FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

IN REPLY REFER TO:

RAO Letter 25
DA 95-703
Adopted: March 31, 1995
Released: April 3, 1995

Responsible Accounting Officer:

Re: **Accounting and Reporting Requirements for Video Dialtone Service**

I. Introduction

This letter provides guidance on video dialtone accounting to local exchange carriers ("LECs") that receive Section 214 authorizations to provide video dialtone service.[1] It sets forth specific guidance on the requirements for accounting classifications, subsidiary records, and amendments to cost allocation manuals ("CAMs") for LECs that provide video dialtone service.[2]

II. Background

In 1991 and 1992, the Commission adopted policies and rules to permit LECs to assume an expanded role in the provision of video services in their telephone service areas.[3] In its 1991 and 1992 Orders, the Commission established a regulatory framework for telephone companies to provide video service on a common carrier basis and provide various related nonregulated

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[1] This includes video dialtone trials and commercial applications.

[2] LECs with annual operating revenues of $100 million or more are required to file a CAM with the Commission. CAMs contain information regarding the carriers' allocation of costs between regulated and nonregulated activities. See 47 C.F.R. § 64.903.

[3] See Telephone Company-Cable Television Cross-Ownership Rules, Section 63.54-63.58, Further Notice of Proposed Rulemaking, First Report and Order and Second Further Notice of Inquiry, 7 FCC Rcd 300 (1991) (First Report and Order), recon., 7 FCC Rcd 5069 (1992), aff'd, National Cable Television Association v FCC, No. 91-1649 (D.C. Cir. Aug. 26, 1994) (NCTA v. FCC); Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd 5781 (1992) (Second Report and Order), aff'd, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244 (1994) ("VDT Recon Order"), appeal pending sub nom. Mankato Citizens Telephone Company v. FCC, No. 92-1404 (D.C. Cir. filed September 9, 1992).

services consistent with the cross-ownership restrictions imposed by the Cable Communications Policy Act of 1984 ("1984 Cable Act").[4] This regulatory framework is called "video dialtone."

On November 7, 1994, the Commission issued the Video Dialtone Reconsideration Order ("VDT Recon Order"). In that Order, the Commission reaffirmed its basic video dialtone framework adopted in the Second Report and Order, and, among other things, set forth accounting and reporting requirements for LECs that offer video dialtone service. The Commission required carriers offering video dialtone to establish two sets of subsidiary accounting records: one to capture the investment, expense and revenue wholly dedicated to video dialtone; the other to capture the investment, expense and revenue shared between video dialtone and other services.[5] Wholly dedicated refers to investment, expense and revenue related exclusively to providing video dialtone service. Shared refers to investment, expense and revenue related to providing video dialtone and other services on a joint or common basis[6].

The VDT Recon Order requires LECs to file a summary of these subsidiary accounting records with the Commission on a quarterly basis. The Commission delegated authority to the Common Carrier Bureau to define the content and format of both the subsidiary accounting records and the quarterly reports, and to provide accounting guidance where necessary for uniform classification of video dialtone investment, expense and revenue.[7] Finally, the VDT Recon Order required LECs to file revisions to their CAMs to reflect the provision of video dialtone service.

III. Accounting Classification

The Commission did not change its Part 32, Uniform System of Accounts for Telecommunications Companies ("USOA") in the VDT Recon Order, but it did require carriers to establish subsidiary accounting records, consistent with that system, in order to isolate video dialtone costs and revenues from other LEC costs and revenues.[8] We therefore require LECs to maintain in subsidiary records, by USOA accounts, all wholly dedicated and shared investment, expense, and revenue related to providing video dialtone service. Finally, consistent with Part 32 of the Commission's rules, Class A companies shall use Class A detail level accounts and

[4] Cable Communications Policy Act of 1984, Pub. L. No. 98-549, §613(b), 98 Stat. 2779 (codified at 47 U.S.C. §533(b)).

[5] VDT Recon Order at para. 173.

[6] By "other services" we mean telephone and other services provided by LECs.

