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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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United Kingdom

Your reference

Our contact

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Date 08 July 2009

Re

Discussion Paper “Leases - Preliminary Views”

Dear Sir David,

We appreciate the opportunity to respond to the Discussion Paper “Leases - Preliminary Views”. This letter represents the view of Deutsche Telekom AG, one of the world's leading telecommunications and information technology service providers. Deutsche Telekom has revenues of over 60 billion EUR and covers the full range of state-of-the-art telecommunications and information technology services.

We fully support the Boards' intention to update and converge existing standards in a manner consistent with a principles-based approach and without undue complexity and compliance cost. However, we do have strong concerns whether the model proposed in the Discussion Paper will ultimately improve the quality of information provided in financial statements. Our concerns are explained in our answers to the questions raised by the Boards in the Discussion Paper.

To summarise, our main concerns are in particular:

- We do not agree with the split of the project into lessee and lessor accounting as we believe that lessee accounting cannot be fully judged unless the accounting

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Date 08 July 2009

To

Page 2

for a transaction involving the allocation of risks and rewards is understood from the standpoint of both the lessee and lessor.

- We concur with the conceptual justification for recognising an asset and a liability, but note that we do not believe that in many instances the recognition criteria (present obligation) of the conceptual framework are met. Instead, renewal options and contingent rents represent contingencies that should be accounted for in accordance with IAS 37.
- We are concerned that an isolated move toward gross presentation of rights and obligations under operating lease contracts on the balance sheet may make financial statements less understandable for financial statement users. Special attention should be paid to ensure that the future accounting model for operating leases aligns and remains consistent with the overall framework for accounting and financial reporting. Inclusion of future events and contingencies such as lease extensions and variable lease rentals in the measurement of rights and obligations, in our opinion, would establish a new basis of accounting that is inconsistent with both historical cost and fair value based accounting models.
- Due to the wide range of unresolved issues on both the lessee and lessor side and the ensuing radical changes to accounting rules, we believe the Boards should take more time than appears is currently being contemplated.

Overall, we believe that significant revisions are required to make the future IFRS on leases appropriate and workable. Also, there are significant open areas that are not covered within the Discussion Paper. We therefore believe that it would be appropriate for the Boards to issue a revised Discussion Paper, taking into account the comment letters received to ensure that preparers and users have an appropriate opportunity to comment.

Please find our comments in the Appendix to this letter. We would be pleased to discuss our comments with you at your convenience.

Yours sincerely

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Date 08 July 2009

To

Page 3

Appendix

Comment Letter on DP “Leases – Preliminary Views”

by Deutsche Telekom AG

Question 1:

The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach? If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

Response:

No, we do not agree.

We believe that a very important project such as this one should take the time and review all issues in a comprehensive manner, including the determination of the scope. Otherwise, in the future, “opportunities to structure transactions” (see section 1.12(c) of the DP) will simply shift from the decision to effect a finance lease vs. an operating lease to a decision to execute a lease vs. e.g. a contract for services or licensing of a right, where possible.

In addition, we believe the scope should satisfactorily distinguish leases from executory contracts such as contracts that can be exited on short notice.

Furthermore, we would like to ask the Boards to explore whether the scope of the new guidance on “on-balance sheet” lease accounting should only include assets that can be legally purchased in their current condition. An example of a legally divided asset is an apartment in a condominium. If the apartment is in a building that has not already been legally divided then the rent of the rooms should be excluded from “on-balance sheet” lease accounting. An example from our industry is a contract for the right to use space on a rooftop of a building to install a mobile phone cell tower in that site. There are numerous other examples from our and other industries such as renting space on a bill board or contracting for (capacity on) telecommunication lines. Said in another way, if the space on a mobile phone cell tower has not already been legally divided, the buyer will legally not have the option to make a buy or lease decision. As a consequence, the rental contract should be excluded from “on-balance sheet” lease accounting and instead be disclosed in the notes to the financial statements.

Date 08 July 2009

To

Page 4

Based on our current operating lease obligation table in the notes of the financial statements and the underlying lease term assumptions, we have estimated that for Deutsche Telekom group the total additional leasing liability could be more than ten billion EUR. We currently include in the lease term the initial non-cancellable lease term, plus optional renewal periods of up to 25 years from date of inception when we believe there is an economic compulsion to renew. We do not believe that bringing this kind of numbers on balance sheet provides meaningful information about the financial condition, results of operations or cash flows of our business because if it were possible to buy the space on a rooftop we believe the price would be much less than the amount that the standard would require us to capitalise. Such contracts should continue to be shown only in a note to the financial statements. In all arrangements described above, the space cannot be bought in its current condition since there typically is no legally divided asset and resp. or an entity does not have the alternative of making a business decision of buying or renting the space.

