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DATE

12 September 2013

RE

Deutsche Telekom AG Comment Letter on Exposure Draft 2013/6 Leases

Dear Mr. Hoogervorst,

We welcome the opportunity to address our comments to the Exposure Draft Leases ("ED/2013/6", "ED Leases, or "ED") issued by the International Accounting Standards Board in May 2013.

This letter represents the view of Deutsche Telekom AG, one of the world's leading integrated telecommunications companies, with approximately 132 million mobile customers, 32 million fixed-network lines, and more than 17 million broadband lines, as of December 31, 2012. The Company is present in around 50 countries. Deutsche Telekom provides fixed-network/broadband, mobile communications, Internet, and IPTV products and services for consumers, and information and communication technology (ICT) solutions for business and corporate customers. With a staff of some 230,000 employees throughout the world, we generated revenue of EUR 58.2 billion in the 2012 financial year, over half of it outside Germany. Our operating lease commitments including optional extension periods were 17.5 billion € as of December 31, 2012. Only a fraction of this amount is legally committed. Our lease expense in 2012 was 2.8 billion €.

We continue to support the IASB's intention to issue a new, quality enhancing and principles-based standard. At the same time, the concepts of the guidance proposed in the latest ED raise a number of concerns which we highlight in this Comment Letter. As you know, the proposed accounting will result in enormous additional cost and has a massive IT and process impact (our initial estimate is a three digit million Euro amount in Germany alone). Many issues and serious concerns arise as a consequence.

The leasing project is very controversial, in our opinion, largely because of the Boards' approach to completely change the classification tests, expense recognition, balance sheet classification and cash flow statement presentation for

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lessees. Another reason for controversy is that the proposed rules are complex and in many cases will not reflect the economic effects of leases as well as the current rules do. At the same time, leases are used by virtually all companies and everybody is affected.

We hope that our comments will receive your proper attention and will lead you to reconsider aspects of the proposed future lease guidance, including our preferred position to finalise the proposals in steps starting with the revision and quality enhancements to the current lease disclosures which should include an enhancement of the definition of the lease term for optional extension periods as explained further below.

To a limited extent, we view the re-exposure draft as an improvement when compared to the first exposure draft, as follows:

1. it eliminates certain complexities,
2. it recognises in general that a lessor should account for certain business models/contracts differently than for other types of contracts,
3. it excludes certain ITC outsourcing contracts from the scope of the standard, and
4. it clarifies the definition of lease payments with respect to the lease term ("significant economic incentive") and therefore better reflects the economic effects of a lease and enhances comparability among preparers.

However, while we continue to agree with the overall objective of this Exposure Draft we think that the benefits derived from the ED do not justify the cost. We do not believe that the IASB's ED Leases proposal with respect to lessor accounting is a conceptual improvement over current accounting. In addition, we believe that the right-of-use model is not soundly grounded in the Conceptual Framework. We are also concerned that users will continue to be compelled to make considerable adjustments to unwind the future IFRS accounting effects in the proposed requirements to accommodate their analyses.

1. Users of financial statements - amount, timing, and uncertainty of an entity's future cash flows

Users frequently adjust the financial statements to capitalise lessees' operating leases based on the disclosures made in the notes of the financial statements. This is also the case for Deutsche Telekom's analysts and rating agencies. With respect to leasing contracts, we believe that investors, analysts, credit rating agencies and other users of financial statements are appropriately interested in the amount, timing, and uncertainty of an entity's future cash flows arising out of leasing contracts. We support this idea and are in favour of providing users of our financial statements with the proper cash flow information.

There appear to be many different views around the world as to how the current leasing standards should be improved with an equally diverse number of stakeholders interested in this project. As a result, the outcome of the Boards' effort appears to be uncertain at the time we write this comment letter.

However, it is clear to us that - at a minimum - the single most useful improvement that could come out of this project in the near future is that users of financial statements will get better information about the amount, timing, and uncertainty of an entity's leasing cash outflows resulting in improved adjustments to financial statements or ideally resulting in a



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situation where adjustments are no longer necessary – particularly for lessees' financial statements. In a first step, this could be achieved by improving a particular disclosure alone.

On the lessee side, the main drivers of expected cash outflows in our industry, aside from the monthly base payments, are determined by

1. legally committed lease periods,
2. preparers' judgement as to whether or not options to extend the lease are included in the lease term, and
3. contingent payments based on consumer price index increases (CPI).

Regardless of the specifics of a new leasing standard (from recognition in the statement of financial position to disclosure improvement only), we believe that it is extremely important for users of financial statements, that lessees disclose or report the following (see also more detailed comments below):

- (i) the extent of their legally committed portions of future cash outflows and
- (ii) the portion of cash outflows that has not yet been legally committed to, but was included in the preparers judgement of the lease term i.e. whether a "significant economic incentive" to exercise one or more options was assumed by the preparer. This includes transparency about the number, terms and payments of lease extension options assumed.

When preparers provide this information, the desired transparency and higher comparability among companies will have been achieved. Relevant and meaningful disclosures alone could address users concerns for better information.

2. Conceptual Framework – Asset definition met, Liability definition met only for legally non-cancellable term

While we agree with the Boards' conclusion in BC 13 that a lessee's right to use an underlying asset meets the definition of an asset in the IASB's Conceptual Framework and in Concepts Statement 6, we have conceptual issues with the right to use notion and disagree with the conclusion that a liability exists for payments due under optional extension periods.

(a) Right to use the underlying asset. We agree that

- (i) the lessee controls the right to use the underlying asset once the asset is delivered during the lease term because the lessor is unable to have access to the resource without the consent of the lessee (or breach of contract);
- (ii) the lessee's control of the right-of-use is demonstrated by its ability to determine how and when it uses the underlying asset and, thus, how it generates future economic benefits from that right-of-use. We also agree that certain existing use restrictions may affect the value of and payments for the right-of-use asset, they do not affect the recognition of the right-of-use asset and that it is not unusual for particular restrictions to be placed on the use of owned assets as well as leased assets, such as assets that are used as security for particular borrowings;
- (iii) the lessee's control of the right-of-use arises from a past event—the signing of the lease and the underlying asset being made available for use by the lessee. Unless the lessee breaches the contract, the lessee has an unconditional right to use the underlying asset.



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However, since the right-of-use asset definition is new and, therefore not be fully grounded in the Conceptual Framework, we suggest to further investigate this asset concept as part of the ongoing Conceptual Framework discussions (see separate section below). The proposed requirements for right-of-use assets recognised by the lessee are defined without resolving what the right-of-use asset is: an underlying tangible asset, an intangible asset, a unique asset subject to lease, or perhaps a service provided over the lease period.

We believe that clarifying what a right-of-use asset actually is, is vital. If it's the underlying asset (such as a cell tower) we suggest the proposed leasing guidance includes a fair value cap for the amounts capitalised similar to the current guidance under IAS 17 for finance leases (IAS 17.20). For example, if the leasing contract for a tower with a remaining 5 year economic life is for a 10 year lease term (5 year non-cancellable with 1 x 5 year optional extension period because there is a significant economic incentive to exercise), then it is clear that the tower site operator will have to replace the current tower with a new tower to fulfil its contract with the lessee. If the right-of-use asset is meant to represent the underlying asset, then there should be a cap of the amount capitalised that should not be more than the fair value of the underlying asset with a 5 year economic life. Otherwise, the amount recognised is overstated and multiple assets (still to be constructed) may be capitalised.

