

Capitalization of Interest Cost

Example 1

Construction began	January 1, 2006		
	Amount	Annual interest rate	
Specific borrowing	\$ 2,000,000	8%	
Other borrowing	\$ 15,000,000	10%	
Other borrowing	\$ 25,000,000	12%	
	2006	2007	2008
Annual construction expenditures (incurred evenly during the year)	\$ 6,000,000	\$ 12,000,000	\$ 3,000,000
Facility became ready for use	April 30, 2008		
Facility started production	July 1, 2008		

Step 1: Weighted average interest rate

	Amount	Annual interest rate	
Specific borrowing	\$ 2,000,000	8%	
	Amount	Annual interest rate	Annual interest cost
Other borrowing	\$ 15,000,000	10%	\$ 1,500,000
Other borrowing	\$ 25,000,000	12%	\$ 3,000,000
Total	\$ 40,000,000	11.25%	\$ 4,500,000

Weighted average interest rate	$\$4,500,000 / \$40,000,000 = 11.25\%$
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Step 2: Average cumulative expenditures

		2006	2007	2008
A	Beginning accumulated expenditures	\$ -	\$ 3,272,500	\$ 10,250,656
B	Expenditures incurred during the year	\$ 6,000,000	\$ 12,000,000	\$ 3,000,000
C=A+B	Ending accumulated expenditures	\$ 6,000,000	\$ 15,272,500	\$ 13,250,656
D=(A+C)/2	Average accumulated expenditures	\$ 3,000,000	\$ 9,272,500	\$ 11,750,656
E	Interest cost to be capitalized	\$ 272,500	\$ 978,156	\$ 418,983
F=C+E	Accumulated expenditures after interest capitalization	\$ 3,272,500	\$ 10,250,656	\$ 12,169,639

Interest cost to be capitalized

	Borrowing amount	Interest rate	Interest cost	Number of months	Interest to be capitalized
	\$ 2,000,000	8%	\$ 160,000		
	\$ 1,000,000	11.25%	\$ 112,500		
2006	\$ 3,000,000		\$ 272,500	12	\$ 272,500
	\$ 2,000,000	8%	\$ 160,000		
	\$ 7,272,500	11.25%	\$ 818,156		
2007	\$ 9,272,500		\$ 978,156	12	\$ 978,156
	\$ 2,000,000	8%	\$ 160,000		
	\$ 9,750,656	11.25%	\$ 1,096,949		
2008	\$ 11,750,656		\$ 1,256,949	4	\$ 418,983
(January 1 - April 30)					