



DEUTSCHE TELEKOM AG

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YOUR REFERENCE Group Accounting & Customer Finance; Principles, Policies and Research
OUR CONTACT Michael Brücks
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DATE 8/12/2016
RE EFRAG's Preliminary Consultation Document relating to the endorsement of IFRS 16

Dear Mr. Watchman,

we very much appreciate the opportunity given by EFRAG to share our views and opinions to the raised questions regarding the implementation of the IFRS 16 Leases standard.

Deutsche Telekom Group is one of the biggest Telecommunications Company (TelCo) in Europe. So far, we have identified an estimated number of more than 400,000 leases (units of account) on the lessee side alone. As a result, we are very much affected by the new leasing standard. We are involved on various levels to discuss our views and insights with other companies both in Europe and the U.S. – within our industry and outside of our peers.

While we started already shortly before the issuance of the standard on 13 January 2016 to set up a project team, we still find ourselves under enormous time pressure to finish the implementation of this project in time with the initial application date of IFRS 15. The interaction of IFRS 16 with IFRS 15 has enormous ramification for our mass market and large customer business models where we sell multiple element arrangements involving elements which need to be evaluated whether they meet the definition of a lease under IFRS 16.

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We made the decision in December 2015 to customise our current lessee lease engine in order to meet the requirements of IFRS 16 and to roll out the newly adjusted tool across subsidiaries in the Deutsche Telekom Group. As we have many subsidiaries with many lease agreements and contracts, which are stored in different locations and medias, in different departments and are often not available in an electronic form, it has proved to be a huge time-consuming and costly effort to capture the relevant data, to normalise the data in a data management tool and to program the lease engine for transition, measurement and particularly the reassessment and modification rules.

Taking this into account, the implementation of IFRS 16 at Deutsche Telekom Group will be costly and time-consuming, despite the simplifications permitted by the standard.

Please find our responses to most of your questions in the Appendix to this letter. We would be pleased to discuss them with you at your convenience.

Sincerely yours,

/s/ Michael Brücks

Vice President

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Appendix

Appendix 1

Question 1 (after para 24)

Do you have any information or evidence on the extent to which leases (that you are party to or otherwise aware of) will be eligible for each of the short-term and low-value assets exceptions identified in paragraph 24? If so, please provide details.

Currently, DT is in the stage of evaluating its lease agreements and capturing the relevant IFRS 16 data. Therefore, it is too early to give a more precise estimation to the extent of which DT is concerned in terms of amounts and volume by short-term leases or low-value leases. We neither have detailed information which business models are potentially in the scope of these policy elections.

DT has made a tentative decision to apply the practical expedients in IFRS 16 regarding short-term leases and low value leases based on identified use cases. This decision was derived from the expectation that DT does not have material volumes of the exempted leases, neither on a single base nor on an accumulated base. However, the basis of this assumption will still have to be verified with data and amounts when they become available. This means we need more reliable information of the expected outcome, which will likely not come in before first quarter of 2017.

If you are a preparer, do you expect to use the exceptions? If so, please:

- (i) **quantify the number and annual lease payments for each category;**

For short-term leases: If the lease term, as defined in IFRS 16 (“accounting lease term”) is truly 12 months or less, it is Deutsche Telekom’s tentative Group accounting policy to exclude these contracts from recognition in the balance sheet unless the Group decides that the contracts of a certain asset class will become part of the process to include them and enter them into the respective IT tool (cost savings). At this early stage in our IFRS 16 project, we do not expect high volumes of significant short-term leases. But we need more insight into the extent DT is affected.