In the ED, subsequent accounting by the lessee for Type A leases generally is prescribed to be consistent with the accounting for tangible/intangible assets and the subsequent accounting by the lessee for Type B leases generally is prescribed to be consistent with the accounting for services (except for the statement of financial position). The ED describes the right-of-use asset held by the lessee under the lease contract as the future economic benefits associated with the lessee's contractual right to use the underlying asset of the lessor over the lease term. The ED also would require that the lessee's right-of-use asset be presented along with similar owned assets in the property, plant, and equipment section of the statement of financial position.

If the Boards were to decide that the right-of-use asset either represents the underlying physical asset or an intangible asset, then there may be conceptual justification for subsequent accounting that requires amortisation of the right-of-use asset over the remaining contractual term in a pattern consistent with the pattern used for tangible assets or intangible assets. In contrast, if the Boards were to decide that the right-of-use asset is a service provided by the lessor to the lessee, only then could it be argued that the subsequent accounting for the right-of-use asset should be the recognition of a single lease expense in the statement of income. However, a decision to view the asset as a service also might suggest, that the right-of-use asset and the lease liability should be presented net in the statement of financial position.

If the right-of-use asset neither represents the underlying physical asset owned by the lessor nor an intangible asset or service because intangibles and services do not involve control over the use of a physical asset, then the right-of-use asset may be unique and represents the benefits accrued by the lessee from access granted by the lessor to use and temporarily control the underlying asset over the lease term as well as from any other rights conveyed by the lessor under the contract (including non-lease components) and, therefore, that subsequent accounting for the lease asset should not be defined by reference to other literature such as IAS 16.

As a result, we believe that clarifying what a right-of-use asset actually is, is an important conceptual issue that needs to be resolved first.



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(b) Financial obligation to make lease payments. The IASB's *Conceptual Framework* defines a liability in 4.4(b) as "a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits." The FASB's Concepts Statement 6 states that "liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." The main characteristics of both definitions of a liability are that the entity has a present obligation that arises from a past event, and the obligation is expected to result in an outflow of economic benefits.

The Boards concluded in BC 15(a) that "the lessee has no contractual right to cancel the lease and avoid the contractual lease payments (or termination penalties) before the end of the lease term." However, this is only true for the legally committed non-cancellable payment portions. Amounts relating to unexercised optional periods to extend the contract are not liabilities at the inception or the commencement of the lease because the obligation to pay will result from a future event, the exercise of the lease term extension option, rather than from a past event as is assumed by the Boards. Before exercising the option, there is no legal or constructive present obligation to another party to whom the "obligation" is owed. 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. 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 extend the lease is exercised. Only contractually unavoidable payments are legally committed obligations and should therefore be recognised as liabilities in the statement of financial position.

3. Current Board discussion on the Conceptual Framework for Financial Reporting (DP/2013/1)

The right-of-use model is based on a notion that an asset is a bundle of rights with individual rights and obligations under the lease contract are treated under the proposed requirements as separate units of account for recognition, measurement and/or presentation purposes. This is a new approach, which has so far been insufficiently debated on a conceptual level. As a result, we are not convinced that the focus on liability recognition has led to capturing the right population to which the right-of-use model should be applied.

We believe that the IASB's on-going review of the Conceptual Framework for Financial Reporting project (DP/2013/1) provides an ideal context to assist the IASB when identifying fundamentally new accounting concepts such as the right-of-use lease model. In that respect, the Conceptual Framework project's work will help refine the following: the definition of the right-of-use, lease liabilities for optional extension periods, distinguish this right from the other rights which are bundled in the asset, investigate whether the somewhat opaque consumption of economic benefits based classification approach is a concept to rely on in a leasing standard and refine the guidance to identify what activities convey the ability to direct the use of an asset and how this links with the business models of lessors ("selling" an asset/providing finance or managing assets).



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4. Lease accounting - a complex area for the Deutsche Telekom Group

Deutsche Telekom, as lessee, does not view the majority of its lessee contracts as a means of obtaining financing, because Deutsche Telekom mainly contracts portions of larger assets while these portions of assets cannot be purchased separately by Deutsche Telekom or any of our competitors (e.g. space on a rooftop of a building to place antennas). To the contrary, we use the flexibility of current operating lease contracts, in most cases in the same way as obtaining a service.

Already today, lease accounting is a complex area that places high demands on professional accountants, requires often manual manpower processing the contracts and is in need of a very sophisticated IT environment. Deutsche Telekom Group is both lessee and lessor for parts of tower sites and spaces on rooftops. We provide access to assets to our customers, such as routers or set top boxes, which are primarily the vehicles for delivery of our services. There are many services requiring the use of assets that are not physically placed at a customer's location but remain at our premises. There are assets, as part of the outsourcing agreements for which our customers specify only the level of required performance but are not able to operate them themselves. Rapid technology developments and rising network investments may overcome traditional building of own networks and introduce different forms of arrangements - network sharing, indefeasible rights of use, capacity agreements, joint ventures. Strict regulatory and anti-monopoly requirements oblige us to enable other operators to connect, use, share, multi-share and sublease parts of our networks. The consideration received can be structured in a complex and individual way – for example there can be a fixed fee covering return on network investment plus variable portion per (non) active connection. The price for using an asset is not always separated from overall service fee. Our customers have ever increasing demands and ask for great flexibility not only in terms of our service but also in terms of assets provided. The need for flexibility, one of the key characteristics of the telecommunications market today, is also reflected in the use of optional extension periods when contracting lease term durations. Due to a very dynamic nature of our industry the ability to make long-term predictions in order to estimate the exercisability of options is much limited.

As a result of the facts above, the accounting for leases has never been as straight-forward for us as it may be for other, less complex industries.

5. Main suggestions for next steps

When considering the impact and applicability of the proposed standard to our environment we want to emphasise the fact that our business models are very complex and that this complexity has to be considered when forming the principles of the new lease standard. We have recently gone through a very intensive and thorough thought process including consultations with three large audit firms, an outreach/field test with the IASB staff and a Board member in order to assess the impact of the proposed lease standard. After having carefully considered the practical implications of the proposed standard, we are disappointed to see only a limited number of (simplification) improvements. As mentioned above, one of the improvements that we do see (and welcome) is the tendency for more arrangements to be



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classified as service arrangements and fewer arrangements being classified as leases. However, we still fear that the accounting for leases including the demands for our automated (and perhaps manual) processing will become even more complex in the future.

Our thorough analysis of the ED Leases leads us to the following suggestion:

1. in a first step, improve current IAS 17 disclosures particularly the lease term definition and information on timing of cash outflows, and
2. re-focus the Boards energy primarily on the conceptual issues involved before moving on to issue a new leasing standard.

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 87123), Barbora Bobalyova (+49 228 181 12786) 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,

/s/ Guillaume Maisondieu

/s/ Michael Brücks

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Attachment – Appendix with answers to specific questions



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Attachment: Comments to the Exposure Draft ED 2013/6 questions

Question 1: Identifying a lease:

This revised Exposure Draft defines a lease as “a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration”. An entity would determine whether a contract contains a lease by assessing whether:

- (a) fulfilment of the contract depends on the use of an identified asset; and
- (b) the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 6–19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Deutsche Telekom's Response:

We consider the proposed guidance an improvement to the current IFRIC 4 requirements. At the same time, we believe that the definition of a lease must capture only those contracts that are not in-substance service arrangements. We acknowledge that this is difficult to achieve because the provision of services often involves some use of assets, and a 'service or executory contract' are not defined terms in IFRSs. In this respect we believe that applying the proposed criteria will require significant judgment resulting in application issues. For example, it is difficult to assess 'control' when the asset is not in the physical possession of and is not directly managed by the lessee.