In addition, beyond the fixed minimum lease term, the remaining periods of the contracts are similar to executory contracts (equally and proportionately unperformed). Another way to look at renewal periods is that for those periods a liability does not exist since there is no present obligation for the renewal periods. We suggest for the Boards to explore these thoughts further in order to determine whether it makes sense to exclude contracts for legally undivided assets and whether periods for renewal options are executory contracts.

Question 2:

Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why. Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

Response:

Conceptually, we do not believe that the exclusion of non-core asset leases has much merit. Accounting of leasing contracts should be based on the transaction, not the business of the entity. Short-term leases to which a company can provide a history that certain type of leasing contracts are truly short-term (e.g. less than one year including renewal terms) should be excluded on the basis of practicality and expensed as incurred. Otherwise, individual entities can always - on the basis of materiality - exclude certain insignificant contracts from the scope of this guidance. This would be similar to the current practice of excluding small additions of property plant and equipment from being capitalised.

However, we believe that setting the right scope as discussed under question 1 above is important.

Date 08 July 2009

To

Page 5

Question 3:

Do you agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.

Response:

Yes, we agree with the Boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract, i.e. a lease contract with no term extension options, contingent rents, etc.

Question 4:

The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognise: (a) an asset representing its right to use the leased item for the lease term (the right-of-use asset) (b) a liability for its obligation to pay rentals. Appendix C describes some possible accounting approaches that were rejected by the boards. Do you support the proposed approach? If you support an alternative approach, please describe the approach and explain why you support it.

Response:

We support the Boards' approach. The basic recognition requirement would be an improvement towards the proposed goal of the standard. However, in our view there is no present obligation to pay rentals beyond the fixed initial lease term and therefore a liability should not be recorded for these potential future payments. The same is true for example for contingent rents. A future event needs to occur in order for these components to be an obligation.

Therefore, we would support a reporting model that would require on balance sheet treatment of usage rights and obligations that fall within the non-cancellable legal term of operating leases, combined with either enhanced disclosures of expected future commitments under expected renewals and sensitivities for future exposures to contingent rentals or the recognition under IAS 37. This would be consistent with the framework in terms of presentation of present obligations and yet would provide financial statement users information that is necessary to make long-term projections about future developments of the business.

In addition, we would like the Boards to cross reference to the knowledge gained from the revenue recognition project with regard to the boundaries of a contract. In response to question 3 regarding the definition of a contract we argued that IAS 32.13 contains a definition of a contract, stating that a contract refers to "an agreement between two or more parties that has clear economic consequences that

Date 08 July 2009

To

Page 6

the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law.” We stated that allocating revenue based on expectations of a customer’s acceptance of an offer would be unreliable, theoretically unsound and unhelpful to users of the financial statements. Similarly, we believe that a liability for periods for which neither a legal obligation exists nor the IAS 37 recognition criteria are met should not be recorded.

Question 5:

The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decided to adopt an approach whereby the lessee recognises: (a) a single right-of-use asset that includes rights acquired under options (b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees. Do you support this proposed approach? If not, why?

Response:

Please refer to our comments regarding scope exemptions. We believe that a decision maker who is faced with a buy or lease decision will have to determine precisely all the components relevant in a contract and make certain assumptions for the various components. This person has all the information available to record the accounting of the components at his or her fingertips.

In situations where a buy or lease decision cannot be made because the asset cannot be bought or is not legally divided in its current condition it becomes much more difficult to make an assessment for all the components. We therefore support the components approach only when a buy or lease decision can be made. Otherwise, componentisation of lease contracts would introduce substantial complexity into the recognition and measurement process, the cost of which would likely exceed benefits to the financial statement users.

In addition, as stated before, we do not believe amounts payable under term extensions, contingent rental agreements and even price index adjustments are current obligations, or liabilities, until a further event transpires that causes them to be an obligation. Until that event happens, the (reasonably possible/probable) amounts are nothing more than contingencies and should be evaluated under IAS 37.

Date 08 July 2009

To

Page 7

Question 6:

Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate? If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.

Response:

We believe that in instances where the asset could alternatively be bought the lessee's obligation should be measured using the lessee's incremental borrowing rate. Since that is the rate with which a buy or lease decision is determined and that is the rate that a lessee would actually pay if the company purchased the asset. In all other instances, the rate implicit in the lease should be used, if it is readily available.

Question 7:

Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost? If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

Response:

Yes, we agree because that is the general measurement approach required in IFRS.