[7] In this Responsible Accounting Officer ("RAO") Letter, we only address the accounting classifications, format and content requirements for LEC subsidiary records and CAM filing requirements. We plan to address the format and content for LEC video dialtone quarterly reports in a separate notice and comment proceeding.

[8] VDT Recon Order at para. 173.

Class B companies shall use Class B detail level accounts in recording video dialtone investment, expense and revenue in subsidiary records.[9]

A. Investment Classifications

For accounting classification purposes, video dialtone investment shall include all plant wholly dedicated to video dialtone or shared between video dialtone and other services. Wholly dedicated investment is defined as investment that is used exclusively for the provision of video dialtone service. Shared investment is defined as investment that is common to, or used jointly to provide video dialtone and other services. Under the VDT Recon Order, LECs must separately track both wholly dedicated and shared video dialtone investment. This requirement covers both new investment purchased for the provision of video dialtone and existing plant converted to video dialtone use. To track net investment, subsidiary records must identify, for each plant account, all accumulated depreciation, amortization and deferred income taxes associated with wholly dedicated and shared video dialtone investment.

In addition, the Commission conditioned LEC authorizations to provide video dialtone service on a requirement that LECs keep subsidiary records to identify, by Part 32 plant account, the cost of plant that is replaced or retired due to either the deployment of video dialtone plant or the deployment of fiber optic network upgrades as mandated under state authority in study areas where VDT deployment occurs.[10]

B. Expense Classification

Video dialtone expense shall include all expenses identified with the exclusive or shared provision of video dialtone service. In addition to ongoing expenses incurred in the provision of video dialtone service, these expenses shall include all expenses incurred during the initial development and deployment stages of video dialtone, such as research and development expense and legal services expense.

In order to implement the Commission's requirement that the Common Carrier Bureau ensure that LEC proposed expense allocations and overhead loadings associated with video dialtone tariff filing are reasonable, we will require separate subsidiary records for dedicated and shared video dialtone expenses.[11] Carriers must also separately identify depreciation and amortization expense associated with wholly dedicated and shared video dialtone investment by each Part 32 plant account.

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[9] 47 C.F.R. § 32.11.

[10] See, e.g., Application of New Jersey Bell Telephone Company for Authority pursuant to Section 214 of the Communications Act of 1934, 9 FCC Rcd 3677, 3690 at para. 72 (1994).

[11] VDT Recon Order at para. 221.

We recognize that some of the expenses that fall into the shared category may be the type of expenses that are tracked by function codes and some may be the type that are not tracked by function codes. Expenses not tracked by function codes are support functions, such as network support, general support, corporate operations and general administrative. Expenses tracked by function codes shall be identified as video dialtone expense using the tracking mechanism.[12] Expenses not tracked by function codes shall be so identified and shall be classified as shared video dialtone expenses. These expenses will be subject to overhead allocation for the video dialtone tariff filing.

IV. Subsidiary Accounting Records

As required by the VDT Recon Order, LECs shall create subsidiary accounting records that identify investment and expense wholly dedicated to video dialtone, or shared between video dialtone and other services.[13] Carriers shall ensure that subsidiary accounting record entries are readily identifiable by account title, account number, subaccount identification, and study area. These records shall also include all initial and ongoing transactions that directly impact investment, expense and revenue accounts. In order to enhance our ability to verify LEC compliance with the Commission's established video dialtone accounting and reporting requirements, carriers shall be required to have internal accounting controls and a complete audit trail for each subsidiary account record. Subsidiary accounting records must be reconcilable with total amounts reported in the Part 32 accounts. In addition, LECs shall maintain these records until such time as the Commission decides otherwise. These requirements do not preclude carriers from creating subaccounts, if necessary, to capture data necessary to provide subsidiary record information.

Consistent with the Commission's requirements on accounting classifications and reporting, carriers shall capture all costs incurred for the provision of video dialtone, including the preliminary planning, and research and development expenses incurred prior to the Commission's approval of Section 214 application. Upon receiving Section 214 authorization from the Commission, carriers must establish subsidiary accounting records and report the results of these records to the Commission on a quarterly basis.