As stated in BC 104, the Boards “decided that the application guidance for ‘the right to control the use of an asset’ should be more consistent with the concept of control applied in other requirements and projects (ie the consolidation requirements and revenue recognition proposals)”. We also agree that the control concept is substantiated by both “benefits” and “power” elements (BC 105 d). When we began analysing the impact of the ED on Deutsche Telekom's business models, we found these references very helpful. For example, determining whether there were substantive or protective rights in the leasing contract was helpful in applying the guidance. **We suggest that the IASB makes it clearer what control is by drawing more on the control definition in the consolidation and revenue recognition guidance.**

We agree with a suggestion in EFRAG's draft comment letter that a **“criterion that could be added to identify a lease is the existence of observable prices for the underlying asset.** The lack of observable prices should give rise to a rebuttable presumption that the asset is of no use to the client without additional goods or services provided by the supplier, and therefore the agreement is not a lease... the absence of an observable price for an asset should be an indication that the



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asset is not a lease component. We believe that when an asset could be used without additional goods or services that only the supplier can provide, a separate price for the asset will be observable.”

When considering the concept of an identified asset, we recommend an **improvement to the definition of a “substantive right to substitute”**. We perceive the wording in paragraph 19 (b) (ii) of “costs associated with substituting the asset so high that they create an economic disincentive” as unclear and not helpful for entities trying to apply this criterion. The Boards do not illustrate how to determine whether substitution costs are so significant that they create an economic disincentive for the supplier to substitute alternative assets. This is an area where diversity in practice exists already today and could again develop in the future.

For example, some suppliers might evaluate whether costs create an economic disincentive based on whether they significantly affect the contract’s margin. Conversely, other suppliers might evaluate whether costs create an economic disincentive based on whether they are significant in terms of their absolute monetary value. In addition, the application of this criterion is not clear to us – is an entity obliged to apply this criterion consistently to all contracts using the same benchmark or shall the comparison be different for different business models?

Furthermore, we certainly miss **consideration of the lessee’s point of view** with regard to the right to substitute. For a lessee, without having insider knowledge of the supplier’s business, it may be difficult if not impossible to assess any supplier’s economic or other barriers. For example, how shall a lessee know whether costs of substitution are “so high” (refer also to the previous comment) for his supplier to prevent him from substitution? We believe that also lessee’s criteria that would effectively prevent substitution should be incorporated into the proposed standard. Examples may be: tailored asset, costs incurred by lessee if leased asset is connected to his other assets, disruption of lessee’s operations, etc. In addition, we believe that the criterion of an identified asset can only be fulfilled if the lessee has actively been involved in the process of the asset’s specification and/ or selection.

When we are providing services to our customers and employ certain underlying assets, we think it is important to consider our customers’ perspective in order to make a determination of whether a service or a lease is present. The questions asked is, is it the asset (a modem, a mobile phone) or is it the service (phone tariff, internet connection) that is of interest to our customer and that primarily drives his decision to enter into a commercial relationship with us? Likewise, when, for example, a fibre optic cable or copper lines are the underlying assets when providing services to customers, it is the connection and capacity which is of main interest to the user, not the underlying communication infrastructure or the equipment employed. In some cases, it is the asset (latest mobile phone model) that drives customer’s decision to enter into contract with us, in other cases, it is the service (cloud computing) which is primarily driving customer’s motivation. As a result, we propose that the new lease standard reflects the concept of an identified asset from a lessee’s point of view. For example, an asset is identified when the customer has alternatives and can perform selection from various types, technical specifications and other asset’s parameters and actively makes decisions regarding his choices. Likewise, the existence of the possibility to enhance or modify an asset based on customer’s wishes is a strong indicator of an identified asset.



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Another point is that we recommend more precise specification of a “physically distinct” portion of an asset. Except for the reference to capacity portion, the wording in paragraph 11 does not provide any further guidance and may lead to difficulties in the application. We believe that the asset may only be “physically distinct” either

1. when it is clearly and on the “first look” separately distinguishable based on its physical appearance, technical specification, usability and purpose or
2. when the asset can be subject to a sale and buy decision or
3. when the asset can be capitalised under the current IAS 16 guidance.

When there is an interrelationship between several elements that are managed as a whole and those elements are not useful for the customers on a stand-alone-basis, then the individual elements should not be defined as the asset. Instead, the asset should be defined at a higher level. For example, in the case of a telecommunications network, the asset is the network and not the individual cables or hardware devices.

With respect to the right to control the use of an identified asset as outlined in paragraphs 12-17, we recommend that the new leasing standard clearly addresses a criterion of control with respect to “technical know-how and the ability to operate” the asset. If a lessee does not have the relevant technological know-how to operate the asset, how can that entity have the ability to direct its use? For example, if hardware is placed in the lessee’s premises and the hardware is operated by an outsourcing provider from a distant destination, then the lessee is not able to technically operate the hardware, even though he may be able to somewhat define the output and performance level expected from the hardware. However, he controls physical access to it.

The proposed paragraph 17 is not very clear in determining whether a customer has the “ability to direct the use”, because it does not outline what “decision-making rights” exactly are, except for output specification. It is therefore challenging to determine whether the right to control the use is present or not. The ED does not indicate how involved in the asset’s design the customer would need to be to demonstrate that it has the ability to direct the asset’s use, or how to consider the customer’s involvement in design together with other ongoing decisions. It would be helpful to clarify this aspect.

Furthermore, we suggest that the clarification with regard to control is made in a sense that control aspect of “power” reflects both the “will” element (ability and authority to direct or enforce others to perform actions that will bring the benefits) and an element of a practical, physical “action” of the lessee (ability to move, transport, handle or sub-let the asset at his own discretion).

With respect to **functional interdependence between hardware and service**, we would like to make reference to BC 105(d), where the Boards explain that the accounting principle in paragraphs 18-19 of the ED (“ability to derive the benefits from use”) is about the „decision-making rights over the use of the asset“, i.e. about the “ability to influence the economic benefits derived”. For example, our customers have no ability to influence the economic benefits derived from our set top boxes when IPTV set-top boxes are coded in such a way that they can only be used to receive Deutsche Telekom’s IPTV services. Decision making rights to influence the economic benefits derived from these pre-programmed set top boxes lie with Deutsche Telekom.



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It is stated in BC 105(f) that when the “asset [is] an inseparable ... part of the overall service provided to the customer” that in this case „... the customer receives services ... that require the use of the asset.“ In other words, the customer does not have the right to control the asset because the customer does not have the ability to influence the economic benefits derived from the hardware. As a result, there is no leasing contract. Based on our reading of the Basis of Conclusion, we believe that the Board intended that, in this case, a lessor should always conclude that there is no lease because there is a very high functional interdependence between the set top box and the network services. We certainly agree with this outcome.

However, we are unclear about the relevance of the half sentence in ED 19(a) „and not sold separately by the supplier or other suppliers“. This seems to be in conflict with what the Boards intended to achieve. In addition, we are unclear about the relevance of potential sales in secondary market in this respect.

