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Statement of Position 79-2

Accounting by Cable Television Companies

March 12, 1979

Proposal to the Financial Accounting Standards Board

Issued by
Accounting Standards Division

American Institute of
Certified Public Accountants

AICPA

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The objective of statements of position is to influence the development of accounting and reporting standards in directions the division believes are in the public interest. It is intended that they should be considered, as deemed appropriate, by bodies having authority to issue pronouncements on the subject. However, statements of position do not establish standards enforceable under the Institute's code of professional ethics.

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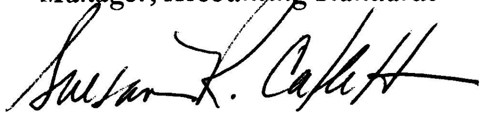

Accounting by Cable Television Companies

Introduction

1. Cable television (CATV) companies have developed diverse specialized industry accounting practices over a period of years, with the result that their financial statements lack comparability. This statement of position summarizes CATV companies' current specialized industry accounting practices. A study of those accounting practices by the AICPA Accounting Standards Division indicates a need for clarification and narrowing of alternative accounting practices within the industry.

General Background

2. Cable television systems receive television signals, which are amplified and distributed to the premises of subscribers, usually over a community-wide coaxial cable distribution network. The signals originate from local and distant television broadcasting stations and are received by the CATV system by means of high antennas, microwave relay, or satellite. CATV systems may also distribute programs that originate in the systems. "Pay cable" service, consisting primarily of uncut and uninterrupted movies and sporting events, has been initiated relatively recently but is already generally available.

3. CATV systems typically distribute signals of the three national TV networks and, to the extent permitted by Federal Communications Commission regulations, signals of independent and educational TV stations (UHF and VHF) and FM radio stations. The systems generally have a capacity of twelve to twenty TV channels, although some newer systems provide more. Many CATV systems require the attachment of a converter to the subscriber's set.

4. The copyright law (Public Law 94-553) defines a cable TV system as follows.

A "cable system" is a facility, located in any state, territory, trust territory, or possession, that in whole or in part receives signals transmitted or programs broadcast by one or more television broadcast stations licensed by the FCC, and makes secondary transmission of such signals or programs by wires, cables, or other communication channels to subscribing members of the public who pay for such services.

5. The copyright law requires cable systems to pay royalty fees computed on the basis of specified percentages of the gross receipts from subscribers to the cable service for the basic service of secondary transmission.

6. For operational and accounting purposes, a cable TV system may include one or more communities and may operate under one or more franchises granted by the governing authorities of the city, county, or state served by the system. Franchises are for a stated term and contain various conditions and limitations, which frequently include prescribed maximum service subscription fees, payment of fees to the local government, conditions of service, including provision of a minimum number of channels, and time limitations on specified construction. Failure to comply with the conditions and limitations of a franchise may give the granting authority the right to terminate the franchise and may result in lawsuits for collection of damages.

7. The cable TV plant required to render service to the subscriber includes the following equipment:

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

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

c. *Drops*—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 TV set, and other associated hardware, which may include a trap to block particular channels.

d. *Converters and descramblers*—devices attached to the subscribers' TV sets when more than twelve channels are provided or when special services are provided, such as "pay cable" or two-way communication.

8. The construction period of a cable TV 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. The period from the first earned subscriber revenue until the end of this construction period is referred to as the "prematurity period" in subsequent sections of this statement. Some system operators will construct the better portions of the franchise area and allow the system's operations to develop before extending it, well after the end of the first major construction period, to more marginal areas.

9. Special circumstances in different franchises will require different planning; the variety of plans would include the following typical franchise development and construction plans:

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

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

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

The length of the prematurity period varies with these circumstances and with the company's construction plan. It might range from less than a month to six months in a small marketing area

with under 5,000 homes, one year in a medium-size area of 25,000 to 30,000 homes, or two years or more in a large urban market.

10. A substantial investment is required to provide for the following costs of a cable TV system:

a. Franchise acquisition costs.

b. Cost of physical facilities (see paragraph 7), including cost of labor for erection, installation, interest on construction in progress, and construction overhead.

c. Costs relating to the cable TV system and signal, such as interest on previously capitalized costs, property taxes, pole rental, and microwave charges, which may be incurred both before and after the first subscriber hookup.

d. Other operating costs (in excess of any revenues) incurred during the construction period and before sufficient subscribers are obtained to achieve break-even operations.

