Deutsche Telekom AG Postfach 20 00, 53105 Bonn, Germany

Sir David Tweedie Chairman International Accounting Standards Board 30 Cannon Street London EC4M 6XH

United Kingdom Via "Open to comment" page on www.iasb.org

Your reference

Phone Subject

Our contact Deutsche Telekom AG, Michael Brücks +49 228 181 87100 Date December 8, 2010

Exposure Draft "Leases" (ED/2010/9)

Dear Sir David,

Deutsche Telekom AG welcomes the opportunity to respond to the International Accounting Standards Board's Exposure Draft (ED) "Leases".

This letter represents the view of Deutsche Telekom AG, one of the world's leading integrated telecommunications companies with over 129 million mobile customers, around 37 million fixed-network lines and nearly 16 million broadband lines (as of September 30, 2010). The Deutsche Telekom Group provides fixed-network, mobile-communications, Internet and IPTV products and services for consumers, and ICT solutions for business and corporate customers.

Deutsche Telekom is generally supportive of the development of a new accounting model that provides solutions to the criticism of today's guidance for leasing contracts and that, as a consequence, ensures comparable, user relevant, and transparent reporting by preparers of financial statements. However, we support such a new leasing standard only when it is indeed an improvement over existing requirements and truly provides solutions to today's shortcomings of IAS 17.

Deutsche Telekom does not believe that in many instances the ED Leases is in fact effective in addressing the existing concerns under IAS 17 with regards to reducing the complexity of lease accounting and achieving true comparability of information among preparers of financial statements. Comparability is not enhanced through the ED Leases as a significant amount of judgement will continue to be required leading likely to different outcomes at different companies for like contracts.

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As a result, Deutsche Telekom does not believe that the ED Leases, in its current state, results in information that is, in many instances, truly relevant to users of financial statements. We believe that a new standard based on ED Leases should not be introduced in its current state and a new Exposure Draft Leases should be issued for debate.

Our main concerns and issues with the ED are primarily related to lessee accounting and are as follows:

Major Concern No. 1	Suggested Changes to ED Leases	Reason(s) for Change
 "Leasing is an important source of finance. Therefore, it is important that lease accounting should provide users of financial statements with a complete and understandable picture of an entity's leasing activities." Deutsche Telekom supports this statement of the IASB and FASB fully. Despite the above statement of the Boards, it appears that in many instances throughout the ED, the Boards - when drafting the leasing guidance in the ED -did not adhere to their stated believe, that leasing is a financing alternative. Leasing is a financing alternative to buying an asset and should not be viewed as 	 Future leasing guidance should merely have those assets in scope which can be separately purchased and recognized and for which a buy-or-lease decision can be prepared. Assets in scope should therefore be separate legal assets or be readily legally dividable into separate assets. Ideally the final leasing standard will relate only to underlying assets or portions of assets that are already marketed or sold in a divided state. We suggest for the Boards to devise appropriate language to define when an asset is legally readily dividable and when not. Appropriate language for the definition can ensure that a sufficient number of 	 We believe that users of financial statements are interested in comparing a company that purchased an asset with a company that did not purchase the asset and chose to lease the asset instead. If some companies prefer to buy and others do not, the future leasing guidance should make sure that comparability between those companies is achieved. Assets that are not legally dividable and/or are perhaps part of a larger asset can typically not be purchased. An example from the telecommunications industry is a contract for space on the top or the side of a building to install cell phone antennas. This space is not for sale and cannot be purchased by anybody in the industry.

 $^{^{\}rm 1}$ see page 5, IASB/FASB's ED Lease INTRODUCTION AND INVITATION TO COMMENT, first sentence

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anything else. A buyor-lease decision should always be possible for items that fall under lease accounting guidance.

This becomes again relevant when deciding on which assets should be in the scope of leasing and in terms of achieving true comparability among companies (see Major Concern No. 2 below).

- different types of contracts fall in the scope so that the definition is not a too limiting as a basis for lease capitalisation.
- For contracts that as a consequence would not fall within the "buy-or lease" concept scope we would accept alternatively the recording of usage rights and obligations for not more than the non-cancellable legally committed term to achieve comparability among companies. (see below).
- Excluding these contracts either directly from the scope or indirectly by clarifying the definition of the "underlying asset" (see Major Concern No. 2 below) would in and of itself result in highly comparable information since no buy-or-lease decision is possible for these items and all "lessees" are naturally treated the same - as capacity/service contracts by expensing the payments in the profit and loss statement.

The underlying assumption behind our suggestion above is that investors, analysts, credit rating agencies and other users of financial statements would not be concerned if a contract for the capacity of a part of a larger (legally undividable) asset is on or off-balance sheet since none of the competitors could purchase the asset. All competitors within one industry would truly be comparable and the users' goals are met. As only 2% of responses received to the Discussion Paper Leases represented users of financial statements, we suggest for the Boards to verify this assertion through their outreach activities with users.

The issue of "portions of an asset" was already recognized in the past by the FASB when the Board excluded contracts involving space and other facilities at airports, ports and bus terminals owned by a governmental unit or authority from finance lease accounting because such space can never be purchased (see FASB Codification 840-10-25 "Lease Involving Facilities Owned by a Government Unit or Authority")

Furthermore, making leasing guidance applicable only to items for which buy-or-lease decisions are possible, assures that companies, in making their buy-or-lease assessment, have to reflect on all the key variables of the contract and can in turn apply them without difficulty to the accounting of the contract. For example, buy-or-lease decisions require a company, at a minimum, to determine the lease term that has the highest probability to occur, an appropriate interest rate, and amounts for contingent rents, etc. Lease accounting will thus become reasonably operational.