The ED’s proposed test for evaluating whether an asset is inseparable from a good or service appears to diverge from the forthcoming revenue recognition standard. The revenue recognition standard’s guidance requires a good or service not to be considered a separate unit of accounting if either the good or service does not provide benefit to the customer on its own or together with other readily available resources, or the good or service is highly dependent upon, or interrelated with, another good or service in the contract. Conversely, under the EDs’ proposed guidance, an identified asset would not be a lease element only if it fails to meet both of those criteria. As a result, more arrangements would be considered to contain a lease compared to the conclusion that would result if the forthcoming revenue recognition standard’s guidance were applied. The Boards’ selection of these criteria may therefore result in a conclusion that some arrangements meet the definition of a lease even though that appears to be contrary to the Boards’ objective. **We suggest making it clear that when the customer does not have the ability to influence the economic benefits derived (e.g. because IPTV service is highly dependent upon, or interrelated with, the necessary set-top boxes), that the definition of a lease is not met.**

In the same context, we are concerned with paragraph 18 “Ability to derive benefits from use”. Based on the information in BC 105(e), the Boards intended to “clarify that only the benefits arising from use of an asset, rather than the benefits arising from ownership of that asset, should be considered when assessing whether a customer has the ability to derive the benefits from use of an asset.” In that context it is unclear to us which “... economic benefits from use of the asset ... could be realised from a commercial transaction with a third party” when the asset is under lease. The asset could only be subleased by the lessee. We recommend amending this paragraph so that it clearly states what benefits shall be considered in the determination of this part of the control criterion.

Here, we also refer to paragraph BC 105(f) stating that “the customer is unable to derive benefits from the use of the asset when the asset has no value or use to the customer without other deliverables in the contract”. Using the word “value” points out to the possibility of realisation of asset’s value in other way and indication that customer has the ability to benefit from the asset.



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Question 2: Lessee accounting

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Deutsche Telekom's Response:

Should the Boards nevertheless decide to continue with the project based on the concepts of the ED Leases without considering our recommendations in the cover letter, we would like to point out that Deutsche Telekom generally supports a model for the recognition of the assets and liabilities arising from a lease by lessees. We support the effects of a right-of-use model on a lessee's profit or loss in which a lessee would recognise separately the amortisation of the right-of-use asset and interest on the lease liability. We believe that when the future payments for leases are capitalised and classified as financial liabilities then these contracts are a source of financing for a lessee and this concept should be consistently accounted for in the statement of financial position, income statement and cash flow statement.

For Type B leases, as proposed in the ED, the amortisation of the right-of-use asset in each period is, in effect, a balancing figure to achieve a straight-line expense in profit or loss, and still combines a financing cost and amortisation of the right-of-use asset element. Accordingly, a lessee would not measure right-of-use assets arising from Type B leases consistent with other non-financial (fixed) assets measured on a cost basis. **The one line operating expense result is not based on conceptually sound accounting concepts and should not be adopted as proposed.**

Having recognised the right-of-use asset separately from the financial lease liability (i.e. pretending we raised debt to "buy" the right-of-use asset) at the commencement date, a lessee should subsequently measure the right-of-use asset independently of the lease liability. Since the approach to lessee accounting is to initially recognise a liability, we believe that it only makes conceptually sense, that the proposed straight-line lease expense (which still consists of interest and amortisation expense) recognition should also be treated as a financing and an amortisation expense element in the income statement, i.e. presentation in two separate lines; just as it is today when we buy an asset and finance it with a loan.

We understand that in the United States, Medicare and other government organisations, for example, will only reimburse hospitals for non-medical equipment rent expense but there is no reimbursement for amortisation and imputed interest expense. We do not believe that such an argument (issues with cost reimbursement in existing contracts with U.S. government agencies) is an appropriate reason to withhold sound accounting principles from an IFRS standard.

We would also like to point out to the Boards that **credit rating agencies typically give credit for the interest expense portion of the operating lease expense** when making their balance sheet adjustments – in essence credit rating agencies currently do not appear to view the expense as a one line expense but rather as two components: interest expense from a loan and amortisation from the asset.



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We therefore propose that a lessee should account for all leases, except short-term leases, according to the principles outlined in this Exposure Draft for Type A leases - as explained further below. Aside from the conceptually superior accounting basis, this result would also reduce the complexity and cost for lessees. Furthermore, accounting by the lessee does not, in our view, raise unit of accounting issues as is the case for lessors (see Question 3 below). The lessee is acquiring an important contractual right (the right-of-use of the underlying asset) by incurring a liability (the obligation to make lease payments).

Should the Boards nevertheless insist on the expense recognition in the income statement in one line, we suggest that preparers are allowed to disclose/classify the amount below EBITDA or, alternatively, that preparers have at least an accounting policy choice as to the consistent treatment in the statement of financial position, P&L and cash flow statement.

Question 3: Lessor accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Deutsche Telekom's Response:

We want to present a strong belief that, in the end, there should only be one type of accounting for lessors in the telecommunications industry such as Deutsche Telekom. We agree with the Boards' attempt to propose changes to today's lessor accounting. Should the Boards decide to go ahead with issuing a new standard, we suggest that it would more accurately reflect the leasing activities of different lessors with different business models and risk/benefit profiles, because leasing contracts are the result of the lessee's intention

- of either gaining access to assets,
- of obtaining finance and/or
- of reducing an entity's exposure to the risks of asset ownership.

Conceptually, we think of lessor (leasing) transactions as being of two types:

1. leases that are substantially the same as "selling" the (whole) underlying asset and
2. those that are not ("failed" sales) ; whereby we believe that in the telecommunication industry very few, if any, industry specific transactions should qualify as sales type transactions.

It appears that this thinking was also confirmed by discussions the Boards had with lessors which "indicate that there are two different lessor business models" (BC 73(b)). In our view, lessor lease classification should be based on a lessor's business model. "Financial/sale" lessors should use something akin to the receivable/residual method. "Operating" lessors - where the lessor retains significant risks or benefits of the underlying asset - should use a model that is similar to today's operating lease accounting.



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We believe that this also reflects how users in the telecommunication industry would view our lessor transactions, because we believe that users measure both real estate and equipment telecommunication industry lessors, as though the leased assets (our basic stock-in-trade merchandise and hardware we keep on hand and use in carrying out our business) are depreciating assets that will be accessed (or “subcontracted”) multiple times over their useful lives with rent revenue and maintenance and operating expenses reported using accrual accounting. Typical hardware involved in the telecommunication industry are copper or fibre lines contracted for several times over relatively short periods of time to different competitor clients.

On the other hand, a lease in which the lessor does not retain significant risks or benefits with respect to the underlying whole asset, is economically similar to the sale of the whole asset and we believe that a full derecognition approach, in this instance, is the appropriate accounting for those kind of transactions (see below). These contracts should be scoped out of the leasing requirements and scoped into the guidance on revenue recognition for lessors and property, plant, and equipment for lessees. The leasing activities of these lessors are primarily about providing financing to lessees facilitating the sale of the assets. Such lessors would typically have no ongoing involvement with the underlying asset while it is the subject of a lease or, if they do, that involvement is priced separately from the lease. Many equipment and vehicle lessors tend to have such a business model.

