Of Interest to You

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In November 2017, the Governmental Accounting Standards Board (GASB) issued an Exposure Draft entitled *Accounting for Interest Cost during the Period of Construction*. The GASB is proposing a standard that would significantly change the way certain interest costs are accounted for during the period of construction of capital assets. And (for once) for the better! If approved in its current form (and I do not anticipate any real challenges to this proposal), governmental entities would simply recognize interest as an expense or an expenditure in the period it's incurred, whether or not it is during the construction period. As such, there would be no further interest capitalization to calculate and report.

A Little History

Governmental entities are currently required to capitalize related interest incurred during the construction period in business-type activities and enterprise funds. The interest expense incurred during *the actual construction period* is considered part of the cost of acquiring the capital asset in question and thus part of the historical cost of the asset. When the construction period ends, further incurrence of interest expense is simply recognized as a period expense.

Current GAAP is actually rooted in standards promulgated for the private sector by the Financial Accounting Standards Board (FASB). Governmental entities have been capitalizing interest costs based on FASB Statement No. 34, *Capitalization of Interest Cost,* for taxable debt and FASB Statement No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants,* for tax-exempt debt. These standards were subsequently incorporated into GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

As for the calculations themselves, the differences between the two approaches are not that significant. For tax-exempt debt, the capitalization period begins when the debt is issued and ends when the asset is substantially completed. The amount of interest expense to be capitalized is the interest expense incurred during this period, *net of any interest earnings on the proceeds of the debt issuance that were temporarily invested during the same time frame.* For taxable debt, the period begins when construction begins (which may be significantly later than the date of debt issuance) and also ends when the asset is substantially completed. However, unlike tax-exempt debt, there is *no netting the interest expense incurred with interest earned on the debt proceeds during the same time period.*

Proposed Changes

The aforementioned calculations can be time-consuming and difficult to actually do correctly. The overall difference made on the historical cost of the related asset is often negligible, as is the effect on the annual depreciation expense that is being recognized. Historically, the argument was made that the interest expense incurred during the construction period is part of the cost of procuring the capital asset. However, the GASB concluded during the research phase of this project that interest costs are associated with the *financing* of the asset and should *not* be considered part of the acquisition cost. Their argument was that *how* a capital asset is financed really has nothing to do with the actual costs incurred to ready a capital asset for use.

As such, the proposed guidance would be to simply recognize interest expense as it is incurred. There would be no more interest capitalization that would be considered part of the historical cost of a capital asset. Of course, interest incurred on governmental fund related debt would continue to be recognized as an expenditure.

The change in approach would be applied prospectively. In other words, there would be no retroactive treatments or prior period adjustments. If approved, the new guidance would be effective for periods beginning after December 15, 2018. The GASB hopes to have a final pronouncement by June 2018.

At least in this instance, the GASB is making something easier. As our friend Martha Stewart would say, “that is a good thing”.