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In summary, our proposal would increase the usefulness to users, make the accounting less burdensome and would reduce compliance costs immensely while at the same time enhancing the preparers' ability to communicate effectively with investors, financial analysts and other financial statement users.

Major Concern No. 2	Suggested Changes to ED Leases	Reason(s) for Change
 Setting aside our Concern No. 1 above, a clarification of scope and a review of the definition of the underlying asset is also crucial for determining whether an arrangement is in substance a lease. The "IFRIC 4 criteria" should not just be transferred without further contemplation. The future leasing guidance should at a minimum address if a portion of a larger asset can itself be the underlying asset for the purposes of evaluating whether or not a lease exists especially in situations when the portion of the larger asset is itself not capitalisable in accordance with IAS 16. 	 In our mind, the "IFRIC 4 criteria" (specified asset and control test) to determine whether or not a lease exists, should be based on an underlying asset that is capitalisable in accordance with IAS 16. Portions of assets that are indivisible should therefore not fall in the definition of the underlying asset. Currently, the ED Leases' test of whether control over an asset exists refers only to the "underlying asset" and does not clarify what exactly that means. The underlying asset is defined in ED Leases Appendix A on page 40 as "The asset for which a right of use is conveyed in a lease". See more detailed revision suggestion under question 4. 	 We do not believe that the Boards have provided a robust, logical and operational distinction between a service or capacity contract and a leasing contract. Examples for "the part of the whole issue" in the telecommunications industry would be, whether the "whole" tower, building, fibre optic cable or satellite is the underlying asset, or whether it is the portion of the whole such as the space on the tower, building or wavelength² in the cable, etc. The latter (portions of a whole) is typically the subject of many contracts in our industry. The space cannot be separately purchased, nor are these parts capitalisable in accordance with IAS 16 including its component approach.

² Specific identifiable assets are, for example, specific fiber within a fiber-optic cable network along with the conduit through which that cable passes, the land on which the conduit rests and a specific component of the telco equipment at each end of the cable necessary to transmit data over the network. The provision of a "wavelength" of capacity, i.e. a specific part of a spectrum on a lit fibre, would not qualify as a fixed asset under IAS 16.

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In other words, since the space on the tower/building or a wavelength in a cable cannot be an asset by itself, using the larger asset as the underlying asset when applying IFRIC 4 would likely result in such contracts being treated as capacity/service contract. This would be the case since "more than an insignificant amount of the output or other utility of the whole asset" (IFRIC 4.9) is used by other parties.

A similar issue regarding what the underlying asset exists for a contract for some of the utility (i.e. a part) of a building, such as a right to install signage or a billboard to the outside of a building.

This issue had been recognized by the Boards before and was highlighted in IFRIC 4.3. but was, in our mind, not sufficiently dealt with as the following paragraph of IFRIC 4 highlights: "In some arrangements, the underlying asset that is the subject of the lease is a portion of a larger asset. This Interpretation does not address how to determine when a portion of a larger asset is itself the underlying asset for the purposes of applying IAS 17. Nevertheless, arrangements in which the underlying asset would represent a unit of account in either IAS 16 or IAS 38 are within the scope of this Interpretation." This paragraph was not even carried forward to the ED Leases. At a minimum, we suggest to do so.

We would also like to point out the fact that this issue was dealt with slightly differently under IFRS and U.S. GAAP³ which also highlights the need to clarify this point in a future leasing standard instead of just brushing it aside.

Major Concern No. 3	Suggested Changes to ED Leases	Reason(s) for Change
Amounts relating to unexercised options to extend the contract should not be recognized as liabilities in the balance sheet as they are not liabilities at the inception or the commencement of the lease.	As stated in our comment letter to the DP "Leases – Preliminary Views", Deutsche Telekom believes that payments for options to extent a lease beyond the legally committed period represent contingencies that should be accounted	 The obligation to pay will result from a future event, the exercise of the lease term extension option, rather than from a past event (see Framework par. 49(b), IAS 37.10 and IASB board members Mr. Cooper in paragraph AV7 of the ED). Before exercising the
 Recognising a liability 	for in accordance with	option, there is no

³ Likewise EITF 01-8 par. 6... "does not address whether an undivided interest or a pro rate portion of property, plant or equipment could be the subject of a lease ... Nevertheless, arrangements that identify a physically distinguishable portion of property, plant or equipment are within the scope of this Issue."

⁴ Please note that we specifically refer to a leasing contract and not to a capacity or service contract, as it is commonly accepted that executory payments for capacity or service contracts are contingent liabilities as defined in IAS 37.

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for unexercised options to extend the lease term would clearly be inconsistent with the Conceptual Framework and would not provide relevant information to users of financial statements.

Options to extent a contract and the related payments are legally avoidable future cash outflows. These options to extend the contract are a part of the agreement that is executory in nature and should be disclosed as such in the financial statements.