In the telecommunication industry, companies often employ or provide access to underlying portions of assets to provide their services to individual clients. These transactions do not transfer the significant risk/benefits of the underlying whole asset from the lessor to the lessee. Providing access to portions of larger asset in and of itself is indicative of a shared risk/benefit profile and should not result in “sale/lease” accounting. Three prominent telecommunication industry business models involving portions of larger assets are:

- (i) Portions of space on and below owned cell phone towers, which itself are only capitalised as a whole under IAS 16. A portion of the tower and the underlying land is made available to competitors to install their antenna and related active equipment to power the antenna.
- (ii) Dark fibre capacity (portion of a larger cable inserted into a duct in the ground) is made available for use to competitors. Approximately 80% of the cost to install the cable is construction cost and 20% is fibre material cost. The whole cable is capitalised under IAS 16 – not individual fibres.
- (iii) Providing/receiving transponder satellite capacity.

We therefore propose clarifying the definition of the underlying asset by adding the underlined section below. This serves to clarify that only assets that are capitalisable in accordance with 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 an identified asset exists, is applied only to items that qualify for recognition (and derecognition) in accordance with IAS 16. Furthermore, the clarification of the definition of the underlying asset in Appendix A of ED Leases will avoid lessor “sale” treatment for the impracticable and costly derecognition of, for example, individual fibre strands that are part of a larger cable whose risks/benefits are intricately tied to those of the whole cable.



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Underlying asset	“An asset that is the subject of a lease , for which a right to use that asset has been conveyed to a lessee . The underlying asset could be a physically distinct portion of a single asset <u>except that it has to qualify for recognition in accordance with IAS 16.</u> ”
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We would like to point out that we do not believe our suggested approach is inconsistent with lessee accounting as proposed in the ED. **Lessor lease classification and accounting need not be symmetrical with lessee accounting** as the Boards appear to believe. The lessee is typically only leasing to obtain the temporary right to use the asset and does not care whether the lessor will sell or re-lease that asset when its lease ends and they return the asset. In the telecommunications industry, the lessee will often only be paying for the temporary right to use of a portion of the whole physical asset such as a cell tower while other carriers are using the assets as well. In other words, the lessor’s economic return is affected by its continuing involvement with the full underlying asset (including the residual asset), while the lessee’s benefits under the lease are limited only to benefits it receives from using a portion of the lessor’s underlying asset over the lease term.

Thus, the economic benefits to the lessee and lessor associated with rights and obligations under a lease contract are not symmetric because the lessor’s economic return is affected by its continuing involvement with the full underlying asset (including the residual asset), while the lessee’s benefits under the lease are limited only to benefits it receives from using a portion of the lessor’s underlying asset over the lease term. That difference should cause differences in the accounting required for lessees and lessors.

(i) “Selling” the underlying whole asset

Lease contracts that

- transfer substantially all of the benefits of the underlying whole asset from the lessor to the lessee and
- where the lessor does not retain exposure to significant risks or benefits

should be accounted for as sales by the lessor and purchases by the lessee of the underlying asset.

We believe such lease arrangements are similar to a purchase and sale of the underlying asset and believe a full derecognition approach appropriately portrays the economics of these kind of lease arrangement. The accounting for those contracts should be consistent with point-in-time sales accounting by the lessor and purchase/acquisition accounting by the lessee.

As stated above, we believe that the leased whole asset is either substantially sold or not substantially sold for financial reporting purposes. For example, based on the ED proposal and the Boards’ forthcoming revenue recognition standard, arrangements where a residual value guarantee provided by a seller to the buyer of an asset is provided, would not, in



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isolation, prevent the seller from concluding that it had transferred control of the asset to the buyer and, therefore, accounting for the arrangement as a sale rather than a lease.

We believe the retained residual in a lease that qualifies for the derecognition approach is quite different than the asset transferred to the lessee and should be viewed as proceeds/receivables rather than a retained interest in the leased asset – similar to the requirements of IAS 17 today.

We prefer a full derecognition method for such sales type leases as we believe the appropriate unit of accounting for a lease is the entire asset. We would also point out that a full derecognition approach would be consistent with the IASB's conclusion on the deconsolidation of a subsidiary with a retained noncontrolling interest.

(ii) "Failed" sale – Lessor retains significant risks or benefits of the underlying asset

Lessors, such as a telecommunications company, manage the underlying asset throughout the lease term and over the economic life of the asset. These lessors are not primarily in the business of providing financing to lessees. Instead, the aim is to generate cash flows from the underlying asset on an ongoing basis by managing the asset over a period of time. In the telecommunication industry, the "lessor" is often required by a regulatory agency to provide access to the hardware that the company owns in order for the competitor to offer its services to its clients by sharing in the use of the capitalised hardware.

Albeit both property lessors and hardware lessors alike have such a business model, we would like to illustrate this situation based on an IAS 40 property lessor's business model, which is the only business model (and the only one for real estate assets) being carried over from other standards into the proposed leasing rules. The principle under IAS 40 is that if a lessor manages the leased assets with the intention of re-leasing or selling the assets at the end of the first lease and successive leases, the lessor is not a financial "sale" lessor and the operating lease method provides the best decision useful information to users. Investment property lessors keep the physical asset on their books rather than record a receivable and residual. They depreciate the asset over the asset's useful life. Rents and residual sales proceeds are revenue.

As stated above, our most significant concern relates to the accounting for leases in which the lessor retains significant risks or benefits related to the underlying asset. Consistent with our view on the unit of accounting for leasing (i.e. only IAS 16 capitalisable assets can be the unit of accounting), we view a lease in which the lessor retains significant risks or benefits related to the underlying asset to be a "failed" sale and not a partial sale of the underlying asset. Accordingly, we do not believe it would be appropriate to use a partial derecognition approach (or receivable residual method) for such leases. If the lessor retained exposure to significant risks or benefits associated with the underlying asset, the Boards' conclusion should be that this lessor would continue to recognise the underlying asset as its asset. Furthermore, it is important to recognise that for many telecommunication assets, such as fibre optic cables, the costs of getting the fibre to its location and in operable condition is the biggest part of the total construction cost. The fibre's material cost is rather low. In addition, several lessees will likely use part of the whole cable over time. Due to these two facts, it is highly



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complex and unreliable to allocate the construction cost of the whole cable to individual fibre strands in order to determine either the value that should be derecognised or accurate residual values of individual fibre strands.

To truly improve financial reporting for lessors, we believe it is critical that lessor accounting be as consistent with the proposed standard on revenue recognition as possible. In our view, a lease in which the lessor retains significant risks or benefits is simply a contract in which control of the underlying asset (the use of the leased item) transfers throughout the contract term rather than at a point in time and should receive accounting treatment comparable to a service contract under the proposed revenue recognition standard. This leads us to conclude that the best financial reporting for a lessor that retains significant risks or benefits related to the underlying whole asset is to continue to apply operating lease accounting to such arrangements, irrespective of whether the underlying asset is property or non-property.

As a result, we believe that the **lessor classification test should be based on the business model** of the lessor as described above and need not be symmetrical to lessee accounting.

Question 4: Classification of leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 28–34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

Deutsche Telekom's Response:

If the standard were issued as proposed in the ED, we agree with a principle that the type of a lease is differentiated based on an expected level of consumption of the economic benefits of an underlying asset assuming that the specific issues that arise when only a portion of a whole underlying asset is contracted for is taken into consideration. When portions of whole assets are involved, applying the practical expedient for property and non-property leases will not necessarily lead to the appropriate outcome. For example, a contract in which a lessor leases out one office floor in a four floor building for periods close to the economic life of a building should not lead to derecognising the equivalent of one floor of the capitalised whole building, when the present value of the payments for the one floor are not substantially all of the fair value of the underlying whole building asset. The lease term test in paragraph 30(a) will lead to inappropriate results. The test should therefore only focus on the fair value comparison in paragraph 30(b).

