Accounting for CompuSafe® Customer Contracts (Leases)

Background

CompuSafes contracts include an embedded lease agreement with the customer (Brink's is leasing the CompuSafe asset to the customer). Therefore, **Compusafe customer contracts are required to be evaluated for proper classification as either capital or operating leases (as described in the "Lease Classification as Capital vs Operating" Learn Once, Globally)**.

This Learn Once, Globally (LOG) is intended to provide guidance on key terms that should be considered when evaluating CompuSafe customer contracts for proper classification as capital or operating leases. This LOG does not apply to situations where the Brink's subsidiary does not own the CompuSafe asset (e.g. the CompuSafe is obtained under an operating lease from the manufacturer).

Guidance

The four criteria for determining whether leases should be accounted for as capital or operating (from the perspective of a lessee) are included in the "Lease Classification as Capital vs Operating" LOG.

Because Brink's is the Lessor in this situation, if the customer contract meets one of the four capital lease criteria contained in the LOG, two additional criteria must be evaluated to confirm that capital lease accounting is appropriate:

1) The collectability of rent is reasonably predictable. *This is normally accomplished by doing a credit check of potential customers.*
2) There are no important uncertainties in the amount of unreimbursable costs that we may incur during the lease term. *Providing a warranty for replacement parts would create "important uncertainties" and would prevent capital lease accounting, even if we charge a monthly fee for the service. However, it is possible to provide a maintenance agreement for immaterial parts. The determination of whether an uncertainty is "important" is complicated and Corporate Accounting should be consulted when making this determination.*

Results of CompuSafe Lease Classification Evaluation and Key Considerations:

Corporate Accounting evaluated customer contracts at all subsidiaries with significant capitalized balances of CompuSafe fixed assets as of 2013. Some of the findings from the country by country analysis are included in *Attachment A* to this document.

The evaluation found three provisions that were consistently included in customer contracts at multiple Brink's subsidiaries which prevented the use of capital lease accounting. These provisions are discussed below. These provisions should be the first factors considered when determining the appropriate lease classification for customer contracts involving the rental of CompuSafes at your reporting entities:

1) *Warranty for replacement parts* – Customer contracts involving the rental of CompuSafes include services to be provided to the customer in addition to the

rental. In many instances these services include a warranty to replace non-functioning parts of the CompuSafe (note readers, screens, etc.). If warranty is provided under the contract to replace significant parts of the CompuSafe at no additional cost to the customer for a period longer than the standard manufacturer's warranty (e.g. Manufacturer provides a 1 year warranty on CompuSafe parts), capital lease accounting is prohibited. This is because the warranty represents an "important uncertainty" in the future cash flows.

Significant parts include those individual parts whose replacement cost is significant when compared to the total cost of the CompuSafe (e.g. greater than 3% of total CompuSafe gross cost value) or those parts that are specially designed for use in a CompuSafe (i.e. not widely available from retail vendors).

Corporate Accounting is aware of two options for structuring the warranty to the customer for replacement parts that would allow capital lease accounting:

a) Exclude replacement of significant parts from the customer contract warranty once the period covered by the manufacturer's warranty has ended, at which time the customer is required to pay an amount that approximates the cost of the significant part in each instance it is replaced.
b) Brink's disclaims liability for the replacement of significant parts in the customer contract and allows the customer to enter into a warranty for the replacement parts directly with a 3rd party (e.g. manufacturer).

2) *Profitability of rent charged to customers* – One of the criteria included in the "Lease Classification as Capital vs Operating" LOG which determines capital or operating lease treatment is a comparison of the present value (PV) of minimum lease payments to 90% of the fair value of the CompuSafe asset. The rent charged in certain cases was not profitable and therefore the PV of minimum lease payments was not greater than 90% of the fair value.

   When evaluating the profitability of the CompuSafe rent, it is important to remember that the rent for accounting purposes may be different from the rental fees stated in the customer contract. US GAAP requires that contract revenue be allocated to all the deliverables (goods / services provided to the customer) included in the contract based on their relative fair value. This is a complex topic that is best illustrated using an example. Please see Attachment B for an example of contract revenue allocation under US GAAP. Once the contract revenue allocated to rent is determined, the PV can be compared to the fair value of the CompuSafe.

   If CompuSafe customer contracts have been financially evaluated and pricing standardized to ensure that a desired margin is received on the total revenue from each contract, the 90% criteria will generally be met.

3) *Insufficient early termination penalties* – Many customer contracts that were evaluated did not charge the customer a significant penalty for terminating the lease early. Unless the penalty is set to a level large enough that it is reasonably assured the customer will not terminate early, we cannot assume that we will collect any rent payments under the lease or that the lease term will extend beyond the date the lease is signed when evaluating the four lease classification criteria included in the "Lease Classification as Capital vs Operating" LOG. Therefore, a customer contract with an insufficient early termination penalty will not qualify for capital lease accounting.

