University of Missouri System
Accounting Policies and Procedures

Policy Number: APM 20.10

Policy Name: <u>Capitalization of Interest Cost</u>

General Policy and Procedure Overview:

The costs of capital assets acquired or constructed are capitalized in accordance with the provisions of APM 20.05. The historical cost of acquiring an asset includes the costs necessarily incurred to bring it to the condition and location necessary for its intended use. If an asset requires a period of time in which to carry out the activities necessary to bring it to that condition and location, the interest cost incurred during that period as a result of expenditures for the asset is a part of the historical cost of acquiring the assets. The amount of interest capitalized, theoretically, should be the amount of interest charged during the assets' acquisition or construction period that could have been avoided if the assets had not been acquired.

For components of capital assets specifically funded with debt financing, capitalized interest is driven by the costs of the associated debt during the acquisition or construction period (FASB Statement No. 34). To the extent that such debt financing is in the form of a tax-exempt borrowing, the amount of interest cost to be capitalized must be reduced by interest earned on the temporary investment of the unspent proceeds of the borrowings (FASB Statement No. 62). For components of capital assets funded by unrestricted operating revenues, the interest capitalized is driven by the University's overall borrowing costs on other outstanding debt (FASB Statement No. 34). Interest is not capitalized for components of capital assets specifically funded by externally restricted gifts or grants (FASB Statement No. 62).

Definition of Key Terms:

Capital Assets – as defined in <u>APM 20.05</u> , capital assets may include land, land improvements, easements, buildings, building improvements, vehicles, machinery equipment, works of art and historical treasures, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.

Capitalization Interest Rate– In cases where funding is specifically provided by unrestricted operating revenues, the University's aggregate average borrowing rate on outstanding debt will be used to determine the capitalization rate. The average borrowing rate on outstanding debt will be calculated annually by the Treasurer's Office.

Detail Policy:

Materiality Threshold:

Interest is capitalized on:

- Bond fund capital asset projects
- Planned capital asset projects requiring more than $5 million in unrestricted funds

Qualifying Assets:

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

Non-Qualifying Assets:

- Land that is not undergoing activities necessary to get it ready for its intended use as discrete projects
- Assets that are already in use or ready for their intended use in the normal operations of the University
- Assets that are not being used in the activities of the University and are not undergoing the activities necessary to get them ready for use.

Capitalization period:

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

- Expenditures for the asset have been made.
- Activities that are necessary to get the asset ready for its intended use are in progress.
- Interest cost is being incurred.

Or

- In situations involving qualifying assets financed with the proceeds of tax-exempt borrowings that are externally restricted (FASB Statement No. 62), the capitalization period begins at the date of the borrowing.

The capitalization period ends when the asset is substantially complete and ready for its intended use. At this time the asset is removed from Construction in Progress and recorded as a capital asset in the Asset Management System.

Determination of the Capitalization Interest Rate:

In cases where funding is specifically provided by debt financing, the cost of the associated debt will be used to determine the capitalization interest rate. In cases where funding is specifically provided by unrestricted operating revenues, the University's aggregate average borrowing rate on outstanding debt will be used to determine the capitalization interest rate. The average borrowing rate on outstanding debt will be calculated annually by the Treasurer's Office.

Amount to be capitalized:

The amount capitalized in an accounting period can be determined by applying the capitalization rate to the average accumulated expenditures for the asset during the period. To the extent assets are specifically financed with the proceeds of tax-exempt borrowings, interest earned through the temporary investment of any unspent borrowings will be offset against the interest cost in determining the capitalization of interest cost.

Responsibility

Accounting Offices**:**

- Work with campus facilities to identify planned capital projects requiring more than $5 million in unrestricted funds.
- Record and calculate the non-bond capitalized interest for planned capital projects requiring more than $5 million in unrestricted funds.
- Record the capitalized interest in the Asset Management System

Controller's Office:

- Record and calculate the amount of interest to be capitalized for bond-funded capital assets.
- Provide the journal entry detail for bond-funded capitalized interest to the campus Accounting Offices.
- Obtain the average borrowing rate on outstanding debt from the Treasurer's Office on an annual basis, and provide to the campus Accounting Offices.

Effective Date: March 1, 2010
Revised Date: May 11, 2011

Questions and Comments?

Questions regarding interpretation and implementation of the Accounting Policy should be directed to the Campus Accounting Office. Suggested edits or revisions to the policy should be directed to the Office of the Controller.

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