If the franchise requires underground construction, construction costs and investment are substantially increased.

11. Cable TV operators lease space on telephone or utility poles or in underground ducts. Pole attachment agreements typically have an initial term of one to five years and thereafter are terminable by either party on relatively short notice.

12. The principal source of cable TV revenue is the monthly subscription fee for primary connections to subscribers. Additional revenues are received (*a*) from subscribers for secondary connections and connection charges, (*b*) from the sale of local advertising or from leasing time on unused channels, and (*c*) from pay cable services.

Current Industry Accounting Practices

Cable TV Investment

13. The cost of materials, labor, and construction overhead is included in the cost of the cable TV plant. Cable TV companies have not uniformly capitalized interest during construction. However, the predominant practice among cable TV companies whose securities are publicly held has been to capitalize interest during

construction and to include the capitalized costs in cable TV plant costs. Depreciation of new cable TV plant is usually computed using the straight-line method over periods that vary from ten to fifteen years.

14. Initial subscriber installation costs, which include the material, labor, and overhead costs of the drop, are capitalized and depreciated over periods similar to or shorter than those used for cable TV plant. The costs of subsequently disconnecting and reconnecting subscribers typically are charged to expense. In addition, some companies have received revenues of the nature of payments in aid of construction from developers and have credited such amounts to the plant account.

15. Except in the smallest systems, it is usually possible to deliver programming to portions of the system (energize the system) and obtain some revenues before construction of the entire system is complete. Thus, virtually every cable TV 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. In general, the larger the city served by the cable TV system, the longer this period will be.

16. Many different methods are used to account for costs and revenues during this prematurity period, although virtually all companies whose securities are publicly held defer such costs in some manner. Practices followed in accumulating the net costs deferred vary widely. Some companies defer all costs, including general and administrative, before maturity; some companies defer only operating costs; others defer only certain specified costs. Some companies depreciate cable TV plant during this period and others do not. Some reduce the deferred costs by the revenues recorded and others do not. Finally, although deferred costs are subject to a recoverability test, recoverability is measured in different ways.

17. Accounting conventions for the determination of the maturity date, at which time deferral ceases and amortization of deferred costs begins, vary significantly within the industry. Some companies define maturity on the basis of the time elapsed since energizing the system, which varies from eighteen months to three years; others define maturity in terms of the number of subscribers

connected; and still others use break-even operations as maturity. The break-even point is sometimes determined on a cash basis and sometimes on an accrual basis. Some companies use the actual break-even point and others use the originally budgeted break-even point.

18. Deferred costs are usually amortized on the straight-line method (*a*) over periods of five to ten years or (*b*) over the estimated useful life of the cable TV system.

19. Some companies separately defer marketing costs during the period before maturity and amortize them over a shorter period, such as three years.

Franchise Costs

20. The costs of original franchise applications are generally deferred until the franchise has been granted and it is determined that the franchise will be developed. Costs of unsuccessful franchise applications and abandoned franchises are charged to expense. Costs of successful applications are amortized on bases similar to those for purchased franchises (paragraph 22).

21. Purchased franchises are accounted for in diverse ways. Some companies allocate costs to purchased franchises in proportion to their fair value. Others allocate any excess of acquisition cost over the fair value of tangible and other identifiable intangible assets acquired, less liabilities assumed, to franchises. Some treat the excess as the cost of franchises and goodwill without separate distinction, and others treat the excess as goodwill alone.

22. Some companies do not amortize the cost of franchises acquired before November 1, 1970. The costs of franchises acquired on or after November 1, 1970, have been amortized, in accordance with APB Opinion 17, over periods of up to forty years. However, periods as short as five to ten years are also used; they are usually related to the remaining franchise term. The straight-line method of amortization is generally used, although other methods can be found in practice. For example, amortization may be based on the ratio of subscribers served in the period to the estimated total number of subscribers to be served in each year during the amortization period.