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[12] All employees that incur video dialtone costs must employ existing time reporting procedures using some type of function codes. For example, carriers that currently utilize time reporting tracking mechanisms in order to identify regulated and nonregulated activities of support functions, such as legal services, must continue to use similar accounting tracking mechanisms for identifying video dialtone expenses. In addition, expenses incurred or services provided by LEC affiliates for LEC provision of video dialtone service must be identified with unique function codes that indicate video dialtone expense.

[13] In the VDT Recon Order, the Commission determined that it was not necessary to make permanent changes to the Commission's USOA for LEC provision of video dialtone. The Commission, however, required that LECs offering video dialtone service create subsidiary records to capture wholly dedicated and shared video dialtone costs. See VDT Recon Order at para 173. Under the Commission's rules, subsidiary records categories are defined as "...segregations of certain regulated costs, expenses and revenues which must be maintained and are subject to specific reporting requirements of this Commission." See 47 C.F.R. §32.9000.

Subsidiary accounting records for investment accounts must include, but shall not be limited to, all telephone plant in service accounts, associated accumulated depreciation, deferred taxes and any associated land and support assets which contain costs related to the provision of video dialtone service. Subsidiary accounting records for video dialtone investment accounts must also identify the investment's location and whether that investment is wholly dedicated to video dialtone or shared between video dialtone and other services. LECs shall maintain subsidiary accounting records so that the content of these records can be traced from the continuing property records ("CPRs") through the accounting system to the general ledger and to the equipment's physical location.

Carriers shall use tracking codes that allow video dialtone expense to be extracted and summarized from the Part 32 USOA expense accounts. Carriers may create tracking codes that are compatible with their existing internal accounting systems. Carriers may use either field reporting codes, job function codes, location codes, or any other identification codes that permits such expenses to be audited.

Subsidiary accounting records for expense shall include all plant-specific operations expense, plant-nonspecific operations expense, customer operations expense, and corporate operations expense accounts that contain any costs related to the provision of video dialtone service. Subsidiary accounting records for video dialtone should separately identify revenues from intrastate and interstate tariffs.[14] Carriers shall identify by subsidiary record category any nonregulated video dialtone revenues.

V. Cost Allocation Manual Filing Requirements

LECs offering video dialtone service must amend their CAMs to reflect both their regulated and nonregulated video dialtone service as follows:

LECs are required, pursuant to the VDT Recon Order, to amend their CAMs prior to providing nonregulated products or services related to video dialtone.[15] We require carriers that receive Section 214 authorizations to provide video dialtone service to implement these requirements by revising Section II (Nonregulated Activities) of their CAMs to include a detailed description of proposed nonregulated video dialtone services that they seek to provide.

CAM revisions must include a statement indicating whether nonregulated video dialtone service is provided through a stand-alone video dialtone system, or a system shared with telephony. Carriers must also establish a new subsection in Section II of their CAMs that identifies all costs incurred in the planning and development of nonregulated activities provided in conjunction with video dialtone service. LECs that currently include enhanced services

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[14] Carriers shall record revenues in Part 32 accounts consistent with the category of video dialtone service set forth in a carrier's tariff provisions. See 47 C.F.R. §32.4999.

[15] VDT Recon Order at 330, para. 181.

planning in their CAMs as a nonregulated activity associated with their provision of telephone service, shall be required to amend their CAMs to specifically identify any planning associated with the provision of nonregulated video dialtone service. In addition, LECs shall amend their existing "Nonregulated Services Matrix"--which shows nonregulated products/services and the USOA accounts associated with these nonregulated products/services--to list each individual USOA account affected by the provision of any nonregulated video dialtone activity.

