

Capitalization of Interest

By: Meredith Lipson and Craig Moye

Capital assets initially are recorded at their historical cost. The cost of a capital asset, for this purpose, should include any “ancillary charges necessary to place the asset in its intended location and condition for use”. Interest incurred during construction is one of the costs required to be capitalized. In governmental accounting, only enterprise funds are required to capitalize interest during construction. Capitalization of interest is addressed by FASB Statement No. 34, *Capitalization of Interest Cost*, amended by FASB Statement No. 62, *Capitalization of Interest Cost in Situation Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants*. The FASB limits the applicability of Statement No. 62 to **tax-exempt borrowings** that are externally restricted to finance acquisition of specified qualifying assets (bond proceeds externally restricted to specific projects) or to service the related debt. Tax-exempt debt is debt issued for a “public” purpose, that is, for which taxpayers are likely to receive substantial benefit. The acquisition of a capital asset can be financed in a variety of ways. The rules for capitalization of interest vary depending on the type of financing, as follows:

Capital acquisition financed by externally restricted tax-exempt debt (FASB Statement No. 62)

Debt is considered to be for a public purpose, and thus **tax-exempt** if it satisfies either of two criteria: (1) less than 10% of the proceeds is used directly or indirectly by a non-governmental entity; or (2) less than 10% of the proceeds is secured directly or indirectly by property used in a trade or business.

- Amount of interest to be capitalized is calculated by “netting” interest expense on a borrowing against related interest earnings on the reinvested unexpended proceeds
- Capitalization of interest begins as of the date of the borrowing and ends when the asset is substantially ready to be placed in service.

Capital acquisition financed by borrowings other than externally restricted tax-exempt debt

- Amount of interest to be capitalized is calculated by applying the interest rate on the borrowing to the average amount of accumulated expenditures for the asset during the period.

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Our Resources

As always, we are available as a resource to you as questions arise. We are in this together as both auditor and auditee will have to keep up with evolving and fluid guidance from the Federal and State governments.

Please contact any of our governmental partners and managers, at 1-800-277-0050 for assistance.

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- Capitalization of interest begins when expenditures have been made (including deposits or progress payments to third parties), interest is being incurred (either in connection with new debt or in connection with existing debt), and activities are in progress to prepare the asset for its intended use. The term “activities” encompasses more than physical construction. It includes all the steps required to prepare the asset for its intended use, including administrative and technical activities during the preconstruction stage as well as activities undertaken after construction has begun in order to overcome unforeseen obstacles (i.e., technical problems, labor disputes, litigation, etc).
- If the enterprise fund suspends substantially all activities related to acquisition of the asset, interest capitalization stops until activities are resumed. However, brief interruptions in activities, interruptions that are externally imposed, and delays that are inherent in the asset acquisition process do not require cessation of interest capitalization.
- Capitalization of interest ends when the asset is substantially ready to be placed in service.
- Any amounts earned on the reinvested unexpended proceeds of the debt would have no effect on interest capitalization

Capital acquisition financed by existing resources

- As long as there is **any** debt outstanding in the fund, related interest expense is considered part of the cost of capital acquisition.
- No netting of interest expense against interest earnings.
- Amount of interest to be capitalized is calculated by applying the weighted average of interest on outstanding debt of the fund to the average amount of accumulated expenditures for the asset during the reporting period.
- Capitalization of interest begins at the start of preconstruction and ends when the asset is substantially ready to be placed in service.

Capital acquisition financed by a capital grant

- No interest is capitalized on any portion of a project that is financed by a capital grant that is externally restricted to the acquisition of specified assets.

Capital acquisition with mixed financing

- With mixed financing, the portion of the acquisition financed by each source must be treated separately.

In addition to the accounting treatments specified above, FASB Statement No. 34 contains two disclosure requirements relating to capitalized interest.

1. For an accounting period in which no interest cost is capitalized, the amount of interest cost incurred and charged to expense during the period and the amount thereof that has been capitalized should be disclosed.
2. For an accounting period in which some interest cost is capitalized, the total amount of interest cost incurred during the period and the amount thereof that has been capitalized should be disclosed.

This newsletter was written by Meredith Lipson and Craig Moye.

Meredith Lipson is a partner in Mauldin & Jenkins governmental practice sector. Most of her experience is with state and local governments. She has twenty years experience in providing public accounting services to the governmental sector. Meredith currently spends 100% of her time serving local governments.



Meredith is a Certified Public Accountant and a member of the American Institute of Certified Public Accountants, the Georgia Society of CPAs, the Government Finance Officers Association, and the Georgia Government Finance Officers Association (GGFOA). She has served on the Ethics Committee of the Georgia Society of CPAs and also volunteers with various community and neighborhood organizations.

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