

PLANT ACCOUNTING: CAPITAL VS. EXPENSE AND ACCOUNTING FOR NEW TECHNOLOGIES

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PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- **USOA Part 32 and Generally Accepted Accounting Principals (GAAP)**
 - **USOA Part 32 – General Comments**
 - USOA Part 32 as adopted by FCC was added to Title 47 of the Code of Federal Regulations in March 1986.
 - Part 32 contains rules governing the accounting system for telephone companies.
 - ILECs are required to record their investments, revenues and expenses in accordance with the Part 32 Uniform System of Accounts (USOA). Part 32 does not apply to CLECs.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- **USOA Part 32 – General Comments (continued)**
 - Provides comparable accounting information.
 - Standardizes accounts and financial reports.
 - Places all companies on the same playing field in the regulatory arena.
 - Designed to show the investment in the company's tangible and intangible telecommunications plant which ordinarily has a service life of more than one year.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- **USOA Part 32 - Support Assets; 2112 – 2124 (excluding 2111 and 2121)**
 - Cost of individual items of equipment classifiable to Accounts 2112 – 2124 (excluding 2111 and 2121) costing \$2,000 or less shall be charged to the applicable expense accounts, except for personal computers falling within Account 2124.
 - Personal computers with a total cost for all components of \$500 or less, shall be charged to the applicable Plant Specific Operations Expense accounts.
 - Retirements are made only for those items previously capitalized.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- **USOA Part 32 Land and Buildings and Network Assets; 2111, 2121, and 2212 - 2441**
 - As a general rule, all new construction should be capitalized regardless of amount.
 - Expenditures for replacement of items considered a unit of property should be capitalized with a corresponding retirement entry made.
 - Expenditures for replacement of items not considered a unit of property should be expensed with no retirement entry made.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- **USOA Part 32 Land and Buildings and Network Assets; 2111, 2121, and 2212 – 2441 (continued)**
 - Costs associated with the construction of new drops should be capitalized as a cost of the cable the drop attaches to. However, drops are typically not considered a unit of property.
 - Charges associated with the replacement of drops not considered a unit of property are typically expensed and no retirement is made.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

Miscellaneous Issues

- Part 32 typically provides accounting information according to GAAP
 - GAAP states that costs incurred during ownership, such as additions, improvements, alterations, replacements and repairs, should be capitalized when they appreciably extend the life (typically beyond one year), increase the capacity, or improve the efficiency or safety of the property, and should be expensed when they do not.
 - Major remodeling to buildings that involves removing and adding walls should be capitalized because it increases capacity and improves efficiency.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- Repainting walls and other similar maintenance clearly should be expensed.
- Replacements of floor coverings, roofs and air conditioning units are a gray area. These items do not extend the life of the building, increase the capacity, etc., but are significant components.
- Most entities do not account for and depreciate their buildings on a component basis. The only segregation is typically between the land and the buildings, so usually the cost of the individual items cannot be identified.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- These costs should be expensed unless the cost of the original items can be identified using property records. If the cost can be identified, a retirement should be made and the new cost capitalized.
- Costs associated with preparing land for the construction of a building should be capitalized as a cost of the building (including the cost of razing a building currently on the land).

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- Aid to Construction
 - Aid to construction is never recorded as revenue.
 - Should be recorded as an offset to the cost of the project.
 - If amounts are received in conjunction with moving or relocating plant, the amounts should first be used to offset expenses or costs, with the remainder either credited to plant or the accumulated depreciation account depending on the situation.
 - Credit plant when a retirement is not involved and credit the appropriate accumulated depreciation account when a retirement is involved.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- Replacement of cards in the central office
 - Most companies maintain “critical spares” which we recommend be charged to plant when purchased.
 - When new cards are placed in service (either from critical spares or inventory issue) they should be capitalized, assuming they are considered a unit of property and the new cards are replacing cards which are obsolete and disposed of. If this is the case, then a retirement entry should be made.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- When new cards are placed in service (either from critical spares or inventory issue) and the new cards are replacing cards which have been sent for repair, then no entry is made for the issuance of the new cards and no retirement entry is made. The cost of repair is expensed.
- A log should be maintained by inventory personnel for items sent for repair. This will enable accounting to reconcile differences between the perpetual inventory and the general ledger. The sent for repair log should be segregated between inventory and critical spares.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- Exempt materials
 - Exempt materials (items too small to include in inventory on a continuous basis) are typically divided between capital and expense based on historical industry percentages or company specific percentages. They are not considered units of property.
 - Part 32 does require that an exempt materials inventory be recorded on the books at year-end. Some companies count once a year and adjust accordingly through the same accounts exempt materials have been charged to throughout the year.

