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Communication NewsFlash

What are the most prevalent sources of revenue fraud within a telecommunication operator, and how can these risks be managed?

In this issue

Introduction

Over the past decade there have been significant changes and advances in telecommunications technology. A side effect of this has been a parallel increase in ability to perpetrate fraud. This increase has been caused by an easing in the complexities to commit fraud, together with an ability to generate significant revenue losses over a relatively short period of time.

Reasons for the increasing incidence of revenue fraud are many, and some examples are listed below;

- The continual striving for greater efficiencies in business.
- The increasing use and reliance on technology and the associated changes in payment systems and channels.
- The flattening of organisational structures.
- Rapid & continuous changes to business operations.
- The inability of the criminal justice system, the police, other regulatory bodies and the Courts, to keep pace with the ever-increasing workload and complexity of matters reported to them.

Telecommunication operator fraud management can be split into three key areas; technology, resources and processes. Whilst technology plays an important part, of equal importance is a well-structured security aware organisation with strong management controls around fraud risk. Although an element of fraud is perpetrated "because they can" (SIM cloning for example), a significant fraud driver is the ability to generate revenue.

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Challenges faced by telecommunication operators, which can pressurise a business into taking high risk decisions, and ultimately leading to needless revenue losses, include:

- Falling profits per customer
- Rising marketing and promotion costs
- Cut-throat competition
- High network acquisition costs
- Falling returns against increasing call volumes
- Outgrowing business processes, and failing to incorporate effective control structures

Examples of revenue fraud risks

Some of the more likely revenue fraud risks faced by telecommunication operators include;

Arbitrage - International number is masked as a "non-premium" destination. Calls from overseas are charged at standard rates where as "B" party are charging a significant interconnect fee back to the "A" party country

Call Selling - Onward sale of high tariff calls often with a local number being diverted internationally. Risk increased through "call stacking". Long duration "trunk seizure" where a line is held open for 24 hours and duration is detected upon completion.

Roaming - Associated with call selling, premium rate and arbitrage fraud. Delay in processing CDRs or TAP files leads to significant interconnect losses.

PABX/DISA - Remote access (DISA) capability allowing authorised users to dial into the PABX, and entering an authorisation code to receive dial tone.

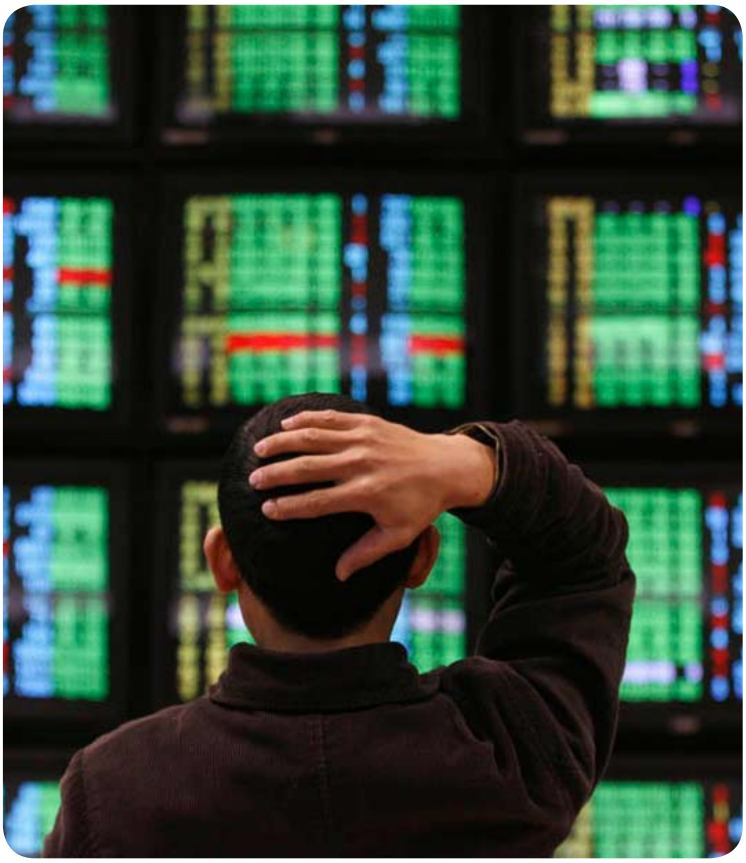
PRS ("premium rate services") - Dishonest inflation of revenue payable to the PRS provider by organising calls into their service, which subsequently not being paid.