Subleases: The wording of paragraph 34 is not clear in two aspects:

- i. the reader only receives the message and the intended purpose when reading the paragraph together with paragraphs BC87-88. Therefore, we propose that the key sentence from paragraph BC87 "the boards decided that an entity should account for a head lease and a sublease as two separate contracts" is added to paragraph 34.



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- ii. Paragraph 34 refers to the classification of the right-of-use asset. The reference seems misleading since not the classification of the right-of-use asset but rather classification of the lease is addressed by the Exposure Draft.

We therefore propose that paragraph 34 is amended as follows: “an entity should account for a head lease and a sublease as two separate contracts. When classifying a sublease, an entity shall use the classification criteria in paragraphs 28-32 and shall not automatically take over the classification of the head lease. An entity shall evaluate the sublease with reference to the underlying asset (for example, the item of property, plant or equipment that is the subject of the lease), rather than with reference to the right-of-use asset”.

Question 5: Lease term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

Deutsche Telekom's Response:

In case the Boards decided to continue with the project by requiring more than just user friendly improved disclosures, we would like to make the following comments with respect to the “accounting” lease term which is longer than the legally committed non-cancellable term.

It is clearly challenging to determine the appropriate accounting lease term where a non-cancellable lease term is followed by options to extend the term. The **term may cover periods extending far into the future for real estate type assets**. This is certainly true for the telecommunication industry. Furthermore, the telecommunication industry typically faces rapid, often unpredictable, technological changes in the future as well as changes in network strategy resulting from strategic transactions and industry consolidation. In this respect, we would like to point out that our company's need for property, plant and equipment (depreciating or amortising 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 assets and liabilities will be recognised 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.

In BC 140, the Boards note that “applying the concept of ‘significant economic incentive’ would provide a threshold that is similar to the concepts of **‘reasonably assured’** and **‘reasonably certain’** in existing US GAAP and IFRS, which the boards understand work well in practice.” This has not been our experience. We see **significant diversity in practice around the world** when determining the ‘reasonably assured’ and ‘reasonably certain’ optional lease term, because under IFRS this term is not further defined and is applied differently among companies around the globe – particularly for real estate like items with long economic lives such as rooftop and tower space rentals. We, therefore, see a



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considerable improvement of the current leasing guidance through **clarifying the meaning of 'reasonably assured' and 'reasonably certain' and by introducing the term "significant economic incentive"**.

In BC 127, the Boards state that it "is a **relatively high hurdle**" whether "the lessee has or does not have a 'significant economic incentive' to exercise an option to extend a lease". In order to make it clear for constituents - including financial statement auditors and enforcement agencies - that this is indeed meant to be a high hurdle, we suggest making the following changes to paragraph B5:

B5	"At the commencement date, <u>there is a rebuttable presumption that the lessee will not exercise an option</u> . An entity <u>nevertheless</u> assesses <u>at the commencement date</u> whether <u>there is evidence</u> that the lessee has a significant economic incentive to exercise, or not to exercise, an option by considering all factors relevant to that assessment—contract-based, asset-based, market-based and entity-based factors...."
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Implementing these changes to B5 would also reduce the frequency of reassessment. Reassessment across a large portfolio of real estate like assets where contracts are amended with high frequency is very onerous.

Aside from the points made above, we think that **the lease term issue has conceptually and practically not been addressed properly**, particularly for real estate assets and real estate like assets with indefinite lives such as land. We believe that a reasonable and conceptually sound proposal would capture the fixed or non-cancellable period only and will include an option to extend exclusively in cases when the entity has in fact no option but to exercise it.

Amounts relating to unexercised options to extend the contract should not be recognised as liabilities in the statement of financial position as they are not liabilities at the inception or the commencement of the lease. Recognising a liability is inconsistent with the Conceptual Framework. Furthermore, this would not provide relevant information to users of financial statements as different companies will arrive at different conclusions depending on their interpretation of what the length of the accounting lease term 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 should be complimented by appropriate cash outflow disclosure as well as more robust disclosure concerning the terms of available, unexercised renewal options. We believe that this approach would still represent a major improvement to today's lessee accounting.

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.



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Question 6: Variable lease payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

Deutsche Telekom's Response:

Contingent rents that are index-linked such as to the consumer price index (CPI) should be expensed when the contingent event occurs because in the telecommunications industry, particularly in the U.S., there are many local index references and it would be very burdensome to reassess these regularly. To highlight the onerousness of a CPI reassessment 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.

A requirement to revise the lease liability during the lease term would represent a significant change from current IFRS requirements for finance leases where the liability is not subsequently reassessed and would likely result in greater volatility in the liabilities recognised by lessees. Such volatility could significantly impact a company's financial position and operating results, the accuracy of its financial forecasts, and its compliance with debt covenants. The reassessment of variable lease payments based on an index potentially could require a significant level of time and effort even though the impact of these reassessments is likely to be minimal.

Estimates of these elements are also not reliable. The longer the lease term, the less reliable are the estimates. In addition, the revenues generated from the use of the leased asset related to the contingency (like inflation from increases in CPI) are not reported in the same periods as the lease costs. For Type A leases, the ED does not indicate in which financial statement caption contingent rentals would be recorded. As a result, it should be clarified whether they could be included with amortisation expense, interest expense, or presented as some other expense.

Having said this, we would like to point out that the Boards' decision to exclude from the measurement of lease payments variable lease payments other than those that are in-substance fixed payments and those based on an index or rate is **inconsistent with the requirements of the forthcoming revenue recognition standard** with respect to variable consideration. The forthcoming revenue recognition standard is expected to require the estimated transaction price to



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include variable consideration to which the vendor has a relatively high level of confidence that it will ultimately be entitled to.

Question 7: Transition

Paragraphs C2–C22 state that a lessee and a lessor would recognise and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Are there any additional transition issues the boards should consider? If yes, what are they and why?

Deutsche Telekom's Response:

We propose that paragraphs C2-C20 regarding transition clearly state that entities are not obliged to reassess the originally determined lease term when transiting to new lease standard, especially for land-type leases. Our rationale behind this proposal is as follows:

We do not see any significant difference between the proposed lease term guidance and existing IAS 17 guidance. The substance of both is the non-cancellable term with extension if economic motives to do so exist. We believe that the benefit of any reassessment would not outweigh costs related to lengthy, time consuming and expensive analysis of thousands of lease contracts with result not different from current lease term.

We also propose that the new lease standard, if adopted, is applied prospectively. Our rationale is that revisiting hundred thousands of contracts is not manageable and the costs and effort for it would be enormous. As a consequence, we would accept moving forward with both existing systems and processes for current lease accounting under IAS 17 as well as implementing new systems prospectively for the new leasing requirements.

Question 8: Disclosure

Paragraphs 58–67 and 98–109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations of amounts recognised in the statement of financial position; and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Deutsche Telekom's Response:

The disclosures under the new ED Leases require even more detailed information than under the current standards while capturing all these amounts in the statement of financial position. Over the past years Deutsche Telekom has recognised a **trend under IFRS towards more detailed information**, which could produce extensive (and not always



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necessary) quantities of information in our financial statements. Therefore, we appreciate the “ten point plan” introduced by the IASB’s Chairman, Mr. Hoogervorst, with its clear direction towards reduction of unnecessary information under the statement “less is more.” We believe that the same approach should be used (and re-thought) for forming the disclosure requirements under the proposed lease standard.

