Statement of Financial Accounting Standards No. 51

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Financial Reporting by Cable Television Companies

November 1981

Financial Accounting Standards Board
of the Financial Accounting Foundation
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FAS 51: Financial Reporting by Cable Television Companies

FAS 51 Summary

This Statement extracts the specialized accounting principles and practices from AICPA Statement of Position 79-2, *Accounting by Cable Television Companies,* and establishes standards of financial accounting and reporting for costs, expenses, and revenues applicable to the construction and operation of a cable television system. During a period while a cable television system is partially under construction and partially in service (the prematurity period), costs incurred that relate to both current and future operations shall be partially capitalized and partially expensed.

INTRODUCTION

1. As discussed in FASB Statement No. 32, *Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters,* the FASB is extracting the specialized [1] accounting and reporting principles and practices from AICPA Statements of Position (SOPs) and Guides on accounting and auditing matters and issuing them in FASB Statements after appropriate due process. This Statement extracts the specialized principles and practices from SOP 79-2, *Accounting by Cable Television Companies,* and establishes financial accounting and reporting standards for certain costs, expenses, and revenues related to cable television systems.

2. The FASB currently has a project under consideration for the effect of rate regulation on accounting for regulated enterprises. Under current practice, the Addendum to APB Opinion No. 2, *Accounting for the "Investment Credit,"* applies only to businesses that are regulated for rate-making purposes on an individual-company-cost-of-service basis and, therefore, does not apply to the financial statements of cable television companies.

3. The Board has concluded that it can reach an informed decision on the basis of existing information without a public hearing and that the effective date and transition specified in paragraph 16 are advisable in the circumstances.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Prematurity Period

4. Before revenue is earned from the first subscriber, management shall establish the beginning and end of the **prematurity period,**[2] subject to a presumption that the prematurity period usually will not exceed two years. The prematurity period frequently will be shorter than two years; a longer period may be reasonably justified only in major urban markets. After the prematurity period is established by management, it shall not be changed except as a result of highly unusual circumstances.

5. A portion [3] of a cable television system that is in the prematurity period and can be clearly distinguished from the remainder of the system shall be accounted for separately. Such a portion would have most of the following characteristics:

a. Geographical differences, such as coverage of a noncontiguous or separately awarded franchise area
b. Mechanical differences, such as a separate head-end [4]
c. Timing differences, such as starting construction or marketing at a significantly later dated.
d. Investment decision differences, such as separate break-even and return-on-investment analyses or separate approval of start of construction
e. Separate accounting records, separate budgets and forecasts, or other accountability differences

Costs incurred by the remainder of the system shall be charged to the portion in the prematurity period only if they are specifically identified with the operations of that portion. Separate projections for the portion shall be developed and the portion's capitalized costs shall be evaluated separately during the prematurity period for recoverability (paragraph 14).

6. During the prematurity period:

a. Costs of cable television plant, including materials, direct labor, and construction overhead shall continue to be capitalized in full.
b. **Subscriber-related costs** and general and administrative expenses shall be expensed as period costs.
c. Programming costs and other system costs [5] that are incurred in anticipation of servicing a fully operating system and that will not vary significantly regardless of the number of subscribers shall be allocated between current and future operations. The proportion attributable to current operations shall be expensed currently and the remainder shall be capitalized. The amount to be expensed currently shall be determined by multiplying the total of such costs for the month by the fraction described in paragraph 7 determined for that month.

7. The following fraction shall be determined each month of the prematurity period. The denominator of the

fraction shall be the total number of subscribers expected at the end of the prematurity period. The numerator of the fraction shall be the greatest of (a) the average number of subscribers expected that month as estimated at the beginning of the prematurity period, (b) the average number of subscribers that would be attained using at least equal (that is, straight-line) monthly progress in adding new subscribers towards the estimate of subscribers at the end of the prematurity period, and (c) the average number of actual subscribers.

8. During the prematurity period, depreciation and amortization expense shall be determined by multiplying (a) the monthly depreciation and amortization of total capitalized costs expected on completion of the prematurity period by (b) the fraction described in paragraph 7, using the depreciation method that will be applied by the company after the prematurity period.

9. The amount of interest cost that is capitalized during the prematurity period shall be determined in accordance with FASB Statement No. 34, *Capitalization of Interest Cost*, by applying an interest capitalization rate determined in accordance with paragraphs 13 and 14 of Statement 34 to the average amount of qualifying assets [6] for the system during the period. Qualifying assets shall be determined in accordance with the guidance in paragraphs 16 and 18 of Statement 34. The amount of interest cost capitalized shall not exceed the total amount of interest cost incurred by the cable television system in that period.

Amortization of Capitalized Costs

10. Costs that have been capitalized in accordance with paragraph 6(c) shall be amortized over the same period used to depreciate the main cable television plant.

Hookup Revenue and Costs

11. Initial hookup revenue shall be recognized as revenue to the extent of **direct selling costs** [7] incurred. The remainder shall be deferred and amortized to income over the estimated average period that subscribers are expected to remain connected to the system.