Note: this could be further qualified with additional requirements:

- Define specific asset classes to be exempted in addition to utilising the length of lease term as basis on which exclusion is determined.
- No leases with options to extend the lease term may qualify (to avoid that entities apply the lease term definition incorrectly)
- No leases which are part of an IT leasing solution become part of this exemption, to assure smooth and efficient processes



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- Alternatively set lease term of 3 month or less
- Core Assets vs. other assets
- Use IAS 16 asset accounting in analogy vs. inventory accounting

In connection with short-term leases, the issue of “enforceable rights” and the resulting lease term was discussed in the IFRS 16 project. Given an agreement where both parties, the lessee and the lessor, each have the right to terminate the agreement within a period of three months – without permission from the other party and with more than an insignificant penalty. This lease agreement won’t have any minimum non-cancellable period. The lease agreement will persist as long as neither party terminates the contract. For instance, DT as the lessee rents a ground from a third party landlord and starts building a tower on the ground, which needs to be decommissioned at the end of the lease agreement. The ground lease could be terminated by each party within three months without any penalty or permission of the other party. To construct the tower is time-consuming and expensive for Deutsche Telekom. One could insist that nobody would enter into such a contract as this agreement is economically not feasible with many risks for the lessee. We need more information of this case, but currently it seems that the contract is enforceable for the maximum period of 3 months and we do not see a lease term longer than 3 months. With regard to IFRS 16.B34 DT would not only consider whether its own (lessee) termination option is reasonably certain, when determine the lease term, it needs to consider the termination option of the lessor, too.

For low-value leases: It is Deutsche Telekom’s tentative decision to apply the policy election for low value leases not to recognise low-value assets in the balance sheet. This needs to be considered when business models and amounts of low-value leases are identified and determined.

- (ii) **indicate the proportion of your leases (by volume and/or value) you estimate to be covered by each of the exceptions.**

Not yet available due to early stage of the IFRS 16 project.

Question 2 (after para 39)

If you are a preparer, which approach to transition do you expect to take? Please explain your reasons for this decision.

Our tentative decision is to apply the modified retrospective method to all leases consistently as required in IFRS 16.5 (b).

A full retrospective method is not applicable for Deutsche Telekom due to the very high volume of lease modifications in the past and because the data are not available to rebuild the history. It would be a huge effort and very expensive for Deutsche Telekom to determine the amounts needed if we decided on applying the full retrospective method. Compared to the usefulness of the information provided by this method it would not



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justify the costs. These costs and cash-outs could be used far better for investments in our network to offer more sophisticated services to our customers or which could be used far better for our shareholders dividend payments.

Appendix 2

Question 3 (after para 20)

Are you aware of:

- (i) **any contracts that you consider to be leases that would not be classified as leases under IFRS 16; or**
- (ii) **any contracts that you consider to be service contracts (or other non-lease contracts) that would be classified as leases under IFRS 16?**

If so, please provide details of these contracts and why you consider that the classification would not be appropriate.

We are currently still in the process of evaluating the guidance on identification of leases and its impact on our business models.

Question 4 (after para 24)

EFRAG is interested in understanding whether leases of intangible assets (other than rights held by a lessee under licensing agreements within the scope of IAS 38) are common. Do you have any information or evidence as to how frequently such leases of intangible assets arise in practice? If so, please provide information about the types of intangible assets that are subject to leases and the significance in operating and monetary terms.

We are aware that software leases could be in the scope of the policy election in IFRS 16. We are in the middle of our assessment of determining the full universe of our leases. Despite the fact that our IFRS 16 project is still in the phase of identifying leases within Deutsche Telekom Group, we do not expect a material impact of intangible lease contracts, neither in size nor in volume. As far as we understand this election, it is only applicable for customised exclusively used software leases. Standard software would not be concerned under this policy election. Therefore, the scope is very limited to very exclusive cases, which based on our knowledge at this moment, we do not expect to have a significant impact.

Question 5 (after para 18)

Do you have any comments on the comparison of IFRS 16 with IAS 17?

Now that IFRS 16 has been published we overall support the guidance.