At the maximum, we suggest **applying an IFRS 8 management** approach type disclosure requirement, i.e. disclose only what segment management reviews. This would help focussing on significant lease transactions only. As a result, paragraphs 58 (lessees), 98 and 100 (lessors) should be amended so that they do not require disclosure of qualitative and quantitative information about all leases. Paragraph 59 for lessees is a good illustration of this principle.

The primary purpose of the disclosure around **lease payment commitments by lessees** is to provide information about the amount, timing and uncertainty of future cash outflows - including those affected by options to extend the lease term. This becomes also clear from the discussion regarding operating lease obligations in the SEC’s Regulation S-K Item 303 – Management’s Discussion and Analysis of Financial Condition and Results of Operations and the related Instructions to Paragraph 303(a) #2, as well as in comments made in a letter by the SEC¹, dated *7-February-2005, to the AICPA*.

The SEC states that “registrants should ensure that the disclosures regarding both operating and capital leases clearly and concisely address the material terms of and accounting for leases. Registrants should provide basic descriptive information about material leases, usual contract terms, and specific provisions in leases relating to rent increases, rent holidays, contingent rents, and leasehold incentives. The accounting for leases should be clearly described in the notes to the financial statements and in the discussion of critical accounting policies in MD&A if appropriate. Known likely trends or uncertainties in future rent or amortization expense that could materially affect operating results or cash flows should be addressed in MD&A.”

Similarly, in the Conceptual Framework, the IASB determined that the “objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions and continues”. To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be relied upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent. Financial statements should represent faithfully the underlying reality of transactions of a company. Furthermore, the IASB has repeatedly placed emphasis on the responsiveness to users and the need for clarity and transparency to be critical to a principles-based system of standards.

¹ Please refer to <http://www.sec.gov/info/accountants/staffletters/cpcf020705.htm>



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We therefore **suggest in a first step** requiring disclosure of information that allows the reader to determine amounts that are legally committed and amounts that are only included in the obligation or disclosure because of optional lease term extension incentives as opposed to those stated in paragraphs 58 et.al., particularly paragraph 67 of the ED.

Maturity analysis of the gross obligation to pay rentals

	Legally committed obligations (CU)	Total obligations* (CU)
XX17	XX	XXX
XX18	XX	XXX
XX19	XX	XXX
XX20	XX	XXX
XX21	XX	XXX
Thereafter**	XX	XXX
Total	XX	XXX

* Includes optional lease periods for which there is a significant economic incentive to extend the term.

** Disclosing as a single amount the sum of undiscounted cash flows (used in the liability measurement) beyond five years for longer term leases will limit usefulness for users of financial statements. We would be willing to accept a detailed breakdown of the cash flows for periods beyond five years, if otherwise the complexity and cost of a new standard and its disclosure is kept to a minimum.

However, if the final standard would require amounts to be recognised in the statement of financial position – as currently proposed in the ED Leases –, then we believe that the maturity disclosure for the items recognised in the statement of financial position as financial liabilities should follow the guidance in IFRS 7 and that there should not be additional requirements resulting out of the future leasing standard.

We believe that many of the suggested disclosures are nice to have for users of financial statements, particularly those requiring the reconciliation of beginning and ending balances. These requirements do not, however, seem to hold scrutiny in a cost-benefit analysis. The reconciliation requirements for lessees are too detailed and overly complicated. Shall the reconciliations consist of “additions for extensions”, “reclassifications of purchase options”, “reductions due to terminations”, “effects of business combinations” etc. (paragraph 61) multiplied by two types of leases plus one for revalued right-of-use assets and divided per category of an underlying assets – this is simply excessive. In practice, it would mean very detailed, individual monitoring of every single contract out of thousands of lease contracts. We would like to see a more detailed explanation why preparers should generate this kind of reconciliation information. For



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example, when amounts are capitalised in the statement of financial position, one would expect less disclosures rather than more disclosures.

On the lessor side, all type B straight line income generating leases should follow the disclosure requirements under IAS 18 and IFRS 7. We do not see any particular disclosure requirements for those kind of leases as they are similar to any other capacity/service contracts generating revenues. Receivables from lease contracts do not have any particularly different risk profile to them when compared to other client receivables.

Currently, Deutsche Telekom and its subsidiaries have no centralised and automated IT systems for monitoring, collection and preparation of disclosure information. Therefore, we perceive the proposed detailed and complex disclosure requirements as too costly both in terms of manpower and systems.

Question 9, 10, and 11 in the ED are for FASB only

n/a

Question 12: Consequential amendment to IAS 40

The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40 Investment Property. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property.

Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

Deutsche Telekom's Response:

Under the assumption that the ED Leases were issued as proposed, we, in general, agree with the proposal that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property.



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Other issues or items requiring clarifications

Assuming that the ED Leases as currently proposed is further developed during future redeliberations, we would like to make the following additional comments.

(i) IFRS 8 Operating Segments – measure reported to chief operating decision maker

IFRS 8 requires that “the amount reported for each operating segment items to be the measure reported to the chief operating decision maker for the purposes of allocating resources to the segment and assessing its performance” (IFRS 8.IN13; IFRS 8.25-27).

Should the future leasing standard result in IFRS guidance and amounts that are contrary to amounts that Deutsche Telekom’s management will find appropriate for managing its business units on a segment level, Deutsche Telekom may sincerely consider whether a measurement basis other than IFRS is more appropriate for the purposes of segment reporting. For example, Deutsche Telekom may decide that the current operating lease model is the best model to depict intersegment transactions in the Deutsche Telekom Group.

The FASB has the intention to provide guidance on related party leases (Question No. 10). Even though this guidance is not directly related to our point with respect to IFRS 8, we are concerned that the Boards - during re-deliberations - may think of changing the lease accounting guidance for intercompany transactions. We would like to make the point, therefore, that IFRS 8 should continue in its current form in this respect and should leave it open to management to decide which measurement basis is most appropriate for intragroup leasing transactions. **Hence, we urge the Boards not to change IFRS 8 in this respect.**

(ii) Primary Asset (Contract of collocation space on a cell tower/mast site)

In its explanations to the primary asset determination in BC 122, the Boards “decided that an entity should determine whether the underlying asset is property or an asset other than property on the basis of the nature of the primary asset within a lease component. The primary asset within a lease component is the predominant asset for which the lessee has contracted for the right to use. The main purpose of any other assets that form part of the lease component is often to facilitate the lessee obtaining benefits from the use of the primary asset.”