- IAS 37 leading likely to a disclosure in the footnotes.
- Based on our view expressed in Major Concern No. 1, we believe that users would find disclosure in the notes to the financial statements beneficial if it depicted separately, (i) potential future cashouts that relate to underlying assets that could have been alternatively purchased (financing transactions) and (ii) potential cash outs for underlying assets that could not have been purchased (none financing transactions).
- At a minimum, it should always be clear from the disclosure whether amounts have been truly legally committed to or whether they are "simply" contingent liabilities and thus executory by nature.

- legal or constructive present obligation to another party to whom the "obligation" is owed.
- In other words, a promise to make lease payments becomes a present obligation (unconditional obligation to pay) of the lessee only when the option to extent the lease is exercised.
- These contract components are contractually avoidable payments, are under the control of the lessee and hence are not a liability; they are executory components of the already signed contract
- Only contractually unavoidable payments are legally committed obligations and should therefore be recognized as liabilities in the balance sheet.

The same is true from the lessor's perspective: (Potential) rents receivable for an extension period do not meet the definition of an asset based on the Conceptual Framework. The lessor has neither an unconditional right to receive nor control over amounts as long as the lessee does not exercise the option.

Including amounts payable and receivable for extension periods requires both the lessee and the lessor to assess the likelihood of the exercise of the option. This is complex and judgemental for both parties and thus reduces comparability among companies within an industry and, as a consequence, does not benefit users of financial statements.

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Addressing our Major Concerns No. 1 and 2 will result in certain capacity contracts in the telecommunications industry to fall outside the scope of the leasing standard. Should the Boards nevertheless decide to go forward with the existing proposal, we would nonetheless agree that contracts that involve partial usage rights (i.e. where major risks and rewards of the underlying (larger) asset remain with lessor) go on the balance sheet - based on only existing non-cancellable legal payment commitments. Optional periods should be excluded.

Suggested Changes to | Descents) for Change

Major Concern No. 4	Suggested Changes to	Reason(s) for Change
	ED Leases	
 We are concerned 	 We propose leasing 	The fair value cap is
that in many	guidance that	especially relevant if the
instances the	includes a fair value	threshold for including
amounts	cap for the amounts	optional lease terms is
recognized for	capitalized similar to	indeed reduced, as
rights-of-use-assets	the current guidance	currently suggested by
overstate the	under IAS 17 for	the Boards, to the
market value of the	finance leases (IAS	"longest possible lease
underlying asset,	17.20)	term that is more likely
especially for	We suggest including	than not" to occur.
certain types of	a requirement to	Without a fair value cap
contracts involving	measure assets and	more than the fair value
rights of use related	liabilities at amounts	might have to be
to real estate.	equal to the present	capitalized in certain
	value of the lease	instances.
	payments or, if lower,	Examples for such a
	the fair value of the	distortion from the
	underlying asset.	telecommunications
	In addition, it should	industry are:
	be clarified that the	 The purchase price of
	applied lease term	land for the
	cannot extend beyond	construction of a cell
	the economic life of	phone tower may well
	the underlying asset	be lower than present
	(e.g. cell phone	value of ground lease
	mast). Otherwise the	payments.
	lease term for the	 The payments for
	right of use asset may	rental of space on
	in certain cases	third party towers
	extend into the	might be higher than
	economic life of a 2nd	the construction price
	asset that the lessor	of the whole tower
	needs to provide,	(depending on the
	which we believe is	business model used
	not the intend of the	by the tower operator
	Boards.	who might recuperate
	 A determination of a 	its investment for the
	lease term beyond	whole tower from the
	the economic life of	first tenant or

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A simple proposal for resolving the issue in our Major Concern No. 4 would be to limit the lease term for balance sheet recognition to the non-cancellable legally committed term as suggested in our Major Concern No. 3.

Please note that some believe that the required annual impairment test will provide for an adjustment to market value. However, in the telecommunications industry, the Cash Generating Unit (CGU) is typically not determined on an asset basis but rather on a higher level such as on a network or regional basis. Therefore, no impairment is likely to result from an impairment test.

In summary, Deutsche Telekom is concerned that the Board did not communicate a clear and consistent conceptual principle throughout the proposal. We recommend the adoption of accounting guidance that is based on the concept that leasing is first and foremost a financing alternative. Lease accounting therefore should exclude contracts for portions of larger assets when these portions of assets cannot be purchased separately by any company. To facilitate this outcome, the IASB should provide robust operational criteria to exclude all service/capacity contacts from the scope - clarifying at a minimum that the underlying asset is an asset in accordance with IAS 16. Following this approach will reduce complexity and at the same time assure comparability of financial statements since none of the companies competing in the marketplace can buy these assets. Any company will have to expense the payments as incurred based on an accrual concept.

If the IASB was to proceed with its current proposal we believe that the lease term for purpose of computing the liability and usage right should only be the non-cancellable legally committed term. We also recommend including a "sanity check" to assure that future leasing rules will include a fair value cap for the amounts capitalized similar to the current guidance under IAS 17 for finance leases (IAS 17.20).

Lastly, appropriate disclosure under the new guidance must assure that a financial statement user is informed about the existing legally binding commitments and the preparer's lease term assumptions. It is critical to provide information about the

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preparer's judgment with respect to the expected timing and amount (lease term and contingent payments) of future payments. By doing so, users of financial statements could judge themselves as to the potential exposure to future cashouts. Currently, a user is not appropriately informed about companies' judgments as to how many lease terms are expected to be "reasonably certain".