   When assessing whether it is reasonably assured that the lease will not terminate early, the amount of the termination penalty as a percentage of future payments due under the customer contract should be the first factor considered. The termination penalty should represent a significant portion of the future payments due under the contract in order to conclude that the continuation of the lease for the full term of the

customer contract is reasonably assured. If the penalty is not equal to the remaining rentals of the contract, Corporate Accounting should be consulted as the definition of significant can be judgmental.
Additionally, the historical rate at which CompuSafes have been returned prior to the end of the customer contract at your reporting entity should be considered. A return rate of less than 10% supports the position that it is reasonably assured the lease will continue for the full term of the customer contract.

Conclusion:

When evaluating the customer contracts involving the rental of CompuSafes at your reporting entity, perform the following steps:

Step 1: Answer the following question: Does the service warranty provided include the replacement of significant parts?

If the answer to this question is "Yes", the contract should be classified as an operating lease. Under this classification, the method of recording revenue related to the lease will not change from the current accounting treatment of recognizing revenue over the term of the contact.

If the answer to this question is "No", proceed to *Step 2*.

Step 2: Consider the following questions:

a) *Are the customer contracts profitable?*

b) *Is the early termination penalty sufficiently large enough to make the continuation of the lease for the full term of the contract reasonably assured?*

c) *Does the customer contract contain a bargain purchase option or transfer of ownership as described in the "Lease Classification as Capital vs Operating" LOG?*

If your response to all of the questions in Step 2 is "No", the contract should be classified as an operating lease.

However, if your response to any of the questions in Step 2 is "Yes", the lease classification criteria included in the "Lease Classification as Capital vs Operating" LOG should be evaluated. ***Determining the classification of leases as Capital vs Operating is complex and subject to significant judgment. Additionally, customer contracts involving the rental of CompuSafes include the delivery of multiple service elements which adds to the complexity of the evaluation. Consultation with Corporate Accounting is required prior to finalizing the analysis.***

Attachment A: CompuSafe Customer Lease Classification Evaluation by Country

The Table below shows the results of the CompuSafe customer lease classification evaluation by country. The evaluation was a 2 step process:

- Step 1: Evaluate whether any of the four Capital Lease classification criteria listed in the "Lease Classification as Capital vs Operating" LOG were met. If not met, the lease is Operating Lease; If met, move to Step 2.
- Step 2: Evaluate whether both of the Lessor specific Capital Lease classification criteria included in the Background section above were met. If not met, the lease is an Operating Lease; If met, the lease is a Capital Lease.

Color Legend:
Red highlighted criteria – Criteria for Capital Lease accounting are NOT MET.
Green highlighted criteria – Criteria for Capital Lease accounting are MET.

	STEP 1: Lease Classification Criteria Capital vs Operating				**STEP 2: Lessor Criteria for Capital Lease Accounting**	
	a) Ownership transfer	**b) Bargain purchase**	**c) 75% of economic life (6 years)**	**d) 90% of fair value**	**Collectability reasonably predictable? No = Operating**	**Uncertainty of non-reimbursed costs? Yes = Operating**
Country 1	**No**	**No**	**No** - Lease may be terminated for a penalty equal to the service fees in the contract for 1 year. This does not represent a significant penalty. Therefore, the non-cancelable lease term does not extend beyond initial date of the lease term.	**No** - As lease may be terminated without significant penalty, the term is not sufficient to recover 90% of the fair value.	N/A – Capita lease classification criteria in step 1 were not met.	N/A – Capita lease classification criteria in step 1 were not met.

Country 2	**No**	**No**	**No** - Lease may be terminated for a penalty equal to the service fees in the contract for 3 months. This does not represent a significant penalty. Therefore, the non-cancelable lease term does not extend beyond initial date of the lease term.	**No** - As lease may be terminated without significant penalty, the term is not sufficient to recover 90% of the fair value.	N/A – Capita lease classification criteria in step 1 were not met.	N/A – Capita lease classification criteria in step 1 were not met.
Country 3	**No**	**No**	**Yes, for 5-year leases** - The 5-year lease agreements represent 83% of economic life. Additionally, the termination penalty (total future contract payments) is significant to reasonably assure the continuation of the lease for the full contractual term. **No, for 3-year leases** (50% of economic life)	**Yes** - The pricing model requires a specific margin over the cost of the CompuSafe. If a lessor prices their contracts to recover its investment plus a return (cost plus margin), by definition it will result in meeting this criterion.	**Yes** - the credit of potential customers is assessed	**Yes** - The warranty covering the replacement of significant parts provided by the Brink's subsidiary is for a term longer than the manufacturer's standard warranty.
Country 4	**No**	**No**	**No** - The termination penalty (full cost of CompuSafe plus removal fees) is significant to reasonably assure the continuation of the lease for the full contractual term. However, the standard contract term is 4 years (67% of economic life).	**Yes** - The pricing model requires a specific margin over the cost of the CompuSafe. If a lessor prices their contracts to recover its investment plus a return (cost plus margin), by definition it will result in meeting this criterion.	**Yes** - the credit of potential customers is assessed	**Yes** - The warranty covering the replacement of significant parts provided by the Brink's subsidiary is for a term longer than the manufacturer's standard warranty.

