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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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SEP 14 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Petition for Rulemaking to Amend Part 32 of the Commission's Rules, Uniform System of Accounts for Class A and Class B Telephone Companies, to adopt the Accounting for Software Required By Statement of Position 98-1	)	RM-9341

COMMENTS OF GTE

GTE Service Corporation and its affiliated domestic telephone operating companies (collectively "GTE")[1] hereby submit comments in response to the *Public Notice* in the above-captioned proceeding.[2] In the *Public Notice*, the Federal Communications Commission ("FCC" or "Commission") seeks comment on the Petition for Rulemaking ("Petition") filed by Bell Atlantic and BellSouth ("Joint Petitioners") to amend the Commission's existing Part 32 rules to accommodate recent changes in generally accepted accounting principles ("GAAP"). The Joint Petitioners request that

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1 GTE's domestic telephone operating companies are: GTE Alaska Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., and Contel of the South, Inc.

2 BellSouth and Bell Atlantic File a Petition for Rulemaking to Amend Part 32 of the Commission's Rules to Adopt the Accounting for Software Required by Statement of Position 98-1, *Public Notice*, (RM-9341), DA 98-1625 (released August 13, 1998).

treatment of software costs in Part 32 rules conform to Statement of Position 98-1 ("SOP 98-1"). The Joint Petitioners also seek waiver of the requirement to perform a revenue requirement study when a change in accounting standard is adopted.

I. DISCUSSION

A. Part 32 rules should be changed to conform to GAAP standards with regard to accounting for software acquisition and development costs.

Prior to SOP 98-1, guidance on accounting for internal-use software was derived from the Statement of Financial Accounting Standards No. 86 (SFAS 86)." SFAS 86 stated that "[t]he Board recognized the majority of companies expense all costs of developing software for internal-use, and the Board was not persuaded that this current predominant practice is improper..."[3] As the FCC developed its new Uniform System of Accounts, it adopted an accounting policy that was consistent with GAAP and the predominant industry practice of expensing the costs of internal-use software.

On March 4, 1998 the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued SOP 98-1, entitled "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." SOP 98-1 is effective for fiscal years beginning after December 15, 1998. SOP 98-1 requires that certain internal-use software costs be capitalized in the year acquired and amortized over future periods.

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[3] SFAS 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed," Appendix B, ¶26.

GTE believes that the FCC's accounting rules should continue to conform to GAAP for internal-use software and recommends that the FCC amend Part 32 to conform to GAAP (i.e., SOP 98-1). Failure to adopt this change to Part 32 would force local exchange carriers ("LECs") to keep separate regulatory and financial accounting records for these costs.[4]

B. Capitalized Software costs are intangible assets.

GTE agrees with the Joint Petitioner's request "...that the cost of software capitalized be classified as an intangible asset to account 32.2690, Intangibles."[5] Current authoritative guidance and prior proposed Commission rulemaking support designating software an intangible asset. Software contains certain qualities that are comparable to the characteristics found in an intangible asset. The Accounting Principles Board Opinion No. 17 (APB 17), Intangible Assets, issued in August 1970, notes the characteristics of an intangible asset, stating, ". . . its lack of physical qualities makes evidence of its existence elusive, its value is often difficult to estimate, and its useful life may be indeterminable."[6]

These same characteristics are inherent in software. First, the true substance and value of computer software is not its physical substance but the content contained on the medium from which it is used. That content represents the intangible nature of the software, and includes programs, procedures and other related documentation that

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4 Petition at 2.

5 Petition at 4.

6 APB 17, Intangible Asset, ¶ 2.

associates it with the computer system. The intrinsic value of computer software lies solely in its intangible characteristics. Second, the value of computer software is subject to a certain degree of uncertainty. The value that is placed on software can vary significantly depending on the demand, deployment, and utilization required by the different users of the software. True value for software used by a particular enterprise many times is incorporated into efficiency gains and added revenues earned, which is difficult to quantify. Third, the life cycle of original software in today's environment tends to be more unpredictable and shorter than in the past as a result of external factors explained in APB 17.[7]

Previous regulatory guidance also supports the classification of capitalized software as an intangible asset. The Commission previously made a determination that capitalized software should be recorded as an intangible asset.[8] In that decision, the Commission proposed a unique account -- 32.2192, Software -- to be included within the broad classification of intangible assets. Account 32.2192 was defined as follows:

32.2192 Software

(a) The costs of software acquired by purchase, license or other right to use (if separately identifiable) shall be charged to this account and amortized to expenses over its estimated useful life, if such estimated useful life exceeds one year. If not separately identifiable, the costs

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7 Those factors include: (1) legal, regulatory and contractual provisions, (2) provisions for renewal or extension, and, (3) the effects of obsolescence, demand, competition and other economic factors.

8 Revision of the Uniform System of Accounts and Financial Reporting Requirements for Class A and Class B Telephone Companies (Part 31, 33, 42 and 43 fo the FCC's Rules), CC Docket No. 78-196, *Further Notice of Proposed Rulemaking* ("*FNPRM*"), (released January 3, 1986).

shall be included in the account appropriate for the asset with which it is associated.

(b) The costs of software enhancements or additions (not constituting a complete replacement) shall be charged to the Plant Specific Operations Expense account for the plant with which the software is associated.

