



UT System Administration Policy Library – Policy UTS142. 5

Policy for Capitalization of Interest Cost

Responsible Officer: Associate Vice Chancellor – Controller and Chief Budget Officer

Sponsoring Office: Office of the Controller

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CONTENTS

Policy Statement

Rationale

Scope

Website Address For This Policy

Related Statutes, Policies, Requirements Or Standards

Contacts

Definitions

Responsibilities

Procedures

Forms Tools/Online Processes

Appendix

POLICY STATEMENT

The capitalized costs of interest during construction for debt-financed projects are the costs of interest related to the acquisition or construction of an asset. The interest costs should be capitalized during the period of time that is required to complete and prepare the asset for its intended use.

When certain tax-exempt borrowings are involved, interest earned on the temporary investments of the proceeds of those borrowings should be deducted from the interest cost of restricted tax-exempt borrowings to determine the net interest allowed to be capitalized.

The capitalization of interest costs is accomplished by debiting (increasing) the Construction in Progress Activity.

RATIONALE

This policy documents authoritative literature for the accounting treatment of capitalizing interest cost as part of the historical cost of acquiring certain assets including situations involving certain tax-exempt borrowings and certain gifts and grants.

SCOPE

All institutions and UT System Administration

WEBSITE ADDRESS FOR THIS POLICY

http://www.utsystem.edu/policy/policies/uts142_5.html

RELATED STATUTES, POLICIES, REQUIREMENTS OR STANDARDS

UT System Administration Policies	Other Statutes, Policies & Standards
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& Standards	
	<ul style="list-style-type: none"> • Governmental Accounting Standards Board (GASB) Statement 34 <u>Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments</u> • GASB Statement 35 <u>Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities</u> • 2001 NACUBO <u>Financial Accounting and Reporting Manual</u> for Higher Education Release 01-3 307.21. • FASB 34 <u>Capitalization of Interest Cost</u> • FASB 62 <u>Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowing and Certain Gifts and Grants</u> • 1997 NACUBO <u>Financial Accounting and Reporting Manual for Higher Education</u> Release 96-6, ¶ 421.35, 432.35.

CONTACTS

If you have any questions about UT System Administration Policy UTS 142.5, *Policy for Capitalization of Interest Cost*, contact the following offices:

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	Office of the	512-499-4527	<u>Controllersoffice@utsystem.edu</u>

	Controller		http://www.utsystem.edu/cont/
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DEFINITIONS

Capital Assets: “Land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period (GASB Statement No. 34 19).”

Infrastructure Assets: Long-lived assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets. Examples of infrastructure assets include roads, bridges, tunnels, drainage systems, water and sewer systems, dams and lighting systems (GASB Statement No. 34 19).

Qualifying Expenditure: One which has required the payment of cash, the transfer of other assets, or the incurring of a liability on which interest is recognized.

Capitalization Rate: The interest rate applied to the average amount of accumulated expenditures for the asset during the period to determine the amount of interest to be capitalized.

- The capitalization rates used in an accounting period shall be based on the rates applicable to borrowings outstanding during the period.
- If there is a specific new borrowing associated with the qualifying asset, the rate on that borrowing may be used as the capitalization rate to be applied to that portion of the average accumulated expenditures for the asset that does not exceed the amount of that borrowing.
- If the average accumulated expenditures for the asset exceed the amounts of specific new borrowings associated with the asset, the capitalization rate to be applied to such excess shall be a weighted average to the rates applicable to other borrowings of the System.
- Identification of the borrowings to be included in the weighted average rate may require judgment to achieve the objective of a reasonable measure of the cost of financing acquisition of the asset in terms of the interest cost incurred that otherwise could have been avoided.

RESPONSIBILITIES

Office of the Controller

- Interpreting this policy and revising it to comply with statutory requirements and as necessary to meet the changing needs of The University of Texas System and calculation of the capitalized interest amount.

Office of Facilities Planning and Construction

- Provide a list of projects which are substantially complete or primarily equipment which should be excluded from the calculation of capitalized interest.

Office of Finance

- Provide the weighted average interest earnings and interest expense.

PROCEDURES

GUIDELINES FOR CAPITALIZATION OF INTEREST

A. Overview

The costs of capital assets [as defined by GASB Statement 34], other than infrastructure and collections, acquired or constructed must always be capitalized. Such costs should include capitalized interest (2001 NACUBO Financial Accounting and Reporting Manual for Higher Education Release 01-3 307.21.)

The objectives of capitalizing interest are to obtain a measure of acquisition cost that more closely reflects the institution's total investment in the asset and to charge a cost that relates to the acquisition of a resource that will benefit future periods against the revenues of each of those future periods.

Interest capitalization on general borrowing would not be applied to assets financed totally by gifts or grants that were restricted by the donor to the project (1997 NACUBO Financial Accounting and Reporting Manual for Higher Education Release 96-6 432.35.)

B. Concept

The historical cost of acquiring certain assets includes the costs necessary to bring it to the condition for its intended use. Interest cost is capitalizable for assets that require a period of time to get them ready for their intended use.

C. Qualifying Assets

1. Assets that are constructed or otherwise produced for the institution's own use (including assets constructed or produced by others for which deposits or progress payments have been made).
2. Assets intended for sale or lease that are constructed or otherwise produced as discrete projects.

D. Nonqualifying Assets

Land that is not undergoing activities necessary to get it ready for its intended use is not a qualifying asset.

E. Capitalization Period

1. The capitalization period begins when all three of the following conditions have been met:
 - a) Qualifying expenditures for the qualifying asset have been made (cash payments have been made or debt has been incurred for construction of the asset).
 - b) Activities that are necessary to get the asset ready for its intended use actually are in progress.
 - c) Interest cost is being incurred.

In situations involving qualifying assets financed with the proceeds of tax-exempt borrowings whose funds are externally restricted to finance the acquisition of specified qualifying assets or to service the related debt.

2. The interest capitalization period ends when the asset is substantially complete and ready for its intended use.

F. Amount to be Capitalized

1. The amount of the interest cost to be capitalized for qualifying assets is intended to be that portion of the interest cost incurred during the assets' acquisition period that theoretically could have been avoided if expenditures for the assets had not been made.
2. The amount capitalized in an accounting period shall be determined by applying an interest rate(s) ("the capitalization rate") to the average amount of accumulated expenditures for the asset during the period.
3. Interest earned shall be offset against interest cost in determining the capitalization of interest cost for those assets financed with the proceeds of tax-

exempt borrowings whose funds are externally restricted to finance the acquisition of specified qualifying assets or to service the related debt.

- a) When assets are provided through tax-exempt borrowings externally restricted for the construction of specific assets, then the amount of interest cost to be capitalized is the total cost of the borrowings less any interest earned on the temporary investment of the proceeds of the borrowings, from the date of borrowing until the assets acquired with the borrowings are ready for their intended use.
- b) This calculation could be made based on quarterly expenditures.
- c) The capitalization rate is the aggregate average borrowing rate on general debt of the institution.

FORMS AND TOOLS/ONLINE PROCESSES

None

APPENDIX

None

Keywords: interest, accounting