Ghosting - Manipulation of network or supporting systems to facilitate fraud. Whole batches of call records are removed prior to billing or, simply not generated.

"SIM/Black/Blue boxing" - Wholesale reseller brings overseas traffic into the country. Calls are routed to end user through "SIM box", where multiple SIM cards have been programmed to utilise cheap/free call rates.

Is your business at risk from revenue fraud? If you are unsure, ask yourself the following ten questions:

1. How much ($) is provided for bad and doubtful debt?
2. How much consumer debt ($) is written off?
3. Has your business carried out a fraud risk assessment?
4. Does your business have an agreed Fraud and Corruption Control Plan?
5. Does a process exist for identifying and reporting fraud across all divisions and operating units of your business?
6. How much fraud was reported in the last financial year ($value, number and classification)?
7. Is the level of fraud reported in proportion to debt provisioning?
8. Do controls exist to monitor and identify channel (third party reseller) fraud?
9. To what extent do adequate controls exist around international and premium usage?
10. How confident are you that you understand the full extent of revenue fraud exposure in your business?



Revenue assurance:
prevent your margins from leaking away

Several sources estimate revenue leakages in the telecommunications industry at 3% to 7% of the total revenue. Although objective verification of these numbers may be impossible, the outcome of revenue assurance projects confirms that the amount of revenue leakages can be significant, and investments in a revenue assurance function may pay off quickly.

What is it?

Revenue assurance is a terminology used for several purposes. Usually it is either used to mean "activities to maximize revenue", or a "department in charge of the revenue assurance function". Revenue assurance procedures usually include the identification of, and a correct response to, errors in the process of capturing revenue. These procedures may capture the entire cycle from service delivery, through primary recording, pricing and invoicing to cash collection. A more sophisticated process will also include procedures such as the prediction of generating (additional) revenue, which may be triggered by the launch of new products, analytical reviews and variance analysis, and technical features like test dialing facilities.

When is it used?

Revenue assurance is usually found in situations where the revenue process is far from straightforward. The increased variety in services provided and in tariff structures has brought revenue assurance to the attention of the Board of Directors. Other reasons are: a response to operational underperformance (real or perceived), particularly in the billing and the collection cycle, and the search for opportunities to maximize the revenue of existing activities, in particular in cases where the market is close to saturation. Not so commonly used, but very well possible, is the usage of revenue assurance to prepare "what-if" scenarios to support important business decisions, for example the profitability of planned network investments or a the launch of a new product.

A dedicated revenue assurance function and a structured set of revenue assurance procedures are not yet common practice in every telecommunication operator. Unfamiliarity, satisfaction with the current performance, and doubt about its benefits are the most common reasons for this.

The revenue assurance function

In practice, there are several ways the revenue assurance activity is structured in the organization. Technically orientated revenue assurance department will have the necessary technical skills, but may lack the knowledge and the attitude to develop and implement revenue assurance in a procedural way. The opposite may apply, when the revenue assurance function is structured as part of the business or the Finance department. Some alternatives often seen in practice are:

1. Revenue assurance as part of the technical function, with a direct functional line to the Finance.
2. Revenue assurance as part of the finance department. The technical component is covered by assigning technical subject-matter experts to revenue assurance.
3. An independent revenue assurance function with specialists from technical, business and financial fields.

Typical processes in the revenue assurance function include: capturing of billable events; completeness of billing; including usage of the proper tariffs; completeness of cash collection; correct treatment of accounts receivable beyond due date; and an overall end-to-end reconciliation. Test dialing is frequently used as an additional procedure, in particular since this process can be highly automated. Note, however that certain types of fraud will not be detected by test dialing. An example is the misuse of free-number facilities.

