Device Programs: An Illustration of Accounting Treatment & Financial Statement Impacts

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Legal Disclaimer

The amounts represented in this document are for illustrative purposes only, and do not represent Sprint's actual per unit results. The intent is to provide an illustration of the different accounting impacts for the device financing programs offered by the company as compared to our traditional subsidy model. Not every general ledger entry associated with a customer transaction is represented, and any omissions in the completeness of the represented data are not material to the general understanding of the differences between the various device programs. Consequently, you should not consider this document to be a complete rendering of the accounting for a customers purchase or lease of a device and service plan from Sprint.

Notes on the Illustrations

- The charts and narrative in this document illustrate the general accounting treatment and financial statement impacts for each of the three postpaid device programs offered to Sprint customers: Traditional Subsidy, Equipment Installment Plan (EIP), and Leasing.
- Illustration shown are for the Income Statement and Cash Flow only. The Balance Sheet side of the equation is not illustrated.
- The numbers are hypothetical and simplified for illustrative purposes, and represent a single device sourced from a Sprint direct channel.
- As illustrated, the 24 month total EBIT and Cash impacts are essentially the same regardless of the device program chosen by the customer.
- The illustrations assume the EIP and leasing customers renew the month-to-month service plans over a 24 month period and the Company collects all of the associated cash.
- The illustrations assume the customer does not elect to upgrade or trade-in the device over the 24 month period, and does not purchase a trade in right. Exercise of an upgrade or trade in right would significantly impact the income statement and cash flow illustrations.
- Any expectations of bad debt experience are not reflected in the illustrations.
- Promotional offers, which are provided to customers in the normal course of business, are not reflected in the illustrations.
- Activation fees charged to customers are not reflected in the illustrations.

Traditional Subsidy

HYPOTHETICAL EXAMPLE FOR ILLUSTRATIVE PURPOSES ONLY:

- numbers are simplified, representing a single device
- device is purchased from a Sprint direct channel

Income Statement	Customer Device Transaction	Each Month	24 Month Total
Service Revenue	$0	$78.75	$1,890
Equipment Revenue	$200	$0	$200
Imputed Interest	$0	$0	$0
Cost of Goods Sold	($650)	$0	($650)
EBITDA	($450)	$78.75	$1,440
Depreciation	$0	$0	$0
EBIT	($450)	$78.75	**$1,440**

- The customer takes ownership of the device when the transaction occurs -

Cash Flow	Customer Device Transaction	Each Month	24 Month Total
Service Payment	$0	$78.75	$1,890
Equipment Payment	$200	$0	$200
Equipment Cost	($650)	$0	($650)
Handset Liquidation	$0	$0	$0
Cash	($450)	$78.75	**$1,440**

The company sells a device to the customer for less than the company's cost of acquiring the device from the manufacturer. The customer enters into a 24 month service contract with the company. The service fees charged to the customer are higher in the subsidized model as compared to the other device financing programs.

Income Statement

- **For the customer device transaction**, the company records Cost of Goods Sold in an amount which exceeds the Equipment Revenue amount recorded, resulting in a loss on the income statement (referred to as equipment net subsidy). The amount of Equipment Revenue recognized represents the consideration received from the customer at the time of the device transaction.
- **Over the next 24 months**, the company ratably recognizes revenue for the provision of service to the customer.

Cash Flow

- **For the customer device transaction**, the company receives consideration from the customer for an amount less than what it cost to acquire the device from the manufacturer.
- **Over the next 24 months**, the company collects cash from the customer for the provision of service.

Equipment Installment Billing

HYPOTHETICAL EXAMPLE FOR ILLUSTRATIVE PURPOSES ONLY:
- numbers are simplified, representing a single device
- device is purchased from a Sprint direct channel

Income Statement	Customer Device Transaction	Each Month	24 Month Total
Service Revenue	$0	$60	$1,440
Equipment Revenue	$600	$0	$600
Imputed Interest	$0	$2	$50
Cost of Goods Sold	($650)	$0	($650)
EBITDA	($50)	$62	$1,440
Depreciation	$0	$0	$0
EBIT	($50)	$62	**$1,440**

- The customer takes ownership of the device when the transaction occurs -

Cash Flow	Customer Device Transaction	Each Month	24 Month Total
Service Payment	$0	$60	$1,440
Equipment Payment	$0	$27	$650
Equipment Cost	($650)	$0	($650)
Handset Liquidation	$0	$0	$0
Cash	($650)	$87	**$1,440**

The company sells the device to the customer at a price equal to the company's cost of acquiring the device from the manufacturer, and the customer agrees to pay for the device in equal installments over the next 24 months, interest free. The customer also enters into a renewable monthly service plan arrangement with the company. As the company charges the full cost of the device to the customer, the company provides the customer with a discounted service rate plan.