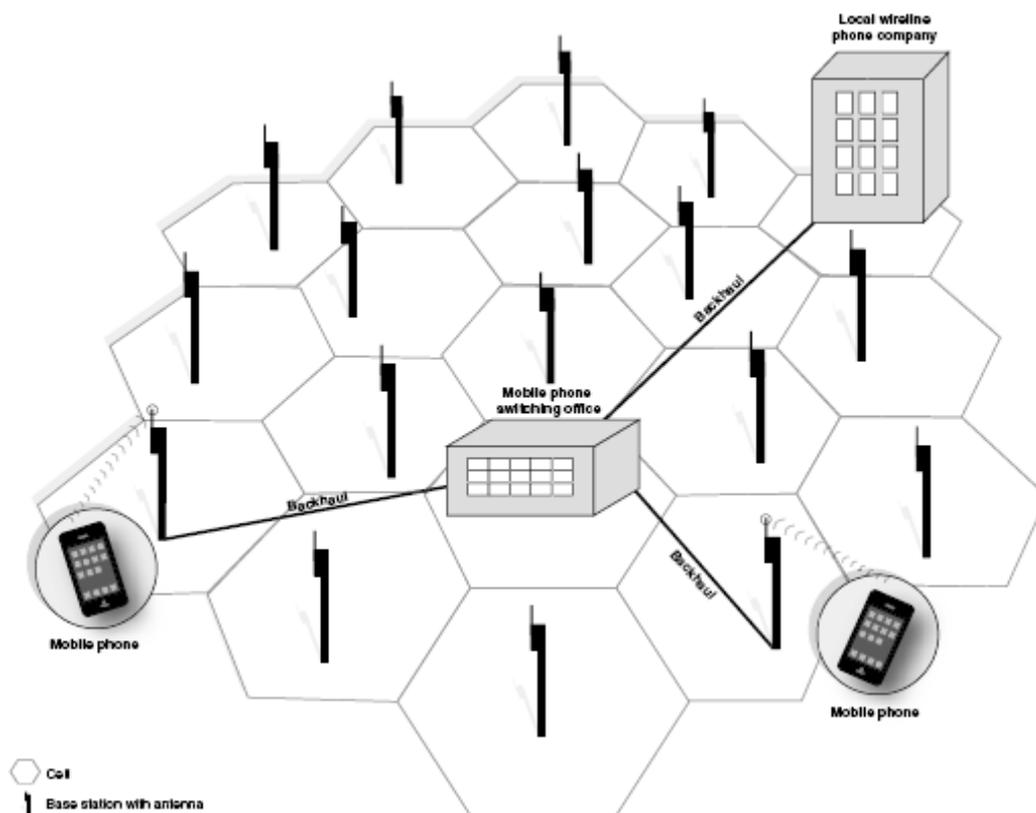
In their re-deliberations from January 2013, the Boards came to the conclusion that contract of collocation space on a cell tower/mast site including sublease of tower space to others “... contains one lease component. It is not possible to benefit from the use of the space on the tower independently of the land on which it is situated, and vice versa.”

Contrary to that conclusion, **we are of the opinion that the primary asset is not the space on the tower but that the property location** where the tower/mast is located (“place on the map”) to get the coverage needed is the primary asset and that to a lesser degree the location/height on the mast itself is of importance to the lessee (see picture of a typical

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Cell Site Structure below). We explained that concept in detail already in separate communications and a meeting with the IASB staff and one Board member.

Typical Cell Site Structure



Depending upon the population density and the topography of a region, a tower site operator typically uses multiple tower sites to provide complete wireless signal coverage in that region to a wireless service provider, such as Deutsche Telekom/T-Mobile. Cell tower locations are engineered in clusters as the relative positioning of each is important to the quality of the overall service in a service area. Therefore, it is difficult to relocate one site within a cluster and the cost of such relocations goes well beyond the cost of the site being relocated. Additionally, there is a significant cost incurred with the civil engineering work and zoning and other regulatory matters. The coverage area of the equipment located at a tower site is defined as a cell. As the number of users increases, the size of each cell decreases and the number of towers required increases.

Therefore, what wireless service providers are contracting for, is in essence the property location where the tower/mast is located to get the coverage needed and to a lesser degree the location/height on the mast itself. **The primary asset is therefore the land.**



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This point is further supported by the example that we provided in our cover letter, i.e. a leasing contract for a tower with a remaining five year economic life when the “significant economic incentive” lease term is determined to be ten years. Accounting for a tower with a five year life should either not assume a lease term of ten years or one should view this scenario as providing further evidence that what a company is really leasing is not the steel structure but the location of the site.

(iii) Integral Equipment

We believe that multi-tenant assets such as cell towers or fibre optic cables should be considered real estate (or property). The definition of property in the ED Leases should be expanded by the Boards to include so called “integral equipment” as defined under U.S. GAAP. This has been a well understood and applied concept and, therefore, does not bear risk of certain unintended effects on other industries or business models.

For example, when a wireless service provider such as Deutsche Telekom/T-Mobile is a lessor of collocation space (subleases) on our own tower sites, the expanded definition would result in the recognition of a straight line pattern of income – similar to today’s operating lease treatment. Under U.S. GAAP today, “integral equipment” is considered real estate and is subject to the scope of various real estate-related accounting standards. The terms property improvements and integral equipment as they are used in U.S. GAAP refer to any physical structure or equipment attached to real estate that cannot be removed and used separately without incurring significant cost. In order for wireless service provider, or a different entity, to remove telecommunication towers/masts and use them separately at a different location, costs (including the decrease in fair value) would exceed 10 percent of the fair value of the equipment, as any party would incur costs both to restore the existing location as well as to identify and develop a new location to install the tower. The determination of whether the towers are integral equipment to the land is based on the significance of the cost to remove towers from its existing location (which would include the cost of repairing damage done to the existing location as a result of the removal), combined with the decrease in the value of towers as a result of that removal. As a result, tower owners typically come to the conclusion that the removal of the towers from one location will result in significant costs associated to removal, damage to equipment, reduction in value of the towers as stand-alone assets, and site restoration costs in excess of 10% of the fair value of the equipment.

Lessors of tower sites view their business as similar to other lessors of multi-tenant property (such as office buildings or other commercial property types). Wireless service providers view the subleasing of tower site space to its competitors to be more akin to a cost sharing arrangement when a wireless service provider owns the tower. Accordingly, it makes sense to expand the definition of property to include tower sites. One way of doing that would be to introduce the concept of “integral equipment” into IFRS and view integral equipment as stock-in-trade merchandise and equipment that a telecommunication industry operator keep on hand and use in carrying out our business. This would be a depreciating asset that will be leased (or subleased) multiple times over their useful lives with rent revenue and maintenance and operating expenses reported using accrual accounting.



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This approach is straight forward, reflects the underlying economics and business model and no additional cash for new IT systems would have to be spent (cost benefit argument).

(iv) Portfolio Approach

Our divisions are in the process of preparing for the implementation of the future revenue recognition standard. In our mass consumer markets (selling several million services/products to residential customers in the fixed line business) we began some time ago renting out TV set-top boxes or routers, instead of selling them. When splitting the contract in leasing and non-leasing service components, we are planning on relying on the portfolio approach (as allowed by the future revenue recognition standard -see below) for the non-leasing components.

As our teams began analysing these multiple element contracts they realised that they would find it very helpful, if the future leasing standard would include similar portfolio approach guidance as the revenue standard.

Excerpt from Re-Exposure Draft Revenue Recognition

“6 This [draft] IFRS specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this [draft] IFRS to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the result of doing so would not differ materially from the result of applying this IFRS to the individual contracts.”

For example, paragraph 21 could be amended as follows: “An entity shall account for each lease component as a separate lease, separately from non-lease components of a contract, except as described in paragraphs 23(b)(ii) and 23(c). An entity shall allocate the consideration in the contract to each separate lease component that has been identified in accordance with paragraphs 22–24. However, as a practical expedient, an entity may apply this [draft] IFRS to a portfolio of contract components with similar characteristics if the entity reasonably expects that the result of doing so would not differ materially from the result of applying this IFRS to the individual contracts.”