Our response to matters on which specific comments was requested is included in the attached Appendix to this letter.

Please contact Michael Brücks (+49 228 181 87100) or Norbert Panek (+49 228 181 87111) if you would like to discuss any of the matters raised by Deutsche Telekom AG. We would be pleased to discuss them with you at your convenience.

Yours sincerely,

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Attachment – Appendix with answers to specific questions

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Appendix	
Comment Letter Exposure Draft "Leases"	
by Deutsche Telekom AG	

Question 1: Lessees

- (a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?
- (b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

Response:

Re a)

Yes, we agree that a lessee should recognise a right-of-use asset and a liability for the (legally contracted) lease payments.

As stated above, options to extent a contract and the related payments during those periods are legally avoidable future cash outflows. These options to extend the contract are not liabilities under IFRS. The obligation to pay will result from a future event, the exercise of the option, rather than from a past event (signing the contract) as is insinuated in BC 6(d) by the IASB: "...the present obligation of the lessee <u>arising from entering the lease</u>....". The liability to make lease payments, according to the Framework, only exists for the legally committed lease term.

Consequently, we propose the following definition for the lease term and lease payments:

lease term	The contractually committed term during which payments are legally unavoidable.
lease payments	Payments arising under a lease during the lease term, including rentals subject to uncertainty during those periods including, but not limited to, contingent rentals and amounts payable by the lessee under residual value guarantees and term option penalties.

Deutsche Telekom believes that payments for options to extend a lease for a period beyond the legally committed period should be accounted for in accordance with IAS 37 leading typically to a disclosure in the footnotes.

If the IASB is nevertheless set on proceeding with its proposal to include amounts for periods not yet legally committed to in the lease assets and the liability, which we disagree with, it is our view that the measurement should be based on the term

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that has the highest probability to occur. This term is not more difficult to determine than the longest term that is more likely than not to occur.

In addition, we ask the Board to clarify why it made this decision, even though the liability recognition criteria have not been met.

Re b)

Yes, we agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments since leasing is a financing alternative to buying an asset. The accounting for the legally committed components in a leasing contract should mirror the purchase of the underlying asset by way of a loan and should be reflected as such in the balance sheet, income statement and the cash flow statement.

Question 2: Lessors

- (a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?
- (b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

Response:

Re a)

We agree with the concept of using two models for lessor accounting. However, the performance obligation approach only makes sense as long as there continues to be alignment between the leasing project and the revenue recognition project (see Deutsche Telekom's separate comment letter to that ED). In BC27 the Board state "in most cases the business model [of the lessor] will indicate when a derecognition approach or a performance obligation approach would be appropriate". We suggest moving the statement to the body of the ED as applying a business model concept seems to be the clearest and most logical guidance to distinguish between the two models.

Re b)

We disagree with the treatment of the residual asset. The residual asset under the derecognition approach is not PP&E, since it is not an asset the lessor uses or intends to use in its business. Rather it is more akin to a financial asset – the present value of the lessor's right to receive a residual payment measured at the inception of the lease. This right should be included in the receivable and unwound by crediting interest income over time as the end of the lease approaches. This right is the expected cash flow from sale or scrapping of the asset at lease expiry.

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Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:

- (a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).
- (b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65). (See also paragraphs BC41–BC46.)

Do you agree that a lessee or a lessor should account for short-term leases in this way?

Why or why not? If not, what alternative approach would you propose and why?

Response:

We have identified two types of situations, among others, that lead to short-term leases. The first involves a leased location that we know we will be vacating. In this case, we will generally only renew the lease for a short period (several months or month-to-month) in order for us to complete the new location including the relocation of our equipment/operations. The second type of short-term lease typically occurs when we are unable to reach agreement with the land lord regarding site access, payment escalation or other clauses in the contract. In this case we would remain on month-to-month status until agreement is reached, or we decide to abandon negotiations and move the location.

In the above cited examples, we entered into short term leases in order to manage our exposure to residual value risk and not as a means of an alternative financing. We are interested in benefitting from the flexibility that these "operating leasing" contracts provide. We, therefore, propose instead to devise accounting rules for short-term contracts, as defined in the ED, which are akin to today's operating lease accounting treatment. We believe that today's IAS 17 "operating lease" guidance should be applied to contracts for short-term car leases, space at industrial fairs, meeting room space, etc.

We would also like to point out that we believe that many companies would like to apply uniform and standardized processes to the large number of leasing contracts that they are party to. As a result, we would be in favour of a leasing standard that

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offers preparers an option to treat short-term leasing contracts in the same way that they treat other contracts instead of being forced to apply an exception to the rule. Whether short-term leases are recorded on a discounted or undiscounted basis on balance sheet should be immaterial. Comparability, as a consequence, is not jeopardized. Having an alternative option available can make processes more efficient and will reduce ongoing compliance costs.

Question 4

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
- (b) Do you agree with the criteria for distinguishing a lease from a purchase or sale in paragraphs B9 and B10? Why or why not? If not, what alternative criteria would you propose and why?
- (c) Do you think that the guidance provided for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

Response:

Re a and c)

We would like to point out that a lease is defined on page 39 of the ED in "Appendix A, Defined Terms". At the same time, a more elaborate definition is provided on page 42 in "Appendix B Application guidance" titled "Definition of a lease (Appendix A)" ranging from paragraph B1 to B4. This appears confusing. The relationship between these two sections should be made clear.