Income Statement

- **For the customer device transaction**, the company records Equipment Revenue, net of effective financing cost, and Cost of Goods Sold, resulting in a net loss on the income statement.
- **Over the next 24 months**, company ratably recognizes service revenue for the provision of service to the customer and imputed interest revenue associated with the effective financing of the equipment installment receivable.

Cash Flow

- **For the initial device transaction with the customer**, the company does not receive consideration from the customer and only recognizes a outflow of cash to acquire the device from the manufacturer.
- **Over the next 24 months**, the customer remits payment to the company for both the device and discounted service rate plan.

Leasing

HYPOTHETICAL EXAMPLE FOR ILLUSTRATIVE PURPOSES ONLY:

- numbers are simplified, representing a single device
- device is purchased from a Sprint direct channel

Income Statement	Customer Device Transaction	Each Month	24 Month Total
Service Revenue	$0	$60	$1,440
Equipment Revenue	$0	$20	$480
Imputed Interest	$0	$0	$0
Cost of Goods Sold	$0	$0	$0
EBITDA	$0	$80	$1,920
Depreciation	$0	($20)	($480)
EBIT	$0	$60	**$1,440**

- The company retains ownership of the device throughout the lease term -

Cash Flow	Customer Device Transaction	Each Month	24 Month Total
Service Payment	$0	$60	$1,440
Equipment Payment	$0	$20	$480
Equipment Cost	($650)	$0	($650)
Handset Liquidation	$0	$0	$170*
Cash	($650)	$80	**$1,440**

**Assumes the device is returned to the company at the at end of the lease term and then sold by the company for an amount equal to its depreciated value*

The company grants the customer the right to use a device over the lease term in exchange for a monthly equipment rental fee. The company retains ownership of the device. The customer also enters into a renewable monthly service plan arrangement with the company. As the equipment rental payments plus the expected liquidation value of the device equal the cost to acquire the device from the manufacturer, the company provides the customer with a discounted service rate plan.

Income Statement

- **For the customer device transaction**, there is no income statement impact, as the company retains ownership of the device. On the balance sheet, the company reclassifies the device from inventory to capital assets.
- **Over the next 24 months,** the company ratably recognizes service revenue for the provision of service to the customer and equipment rental revenue. Additionally, the company records depreciation expense associated with the capitalized device.

Cash Flow

- **For the initial device transaction with the customer**, the company does not receive consideration from the customer and only recognizes a outflow of cash to acquire the device from the manufacturer.
- **Over the next 24 months**, the customer remits payment to the company for both the rental of the device and discounted service rate plan.
- **At the end of the lease term**, the company receives proceeds from the disposition of the device returned by the customer.

Income Statement Impacts by Device Program

Traditional Subsidy

	Customer Device Transaction	Each Month	24 Month Total
Service Revenue	$0	$78.75	$1,890
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Imputed Interest	$0	$0	$0
Cost of Goods Sold	($650)	$0	($650)
EBITDA	($450)	$78.75	$1,440
Depreciation	$0	$0	$0
EBIT	($450)	$78.75	**$1,440**

Equipment Installment Plan

	Customer Device Transaction	Each Month	24 Month Total
Service Revenue	$0	$60	$1,440
Equipment Revenue	$600	$0	$600
Imputed Interest	$0	$2	$50
Cost of Goods Sold	($650)	$0	($650)
EBITDA	($50)	$62	$1,440
Depreciation	$0	$0	$0
EBIT	($50)	$62	**$1,440**

Leasing

	Customer Device Transaction	Each Month	24 Month Total
Service Revenue	$0	$60	$1,440
Equipment Revenue	$0	$20	$480
Imputed Interest	$0	$0	$0
Cost of Goods Sold	$0	$0	$0
EBITDA	$0	$80	$1,920
Depreciation	$0	($20)	($480)
EBIT	$0	$60	**$1,440**

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Cash Flow Impacts by Device Program

Traditional Subsidy

	Customer Device Transaction	Each Month	24 Month Total
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Equipment Payment	$200	$0	$200
Equipment Cost	($650)	$0	($650)
Handset Liquidation	$0	$0	$0
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Equipment Installment Plan

	Customer Device Transaction	Each Month	24 Month Total
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Equipment Payment	$0	$27	$650
Equipment Cost	($650)	$0	($650)
Handset Liquidation	$0	$0	$0
Cash	($650)	$87	$1,440

Leasing*

	Customer Device Transaction	Each Month	24 Month Total
Service Payment	$0	$60	$1,440
Equipment Payment	$0	$20	$480
Equipment Cost	($650)	$0	($650)
Handset Liquidation	$0	$0	$170
Cash	($650)	$80	$1,440

**Assumes the device is returned to the company at the at end of the lease term and then sold by the company for an amount equal to its depreciated value.*

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