

Calculations – Capitalized Interest - What Is It And Why Is It Important?

Guidance

Always consult the bond covenants or loan agreement (covenants) to determine the specific requirements for Capitalized Interest. This may or may not involve consultations with your financial advisor, bond counsel and or Certified Public Accountant.

Definition

Capitalized Interest is an amount of interest paid during the period of time prior to the asset being completed and placed into service. Capitalized Interest is relevant to and important to the proper recording of the total cost of an asset. It is also relevant to the accounting for funds provided to construct and complete an asset for purposes of Final Accounting (an issue separate and apart from the financial reporting requirements).

Importance

Two aspects of Capitalized Interest are important:

- a) Financial reporting based on Generally Accepted Accounting Principles (GAAP) provides guidance on how to account for Capitalized Interest. Normally, the cost of funds borrowed to create an asset are added to the cost of the asset and then depreciated over time as part of depreciation expense rather than being reported as interest expense during the year incurred. Borrowers should consult their Certified Public Accountant for guidance on proper accounting recognition of Capitalized Interest.

- b) Separately from the financial reporting described above, in the Final Accounting process after a project is complete and placed in service, Capitalized Interest may be allowable as an expenditure of funds provided to complete the project. The amount of interest expense in the first two years is generally allowable and reported as a line item in the use of funds during the Final Accounting process.

Financial Compliance can provide more guidance on Capitalized Interest as part of the overall Final Accounting process.

See also “Final Accounting - Sources and Uses Form, Preparation of” for additional guidance.