

Capitalization of Interest Cost
Example 3

Construction began	January 1, 2006		
	Amount	Annual interest rate	
Specific borrowing	\$ 3,200,000	7%	
Other borrowing	\$ 7,600,000	8%	
Other borrowing	\$ 29,000,000	6%	
	2006	2007	2008
Annual construction expenditures (incurred evenly during the year)	\$ 8,500,000	\$ 15,200,000	\$ 5,600,000
Facility became ready for use	August 31, 2008		
Facility started production	November 1, 2008		

Step 1: Weighted average interest rate

	Amount	Annual interest rate	
Specific borrowing	\$ 3,200,000	7%	
	Amount	Annual interest rate	Annual interest cost
Other borrowing	\$ 7,600,000	8%	\$ 608,000
Other borrowing	\$ 29,000,000	6%	\$ 1,740,000
Total	\$ 36,600,000	6.42%	\$ 2,348,000

Weighted average interest rate	$\$2,348,000 / \$36,600,000 = 6.42\%$
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Step 2: Average cumulative expenditures

		2006	2007	2008
A	Beginning accumulated expenditures	\$ -	\$ 4,541,361	\$ 12,938,976
B	Expenditures incurred during the year	\$ 8,500,000	\$ 15,200,000	\$ 5,600,000
C=A+B	Ending accumulated expenditures	\$ 8,500,000	\$ 19,741,361	\$ 18,538,976
D=(A+C)/2	Average accumulated expenditures	\$ 4,250,000	\$ 12,141,361	\$ 15,738,976
E	Interest cost to be capitalized	\$ 291,361	\$ 797,615	\$ 685,609
F=C+E	Accumulated expenditures after interest capitalization	\$ 4,541,361	\$ 12,938,976	\$ 16,424,584

Interest cost to be capitalized

	Borrowing amount	Interest rate	Interest cost	Number of months	Interest to be capitalized
2006	\$ 3,200,000	7%	\$ 224,000	12	\$ 291,361
	\$ 1,050,000	6.42%	\$ 67,361		
	\$ 4,250,000		\$ 291,361		
2007	\$ 3,200,000	7%	\$ 224,000	12	\$ 797,615
	\$ 8,941,361	6.42%	\$ 573,615		
	\$ 12,141,361		\$ 797,615		
2008 (January 1 - August 31)	\$ 3,200,000	7%	\$ 224,000	8	\$ 685,609
	\$ 12,538,976	6.42%	\$ 804,413		
	\$ 15,738,976		\$ 1,028,413		