(c) Amounts included in this account shall be amortized over its estimated useful life to Account 6564, Amortization Expense – Intangible. [9]

Ultimately, in the *Report and Order* adopting Part 32, the Commission decided to delete this separate software account. The Commission stated, however, that "(w)hen and if the Financial Accounting Standards Board provides more definitive standards for treatment of software costs, we will consider making such changes as are necessary to conform with GAAP treatment."[10] The FCC's proposal in that docket clearly treated software as an intangible asset. The characteristics of software have not changed since. Therefore, the FCC's determination in CC Docket 78-196 that software costs should be classified as an intangible asset remains valid.

GTE also notes that the current definition contained within USOA 32.2690 is broad enough to accommodate capitalized software within its scope. Account 32.2690 is defined as follows:

32.2690 Intangibles

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[9] *FNPRM*, at 77.

[10] Revision of the Uniform System of Accounts and Financial Reporting Requirements for Class A and Class B Telephone Companies (Part 31, 33, 42 and 43 fo the FCC's Rules), CC Docket No. 78-196, *Report and Order*, 51 F.R. 24745 (July 8, 1986), at ¶ 132.

(a) This account shall include the cost of organizing and incorporating the company, the original cost of government franchises, the original cost of patent rights, and other intangible property having a life of more than one year and used in connection with the company's telecommunications operations.[11]

Intangible assets include items such as patents, copyrights, leases, licenses or trademarks that represent certain rights to use, sell or operate something, and as described above contain certain characteristics not found within the tangible asset classification. Like other intangible assets, computer software costs may be incurred through license arrangements, lease agreements, contractual right-to-use (RTU) agreements, or constructed internally.

GTE agrees with the Joint Petitioners that computer software developed or purchased for internal-use as defined in SOP 98-1 meets the characteristics of an intangible asset and should receive intangible treatment. Further, GTE agrees with the Joint Petitioners' suggested modifications to Part 32 as noted in attachment 1 to the Petition and request that these changes be made to incorporate internal-use software.[12]

C. The Commission should not prescribe ranges of amortization periods for different types of capitalized software.

As a general principle, GTE believes that the amortization period should match the useful life of the asset. SOP 98-1 provides guidance regarding the amortization of software, stating:

> In determining and periodically reassessing the estimated useful life over which the costs incurred for internal-use computer software will be

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[11] 47 C.F.R. § 32.2690.

[12] Petition at 5.

> amortized, entities should consider the effects of obsolescence, technology, competition, and other economic factors. Entities should consider rapid changes that may be occurring in the development of software products, software operating systems, or computer hardware and whether management intends to replace any technologically inferior software or hardware. Given the history of rapid changes in technology, software often has had a relatively short useful life.[13]

SOP 98-1 wisely does not prescribe a specified period or range of amortization for different types of software. To do so would undermine the accounting principles designed to properly match revenues and expenses. The useful life of software as with other intangibles is subject to a number of external factors such as regulatory requirements, technology changes, competition, and vendor restrictions. Due to the swift pace of change in technology, software lives are becoming more difficult to predict. For these reasons, GTE recommends that amortization lives be determined by each company based on the estimated useful life of the software at the time it is placed into service.

D. GTE supports the Joint Petitioner's requests for a waiver of the requirement to perform a revenue requirement study.

Part 32 rules require that when a change in an accounting standard is to be adopted, a revenue requirement study must be provided.[14] In the Petition, Joint Petitioners seek waiver of this requirement. They argue that special circumstances exist that warrant a deviation from the rule. In particular, they argue that the revenue requirement study provision no longer serves a purpose for price cap carriers, because

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[13] SOP 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," ¶ 37.

[14] 47 C.F.R. § 32.16(a).

the price cap rules exclude exogenous treatment for accounting changes that have no cash flow impact. As a result, they argue, the proposed accounting change has no rate impacts and a revenue requirement study would serve no useful purpose.[15]

GTE supports waiver of the revenue requirement study and the reasons given by Joint Petitioners in support of the waiver. GTE also notes that Commission's Part 32 Rules place the burden of complying with the revenue requirement study solely on incumbent local exchange carriers ("ILECs"). As such, failure to grant the waiver will bestow a competitive advantage on ILEC competitors that are not required to perform the costly revenue requirement study.

E. The SOP 98-1 accounting change does not warrant exogenous price cap treatment.

The FCC previously redefined "exogenous change" so that only changes that affect a carrier's cash flow are permitted exogenous treatment.[16] The proposed accounting change for software has no impact on cash flow and will have no impact on carriers price cap indices or rates. Accordingly, GTE agrees with the Joint Petitioners that the proposed accounting change should not receive exogenous price cap treatment.

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[15] Petition at 6

[16] Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, *First Report and Order*, 10 FCC Rcd 8961, 9089-9092 (1995).

II. CONCLUSION

GTE urges the Commission is adopt the recommendations of the Joint Petitioners and conform Part 32 to SOP 98-1. Failing to do so will force carriers subject to Part 32 to maintain costly separate records for financial and regulatory purposes.

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Respectfully submitted,

GTE Service Corporation and its affiliated domestic telephone operating companies

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Certificate of Service

I, Judy R. Quinlan, hereby certify that copies of the foregoing "Comments of GTE" have been mailed by first class United States mail, postage prepaid, on September 14, 1998 to the parties listed below:

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