Hookup Revenue

23. Companies engage in various marketing activities to obtain subscribers, some of which involve relatively expensive advertising efforts. The amounts charged by cable TV companies to subscribers for hookups vary; sometimes there is a substantial charge, sometimes there is none. Also, the revenues are accounted for in diverse ways. Many companies record them as subscriber revenues; others record them as an offset to marketing costs. In either event, companies believe hookup revenue to be incidental, either because it is often waived as part of a promotional campaign, or because it relates more to the marketing effort involved than to the costs of hooking up new subscribers. During the early stages of system development, companies record hookup revenue as a reduction of deferred costs.

The Division's Conclusions

Accounting During the Prematurity Period of a Cable TV System

24. The accounting standards division believes that recovery of the investment in a cable TV system (paragraph 10) is usually predictable and, accordingly, that costs incurred during construction before the first subscriber hookup may be capitalized. In addition, since major construction activity normally continues after the first subscriber hookup, a portion of certain costs relating to the cable TV system and signal should usually continue to be capitalized. Furthermore, the division believes that the most theoretically appropriate, systematic, and rational allocation of capitalized plant would result from a computation that attempts to approximate depreciation on the basis of total "subscriber months" over the life of a system. For example, if a system were expected to have an average of 1,000 subscribers over its 180-month depreciation life and had achieved 300 subscribers, current monthly depreciation would be 300/180,000 of the cost of the system.

25. The following paragraphs contain the division's recommendations for conforming accounting practice within the industry while implementing the general conclusions in paragraph 24 in a practical manner:

Recoverability (paragraph 26).
Prematurity period (paragraph 27).

Cost of physical facilities (paragraph 28).

Period costs (paragraph 29).

Other capitalizable costs (paragraph 30).

Capitalization and depreciation formula (paragraphs 31-32).

Revenues (paragraph 33).

These recommendations recognize the appropriateness of capitalization of certain costs and of lower than straight-line depreciation during the prematurity period, but, for practical reasons, they do not permit inclusion in the depreciation base of increases in estimated subscribers expected to occur after the prematurity period. Thus, in the example in paragraph 24, average number of subscribers is to be calculated using subscribers expected at the end of the prematurity period for all years after that date.

26. *Recoverability.* An overriding consideration in reflecting incurred costs as assets is the expectation of recovery. Accordingly, circumstances must indicate that expected revenues from a cable TV system will be sufficient to cover expected operating expenses, including amortization of intangible assets and depreciation of plant. Otherwise, no additional costs should be capitalized, and an evaluation should be made to determine if a write-down to recoverable values (through operations or sale of the system) of intangible assets and previously capitalized plant is indicated.

27. *Prematurity Period.* Before the first earned subscriber revenue, management must determine a prematurity period for purposes of determining capitalized costs, depreciation, and amortization. This period begins with the first earned subscriber revenue. Its end will vary with circumstances at the system, but will be determined based on the company's plans for completion of its first major construction period (paragraphs 8 and 9) or achievement of a specific predetermined subscriber level at which no additional cash investments will be required for other than physical facilities and interest. Information submitted to the division indicates that there should be a presumption that the period should not be longer than two years, and that it will frequently be shorter. Only in the largest major urban markets could a longer period be reasonably justified. Once determined, the prematurity

period should not be changed except under highly unusual circumstances. Inability of management to make a reasonable estimate of the prematurity period is likely to indicate either an extremely short period or uncertainty of recovery. In either case, additional costs should not be capitalized.

28. *Cost of Physical Facilities.* Nothing in this statement (other than the discussion of lack of recoverability in paragraph 26 and the discussion of interest during construction in paragraphs 34-35) is intended to suggest that construction costs of physical facilities, including direct labor and construction overhead, should not be capitalized in full during and after the prematurity period.

29. *Period Costs.* During the prematurity period, subscriber-related costs and selling, marketing, and administrative expenses should be accounted for as period costs and should not be considered for capitalization. Such costs include those relating to existing subscribers such as billing and collection, bad debts, and mailings; costs of repairs and maintenance of taps and connections; franchise fees related to revenues or number of subscribers; general and administrative system costs such as salaries 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 (paragraph 43).

30. *Other Capitalizable Costs.* During the prematurity period, the cable TV system is partially under construction and partially servicing current operations. Management must distinguish between costs of physical facilities (paragraph 28), costs attributable solely to current operations and their administration (paragraph 29), and the generally fixed costs relating to the cable TV system and signal, which are attributable to both current and future operations. The last category includes interest (paragraphs 34-35) on previously capitalized tangible and intangible costs; property taxes based on valuation as a fully operating system; pole, underground duct, antenna site and microwave rental; and local origination programming to satisfy franchise requirements.