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Question 6 (after para 34)

Do you have any views or information on how IFRS 16 can be expected to affect the behaviour of investors and/or lenders? If so, do you have any views or information on whether and how IFRS 16 could, for European companies that apply IFRS, positively or negatively affect:

- (i) the overall cost of capital;
- (ii) access to finance and cost of credit?

Please provide any available evidence.

We do not expect a significant impact out of transition to IFRS 16 neither on the behaviour of our investors nor on our lenders.

EFRAG's Preliminary Consultation Document on the endorsement of IFRS 16 Leases

Appendix 3: Assessing whether IFRS 16 is conducive to the European public good

Question 7 (after para 41)

Do you have views or information on how IFRS 16 might affect entities' use of leasing? For example, do you expect lessees to:

- (i) reduce their use of leases with a corresponding increase in purchases of assets;

Due to the business model of Deutsche Telekom the question whether to buy or lease an asset is for the most significant lease agreements not decisive. The main activities of Deutsche Telekom as a lessee are either leasing small parcels of ground to build our own masts or towers on this ground or leasing roof top spaces or spaces on competitor's masts, tower, etc. to install our own telecommunication equipment on it.

For most leases Deutsche Telekom is not able to buy the space on the building, tower, mast, etc. This is either not possible because of legal or economic restrictions (i.e. one could not buy only the roof of a building) or economically not feasible for Deutsche Telekom. For instance, to buy a whole asset (i.e. a building) whilst only a small part of the asset (i.e. a space on the roof) is needed for the business itself is not economically feasible. Imagine a building in the centre of a city, where the lessor is renting floors of the building to different shop owners and the spaces on the roof top are rented to different TelCos for installation of mobile telecommunication network assets, e.g. poles and antennas. Why should Deutsche Telekom buy the whole building to use only a space on the roof? The same applies to public ground, space on masts, towers, etc. of TelCo competitors, etc.



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(ii) reduce their use of leases without a corresponding increase in purchases of assets;

Due to the fact that Deutsche Telekom must operate its telecommunication network as a whole (for mobile services, internet services and other telecommunication services) and guarantee the performance of the underlying network to our customers, Deutsche Telekom will not have a substantial opportunity to reduce its overall size of its leases unless technology changes which in turn requires different sites in different micro and macro locations.

(iii) seek to change the terms of new or existing leases?

Currently, we do not think about a change in the terms of our existing lease. However, we are still assessing all of our leases and it may prove helpful to require lessors to clearly distinguish between lease payments and non-lease payments when billing. But due to the fact that our IT lease tools and data management systems will change because of the implementation of IFRS 16 and existing processes will be harmonised, a change in the terms of new leasing contracts will be possible.

Please provide any available evidence.

We are currently unable to predict any possible outcome or the impact which will arise from the new IT Systems.

Question 8 (after para 43)

Do you have any additional information or views on how the endorsement of IFRS 16 can be expected to affect the leasing industry in Europe? EFRAG is particularly looking for views from the leasing industry.

Please provide any available evidence.

Not applicable for Deutsche Telekom.

Question 9 (after para 48)

Do you have any information or views on how the endorsement of IFRS 16 can be expected to affect SMEs in Europe?

Please provide any available evidence.

Not applicable for Deutsche Telekom.



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Question 11 (after para 66)

What is your view on the relative costs of applying IFRS 16 and US GAAP? Do you have any other views as to the advantages or disadvantages of IFRS 16 compared to US GAAP?

Please provide any available evidence.

As one of Deutsche Telekom biggest subsidiaries is a big US listed company, we are concerned about the many differences between IFRS 16 and ASC 842. An assessment of the differences is currently underway, but at an early stage. Therefore we are unable to make an estimation on the relative costs.

The biggest disadvantage we see is that both standards are not aligned. At least our US listed company needs to apply both rules in its financial statements and must observe the existing differences between IFRS 16 and ASC 842.