We refer to our Major Concern No. 2 in which we propose revising the definition of the underlying asset by adding the double underlined section below. This serves to clarify that only assets that are capitalisable according to IAS 16 meet the definition of an underlying asset. This in turn will make it clear that the test of whether the right to control the use of a specified asset exists, is applied only to items that qualify for recognition in accordance with IAS 16.

Underlying asset	"An item that qualifies for recognition in accordance with IAS 16, for which a right of use is conveyed in a
	lease"

In addition, we suggest that the IASB further clarify and improve the criteria in paragraphs B2 to B4. We think that a key feature is whether the asset used is easily exchangeable or replaceable by another that can provide substantially the same goods or services. When transactions involve non-specialised assets or assets that are not strictly related to the activity of the entity, those transactions are more likely to be entered into to obtain a service rather than the right to use the underlying asset. For example, a broadband customer will usually receive a modem or router that meets specifications set by its internet provider. Such an asset is an unavoidable necessity rather than something the customer sets out to acquire.

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Furthermore, we believe that the ability of the supplier to replace the assets and to continue providing the required goods or services is a key indicator of whether the customer is interested in the asset as such or whether the asset is merely a "vehicle" for receiving a service. In this context it is irrelevant that the supplier may not have a practice to replace the assets.

Re b)

Yes, we agree with this concept. On the other hand, as noted before with respect to short-term leases, any exception provided will make it harder and more costly to apply uniform and standardized processes to the large number of contracts that preparers are party to.

Question 5: Scope and scope exclusions

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33-BC46).

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

Response:

We believe that there is no conceptual basis for excluding intangible assets from the scope of the proposals. As others have also pointed out before, contracts may include both tangible and intangible assets, as is the case in the IT industry where many product offerings and solutions include both equipment and software. It appears that entities will have to segment those contracts and apply different requirements to each component. We believe that this would create additional complexity and lower comparability that does not benefit users of financial statements.

Even the IASB admits in paragraph BC36 of the ED that there is no conceptual reason to exclude lease of intangible assets. In our mind, this is also true for the exclusion of "quasi" purchase and sale contracts. We think that these exclusions may lead to a different accounting treatment for similar transactions and undermines comparability among prepares of financial statements.

IFRIC 4, which the ED proposes to replace, scopes out arrangements falling within the scope of IFRIC 12 "Service Concession Arrangements". The ED Leases does not propose to scope out such arrangements. Due to the definition of a lease it is likely that service concession arrangements would - under the ED's proposals - fall within the ED Leases' scope. We believe that this is an unintended result and suggest adding a scope exclusion for Service Concession Arrangements.

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Otherwise the future leasing guidance should make it clear how such arrangements are supposed to be accounted for.

Question 6: Contracts that contain both service and lease components

The exposure draft proposes that lessees and lessors should apply the proposals in *Revenue from Contracts with Customers* to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B6-B8 and BC47-BC54).

If the service component in a contract that contains service components and lease components is not distinct:

- The FASB proposes that the lessee and lessor should apply the lease accounting requirements to the combined contract.
- The IASB proposes that (i) a lessee should apply the lease accounting requirements to the combined contract; (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract; (iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements and the service component in accordance with the proposals in *Revenue from Contracts with Customers*.

Do you agree with either approach to accounting for leases that contain service and lease components appropriate? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

Response:

We agree that entities should assess if services are distinct using the criteria in the final Revenue Recognition standard. However, we have a concern about the criteria currently contemplated in the Revenue Recognition ED. We have expressed these concerns in our comment letter regarding the Revenue Recognition ED, accordingly. We generally agree with the proposal of the Revenue Recognition ED but we believe that only an entity's own ordinary course of business shall be considered when determining whether a good or service is distinct. This restriction would provide consistency with the commercial substance of an arrangement, as well as comparability between reporting entities and practicability (or possibility) to implement.

Deutsche Telekom believes that when a contract includes both lease elements and non-distinct services including executory costs (such as taxes and insurance), a lessee should carve-out these types of costs and account for them as separately as period expenses. If the Boards decide against our proposal, we suggest applying the IASB's suggestion: identify the predominant component and treat the whole contract accordingly. This is the case because identifying the predominant component requires a lesser degree of precision that identifying the relative fair values of each component which lessees typically will be able to do.

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A lessor, on the other hand, should always be required to account for the services and lease components of a contract separately, as they should generally be able to determine the required information.

Question 7: Purchase options

The exposure draft proposes that a contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus a contract is accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraph 8 and BC63 and BC64).

Do you agree that a lessee or a lessor should account for purchase options when they are exercised? Why or why not? If not, when do you think that a lessee or a lessor should account for a purchase option and why?

Response:

Deutsche Telekom does not see a conceptual reason to treat options to purchase and options to extend a lease differently. Purchase options should be considered extensions of the lease term and considered as such. As stated previously in our comment letter to the DP "Leases – Preliminary Views", Deutsche Telekom believes that payments for options to extend a lease⁵ beyond the legally committed period represent contingencies that should be accounted for in accordance with IAS 37 leading in many instances to a disclosure in the footnotes.