The division of these costs between costs capitalized and costs expensed should be determined as described in paragraphs 31 and 32.

31. *Capitalization and Depreciation Formula.* Based on the plans described in paragraph 27, management should estimate the number of subscribers expected during each month of the prematurity period. During the prematurity period, costs attributable to both current and future operations (paragraph 30) should be charged to expense in an amount equal to the fraction of average subscribers expected during each month to total subscribers expected at the end of the prematurity period; only the balance should be capitalized. During the same period, depreciation should be computed as the foregoing fraction applied to monthly depreciation and amortization of total anticipated capitalized costs expected on completion of the prematurity period, using the straight-line or other depreciation method normally applied by the company after the prematurity period.

32. The division believes that an objective upper limit to the costs capitalized and a lower limit on depreciation charged under the formula in paragraph 31 is necessary to ensure that excessive costs are not capitalized and adequate depreciation is provided. Accordingly, the division believes that the estimated number of subscribers during each month of the prematurity period should reflect, on a cumulative basis, at least equal (that is, straight-line) monthly progress in adding new subscribers toward the estimate at the end of the period. Furthermore, monthly amounts charged to expense should be increased whenever it becomes clear that the actual number of subscribers is increasing at a rate faster than expected.

33. *Revenues.* During the prematurity period, all revenues except those from hookups (paragraph 43) should be reported as system revenues, and the portion of costs, depreciation, and amortization charged to expense under the formula described in paragraphs 31 and 32 as well as the period costs described in paragraph 29 should be included in appropriate categories of costs of services.

Interest During Construction

34. In November 1974, the Securities and Exchange Commission issued Accounting Series Release 163, which, broadly speaking, precludes adoption of the practice of capitalizing interest during construction by companies, other than public utilities, registered with the SEC. The Financial Accounting Standards Board is currently considering the matter of accounting for interest costs and any pronouncement issued is expected to be applicable to cable television companies.

35. The accounting standards division believes that because of FASB's pending consideration of accounting for interest costs, it should state no conclusion at this time on the general subject of interest capitalization. However, companies that do not capitalize interest before energizing should not do so in subsequent periods (paragraphs 24 through 33).

Segmentation

36. In certain cases, a portion of a cable TV system may be clearly distinguishable from the remainder of the system.[1] 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.

c. Timing differences, such as starting construction or marketing at a significantly later date.

d. Investment decision differences, such as separate break-even and return-on-investment analyses or separate approval of the start of construction.

e. Accountability differences, such as separate revenue and expense accounts and separate budgets and forecasts.

37. The division believes that a portion that can be clearly distinguished from the remainder of the system should be accounted

[1] Some cable television companies have used the word "segment" to refer to a portion of a cable TV system. In view of the use of "segment" in a different context in FASB Statement no. 14, the word "portion" has been used here.

for as a separate system. Costs incurred by the remainder of the system should be charged to the portion only if they are specifically identified with the operations of that portion. General allocations should not be used for purposes of determining portion prematurity costs that may be capitalized in accordance with the recommendations made elsewhere in this statement. Separate projections for the portion should be developed and the portion's capitalized costs should be evaluated for recoverability separately from the remainder of the system.

Purchased Franchises and Goodwill

38. When a cable TV system is acquired in a transaction accounted for as a purchase, values should be assigned to franchises and goodwill in accordance with APB Opinion 16 and amortized in accordance with APB Opinion 17. The following examples indicate the types of analysis appropriate for cost allocation and amortization.

a. If a single system is acquired, the values of franchise costs and goodwill ordinarily would not be separable and therefore would be assigned the same life.

b. If a company that operates multiple systems is acquired, the several franchises acquired will have various remaining terms and prospects for renewal, and the franchises may provide for different allowable rates to be charged for the monthly service as well as other different conditions and limitations. The value of an amortization period for each franchise would have to be determined separately. Any excess of the cost of the acquired company over the sum of the amounts assigned to identifiable assets acquired (including individual franchises) less liabilities assumed should be recorded as goodwill related to the entire operation. The amortization period for this goodwill would be determined independently of the various franchise lives.