PLANT ACCOUNTING CAPITALIZATION VS. EXPENSE

- DSL modems owned by the ILEC
 - Some companies expense as they do not anticipate the modem having any value upon termination of DSL service.

ACCOUNTING FOR NEW TECHNOLOGIES

- **Fiber to the Home (FTTH)/Triple Play**
 - **FTTH**
 - All cable charged to 2423 “Buried Fiber”.
 - Fiber drop is not a unit of property.
 - We recommend electronic equipment including the NID be charged to 2232 “Circuit Equipment”.
 - Segregation of the nonregulated portion (Video and at times Internet) should be addressed by the internal revenue requirements department or your cost consultant.
 - If management desires a balance sheet by line of business, we suggest segregating using the cost study percentages.

ACCOUNTING FOR NEW TECHNOLOGIES

- **Fiber to the Home (FTTH)/Triple Play**
 - **Triple Play**
 - For bundled services, record all revenues according to tariff filed. Local to account 5001, Internet to account 5082 or account 5280 and Video to account 5280. Discounts cannot be applied to tariffed regulated services.
 - We suggest Video Set Top Boxes (STB) be capitalized to a customer premises account (2311) and accounted for cradle to grave if the company retains ownership of the box. If ownership transfers to customer, expense in current period to 6311 “Cost of Sales”.

ACCOUNTING FOR NEW TECHNOLOGIES

- **Triple Play (continued)**
 - As previously mentioned, we recommend electronic equipment, including the NID, be charged to 2232 “Circuit Equipment”.
 - We also recommend sub accounts in order to facilitate preparing an income statement by line of business.

ACCOUNTING FOR NEW TECHNOLOGIES

- **Soft Switch**

- Purchase of a soft switch is to be charged to account 2212 “Digital Switching”. We suggest segregating in separate sub account.
- If used within the regulated ILEC, the switch should be depreciated using the same depreciation rate which was used for the replaced digital switching equipment.
- Theoretically, it would appear a shorter life should be used to depreciate the switch due to rapid technological changes.

ACCOUNTING FOR NEW TECHNOLOGIES

- **Soft Switch (continued)**
 - However, the PUC would have to approve the rate, and we are not aware of any filings for a shorter life.
 - Filing would require support documenting the potential shorter life (typically support is in the form of statistical information provided by engineers).

ACCOUNTING FOR NEW TECHNOLOGIES

- **Landline Network and Wireless Network**
 - Consumers are using both networks to access a broad range of content: Voice, Data, Text, Audio, Video, Security Services, etc.
 - When new technologies arise, you should first ask yourself if the services are regulated or nonregulated.
 - Typically, if a service is billed under the NECA or TSTCI state tariff, it is regulated and should be accounted for using Part 32 methodology.

ACCOUNTING FOR NEW TECHNOLOGIES

- **Landline Network and Wireless Network (continued)**
 - If nonregulated, more freedom in accounting for the service, however, it should clearly be segregated as nonregulated.
 - Companies should continuously be aware of traffic carried on their network and make every effort possible to bill the appropriate provider access. This ensures the cost recovery system works properly (on the interstate side) and also provides revenues on the bill and keep side (intrastate).

*Thank You for Your
Attention!!*