We would also like to point out that while from today's perspective a purchase option may be at a "bargain" price compared to the projected market value of the asset at the future point in time, uncertainty remains whether future events and decisions will make it advantageous not to proceed with the purchase after all. For example, a lease of a parcel of land with an option to purchase it for a bargain purchase price in the future will transfer all economic benefits, but not the risks from the lessor to the lessee. If subsequently the property becomes contaminated by no fault of the lessee or the lessee's operations otherwise no longer require use of that property, having the right to return the property to the lessor becomes a valuable right which distinguishes an outright binding purchase from a lease with a purchase option. The same holds naturally true for lease renewal options. Thus, this issue may not be as clear and simple as suggested.

Should the Boards decide to retain the guidance of the ED, we believe that the same treatment should apply to purchase and extension options as each is a form of residual expectation from the leased property. Different accounting approaches to renewal options and purchase options, which are economically similar in practice, will create structuring opportunities and should be avoided.

⁵ Please note that we specifically refer to a leasing contract and not to a capacity or service contract, as it is commonly accepted that executory payments for capacity or service contracts are contingent liabilities as defined in IAS 37.

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Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

Response:

As stated in our Major Concern No. 3, amounts relating to unexercised options to extend the contract should not be recognized as liabilities in the balance sheet as they are not liabilities at the inception or the commencement of the lease. Recognising a liability would clearly be inconsistent with the Conceptual Framework. Furthermore, this would not provide relevant information to users of financial statements as different companies will come up with different conclusions depending on their interpretation of what the length of the lease term more likely than not to occur may be. We suggest that only the legally committed lease term should be taken into consideration for capitalisation as this is less susceptible to varied interpretations than those in the ED. This approach would still represent a major improvement taking into consideration the essential nature of leasing contracts.

We would also like to point out that our company's need for additional property, plant and equipment (depreciating or amortizing assets) is based on our business plan, normally not exceeding a certain number of years. To consider a projection for a lease term greater than both the business plan horizon and the contractually committed lease term will mean that asset and liabilities will be recognized that, for example, lack the evidence that is required under the IAS 36 impairment rules, where the accounting is at least supported by management budgets and other plans. It is questionable whether users of financial statements will find information useful, which may not be supportable by a company's customary planning process.

From a lessor's perspective we do not support the proposal that amounts due under renewal options should be included in the lease receivable. The lessor has neither an unconditional right to receive (nor does he have control over) these amounts as long as the lessee does not exercise the optional lease terms.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease contract should be included in the measurement of lease assets and lease liabilities using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why? Do you agree that lessors can only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the lease receivable if they can be measured reliably? Why or why not?

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Response:

As stated above, when buy-or-lease decisions are possible, a lessee will have already considered what amounts of contingent rents are likely to be paid. The same should hold true for the lessor. We agree that for the legally committed lease term, contingent rentals and similar contract components that are specified in the lease contract should be considered in the measurement of lease assets and lease liabilities using an expected outcome technique. Contingent payments during optional periods should not be taken into consideration.

To highlight the onerousness of this exercise we would like to point out that many of our lease contracts include payment escalators during optional periods based on a local, regional CPI or other complex lease specific indices rather than national CPI. Contingent rental clauses may be used in combination with fixed escalators (e.g. contract may provide that rent shall escalate based on greater of CPI or fixed percentage for initial 5-year term and CPI for additional five 5-year renewal option periods). In addition, the CPI or fair value calculation is not based on the same information for all leases. While some leases use the national CPI, others are based on a regional or local version of this index. Furthermore, the lease escalator might involve average or lag indexation (average of last three years' CPI, etc.). Similarly, fair value or market rent reset requirements vary and may be determined on a regional or local basis, at times becoming as specific as the fair value of similar lease rates in the specific city or even specific neighborhood within the city. In addition, the dates and time periods for recalculating rental payments based upon a local or national CPI or other similar indices varies with each lease.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the obligation or receivable arising from changes in the lease term or contingent payments since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

Response:

We believe that it would be onerous to require a periodic reassessment of changes in the obligation or receivable arising from changes in the lease term or contingent payments.

As mentioned in the replies to Question 8 and 9 above, Deutsche Telekom does not support the proposal that options to extend the lease term and contingent payments during those periods are included in the measurement of lease receivables and liabilities as proposed by the IASB. However, if the IASB was to proceed with its proposal then we would agree that requiring a periodic reassessment would be very onerous and would again not be in line with the

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concept of leasing as a financing alternative where these decisions are made once at the beginning of the lease or when the lease is renegotiated. Therefore, we recommend that reassessments be performed only upon exercise, modification or cancellation of a renewal term that was included in the initial determination of the lease term.

Question 11

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

Response:

We generally agree with the basic premise of the proposed criteria for a sale and leaseback transaction. However, we strongly encourage you to align the criteria in the ED Leases with the criteria in the revenue recognition exposure draft. Currently, the sale-leaseback criteria in the ED Leases are more restrictive than the revenue recognition criteria proposed in the revenue recognition exposure draft. That is, terms that would typically not preclude the recognition of revenue for a sale may result in a sale and leaseback not qualifying for sale (and leaseback) accounting under the proposed leasing rules.

