

The Deloitte logo, consisting of the word "Deloitte" in a white, bold, sans-serif font, followed by a small green dot.

# Start Up and Development Costs

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# Guidance

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- Statement of Position 98-5, *Reporting on the Costs of Start-up Activities*
  - Primary guidance
  - Types of costs defined as start-up
  - Development activities
  - Construction activities

# SOP 98-5

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- For purposes of this SOP, start-up activities are defined broadly as those one-time activities related to opening a new facility, introducing a new product or service, conducting business in a new territory, conducting business with a new class of customer
- The SOP concludes in paragraph 12 “Costs of start-up activities, including organization costs, should be expensed as incurred”

# SOP 98-5

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- The standard purposely did not provide a list:
  - “AcSEC did not attempt to provide an all-inclusive detailed list of such costs because entities have different accounting policies for the kinds of costs capitalized under existing generally accepted accounting principles (for example, property, plant, and equipment). AcSEC believes entities are best capable of identifying those costs.”

# Issues to Discuss

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- So when do you start capitalizing?
- What types of costs can be capitalized?
- What about overhead?
- What about project development and evaluation costs?
- Capitalized Interest (SFAS 34)

## SOP 98-5 (Start/End)

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“AcSEC decided that it was not necessary to develop boundaries for when the start-up period begins and ends. The definition of start-up activities is based on the nature of the activities and not the time period in which they occur. AcSEC believes that costs previously capitalized by entities as start-up costs will be expensed as incurred as start-up costs or some other costs, such as general and administrative.”

## Footnotes *(cont.)*

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“The Company capitalizes project development costs once it is determined that it is probable such costs will be realized through the ultimate construction of a power plant or other site. These costs include professional services, salaries, permits and other costs directly related to the development of a new project...”

# SOP 98-5 (Expense Mode)

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Business development activities are incurred in the normal course of business evaluation and expansion (EXPENSE)

- Deciding where to locate a facility
- Feasibility studies
- Discussions with governmental, potential contractors, communities, potential investors
- Travel
- Legal, accounting, tax evaluations



# SOP 98-5 (Capitalize Mode)

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Is the project considered probable? The indicators could include:

- Execution of a PPA
- Project financing
- Permitting and execution of a construction contract
- Specifically identified site, project or contract
- Other milestones

# SOP 98-5 (Types of Costs Capitalized)

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- Are the costs directly related to the project?
- What are the costs to construct the asset and get it ready for its intended use
- Follow existing GAAP
- Would the costs have other wise been incurred
- Overhead becomes problematic

An important distinguishing fact may be are the costs project acquisition, development, or construction related as opposed to costs related to a **possible** development or evaluation

# Footnotes

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“Property, plant and equipment items are recorded at cost. We capitalize costs incurred with the construction of power plants, the development of geothermal properties, and the refurbishment of major turbine generator equipment...”

## Footnotes (*cont.*) – Cap Interest

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“...capitalizes interest on projects during their construction period. The Company determines which debt instruments represent a reasonable measure of the cost of financing construction assets in terms of interest cost incurred that otherwise could have been avoided. These debt instruments and associated interest costs are included in the calculation of the weighted average interest rate used for determining the capitalization rate...”

## Footnotes *(cont.)*

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... Upon commencement of construction, these costs either are transferred to construction work in progress or remain in other assets, depending upon the nature of the cost. Capitalized development costs are charged to O&M expenses when the development of a project is no longer probable.”

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