

CITY OF MADISON – FISCAL SERVICES

Capitalized Interest Policy

Purpose: The purpose of this Policy is to document the accounting treatment of capitalizing interest cost as part of the historical cost of acquiring Business Activity assets, including situations involving certain tax-exempt borrowings, gifts and grants.

Policy: The capitalized cost of interest during construction for debt-financed projects are the costs of interest related to the acquisition/construction of an asset or infrastructure project. The interest costs should be capitalized during the period of time required to complete and prepare the asset for the intended use.

Tax-Exempt Borrowings: When certain tax-exempt borrowings are involved, interest earned on the temporary investments of the proceeds should be deducted from the interest costs of tax-exempt borrowings to determine the net interest allowed to be capitalized.

Capitalization of Interest Costs: Capitalization of interest costs is accomplished by debiting (increasing) the construction in progress activity and crediting (decreasing) interest expense.

Guidelines for Capitalization of Interest

The cost of Business Activity capital assets acquired or constructed must always be capitalized. Such costs should also include capitalized interest if the construction project or purchase:

- Is greater than \$500,000
- Takes place over a period of 60 days or greater.

Capitalizing interest allows the Activity to determine an asset acquisition cost that more closely reflects the total investment in the asset. It also allows the Activity to charge all costs that relate to the acquisition of a resource that will benefit future periods against the revenues of those future periods (through depreciation).

The historical cost of acquiring certain assets includes the costs necessary to bring it into the condition for its intended use. Interest costs should be added to any capitalized assets that require a period of time to get them ready for their intended use.

Interest capitalization on general borrowing will not be applied to assets financed totally by gifts or grants that were restricted by the donor to the project.

Qualifying Assets

Qualifying assets include the following:

- Assets that are constructed or otherwise produced for the Activity's use, including assets constructed or produced by others for which deposits or progress payments have been made.
- Assets intended for sale or lease that are constructed or otherwise produced as discrete projects.

Non-qualifying Assets include following:

- Assets with a total cost less than \$500,000.
- Assets purchased or constructed in less than 60 days.
- Land that is not undergoing activities necessary to get it ready for its intended use.
- Easement purchases.

Capitalization period

The capitalization period begins when all three of the following conditions have been met:

- Qualifying expenditure for the qualifying asset have been made (cash payments have been made or debt has been incurred for construction of the asset).
- Activities that are necessary to get the asset ready for its intended use actually are in progress; and
- Interest cost is being incurred.

The capitalization period ends when the asset or infrastructure project is substantially complete and ready for its intended use.

Capitalization Amount

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 asset's acquisition period that theoretically could have been avoided if expenditures for the asset had not been made.

The amount capitalized annually shall be determined by applying interest rates(s) (the capitalization rate) to the average amount of accumulated expenditures for the asset during the period.

Capitalization Rate

The capitalization rate will be determined as the average true interest costs of any debt issue with unspent proceeds less the average interest earned on investments for the same period. If all proceeds are spent, the average interest earned on investments will be used.