39. Intangible assets other than franchises and goodwill may be identified in the purchase of some cable TV systems. For example, values may be ascribed to noncancelable exclusive agreements for sporting events, to subscriber lists, or to a rate below current market for pole rental. Such assets should also be amortized in accordance with the provisions of APB Opinion 17.

Depreciation and Amortization

40. Since costs incurred to bring a cable system to a fully operational status create a resource with a period of expected benefit not substantially different from the useful life of the physical facilities, the division believes that the amortization period for such costs should be the same as that used to depreciate the main cable TV distribution system.

41. A number of factors are involved in determining the proper lives for depreciation and amortization purposes. These factors include the legal franchise life, the economic useful life of the main cable television plant, and the accounting life of the main cable television plant. If the accounting life used is longer than the legal franchise life, there should be justification to support the conclusion that the unamortized assets will be recovered at the end of the franchise. Support for such a conclusion would include but not be limited to the ability to recover the net book value on disposal or the likely renewal of the system's franchise; the latter could be either on terms similar to or different from the original franchise. If the terms of a likely franchise renewal are expected to cause a significant diminution in value to the owner of the system, the original franchise life should be used for amortization of other assets.

42. Once the system is fully operational, it should continue to be reviewed for recoverability as described in paragraph 26.

Hookup Revenue

43. The division believes that hookup revenue should be allocated to systems revenue to the extent of direct selling costs, with any balance deferred and taken into income over the estimated average period that subscribers are expected to remain connected to the system.

44. Direct selling costs include commissions, the portion of salespersons' compensation other than commissions that results in obtaining subscribers, and costs of processing documents relating to new subscribers acquired. They should not include supervisory and administrative expenses or indirect expenses such as rent and facilities costs.

45. The cost of a subscriber connection made at a location where a previous customer had been connected to the system should be charged to expense unless the cost of the previous connection has been written off.

Programming Material

46. The costs of programming material produced for internal use or for sale to others should be accounted for in accordance with the provisions of the AICPA Industry Accounting Guide, *Accounting for Motion Picture Films*. Purchased program material should be accounted for in accordance with the recommendations made in the division's Statement of Position 75-5, *Accounting Practices in the Broadcasting Industry*.

Accounting Principles for Regulated Industries

47. Some states have adopted legislation that regulates CATV systems as public utilities. Cable TV systems are similar to utilities only in that they require heavy plant investment, service by "connection" for each subscriber, and are subject (in varying degrees) to regulation of subscription rates and levels of service required to maintain their franchise rights. Other aspects of cable TV systems are not similar to public utilities. There has been no identifiable consistency in the application of the rate-making process for cable TV systems; the procedures for setting utility rates, on the other hand, are similar in nature. Finally, since the operator competes with other entertainment industries, service charges sometimes are less than the authorized rates.

48. The division believes that the addendum to APB Opinion 2 does not apply to the financial statements of cable TV companies.

Financial Statement Presentation

49. Since a cable TV company generates its revenue through use of its property, plant, and equipment, it has few current assets as that expression is defined in terms of a one-year operating cycle. Therefore, the division believes that it is not necessary to identify current assets and liabilities separately in the financial statements. Debt maturities should be disclosed in the financial statements or related notes.

50. Costs incurred to bring a cable TV system to a fully operational status that are capitalized under the provisions of paragraphs 24 to 33 should be classified with plant and equipment, but separately identified. Companies with systems under construction or in the prematurity period should disclose amounts capitalized during the reporting period and the ending date of the prematurity period.

Transition

51. This statement of position should be applied in financial statements for fiscal years beginning after December 15, 1978, although earlier application is encouraged. Accounting changes adopted to apply the recommendations of this statement of position should be made retroactively by restating the financial statements of prior periods.

52. Companies may not have readily available the forecast information needed to make the required calculations under paragraphs 24–33. In that event, actual historical subscriber data may be substituted for the forecast information.

53. Companies that do not expect to have systems in the prematurity period in the future should continue their previous method of accounting for already mature systems, in accordance with APB Opinion 20, paragraph 16. For example, a single locally owned system, the owners of which expect to make no investments in additional cable TV systems, should not change its previous accounting. Systems that are subsidiaries or divisions of multiple system groups, however, should follow the accounting recommended for the group.