Question 8:

The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. Do you agree with this proposed approach? If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favour and why.

Response:

Yes, we agree with the Boards' tentative view to subsequently measure both the right-to-use asset and obligation to pay rentals on an amortised cost basis.

Date 08 July 2009

To

Page 8

Question 9:

Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.

Response:

We do not believe there should be an option to measure a lease obligation at fair value as this would reduce further comparability among entities which we consider important in lease accounting. Furthermore, we believe that measuring lease obligations at fair value will introduce an unacceptable degree of subjectivity and unreliability into lease accounting.

Question 10:

Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons. If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows? Please explain your reasons.

Response:

Revisions should only be made when there is a change in the estimated cash flows. Assuming that the entity makes a buy or lease decision, the entity would calculate with the incremental borrowing rate at the day it makes that decision. In buy or lease decisions, interest rates will only need to be reconsidered when there is a change to the contract that will change the estimated future cash flows. Interest rates reflect the circumstances that prevailed when the transaction was entered into. Similarly, reflecting changes in an entity's incremental borrowing rate is not consistent with the way other financial liabilities are subsequently measured.

Furthermore, as stated below, our group is lessee under more than tens of thousands of individual leases, reviewing the incremental borrowing rate at each balance sheet date would be impracticable to do and would be very costly without receiving much benefit in return. From a practical perspective, we therefore propose not to revise the obligation to reflect changes in the borrowing rate.

Date 08 July 2009

To

Page 9

Question 11:

In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities. Do you agree with the proposed approach taken by the boards? If you disagree, please explain why.

Response:

We generally agree with the approach taken by the Boards. We agree also that a lessee's obligation to pay rentals during the non-cancellable term of a lease meets the definition of a financial liability. Financial instruments standards are currently being rewritten and it may be difficult to align the standards in time.

Furthermore, and as stated before, we do not believe that there is a current obligation for renewal options and contingent rents etc. These are contingencies and should be accounted for under IAS 37.

Question 12:

Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortisation or depreciation in the income statement. Would you support this approach? If so, for which leases? Please explain your reasons.

Response:

No, we disagree. The substance of the proposed new accounting rules and the transaction is that the entity has funded an asset by assuming an obligation. The related expenses are clearly depreciation or amortisation. Payments under short-term leases may be recorded as rental expense; however, as such agreements may differ only in terms of legal form from other executory contracts (see discussion under Question 1).

Date 08 July 2009

To

Page 10

Question 13:

The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, i.e. in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

Response:

No, we disagree. We believe the option to extend for five years should only be recognised once it becomes recognisable in accordance with IAS 37.

Question 14:

The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why. Would requiring reassessment of the lease term provide users of financial statements with more relevant information? Please explain why.

Response:

We do support the Boards' tentative decision that changes in the obligation to pay rentals should be recognised as an adjustment to the carrying amount of the right-of-use asset. However, we disagree with the Boards' tentative decision that the lease term should be reassessed at each reporting date.

As indicated in our response to question 5, payments due under options should be recognised in accordance with IAS 37. The recognition criteria of IAS 37 should conceptually be reassessed at each reporting date based on facts or circumstances at that date. Changes should be recognised as an adjustment to the carrying amount of the right-to-use asset.

In terms of practicality we would like the Boards to be aware of the fact that as of December 31, 2008, one of our large regional operations alone was lessee under more than tens of thousands of individual leases. Many of these lease contracts involve custom terms regarding usage rights, payment escalation, renewal options, etc. Reviewing the estimated term of each lease at each balance sheet date would

Date 08 July 2009

To

Page 11

be impracticable, if not impossible. From a practical perspective, we therefore propose that the lease term would be reconsidered only upon a triggering event such as modification of the lease.

Question 15:

The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease. Do you agree with the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

Response:

We do not agree with the Boards' conclusion. Albeit, we agree with the Boards' reasoning that a purchase option is in substance similar to a renewal option for the remainder of the asset's life. As we think that there should be similar accounting for similar circumstances, we refer to our answer to question 5 in that we believe that payments due under purchase options should only be recognised once it becomes recognisable in accordance with IAS 37.

Question 16:

The boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. Do you support the proposed approach? If you disagree with the proposed approach, what alternative approach would you recommend and why?

Response:

We disagree with the Boards' conclusion. Conceptually, we believe that an obligation to pay contingent rents should only be recognised when the IAS 37 recognition criteria are met.

Date 08 July 2009

To

Page 12

Question 17:

The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes. However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes. Which of these approaches to measuring the lessee's obligation to pay rentals do you support? Please explain your reasons.