Implementation of revenue assurance

Implementation of a revenue assurance function usually requires external support. An obvious advantage is that the company will gain maximum benefit from expertise obtained in the industry and lessons learnt in previous implementations. Another advantage is that an external specialist will be able to help you to tailor the revenue assurance to your needs, applying the best mix of processes and tools that will fit your specific circumstances. Important variables are: the nature and size of your organization, your current market and future estimated market developments, and other objectives to be realized. Do you want to focus on maximizing the capturing process of your current revenue? Do you want to be able to estimate the impact, including cost-benefit analysis, of new targeted markets or products? Or do you want to focus on opportunity losses (in this case the term revenue maximizing is often used)?

Global Revenue Assurance Professionals Association

The Global Revenue Assurance Professionals Association (GRAPA) has offered certification for telecommunications professionals since 2009. They have developed a set of standards for revenue assurance, and they organize conferences on a regular basis. Training sessions for certification are held on a regular basis in several places across the world. Their online library contains a number of interesting articles and books for further reading and study.

IFRIC 13 Customer Loyalty Programmes

Introduction

In line with the International Financial Reporting Standard ('IFRS') convergence program launched by the Indonesian Institute of Accountants, one of interpretations that that needs to be considered is the application of the International Financial Reporting Interpretations Committee (IFRIC) of IFRIC 13, Customer Loyalty Programmes. IFRIC 13 has implications for telecommunication operators. This journal considers the accounting and the practical implications that arise from the guidance in IFRIC 13. Telecommunications companies operate in a highly competitive environment. For many operators, the focus has moved from acquiring new customers to maintaining market share and encouraging the customer base to increase usage. One manifestation of this change in emphasis is the proliferation of customer incentive and customer loyalty programmes. The accounting practice for customer loyalty arrangements in the telecommunication sector has been varied. IFRIC 13 was issued to bring consistency and comparability to accounting for loyalty programmes across industry sectors. While understanding the technical provisions of the interpretation is important, it is only half the battle. As operators prepare to apply IFRIC 13 in upcoming interim and annual financial statements, the practical implications in terms of data gathering and changes to systems and processes are becoming apparent.

Why IFRIC 13 issued?

Customer loyalty programmes are widespread. Telecommunication operators, retailers, airlines, hotels and similar businesses offer many incentives to their customers. The incentives offered through loyalty programmes often take the form of a "points" scheme, in which customers earn points for purchasing goods or services. The customers can redeem the points for free or discounted goods and services. This publication explores the accounting for award credits, or points, under IFRIC 13 Customer Loyalty Programmes (IFRIC 13).

How will IFRIC 13 affect telecommunication operators?

Most telecommunication companies operate in a highly competitive environment and invest significantly in acquiring and retaining customers. Their incentive arrangements typically include:
- Free gifts (such as MP3 players or digital cameras) on signing or renewing a contract for service.
- Arrangements in which customers can earn the right to a discount on equipment (handsets, modems and other devices) or service on the condition that they renew their service contract.
- Awards that entitle customers to discounted goods and services from their telecommunication service provider.
- More complex arrangements that include points that entitle the holder to discounted goods or services provided by another company (for example, the ability to earn air miles).

In our view, there are two key areas of consideration for telecommunication operators:
1. Which customer incentive arrangements are within the scope of IFRIC 13?
2. If the arrangement is within the scope, how can the fair value of the incentive be determined?
3. Before examining these two specific areas, we have summarised, below, the principal requirements of IFRIC 13.

So, what exactly is a loyalty programme?

According to IFRIC 13, a customer loyalty programme has the following characteristics:
- Entities use loyalty programmes to give incentive to customers to buy additional goods or services.
- Entities grant credits (in the form of points) to customers with each purchase of goods or services. Customers may redeem the points to receive free or discounted goods or services in the future.
- The programmes can operate in a variety of ways:
  - Customers must collect a minimum number or value of points before redeeming them.
  - Customers may earn points on a single purchase or on contract renewal over a specified period.
  - Either the entity or a third party may run the programme.

Historically the accounting for loyalty points has been varied. But IFRIC 13 treats points as something sold in their own right as part of a multiple element arrangement. Although not part of the interpretation itself, the IFRIC also clarified that points are distinct from marketing expenses because they are granted to a customer as part of a sales transaction. Marketing expenses, in contrast, are incurred independently of the sales transactions they are designed to secure.