Country 5	No	No	**No** - The termination penalty is significant to reasonably assure the continuation of the lease for the full contractual term. However, the standard term is 1 - 3 years (50% or less of economic life).	**Yes** - for certain customer contracts.	**Yes** - the credit of potential customers is assessed	**Yes** - The warranty covering the replacement of significant parts provided by the Brink's subsidiary is for a term longer than the manufacturer's standard warranty.

Attachment B: Contract Revenue Allocation Example

Purpose: This document explains and shows an example of how to allocate contract revenue to the deliverables included in the contract under US GAAP.

Background:

Brink's Subsidiary offers Customer A a 4 year CompuSafe contract which includes the following services:
a) CompuSafe Rental and installation;
b) CIT services;
d) Maintenance plan.

NOTE: For additional information on identifying deliverables in customer contracts, please see the Revenue Recognition - ID Multiple Elements Learn Once, Globally.

Step 1: Determine total contract revenue:

For the purposes of this example, assume the monthly fees specified in the contract include the following:

Good / Service	*Monthly fee*
Rental of CompuSafe	150
CIT Service	200
Maintenance plan	50
Total monthly Revenue	***400***

- Additionally, a 1 time installation fee of **300** is due upon the installation of the CompuSafe.

Step 2: Estimate the fair value of each deliverable in the contract:

We must estimate the fair value of all individual services included in the CompuSafe contracts, independent of one another. US GAAP provides the following hierarchy that should be used when estimating the fair value of goods / services provided by Brink's Subsidiary:

A) Vendor Specific Objective Evidence (VSOE) - VSOE exists if we provide the good / service to other customers by itself. For example, if we have a customer for which we only provide Money Processing services, the fees that we charge this customer may be used as a basis for estimating the fair value of the money processing component of the CompuSafe contract. VSOE is the most reliable form of evidence. If it is available, it should be used.

B) Third Party Evidence (TPE) - TPE exists when one of our competitors provides the good / service to their customers on a stand-alone basis and the fees charged are publicly known. If VSOE is not available, TPE should be used.

C) Estimated fair value - If neither VSOE nor TPE exists, we must estimate the fair value of the good or service. Estimates may be based on prices for similar goods / services, known or expected margins for goods / services, etc. There is no detailed guidance for how estimates should be calculated. However, we should be able to support the inputs / assumptions used in any estimate.

Fair value of goods / services in example contract:

CompuSafe Rental - No VSOE or TPE is available. The Brink's Subsidiary in this example prices its contracts to ensure that it receives a 10% margin over the cost of a CompuSafe during a 4 year rental. This should be supported by internal sales policies / financial analysis. Assuming the average cost of the CompuSafe model is 5,000, we estimate the fair value of the CompuSafe rental to be ***5,500*** (5,000 cost x 110% margin).

CompuSafe installation - No VSOE or TPE is available. For this type of service the Brink's Subsidiary prices its contracts to ensure that it receives at least a 5% margin over cost. This should be supported by internal sales policies / financial analysis. Assuming the average cost of installation is 400, we estimate the fair value to be 42***0*** (400 cost x 105% margin).

CIT - The Brink's Subsidiary provides CIT services to customers on a stand-alone basis, therefore, VSOE is available. The fair value for this service is estimated using the stand-alone CIT fees charged annually to a similar customer (similar geographic region, frequency of pick-ups, etc). Assume the similar customer is charged 2,000 annually. In this instance we would estimate the fair value of the service to be ***8,000*** (2,000 x 4 years).

Maintenance - No VSOE or TPE is available. For this type of service the Brink's Subsidiary prices its contracts to ensure that it receives at least a 5% margin over cost. This should be supported by internal sales policies / financial analysis. Assuming the annual average cost of providing maintenance coverage is 150, we estimate the fair value to be ***630*** (150 cost x 4 years x 105% margin).

Step 3: Allocate Contract revenue

Once the total contract revenue and fair value of deliverables are known, the contract revenue should be allocated based on the relative fair value as shown below:

Good / Service	*Fair Value*	*% of total Fair Value*	*Monthly Fee*	*Allocated Monthly Revenue*
Rental of CompuSafe	**5,500**	**38%**	**400**	**151**
CIT Service	8,000	55%	400	220
Maintenance plan	630	4%	400	17
CompuSafe install	420	3%	400	12
Total:	14,550	100%		400

Additionally, the one-time installation fee should also be allocated in the same manner:

Good / Service	*% of total Fair Value*	Installation Fee	*Allocated Installation Fee*
Rental of CompuSafe	**38%**	**300**	**113**
CIT Service	55%	300	165
Maintenance plan	4%	300	13
CompuSafe install	3%	300	9
Total:	100%		300

Therefore, in the example above, the present value of minimum lease payments would be calculated using monthly rent of 151 for 4 years, plus a one-time payment of 113 from the installation fee.

Estimating the fair value of goods and services in a contract can be a complex process. Please consult with Corporate Accounting for assistance and / or any questions you may have.