To highlight this point under current IFRS rules, the question previously arose, whether the conditions for the recognition of a sale in IAS 18.14 must be met before a transaction is accounted for as a sale (and lease back) transaction under IAS 17, in particular whether transactions that take the form of a sale and leaseback transaction should be accounted for as such when the seller retains effective control of the leased asset. In March 2007, IFRIC decided that IAS 17 rather than IAS 18 provides more specific guidance with respect to sale and leaseback transactions. Consequently, it was made clear that it was not necessary to apply the requirements of IAS 18.14 to sale and leaseback transactions when a transaction was within the scope of IAS 17.

In order to avoid such confusion and the need for future clarification it should be clear from the leasing guidance that the test for whether a sale took place or not is performed in accordance with the revenue recognition guidance.

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Question 12: Statement of financial position

- (a) Do you agree that a lessee should present its liability to make lease payments separately from other financial liabilities and present right-of-use assets as if they were tangible assets within property, plant and equipment, or investment property as appropriate, but separately from other assets that the lessee does not lease (paragraphs 25-27, 42-45, 60-63 and BC142-159)? Why or why not? What alternative presentation do you propose and why?
- (b) Do you agree that a lessor applying the performance obligation approach should present its underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? What alternative presentation do you propose and why?
- (c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? What alternative presentation do you propose and why?
- (d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease separately (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

Response:

Re a)

Deutsche Telekom agrees with the proposals for lessees and with the arguments in paragraph BC143 of the ED. We believe that financial statement users should clearly see these assets and liabilities and be able to differentiate them from other financial liabilities. A separate presentation is justified. This is especially true if the Boards go through with their current proposals to include optional lease term extensions that have not yet been exercised and are executory in nature. The amounts for this spurious portion of the "liability" should be noticeable as such by users of financial statements.

Re c)

We agree that a separate presentation is justified. However, as stated above, we believe that the residual asset is not property, plant and equipment but rather a financial asset, that represents the expected cash flow from sale or scrapping of the asset at lease expiry. A representation together with the receivable appears more appropriate.

Re b and d)

Deutsche Telekom believes that the sample disclosure included in B29 of multiple lease liabilities in separate sections on the face of financial statements could be confusing to users of financial statements. Instead, these disclosures could be better addressed in the notes to the financial statements. In addition, we suggest requiring a net presentation of the underlying asset and performance obligation.

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Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and expense separately from other income and expenses in the statement of comprehensive income (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

Response:

Since a contract that falls within a leasing standard should be viewed as an alternative way of financing an asset and since most of these transactions are material in nature, we support that lease related amortization and interest expense is presented separately from other amortization expense and other interest expense. We believe that this presentation provides useful information.

Question 14: Statement of cash flows

Do you think that cash flows arising from lease contracts should be presented on the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

Response:

When buying an asset via a bank loan, interest payments on the loan are often classified as cash flows from operating activities (IAS 7.33), whereas the principal payments are classified as cash flows from financing activities. Since a contract that falls within the leasing guidance should be viewed as an alternative way of financing an asset, the cash flow classification requirements in the Exposure Draft (classification of leasing payments [interest and principal] as financing cash flows) should be aligned with the guidance of IAS 7 in its treatment of cash flows related to bank loans.

We support that these cash flows are presented separately from other cash flows.

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Question 15

Do you agree that lessee and lessors should disclose quantitative and qualitative information that:

- (a) identifies and explains the amounts recognised in the financial statements arising from lease contracts; and
- (b) describes how lease contracts may affect the amount, timing, and uncertainty of the entity"s future cash flows? (paragraphs 70-86 and BC168-BC183) Why or why not? If not, how would you amend the objectives and why?

Response:

Deutsche Telekom believes that the number of disclosure requirements is excessive. However, we also believe that comparability of one preparer's leasing transactions with another preparer's is of utmost importance.

We therefore disagree with the requirement in paragraph 71 of the Exposure Draft that an entity should consider the level of disclosures appropriate to satisfy the objectives in paragraph 70. This should be reworded. Otherwise it could leave the impression that the disclosure of all items does not have to be regarded as mandatory in all situations.

Regardless of the requirements of the final standard, we find it extremely important for the users of financial statement that lessee's disclose the extent of their legally committed portions of future cash outflows and the part that has not yet been legally committed to due to the way companies' manage residual risk in the asset and their flexibility needs under the contract. This achieves higher comparability among companies.

Question 16

The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88-96 and BC186-BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

Do you think that full retrospective application of lease accounting should be permitted? Why or why not?

Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

Response:

We agree that mandatory full retrospective application would be onerous for longterm leases, and welcome the relief given to preparers. To maintain comparability between financial statements, Deutsche Telekom believes that the final standard should have a single effective date some time in the future to allow preparers to fully assess the complex and demanding impact of the proposal. Early adoption

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should not be permitted as this distorts comparability. We suggest an effective date of 1 January 2015 at the earliest – assuming a finalization of the standard in 2011.

In addition, we suggest grandfathering existing finance leases since a cost benefit analysis of applying the new leasing guidance to existing finance leases would most likely come to the conclusion that the difference is not significant and users will not benefit from applying the new rules to existing finance lease contracts.

Question 17

Paragraphs BC200-BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals outweigh the cost? Why or why not?

Response:

We encourage the IASB to expand its current outreach activities to collect additional information on the costs associated with the implementation of the proposals and their potential effects. We believe that it is currently difficult for many companies to actually quantify the cost involved which will depend on the final standard's design.