12. Initial subscriber installation costs, including material, labor, and overhead costs of the drop,[8] shall be capitalized and depreciated over a period no longer than the depreciation period used for cable television plant. The costs of subsequently disconnecting and reconnecting shall be charged to expense.

Franchise Costs

13. Costs of successful franchise applications shall be capitalized and amortized in accordance with the provisions of APB Opinion No. 17, *Intangible Assets.* Costs of unsuccessful franchise applications and abandoned franchises shall be charged to expense.

Recoverability

14. Capitalized plant and intangible assets shall be evaluated periodically to determine whether the costs are

recoverable (through operations or sale of the system). If recoverability is doubtful, capitalized costs shall be written down to recoverable values. Capitalization of costs shall not cease when the total cost reaches an amount that is not fully recoverable. Capitalization of costs shall continue, and the provision required to reduce capitalized costs to recoverable value shall be increased.

Amendment to Statement No. 32

15. The reference to AICPA Statement of Position 79-2, *Accounting by Cable Television Companies*, is deleted from Appendix A of Statement 32.

Effective Date and Transition

16. The provisions of this Statement shall be effective for fiscal years beginning after December 15, 1981. Earlier application is permitted but not required. The provisions of this Statement may be, but are not required to be, applied retroactively for previously issued financial statements. If applied retroactively and if the estimates of subscribers needed to make the calculations required by some provisions of this Statement are not readily available, actual historical subscriber data may be used instead.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

Appendix A: GLOSSARY

17. This appendix defines certain terms that are used in this Statement.

Cable Television Plant

The cable television plant required to render service to the subscriber includes the following equipment:

a. *Head-end*—This includes the equipment used to receive signals of distant television or radio stations, whether directly from the transmitter or from a microwave relay system. It also includes the studio facilities required for operator-originated programming, if any.

b. *Cable*—This consists of cable and amplifiers (which maintain the quality of the signal) covering the subscriber area, either on utility poles or underground.

c. *Drops*—These consist of the hardware that provides access to the main cable, the short length of cable that brings the signal from the main cable to the subscriber's television set, and other associated hardware, which may include a trap to block particular channels.

d. *Converters and descramblers*—These devices are attached to the subscriber's television sets when more than 12 channels are provided or when special services are provided, such as "pay cable" or 2-way communication.

Direct Selling Costs

Direct selling costs include commissions, the portion of a salesperson's compensation other than commissions for obtaining new subscribers, local advertising targeted for acquisition of new subscribers, and costs of processing documents related to new subscribers acquired. Direct selling costs do not include supervisory and administrative expenses or indirect expenses, such as rent and costs of facilities.

Prematurity Period

During the prematurity period, the cable television system is partially under construction and partially in service. The prematurity period begins with the first earned subscriber revenue. Its end will vary with circumstances of the system but will be determined based on plans for completion of the first major construction period [9] or achievement of a specified predetermined subscriber level at which no additional investment will be required for other than cable television plant. The length of the prematurity period varies with the franchise development and construction plans. Such plans may consist of:

a. Small franchise that is characterized by the absence of free television signal and a short construction period. The entire system is "energized" at one time near the end of the construction period.

b. Medium-size franchise that is characterized by some direct competition from free television and by a more extensive geographical franchise area lending itself to incremental construction. Some parts of the system are "energized" as construction progresses.

c. Large metropolitan franchise that is characterized by heavy direct competition from free television and fringe area signal inadequacy, high cost, and difficult construction. Many parts of the system are "energized" as construction progresses.

Except in the smallest systems, programming is usually delivered to portions of the system and some revenues are obtained before construction of the entire system is complete. Thus, virtually every cable television system experiences a prematurity period during which it is receiving some revenue while continuing to incur substantial costs related to the establishment of the total system.

Subscriber-Related Costs

These are costs incurred to obtain and retain subscribers to the cable television system and include costs of billing and collection, bad debts, and mailings; repairs and maintenance of taps and connections; franchise fees related to revenues or number of subscribers; general and administrative system costs, such as salary of the system manager and office rent; programming costs for additional channels used in the marketing effort or costs related to revenues from, or number of subscribers to, per channel or per program service; and direct selling costs.

Appendix B: BACKGROUND INFORMATION AND SUMMARY OF CONSIDERATION OF COMMENTS ON EXPOSURE DRAFT

18. This Statement extracts the specialized accounting and reporting principles and practices from SOP 79-2 and codifies them as FASB standards without significant change. Board members have assented to the issuance of this Statement on the basis that it is an appropriate extraction of those existing specialized principles and practices and that a comprehensive reconsideration of those principles and practices was not contemplated in undertaking this FASB project. Some of the background material, discussion of accounting alternatives, and general accounting guidance have not been carried forward from the SOP. The Board's conceptual framework project on accounting recognition criteria will address revenue recognition issues that may pertain to those addressed in this Statement. A Statement of Financial Accounting Concepts resulting from that project in due course will serve as a basis for evaluating existing standards and practices. Accordingly, the Board may wish to evaluate the standards in this Statement when its conceptual framework project is completed.