IFRIC 13 clarifies that loyalty programmes are multiple element arrangements, in which the consideration received for the sale of goods or services (from which points are earned) is allocated between:
1. The goods or services delivered; and
2. The points that will be redeemed in the future.

The consideration should be allocated to the goods or services initially provided and to the points, based on their fair value. Fair value is defined as the amount that the points could be sold for on a stand-alone basis. The consideration allocated to the points should be presented as deferred revenue on the balance sheet and should be released to the income statement when the points are redeemed or expire.

A customer incentive arrangement is included within the scope of IFRIC 13 if both of the following conditions are met:
- The entity grants points to its customers as part of a sales transaction - that is a sale of goods or a rendering of services; and
- Subject to meeting any further qualifying conditions, the customers can redeem the points in the future for free or discounted goods or services.

It follows that IFRIC 13 does not apply where there is no link to a sales transaction. An example is a voucher for a price reduction on a handset included in a newspaper promotion.

What is fair value?

Consideration received or receivable from customers is allocated to the various elements of the arrangement using fair values. This might be estimated using just the fair value of the points or the relative fair values of the points and the goods or services sold. IFRIC 13 allows management's judgment and does not mandate a specific approach for estimating a point's fair value. The guidance also recognises that there may not be an observable market for the incentive and hence an estimate will be required. The fair value of a point is expected to be based on:

- The discount that the customer will receive, that is, "the amount the customer will save"; and
- The expected redemption rate of the points.

Fair value is the amount the customer will save by redeeming the points. The face value of a point is not necessarily its fair value. It is also necessary to take into account the redemption rate assumed in respect of the points. While the redemption rate should be revisited each balance sheet date, the amount of revenue deferred in respect of the points is not remeasured. The rate of recognition of the deferred revenue is adjusted for any changes in redemption rates.

Principal or agent?

IFRIC 13 requires an entity issuing points to determine whether it is collecting revenue on its own account (as principal in the transaction) or on behalf of a third party (as an agent). When the entity is collecting revenue on behalf of a third party, it earns commission income:

- Commission income is the net amount - the difference between the consideration allocated to the points and the amount payable to the third party supplying the points.
- Commission income should be deferred until the third party is obliged to supply the awards and is entitled to receive consideration for doing so.

When the issuing entity is acting as principal and is collecting consideration on its own behalf, then revenue should be measured as the gross consideration. An element of the revenue, however, clearly will need to be deferred until the points are redeemed or expire.

Revenue or other income?

The points might be redeemed against goods or services not supplied in the normal course of business.
There are two aspects to consider:

1. Typically a company would not buy or trade goods that are not used in its ordinary course of business, so a third party is likely to be involved. Hence, it will be necessary to determine whether the operator is acting as agent or as principal.
2. When no third party is involved, the guidance in IAS 18 should be applied to determine whether the income statement credit is to revenue or to other income. The standard defines revenue in the context of "the ordinary activities of the entity". Determining the ordinary activities, and therefore distinguishing revenue from other income, is not always clear. Indeed, an item could be revenue for one operator but other income for another in the same market. The facts and circumstances of the business and the transaction should be considered on a case-by-case basis.

What data does the company need to collect?

Operators that issue points will need to collect sufficient information to enable them to estimate the individual fair value of the points, expected level of redemptions, actual redemptions and cancellations/lapses. The following list illustrates how individual fair value should be determined.

Type of incentive	Indicative individual fair values
Money-off coupon or voucher attached to a product	Cash value of coupon or voucher
Points earned as goods or services are purchased	Based on the value of the goods or services the points can buy or on the price at which they can be sold
Points earned from the operator that can be used in other stores	Based on the value of the goods or services the points can buy

Historical information often will provide the best evidence to support an estimate of the redemption rate. However, the assumptions used in highly complex arrangements may need to be discussed with a valuation specialist.