Response:

From a conceptual view, we support the IASB's approach as it is in line with the approach under IAS 37. For this reason, we believe the Boards should consider renewal options only when they can be recognised under IAS 37 (see question 13).

However, in terms of practicality we would like the Boards to consider that for entities with wide spread leasing activities creation of an accounting and reporting solution that follows either of the two Boards' proposals would be extremely challenging, costly, and possibly impracticable. We therefore propose that contingent rentals should be excluded from the initial measurement of the usage right and lease obligation and remeasured and adjusted prospectively only upon removal of the contingency or a triggering event such as a modification of the lease similar to present treatment under straight-line operating lease expense recognition rules.

Question 18:

The FASB tentatively decided that, if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease. Do you support the proposed approach? Please explain your reasons.

Response:

We agree with this proposal, as a change in the underlying index is more a reflection of the fair value of the liability and not the service potential of the asset. We disagree with a leasing standard that contemplates the introduction of fair value measurements.

Date 08 July 2009

To

Page 14

Question 20:

The boards discussed two possible approaches to recognising all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments: (a) recognise any change in the liability in profit or loss, or (b) recognise any change in the liability as an adjustment to the carrying amount of the right-of-use asset. Which of these two approaches do you support? Please explain your reasons. If you support neither approach, please describe any alternative approach you would prefer and why.

Response:

We would favour an approach that would recognise all remeasurements of the liability under alternative (b). This approach is also similar to the one used for asset retirement obligations in accordance with IAS 16, IAS 37 and IFRIC 1.

Question 21:

The boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives. Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?

Response:

We agree with these proposals.

Question 22:

Should the lessee's obligation to pay rentals be presented separately in the statement of financial position? Please explain your reasons. What additional information would separate presentation provide?

Response:

Yes, since they represent a different class of financial liability.

Date 08 July 2009

To

Page 15

Question 23:

This chapter describes three approaches to presentation of the right-of-use asset in the statement of financial position. How should the right-of-use asset be presented in the statement of financial position? Please explain your reasons. What additional disclosures (if any) do you think are necessary under each of the approaches?

Response:

The asset should be presented according to the nature of the underlying asset and should be disclosed separately from owned assets in the notes as we believe that it is important for a financial statement user to discern the amount of owned assets from the amount of leased assets.

Question 24:

Are there any lessee issues not described in this discussion paper that should be addressed in this project? Please describe those issues.

Response:

We recommend that head and sublease issues as well as sale and leaseback transactions be covered.

Question 25:

Do you think that a lessor's right to receive rentals under a lease meets the definition of an asset? Please explain your reasons.

Response:

Yes, lessor's right to receive rentals under a lease meets the definition of an asset to the extent of the minimum lease payments since minimum lease payments are a resource controlled by the lessor as a result of a past event from which future economic benefits are expected to flow to the lessor. Further guidance should be provided for the accounting of leases with options from a lessor's point of view.

Date 08 July 2009

To

Page 16

Question 26:

This chapter describes two possible approaches to lessor accounting under a right-of-use model: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor. Which of these two approaches do you support? Please explain your reasons.

Response:

As stated before, we do not agree with the split of the project into lessee and lessor accounting as we believe that lessee accounting cannot be fully judged unless the accounting for a transaction involving the allocation of risks and rewards is understood from the standpoint of both the lessee and lessor.

Having said that, we prefer the approach in which there is derecognition of the leased item since it is conceptually sound and consistent with the approach for lessees. This approach avoids double accounting for assets and results in financial information that is more relevant and understandable for users of financial statements.

Question 27:

Should the boards explore when it would be appropriate for a lessor to recognise income at the inception of the lease? Please explain your reasons.

Response:

In general, revenue recognition for lessors should be based on the same principles as they are currently developed within the revenue recognition project by the Boards. Specific guidance of revenue recognition issues for dealer's and manufacturer's leases should be provided. We believe dealers should recognise income at the inception of the lease since there is a sale of goods and the financing of the sale.

Question 28:

Should accounting for investment properties be included within the scope of any proposed new standard on lessor accounting? Please explain your reasons.

Response:

The accounting for investment properties should not be ignored because they can make up a substantial part of a lessor's real estate portfolio.

Date 08 July 2009

To

Page 17

Question 29:

Are there any lessor accounting issues not described in this discussion paper that the boards should consider? Please describe those issues.

Response:

We are currently not aware of any issues. However, please refer to our comments in question 26 and 27 and in the introduction of this response. We believe lessor accounting issues require much more analysis by the Boards, and its outcome should be shared with the constituents in a second discussion paper before going further with this discussion paper