19. SOP 79-2 was developed to clarify and standardize the diverse accounting practices being followed in the cable television industry, particularly the practices relating to accounting for costs during the prematurity period while the cable television system is partially under construction and partially in service. Before 1979, cable television companies differed as to the types of costs capitalized during the prematurity period and used different criteria to determine the date at which capitalization of some costs ceases and amortization of those costs begins. The SOP specified that all direct construction costs should be capitalized and that costs attributable to current operations and their administration should be charged to expense. For certain costs that relate to the cable television system and that benefit both current and future operations, the SOP specified that a proportion of such costs should be charged to current operations and the remainder should be capitalized.

20. An Exposure Draft of a proposed Statement, *Financial Accounting and Reporting by Cable Television Companies*, was issued June 12, 1981. The Board received 23 comment letters in response to the Exposure Draft. Certain of the comments received and the Board's consideration of them are discussed in this appendix.

21. The transition provisions in the Exposure Draft called for retroactive restatement except for companies that do not expect to have systems in the prematurity period in the future. These companies were permitted to continue their previous method of accounting for already mature systems. Several respondents from the cable television industry suggested that the transition provisions be modified to allow prospective application because retroactive application would require greater accounting effort than the resulting informational benefits. They believe that many cable television companies were expensing some costs that SOP 79-2 recommended be capitalized. They recommended that prospective application be permitted because of the additional

administrative burden that retroactive application would entail. The Board has considered these comments and the fact that major cable television companies have complied with SOP 79-2 and concluded that prospective application should be permitted.

22. Some respondents stated that paragraph 8(a) of the Exposure Draft implied that all interest cost incurred during the prematurity period should be capitalized, even though a portion of the cable television system is in use. The Board believes that paragraph 18 of Statement 34 prohibits capitalization of interest cost on the portion of the cable television system that is substantially complete and ready for its intended use. Accordingly, this Statement clarifies that all interest cost incurred during the prematurity period is not necessarily eligible to be capitalized.

23. Some respondents requested that guidance be included regarding accounting for costs of franchise applications. They indicated that practice varies with respect to the accounting for such costs and that additional guidance would enhance uniformity in practice. The Board has included such guidance to clarify the accounting for costs of franchise applications.

24. Some respondents suggested that the definition of direct selling costs be clarified regarding the circumstances under which advertising may be included. The Board believes that the intent of SOP 79-2 was to limit such costs to those pertaining to direct efforts to obtain new subscribers. Accordingly, the definition has been clarified to indicate that local advertising targeted for acquisition of new subscribers is a direct selling cost.

25. Several respondents suggested various substantive changes to the Exposure Draft (such as eliminating certain of the choices for the numerator of the capitalization fraction, reconsideration of provisions for deferral of hookup revenue and expensing of direct selling costs, changing the amortization period for costs capitalized during the prematurity period, and including certain general and administrative costs with other costs that are deferred during the prematurity period). Adoption of those suggestions would have required a reconsideration of some of the provisions of SOP 79-2. Such a reconsideration is not contemplated in the extraction project unless a proposed change meets one of the three criteria for change included in the "Notice for Recipients of This Exposure Draft" or is broadly supported. None of the proposed changes met the criteria for change and none was broadly supported. Accordingly, the Board did not adopt those suggestions.

Footnotes

FAS51, Footnote 1--The term *specialized* is used to refer to those accounting and reporting principles and practices in AICPA Guides and SOPs that are neither superseded by nor contained in Accounting Research Bulletins, APB Opinions, FASB Statements, or FASB Interpretations.

FAS51, Footnote 2--Terms defined in the glossary (Appendix A) are in **boldface type** the first time they appear in this Statement.

FAS51, Footnote 3--Some cable television companies have used the word *segment* to refer to a portion of a cable television system. In view of the use of *segment* in a different context in FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise,* the word *portion* has been used here.

FAS51, Footnote 4--Refer to paragraph 17 for a description of *head-end* in the definition of **cable television plant.**

FAS51, Footnote 5--Those costs include property taxes based on valuation as a fully operating system; pole, underground duct, antenna site, and microwave rental based on rental costs for a fully operating system; and local origination programming to satisfy franchise requirements.

FAS51, Footnote 6--During the prematurity period, a portion of the system is in use in the earnings activity of the enterprise and is not eligible for interest capitalization. The portion of the cost of the system that represents a qualifying asset is the amount of accumulated expenditures in excess of the fraction specified in paragraph 7 of the total estimated cost of the system at the end of the prematurity period.

FAS51, Footnote 7--Such costs are subscriber-related costs that are expensed in accordance with paragraph 6(b).

FAS51, Footnote 8--Refer to paragraph 17 for a description of *drop* in the definition of *cable television plant.*

FAS51 Appendix A, Footnote 9--The construction period of a cable television system varies with the size of the franchise area, density of population, and difficulty of physical construction. The construction period is not completed until the head-end, main cable, and distribution cables are installed, and includes a reasonable time to provide for installation of subscriber drops and related hardware. During the construction period, many system operators complete installation of drops and begin to provide service to some subscribers in some parts of the system while construction continues. Providing the signal for the first time is referred to as "energizing" the system.