The recently issued VAT implementing regulations (i.e. MoF regulations) which confirm possible impact to the telecommunication operators

The following are the main changes in the recently issued VAT implementing regulations which have a possible impact to the telecommunication operators:

Export of Taxable Services

- The amended VAT law provides that export of services is subject to 0% VAT, however the Minister of Finance (MoF) is authorised to regulate the limitation and types of such services.
- The MoF Regulation No.70/PMK.03/2010 dated 31 March 2010 defines that the 0% VAT is only applicable to the following services :
  a. Toll manufacturing services, with certain conditions, among others, that the manufactured goods should be exported.
  b. Repair and maintenance services which are attached to services or movable goods utilised outside the customs area.
  c. Construction services, i.e. consultation on construction planning, construction work performance, construction work supervision, which are attached to services or immovable goods located outside the customs area.
- Export of other services, for example interconnection services rendered to offshore telecommunication operators would be subject to 10% VAT.

It has been common practice in the business of telecommunication operators whereby they do not charge any VAT on interconnection services rendered to offshore telecommunication operators because the services are consumed overseas. This view was confirmed in several private tax rulings and several tax court appeal decisions issued to several telecommunication operators.

This MoF Decree may however change the practice in the telecommunication operator companies as in the following:

- The telecommunication operators will have to charge 10% VAT on interconnection services rendered to foreign telecommunication operators; or
- If the supplies for the interconnection services are treated as a non-taxable delivery, the Indonesian tax office (ITO) will require the companies to recalculate its their creditable input VAT at the end of the year.

Tax Invoices

Previously, a tax invoice may be issued by the end of the month the incurrence of the underlying taxable event (delivery of taxable goods or taxable services).

In the amended VAT law and its implementing regulation, in principle a tax invoice must be issued at the same time as the incurrence of the underlying taxable event (delivery of taxable goods or taxable services). However, if a payment takes place before the underlying taxable event, a tax invoice must be issued at the payment date. Where a project is delivered in stages and paid on a term basis, a tax invoice must be issued upon the receipt of each term payment. Alternatively, a combined tax invoice can be issued for one-month deliveries of taxable goods or services to the same buyers or customers at the end of the relevant month.

There is no further guidance on or definition of the time of delivery and for taxable services providers, including telecommunication operators, the time to raise a tax invoice must be carefully reviewed. They may have to issue a combined VAT invoice for one-month deliveries of taxable services to the same customers at the end of the relevant month (to the extent that payment is received after the delivery of the taxable services). Late issuance of a VAT invoice is subject to a penalty at 2% of the Tax Base (the invoice amount).

Code of conduct The way we do business*

Putting our values in action

Excellence	Teamwork	Leadership
Delivering what we promise and adding value beyond what is expected.	The best solutions come from working together with colleagues and clients.	Leading with clients, leading with people and thought leadership.
We achieve excellence through **innovation, learning and agility.**	Effective teamwork requires **relationships, respects and sharing.**	Leadership demands **courage, vision and integrity.**

This summary is not intended as professional advice. It is suggested to always consult with your usual PwC contact.

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Your PricewaterhouseCoopers Indonesia contacts

For further information on how PricewaterhouseCoopers Indonesia can assist you, please contact one of the following specialists based in our Jakarta office:


Eddy Rintis
+62 21 528 91040
eddy.rintis@id.pwc.com


Rizal Satar
+62 21 528 90350
rizal.satar@id.pwc.com


Irhoan Tanudiredja
+62 21 528 90500
irhoan.tanudiredja@id.pwc.com


Ay Tjhing Phan
+62 21 528 90658
ay.tjhing.phan@id.pwc.com


Chrisna Wardhana
+62 21 528 90678
chrisna.wardhana@id.pwc.com


Cornelis P Poelman
+62 21 528 90683
cornelis.p.poelman@id.pwc.com


Triono Soedirdjo
+62 21 528 91033
triono.soedirdjo@id.pwc.com


Harry Tanoto
+62 21 528 90739
harry.tanoto@id.pwc.com


Subianto
+62 21 528 90992
subianto.subianto@id.pwc.com

Plaza 89
Jl. H.R. Rasuna Said Kav. X-7 No.6
Jakarta 12940 - INDONESIA
P.O. Box 2473 JKP 10001
Telp: +62 21 5212901
Fax: +62 21 5290 5555/5290 5050