

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 | $\$4,500,000 / \$40,000,000 = 11.25\%$ |
|--------------------------------|--|

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 |
|---------------------------------------|------------------|---------------|---------------------|------------------|----------------------------|
| 2006 | \$ 2,000,000 | 8% | \$ 160,000 | 12 | \$ 272,500 |
| | \$ 1,000,000 | 11.25% | \$ 112,500 | | |
| | \$ 3,000,000 | | \$ 272,500 | | |
| 2007 | \$ 2,000,000 | 8% | \$ 160,000 | 12 | \$ 978,156 |
| | \$ 7,272,500 | 11.25% | \$ 818,156 | | |
| | \$ 9,272,500 | | \$ 978,156 | | |
| 2008 (January 1 - April 30) | \$ 2,000,000 | 8% | \$ 160,000 | 4 | \$ 418,983 |
| | \$ 9,750,656 | 11.25% | \$ 1,096,949 | | |
| | \$ 11,750,656 | | \$ 1,256,949 | | |