponders’. In a single satellite, there can be 12 to 60 such transponders. These transponders are mainly used for broadcasting (DTH, TV), DSNG and telecommunications (Public Switched Telephone Network and VSAT for closed user groups).

11. The capacity of a satellite is determined by multiplying the number of transponders on it with frequency bandwidth of each such transponder measured in ‘Mega Hertz (MHz)’. Each transponder is assigned equal and specific ranges of frequencies, each with a start frequency and end frequency, called as up-linking frequency range and down-linking frequency ranges as explained more elaborately in the following paragraphs. The difference between the start frequency and end frequency (of either up-link or down-link) is called the ‘bandwidth’ and is the accepted parameter for capacity.

12. As per the requirements of different customers, each of them is allotted a capacity in terms of a particular bandwidth. It is within this range of frequencies that the customer can throw up/transmit their signals into space. This activity is called ‘up-linking’. The transponder in the satellite will pick up the signals thrown up/transmitted by the customers and amplify them so that the said signals can be retransmitted back on a greater area called the ‘foot print’. The ground station of the customer will have the equipment to identify and receive such signals which are thrown back/retransmitted by the transponders in the specified frequencies. This activity is called ‘down-linking’.

13. For providing access to the satellite transponders to users so that this activity of picking up signals, amplifying them and throwing/ retransmitting them back into the space, the company charges the customers a consideration called ‘space segment charges (SSC)’.

14. The Union Cabinet approved the norms, guidelines and procedures for implementing the new Satellite Communications (SATCOM) Policy (copy supplied by the querist for the perusal of the Committee), as intimated by DOS Note dated 10-10-2000 (copy supplied by the querist for the perusal of the Committee). As per paragraph 2.3 - Basic Guidelines – “As a baseline making the INSAT capacity available to the commercial sector should be based on sound business lines, i.e., this activity should be on a ‘for profit’ basis and at the same time consistent with the Government policies in the concerned user sectors. As per paragraph 2.6, ‘Commercial and Contractual Factors’, all the commercial activities of INSAT space segment shall be carried out by the Department of Space (DOS) which means the organisation created in DOS for this purpose or the corporate structure meant for operating the INSAT system, if and when such an organisation is created. The querist has supplied a copy of SATCOM Policy and DOS Note for the perusal of the Committee. Since DOS had already incorporated the company

during 1992, no separate corporate structure for operating the INSAT system was created and the responsibility of commercialisation of the INSAT capacity was transferred to the company.

15. The activities of billing and revenue collection pertaining to leasing of the INSAT capacity were transferred from Department of Telecommunication (DOT) (XYZ Ltd.) to DOS from July 1, 2003 (copy of the communication from DOT to DOS has been supplied by the querist for the perusal of the Committee). Prior to this date, the revenue collection and recognition were done by XYZ, a corporate entity under DOT based on licence agreement entered into by DOT. (The querist has supplied a sample copy of the invoice raised by XYZ Ltd. for the perusal of the Committee.) As per the understanding of the querist, XYZ Ltd. recognised full amount shown in their invoice as its revenue and the cost of receiving the service from DOS was paid for by XYZ Ltd. to DOS. This cost was treated as expenditure in the books of XYZ Ltd.

16. The existing system of billing and revenue recognition is being followed in the company consistently since 2003 which is similar to the billing and revenue recognition adopted by XYZ Ltd. earlier.

17. DOS on behalf of Hon'ble President of India, since 2003, enters into contracts with the customers for providing 'Space Segment Capacity (SSC)' of the INSAT/GSAT systems.

18. The SSC for the INSAT/ GSAT satellites are fixed by the Government of India and included in the agreements. In contrast, SSC in respect of foreign transponder capacities are negotiated with the satellite operators and fixed by the company and included in the agreements for these capacities. As there are inter-departmental involvement in transponder leasing, like Department of Telecommunication, Department of Space, etc., the agreement is entered into between DOS and the end customer and not directly by the company, though negotiated by the company and the company is responsible for rendering the service of providing space segment.

19. The company, to fulfil its obligations, obtains the service from the INSAT/ GSAT satellites of DOS and provides the same to its end customers. Any tax liability, as per the current provisions of law shall be paid by the company on both as a service provider as well as recipient of service on reverse charge basis, if any.