LECs must also amend Section VI (Cost Apportionment Tables) of their CAMs, so that existing cost allocation tables include apportionment procedures for investment and expense used in the provision of regulated and nonregulated video dialtone service. We require LECs to justify and/or amend, if necessary, their existing cost apportionment methodology and allocators for their provision of video dialtone service. LECs that choose not to modify their cost apportionment methodology or allocators for video dialtone, must also explain why their existing methodology or allocation factors are still valid for their regulated, nonregulated and common cost pools. In addition, because the allocation for nonregulated usage of common network plant is determined by a three-year forecast of investment usage, LECs shall revise their forecast usage allocator to reflect accurately the provision of any nonregulated video dialtone service offered on common network plant. Moreover, carriers that currently do not provide nonregulated services that use common network plant, but "reasonably anticipate" offering such services during the plant's three-year forecast usage period, shall include revised apportionment procedures for the nonregulated usage of network plant in the Section VI, Cost Apportionment Tables.[16]

Finally, we require LECs to amend their CAMs to identify any affiliate transactions related to their provision of video dialtone service. LECs must amend Section V (Affiliate Transactions) of their CAMs by listing all transactions with affiliates that involve video dialtone service. This listing must contain a brief description of the nature, terms and frequency of each transaction. LECs that currently list transactions involving affiliates providing video related services in existing CAMs, must amend such CAMs to indicate which, if any, specific transactions relate to the provision of video dialtone service.

As required by the VDT Recon Order, LECs shall file CAM revisions within thirty days after the effective date of their Section 214 authorization and at least sixty days prior to providing nonregulated products or services related to video dialtone.

VI. Accounting Consistency/Uniformity Issues

In reviewing various LEC Section 214 applications for video dialtone service, we have found certain inconsistencies in the accounting classification of asynchronous transfer mode ("ATM") equipment. LECs have described ATM equipment as providing the basic connection between the various video servers and various destinations. Some LECs have provisionally classified ATM equipment in Account 2212, Digital electronic switching; other LECs have

[16] See American Telephone & Telegraph Company's Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, 4 FCC Rcd 6930 at para. 6-7 (1989).

classified the same type of equipment in Account 2232, Circuit equipment. Based on our analysis of video dialtone ATM equipment and LEC descriptions of the functional purpose of such equipment, we find that, although certain carriers have classified ATM equipment as switches, this equipment does not perform the functions performed by traditional network switches.[17] We find based on the data before us, that ATM video dialtone equipment does not, at this stage of LEC video dialtone deployment, meet established criteria for classification as a switch. Therefore, carriers shall classify ATM equipment as circuit equipment and record it in Account 2232, Circuit equipment. Our decision regarding the accounting classification for video dialtone ATM equipment does not in anyway preclude LECs from demonstrating at a future date any functional change that should alter this classification.

Finally, we intend to amend RAO Letter No. 6 shortly to incorporate video dialtone plant investment within our existing itemized list of telecommunications plant in service.[18]

This letter is issued pursuant to authority delegated under §0.291 of the Commission's Rules, 47 C.F.R. §0.291. Applications for review under Section 1.115 of the Commission's Rules, 47 C.F.R. §1.115, must be filed within 30 days of the date of this letter. See 47 C.F.R. §1.4(b)(2).

If you have any questions, please contact Kenneth Ackerman or Daniel Gonzalez at (202) 418-0810.

Sincerely,

Kenneth P. Moran
Chief, Accounting and Audits Division
Common Carrier Bureau

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[17] The criteria for switch classification are met if equipment performs some, but not necessarily all, of the following basic switching functions: 1) Attending - monitors for off-hook signals; 2) Control - determines call destination and assigns call to available line or trunk; 3) Busy testing - determines whether the called line/trunk is busy; 4) Information receiving- receives control and busy test results; 5) Information transmitting - transmits control and busy test results to tell the alerting and interconnection functions whether to complete the call; 6) Interconnection - connects subscriber line to subscriber line or subscriber line to trunk; 7) Alerting - rings the called subscriber's line or other signalling means if the call is destined for another exchange; 8) Supervising- monitors for call termination so the line can be released. See Responsible Accounting Officer Letter 21, 7 FCC Rcd 6075 (1992).

[18] See Revised Responsible Accounting Officer Letter 6, 4 FCC Rcd 1965 (1989).