Many entities will first need to gather the necessary data of all leases (both Group internal and external as well as lessee and lessor side) to ensure completeness. When central inventory system neither exists on a Group wide nor on a segment wide basis, information has to be collected and inventoried from numerous decentralized locations perhaps even from various locations within legal entities. There is a need to retrieve and review key provisions of all leases in order to apply the new rules - which will be very costly. New processes and internal controls need to be designed. Additional costs include for instance education of employees and robust upgrades of IT accounting systems. The manpower and cost involved will be substantial and seems excessive.

Despite our general conceptual support for the direction of the proposal to bring leases on balance sheet, Deutsche Telekom is not convinced that the benefits demonstrably outweigh the costs. As stated in the beginning of our letter, we believe that users of financial statements are interested in comparing a company that purchased an asset with a company that did not purchase the asset and instead chose to lease the asset. Our proposals outlined above would make the accounting much easier and would reduce compliance costs immensely without reducing the preparers' ability to communicate effectively with investors, financial analysts and other financial statement users.

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Question 18

Do you have any other comments on the proposals?

Response:

General note: The current proposal introduces significant complexity, judgment, cost and risk into the financial statemens. We believe that the current ED reduces understandability for users of financial statements.

Initial direct costs: Paragraph 12 of the Exposure Draft requires a lessee to measure the right-of-use asset initially at the amount of the liability to make lease payments plus any initial direct costs incurred by the lessee. Initial direct costs are defined as recoverable costs that are directly attributable to negotiating and arranging a lease that would not have been incurred had the lease transaction not been made.

The recently issued Exposure Draft Insurance Contracts requires including incremental acquisition costs in the present value of the fulfilment cash flows; and exclude all other acquisition costs. The Revenue Recognition Exposure Draft allows capitalising contract costs only if certain conditions are met, and require expensing the cost of obtaining a contract (for example, the cost of selling, marketing, advertising, bid and proposals, and negotiations).

It is unclear if the capitalisation requirements under the different proposals are meant to be equivalent or not. We believe that equivalent requirements should apply and advise to use consistent concepts and wording across the different proposals.

Asset retirement Obligations (ARO): Currently, obligations imposed by a lease agreement to return a leased asset to its original condition (if it has been modified by the lessee) generally do not meet the definition of a minimum lease payment or a contingent rental and, therefore, are accounted for by the lessee as an ARO and thus appears to be outside the scope of the ED Leases. In other words, if an improvement to leased property has been recognized as an asset on the lessee's balance sheet (leasehold improvements), any obligation to remove that improvement on expiration of the lease should generally be accounted for as an ARO and included in the cost of the leasehold improvement. For example, a lessee who leases retail space and installs its own improvements would have an obligation to remove the improvements at the expiration of the lease. Therefore, the Boards have taken the position that the obligation to remove the leasehold improvements does not arise solely because of the lease, but instead is a direct result of the lessee's subsequent use (decision to modify the leased space). Accordingly, such costs are currently excluded from minimum lease payments.

The future leasing guidance should make clear whether no change is intended to the accounting for AROs, or whether remediation costs related to lease contracts in

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the future should be included in the definition of lease payments and measurement of lease liability and usage right.

Complexity of leasing contracts and lease accounting: We believe that it has been generally accepted that the accounting for leasing contracts is often very challenging and incredibly complex. We find the apparent ease with which both Boards move this project forward somewhat perplexing and suggest to thoroughly in due time explore all open issues.

For example, consider the following issues that are not specifically addressed by the Exposure Draft. If they remain unaddressed, the issues can undermine the intended comparability goal to assure consistent application for like contracts:

- Many times the date of inception and commencement date are almost simultaneous. However, in some leases there is a significant delay between the two dates (e.g., build-to-suit real estate assets). The ED does not address accounting for any transactions prior to the commencement date or the effect of changes that could occur between the inception and commencement of a lease.
- A lease contract with a new lessor may include incentives for the lessee to enter into the lease, such as an up-front cash payment to the lessee, payment of certain costs for the lessee (such as moving expenses or leasehold improvements), or the assumption by the lessor of the lessee's preexisting lease with a third party. The ED does not address accounting for lease incentives.
- A reduction in the liability to make lease payments due to a decrease in the lease term could exceed the carrying amount of the right-of-use asset (particularly in a lease with increasing lease payments). The ED does not indicate how a lessee should account for such a reduction in the liability.
- The ED does not address how to separate and allocate payments among contracts to lease more than one asset (leases of multiple specified assets).
- In real estate leases it is not uncommon that term extension options in a sublease exceed the lessor's/head-lessee's remaining lease renewals for the underlying asset. Such subleases provide for renewal assuming the lessor making reasonable efforts to renew the lease of the underlying asset. However, in the event the lessor is unable to renew the head-lease, sublease extensions for respective option terms are voided. It should seem that the rights conveyed under a sublease recorded by the sub-lessee should not exceed the rights available to the lessor. However, the lessee will often lack information to assess the lessor's remaining extension options and any other restrictions that may apply to the lessor such as zoning and permit renewal requirements. The ED does not address how the accounting model would prevent usage rights by a sub-lessee from exceeding the usage rights of the lessor/head-lessee.

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 The ED does not discuss transition provisions for contracts that are leases under existing standards but excluded from the proposed new standard as they are intangible assets or they represent purchases/sales.