20. The company is required to carry out various activities to render the service to its customers. Some such activities are provided herewith:

- (i) Procure services in the form of space segment from DOS and arrange leasing of the same to its customers.
- (ii) Billing of customers on a monthly / quarterly / annually / occasional use etc. basis at the rates, terms and conditions of the individual contracts. (The querist has supplied a copy of an invoice raised for the perusal of the Committee.)
- (iii) Realisation of payments against invoices raised on customers.
- (iv) Levying, collection and remittance of service tax to appropriate authorities, filing of tax returns and maintenance of related records according to the related tax statutes.
- (v) Market INSAT /GSAT space segment capacity both in local and global markets.

21. The company invoices SSC on monthly/ quarterly/ six monthly/ annually as per the agreements' terms as per rates prescribed in the agreements with the customers along with

service tax. The company is registered as a service provider as required under the provisions of Chapter-V of the Finance Act, 1994 and has been discharging service tax on the entire amount invoiced by it on INSAT/GSAT SSC and from 16.05.2008 for foreign satellite SSC. (The querist has supplied illustrative copies of the returns filed under the Finance Act, 1944 for the said period for the perusal of the Committee.)

22. *The cost of service rendered by DOS to the company is based on agreement (Memorandum of Understanding (MoU)) between DOS and the company and a fixed percentage of the contracted value with the end customer is agreed to be the cost of such service. The copy of Agreement/MoU has been separately provided by the querist for the perusal of the Committee. (Emphasis supplied by the querist.)*

23. Apart from the SSC, the company claims penal interest for delay in remittance of SSC by the customers as per the terms of the agreements and the said penal interest is treated as income of the company.

24. The company is currently raising invoices on the customers for SSC and recognizing the entire amount as revenue in its books of account. The cost of SSC, based on DOS Order (85%) is booked against each invoice raised for SSC. Since the invoices are raised based on the price fixed by GOI, the company cannot negotiate the price with the customers or offer any discount on INSAT/GSAT SSC.

25. On receipts from customers, the actual receipts of SSC portion of the INSAT/ GSAT satellites are transferred to DOS and 15% of the SSC is claimed as the company's share from DOS on a quarterly basis as per procedure for sharing of revenue from leasing of INSAT/GSAT satellite transponder capacity. The company retains the penal interest received and accounts it as 'other income'.

26. The querist has also separately informed that the credit risk for the amount receivable from the customers is borne by the company. The company provides for doubtful debts in case of dues for more than three years based on the recommendation of a Debtor Review Committee constituted on direction by the Board and in accordance with the company's accounting policy. The company has also written off bad debts in the past and hence, the credit risk is borne by the company. Further, legal action against customers for recovery of dues, wherever required, is also taken by the company.

## **B. Query**

27. On the basis of the above, the querist has sought the opinion of the Committee as to whether inclusion of the gross revenue from operations for providing the INSAT/GSAT satellite capacity to customers is in order. If not, whether the company's share of revenue in respect of these capacities alone is to be considered as revenue to the company in view of the existing relationship between the company and Department of Space (DOS).

## **C. Points considered by the Committee**

28. The Committee notes that the basic issue raised by the querist relates to whether inclusion of gross revenue from operations for providing the INSAT/GSAT satellite capacity to customers is in order. Therefore, the Committee has examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, timing of recognition of costs and revenue, accounting treatment of receipts/SSC in respect of foreign satellites/transponders capacity or any other income being earned by the company, etc. Further, the Committee wishes to point out that its opinion is expressed purely from accounting perspective and not from tax (income tax or service tax) or legal perspective. Incidentally, the Committee notes that under the MoU entered into between the Department of Space and the company, the terms, 'revenue sharing/share of profits' or

'fee' in lieu of services rendered by the company to DOS/value of works carried out by the company, have been used interchangeably; however, the same does not affect the opinion expressed hereinafter.

29. As regards the issue raised by the querist with regard to recognition of revenue on gross basis or net basis, the Committee is of the view that the same would depend upon the capacity in which the company is working vis-à-vis DOS, viz., whether the company is acting as an agent of the DOS or not. In this regard, the Committee notes the following from the Memorandum of Understanding between DOS and the company:

- (i) Being *commercial arm of ISRO*, the company is the only company charged with the *administration* of contracts of this nature with third party clients for provision of space segment capacity. The company shall interface with the customers and DOS for administering such agreements, raise invoices, collect charges for provision of capacity as per agreements and do all such acts necessary to fulfil its contractual obligations towards such third party in the regular course of business.
- (ii) The company will charge a fee, from DOS for all services rendered to DOS as part of the contracts entered into between the company and third parties, for all the functions related to space segment capacity.
- (iii) DOS enters into agreement with Indian and Foreign users for provision of the INSAT transponder capacity.
- (iv) The revenue sharing arrangement between DOS/ISRO and the company for INSAT/VSAT transponder leasing is 85:15. The revenue sharing arrangement shall be based on estimates of the value of works carried out by ISRO/DOS and value of works carried out by the company.
- (v) The entire revenue collected by the company *on behalf of DOS* has to be first transferred to DOS/*Government* of India and then the company may claim their due share on a quarterly basis from DOS/ Government of India. ... The company's share of profit is later remitted by DOS.
- (vi) DOS may revise this revenue sharing formula from time to time. The revenue sharing so finalised is binding on the company.