Furthermore the US GAAP guidance is more rules-based and detailed, while IFRS is more principles-based. That means IFRS 16 offers more room for interpretation. At first sight, a principles-based standard is more difficult to apply and lots of discussions are needed to find a solution on many accounting questions, which are not answered by the standard. But it offers on the contrary room on how to apply the rules and set policies. Individual circumstances of different branches or business models can be better addressed.

Question 12 (after para 115)

What is your view on the one-off and ongoing costs for preparers? (Please indicate whether you are (a) a lessee; (b) a lessor; (c) both a lessee and a lessor or (d) neither a lessee nor a lessor).

Will preparers that already report finance leases have lower costs than preparers without finance leases?

Deutsche Telekom currently uses different IT tools to determine its lease agreements. The required information and data are not bundled in one contract tool. We decided to implement a contract management tool to centralise and harmonise all lease agreements on the lessee side. This is very expensive to custom-build, but offers the opportunity to get a head start before proper solutions by IT vendors were offered. This new customised IT data management and lease calculation engine will be generated by re-programming our existing finance lease engine for purposes of IFRS 16 and all big subsidiaries within Deutsche Telekom Group will use this tool for recognition and measurement of its lease agreements on the lessee side.

Furthermore, Deutsche Telekom has many contracts with variable lease payments, especially adjustments resulting from a change in an index. This fact will be considered at initial application of IFRS 16 to the respective finance leases: The carrying amount of the RoU Asset and the lease liability at initial recognition is the same as the carrying amount of the finance lease asset and finance lease liability immediately before that date measured applying IAS 17. This could be seen as making transition simple, but on the other hand, IFRS 16 states that a lessee shall re-measure the lease liability by discounting the revised lease payments, when



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there is a change in future lease payments resulting from a change in an index. Consequently and due to the new definition of lease liability and lease payments in IFRS 16, the lease liability must be re-measured already at initial application to catch up with past index adjustments. The simplification of using a grandfathered amount for all finance leases is jeopardised by the requirement to re-measure the lease liability at initial application because of index payments.

Please provide any evidence you have on the expected magnitude of the costs.

Question 13 (after para 118)

If you are a user, are you aware of any costs in addition to those identified by EFRAG in paragraphs 116 to 118 of Appendix 3? Please quantify if possible and provide any available evidence.

Not applicable.

Question 14 (after para 128)

If a lessee has to develop new systems to support the accounting for leases, to what extent do you, as a lessee, expect internal benefits from the information provided by the new information? Please quantify to the extent possible.

Do you agree with the benefits for users and preparers identified above? Are there any additional benefits for users and preparers?

We agree with the listed benefits for users and preparers. Deutsche Telekom shares the arguments made by EFRAG, especially benefits for preparers that arise from the elimination of operating and finance leases, the improvements in the external financial reporting of leases and improvements in the quality and/or availability of internal management information.

Please provide any available evidence.

Not yet available.

Question 16

Are there any issues that have not been raised in this Preliminary Consultation Document that should be considered by EFRAG? Please explain your view.

We are currently in the process of implementing new IT systems and processes in order to adopt IFRS 15 as of 1 January 2018. The IASB decided and we quote IFRS 16.BC272 "to limit early application of IFRS 16 to entities that also apply IFRS 15. This is because some of the requirements of IFRS 16 depend on an entity also applying the requirements of IFRS 15 (and not the Standards that were superseded by IFRS 15)". While we are not fully aware of all the details of the IASB's reasoning, the IASB itself must have been concerned on a



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conceptual level that the interplay between IFRS 15 and IFRS 16 is an important factor to consider when applying both standards.

We would like to refer to our second letter where we hint to the possibility that the Deutsche Telekom Group may find in the course of 2017 that implementing IFRS 16 is too complex and time consuming for an early implementation on 1 January 2018. Deutsche Telekom, therefore, would like to propose that preparers receive more flexibility and are allowed to bifurcate the effective date of the supply side (supplier lessor on 1/1/2018) from the customer (lessee on 1/1/2019) side.