CAPITAL AND OPERATING LEASES

1. To assist in determining whether the lease is a capital or an operating lease, the DRAM shall be provided with a copy of all proposed leasing agreements detailing all the charges applicable to the leasing arrangement along with any other pertinent details, such as the fair value of the leased property, an end lease “bargain purchase option”, salvage value, etc.

CAPITAL LEASE

2. As detailed below, a capital lease is a lease that, from the “point of view” of the lessee (i.e. the leasing NPP entity), transfers substantially all the benefits and disadvantages of ownership to the leasing NPP entity:

a. a lease normally transfers substantially all of the benefits and risks of ownership to the leasing NPP entity when, at the inception of the lease, one or more of the following conditions are present:

(1) There is reasonable assurance that the NPP entity will obtain ownership of the leased property by the end of the lease term. Reasonable assurance that the NPP entity will obtain ownership is present when the terms of the lease result in ownership being transferred to the NPP entity by the end of the lease term or, when the lease provides for a bargain purchase option;

(2) The lease term is of such duration that the NPP entity will receive substantially all of the economic benefits expected to be derived from the use of the leased property over its life span. Although the lease term may not be equal to the economic life of the leased property in terms of years, the NPP entity is normally expected to receive substantially all of the economic benefits to be derived from the leased property when the lease term is equal to a major portion (usually 75 percent or more) of the economic life of the leased property. This is due to the fact that new equipment, with later technology and in prime condition, may be assumed to be more efficient than old equipment that has been subject to obsolescence and wear; and

(3) The lessor (the company leasing the property to NPP) is assured of recovering the investment in the leased property and of earning a return on the investment as a result of the lease agreement. This condition exists if the present value, at the beginning of the lease term, of the minimum lease payments, excluding any portion thereof relating to executory costs, is equal to substantially all (usually 90 percent or more) of the fair value of the leased property, at the inception of the lease. In determining the present value, the discount rate used by the NPP entity is the lower of the NPP entity's rate for

incremental borrowing (i.e. the CFCF Rate (currently 4%)) and the interest rate implicit in the lease, if known.

Note: A bargain purchase option is a provision allowing the NPP entity to purchase the leased property at a lower than market value price that appears at the time of signing the lease, to be attractive enough to provide reasonable assurance that the option to purchase will be exercised.

3. A decision tree (Appendix 1 to Annex F) is provided to assist in determining whether the lease is a capital or an operating lease. The decision tree/analysis of the classification of the lease should be completed by the outlet manager in consultation with the DRAM.

Capital Lease Analysis

4. Upon determination that a proposed lease is a capital lease, a capital lease analysis shall be conducted IAW the instructions detailed at Appendix 2 to Annex F (Capital Lease Analysis Standard Operating Procedures) using:

a. for 54 month standard equipment leases, Appendix 3 to Annex F (54 Months Standard Equipment Lease and Loan Term);

b. for 60 month standard equipment leases Appendix 4 to Annex F (60 Months Standard Equipment Lease and Loan Term) and

c. for 60 month vehicle leases Appendix 5 to Annex F (60 Months Vehicle Lease and Loan Term).

Note: For leases that fall outside of the parameters of Appendices 3, 4 and 5 contact Finance Accounting Policy and Procedures Analyst (APPA) for assistance.

5. If the decision is made to move forward with the capital lease, a copy of the "summary and data table page" from the applicable Appendix along with a copy of the lease and supporting documentation shall be attached to a CER and submitted (along with an electronic copy of the applicable Appendix) to CFO for approval (via the local NPPAM/DRAM).

Note: In circumstances where capital leases are costlier than acquisition through a CFCF loan, the CER must be accompanied by documentation to support and validate this method of acquisition.

Accounting Action

6. To report the entity’s total resources and all aspects of the NPP entity's long-term obligations, a capital lease shall be accounted for as an acquisition of an FA and an assumption of an obligation.

a. the capitalized value of a depreciable FA under a capital lease shall be the lesser of the present value of the minimum lease payments (excluding the portion thereof relating to executory costs such as mandatory maintenance costs included in the lease payments) and the leased FA's “fair value”. The capital lease shall be amortized over the period of expected use on a straight-line basis:

(1) if the lease contains terms that allows ownership to pass to the NPP entity or there is a bargain purchase option, the period of amortization shall be the economic life of the FA (as determined by CFO);

(2) otherwise, the property shall be amortized over the lease term;

b. an obligation under a capital lease is similar to a loan. Lease payments shall be allocated to a reduction of the obligation, interest expense and any related executory costs. The interest expense is calculated using the discount rate used in computing the present value of the minimum lease payments applied to the remaining balance of the obligation.

Alternatively, when circumstance warrant (such as in the case where a golf equipment supplier charges lease payments only during the operating season) for ease of administration interest payments can be based on cash flow and prorated (straight-lined). For example, if the capitalized value is assumed to be the “fair value” of $20K (as per a supporting invoice and / or lease contract) and the mandatory lease payments equal $22K (with no executory costs), for every $1K in lease payments $909.09 (rounded) would go against reducing the obligation and the balance of $90.91 would be charged to interest expense ($1K/$22Kx$20K = $909.09);

c. in order to distinguish between FA that the enterprise owns and those that it only has the right to use, FA leased under capital leases shall be presented separately. The related lease obligations shall be separated from other long-term obligations and any portion of lease obligations payable within a year out of current funds shall be included in current liabilities;

d. for each major category of capital leased property and equipment, there shall be disclosure of:

(1) cost;

(2) accumulated amortization, including the amount of any write-downs; and

(3) the amortization method used, including the amortization period or rate;

e. for an obligation under a capital lease, there shall be disclosure of:

(1) the interest rate;

(2) the maturity date;

(3) the amount outstanding; and

(4) if the leases are secured, the fact that they are secured;

f. interest expense related to lease obligations shall be disclosed separately, or as part of interest on long-term indebtedness; and

g. the total amount of payments estimated to be required in each of the next five years to meet repayment or retirement provisions shall be disclosed.

Operating Lease

7. An operating lease is a lease in which the lessor does not transfer substantially all the benefits and risks of ownership to the NPP entity and equates to rental of the leased vehicle or equipment - in essence, if it is not a capital lease, it is an operating lease.

8. Because most operating leases are short term, charging lease rentals to expense on a straight-line basis over the lease term, even if not payable in such a manner, would normally result in recognition of the expense in a manner that is representative of the time pattern in which the user derives benefit from the leased property. Alternatively, when circumstance warrant (such as in the case where a golf equipment supplier charges lease payments only during the operating season) for ease of administration payments for leased equipment can be recognized as expense in the accounting period in which they are made.

9. Disclosure shall be made of the future minimum lease payments in total and for each of the five succeeding years under operating leases. The nature of other commitments under such leases shall also be described. Leases with an initial term of one year or less may be excluded from this disclosure requirement.

10. All property acquired under an operating leasing agreement shall be controlled in accordance with the procedures for items on loan as per Annex E (Loan and Donated Fixed Assets).

Appendix 1 – Lease Decision Tree
Appendix 2 – Capital Lease Analysis Standard Operating Procedures
Appendix 3 – 54 Month Standard Equipment Lease & Loan Term
Appendix 4 – 60 Month Standard Equipment Lease & Loan Term
Appendix 5 – 60 Months Vehicle Lease & Loan Term