The Committee also notes from the MOU/Agreement signed between the DOS and the customer for provision of space segment capacity in the INSAT/GSAT systems that the company will act as the contract manager/administrator to administer the MOU/Agreement and all the services under the contract are actually provided by the DOS/ISRO using their facilities/assets. Further, all the decisions under the contract, such as, for any addition/reduction in the capacity provided by the DOS, sub-leasing of the transponder capacity, termination of contract, forfeiture of caution deposit, etc. are taken by the DOS. Moreover, the prices/charges to be charged to the customer and any revision in the same is decided by the DOS, as per its pricing policy. DOS is also liable to indemnify and hold customer harmless from any loss, damage, liability, etc. arising from DOS' exercising use, control or operation of the concerned satellite. The Committee also notes that although invoices are raised in the name of the company, the actual contract with the customers is entered into by the DOS. As far as credit risk is concerned, the Committee notes from the MOU between the company and the DOS that the revenue sharing between the DOS and the company shall be *on collection* after accounting for expenditure on the activity, taxes and duties, etc. The Committee further notes from the

Exhibit-B, Payment Schedule to the agreement of the DOS with the customer (a private company), as provided by the querist for the perusal of the Committee, *inter alia*, provides that the DOS shall have the right to black out the provisioned capacity if customer defaults on payments as stipulated in this agreement and that upon signing of the contract, customer will require to deposit with the DOS a refundable and interest free 'Caution Deposit' which shall be refunded at the end of agreement upon reconciliation of accounts and remittance of all dues under the agreement. Further, the agreement with the customer also, *inter alia*, provides that DOS has the right to terminate the agreement, including forfeiture of caution deposit, if the customer fails to make two consecutive periodic payments for space segment capacity. These clauses indicate that credit risk is not borne by the company as the revenue sharing will be on collected amount and any non-payment of dues by the customer shall be adjusted against the caution money deposited. Moreover, it appears to the Committee that the company claims to be bearing the credit risk on the ground that the company has provided for and written off bad debts in the past on the debtors/receivables which the company has recognised on the basis of gross revenue in its financial statements, as per the accounting policy followed by it. In this regard, the Committee is of the view that mere accounting treatment accorded by the company does not determine whether the company bears the credit risk or not. Further, the Committee is of the view that bearing of credit risk is not the only relevant indicator to determine the capacity (viz., principal or agent) in which the company may be working; rather other factors, such as, control over the goods/services before these are provided to customers, discretion in establishing prices, etc. in the specific facts and circumstances of the company should also be considered.

30. From the above, the Committee is of the view that the company, while interfacing with the customers for provision of space segment capacity, is only rendering administrative services as contract manager to the DOS, for which it is being paid a fixed fee and is, therefore, acting only as an agent of the DOS. Accordingly, the principle of revenue recognition for agency relationship as enunciated in the following definition of 'revenue' as per Accounting Standard (AS) 9, 'Revenue Recognition', notified under the Companies (Accounting Standards) Rules, 2006 should be applied in the extant case:

***"4.1 Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration."***

From the above, the Committee is of the view that in the extant case, revenue for the company is the amount of fees received by it as agent of the DOS and not the amount of invoice or gross inflow. Therefore, the accounting treatment followed by the company of inclusion of the gross revenue from operations for providing the INSAT/GSAT satellite capacity to customers is not in order and only the fee received from the DOS on this account should be recognised as revenue of the company, following the principles of AS 9.

#### **D. Opinion**

31. On the basis of the above, the Committee is of the view that the existing practice of

the company to recognise the gross revenue from operations for providing INSAT/GSAT satellite capacity to consumers is not in order considering the principles of AS 9; rather the company's share of revenue, i.e., the amount of fees received in respect of these capacities alone is to be considered as revenue to the company in view of the existing relationship between the company and Department of Space (DOS), as discussed in paragraphs 29 and 30 above.

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