

Consolidated statement of income

	Note	1996 millions of DM	1995 millions of DM	1994 millions of DM
Net revenue	(1)	63,075	66,135	63,814
Increase in inventories and other own capitalized costs	(2)	3,454	3,320	3,704
Total operating performance		66,529	69,455	67,518
Other operating income	(3)	3,905	2,138	1,921
Goods and services purchased	(4)	(10,224)	(9,506)	(9,285)
Personnel costs	(5)	(18,777)	(18,502)	(18,157)
Depreciation and amortization	(6)	(17,653)	(15,377)	(14,589)
Other operating expenses	(7)	(9,455)	(9,685)	(8,268)
Financial income (expense) net	(8)	(7,714)	(8,211)	(7,927)
Results from ordinary business activities		6,611	10,312	11,213
Extraordinary income (losses)	(9)	(2,475)	(1,264)	(357)
Special charge relating to other Post entities	(10)	–	–	(2,320)
Taxes, Levy to the Federal Republic of Germany	(11)	(2,215)	(3,778)	(4,945)
Income after taxes		1,921	5,270	3,591
(Income) losses applicable to minority shareholders	(12)	(163)	2	4
Net income	(13)	1,758	5,272	3,595
Unappropriated net income carried forward from previous year		91	–	
Transfer to retained earnings		(202)	(3,981)	
Unappropriated net income (unappropriated net income of Deutsche Telekom AG)		1,647	1,291	
Earnings per share in DM (1994 pro forma earnings per share)		0.83	2.60	1.77

Consolidated balance sheet

	Note	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Assets			
Noncurrent assets			
Intangible assets	(14)	1,429	796
Property, plant and equipment	(15)	134,588	133,755
Financial assets	(16)	8,282	4,664
		144,299	139,215
Current assets			
Inventories, materials and supplies	(17)	2,098	2,305
Receivables	(18)	7,465	6,852
Other assets	(19)	1,018	853
Marketable securities	(20)	4	–
Liquid assets	(21)	17,852	10,008
		28,437	20,018
Prepaid expenses, deferred charges and deferred taxation	(22)	1,589	1,014
		174,325	160,247
Shareholders' equity and liabilities			
Shareholders' equity	(23)		
Capital stock	(24)	13,719	10,000
Additional paid-in capital	(25)	27,869	11,292
Retained earnings (deficit)	(26)	2,171	2,144
Unappropriated net income		1,647	1,291
Minority interest	(27)	1,193	5
		46,599	24,732
Accruals			
Pensions and similar obligations	(28)	6,293	6,029
Other accruals	(29)	8,637	6,964
		14,930	12,993
Liabilities	(30)		
Debt		99,888	110,387
Other		12,115	11,646
		112,003	122,033
Deferred income		793	489
		174,325	160,247

Consolidated
noncurrent assets

	Acquisition or construction cost						
	Jan. 1, 1996	Translation adjustment	Changes in the composition of the Deutsche Telekom group	Additions	Disposals	Reclassi- fications	Dec. 31, 1996
millions of DM							
Intangible assets							
Concessions, industrial and similar rights and assets, and licenses in such rights and assets	1,228	(1)	111	357	50	178	1,823
Goodwill							
from individual company financial statements	1	(0)	(0)	0	0	0	1
arising from consolidation	90	(52)	557	5	0	6	606
Advance payments	6	0	0	91	0	(9)	88
	1,325	(53)	668	453	50	175	2,518
Property, plant and equipment							
Land and equivalent rights, and buildings including buildings on land owned by third parties	38,012	(3)	437	916	111	315	39,566
Technical equipment and machinery	101,936	(27)	2,437	9,026	1,671	3,336	115,037
Other equipment, plant and office equipment	4,402	(2)	133	1,200	340	386	5,779
Advance payments and construction in progress	4,768	(1)	344	5,440	54	(4,206)	6,291
	149,118	(33)	3,351	16,582	2,176	(169)	166,673
Financial assets							
Investments in unconsolidated subsidiaries	0	0	0	0	0	12	12
Loans to unconsolidated subsidiaries	1	0	0	0	0	(1)	0
Investments in associated companies	2,112	79	(1,015)	2,173	414	46	2,981
Other investments in related companies	802	0	0	2,907	80	(12)	3,617
Long-term loans to associated and related companies	117	0	0	129	36	(61)	149
Other investments in noncurrent securities	12	0	1	327	3	0	337
Other long-term loans	1,718	0	4	34	241	10	1,525
	4,762	79	(1,010)	5,570	774	(6)	8,621
	155,205	(7)	3,009	22,605	3,000	0	177,812

	Depreciation, amortization and write-downs							Net carrying amount	
	Jan. 1, 1996	Translation adjustment	Changes in the composition of the Deutsche Telekom group	Additions	Disposals	Reclassi- fications	Write-ups	Dec. 31, 1996	Dec. 31, 1995
	480	0	24	456	29	8	0	939	884
	0	0	0	0	0	0	0	0	1
	49	(7)	47	60	0	1	0	150	456
	0	0	0	0	0	0	0	0	88
	529	(7)	71	516	29	9	0	1,089	1,429
	1,298	(1)	35	1,317	12	(11)	0	2,626	36,940
	12,984	(9)	484	14,556	718	10	0	27,307	87,730
	1,081	(1)	50	1,264	235	(7)	0	2,152	3,627
	0	0	0	0	0	0	0	0	6,291
	15,363	(11)	569	17,137	965	(8)	0	32,085	134,588
	0	0	0	12	0	0	0	12	0
	0	0	0	0	0	0	0	0	0
	92	10	0	224	0	(1)	0	325	2,656
	3	0	0	0	3	0	0	0	3,617
	3	0	0	0	2	0	0	1	148
	0	0	0	0	0	0	0	0	337
	0	0	2	0	0	0	(1)	1	1,524
	98	10	2	236	5	(1)	(1)	339	8,282
	15,990	(8)	642	17,889	999	0	(1)	33,513	144,299

Consolidated statement of cash flows

	Note	1996 millions of DM	1995 millions of DM	1994 millions of DM
Net income		1,758	5,272	3,595
Income (losses) applicable to minority shareholders		163	(2)	(4)
Income after taxes		1,921	5,270	3,591
Depreciation and amortization		17,653	15,377	14,589
Income tax expense		1,385	614	64
Net interest expense		7,270	8,197	7,848
Net losses from the disposition of noncurrent assets		1,026	1,337	940
Accruals for personnel restructuring measures		1,388	785	349
Changes in pension accruals		264	185	162
Special charge relating to other Post entities		–	–	2,320
Other noncash income and expense		134	207	439
Increase/decrease in trade accounts receivable		(298)	(815)	404
Increase/decrease in inventories		283	234	126
Increase/decrease in trade accounts payable		(164)	(351)	(826)
Increase/decrease in other current assets and liabilities		1,544	627	1,142
Income taxes paid		(2,166)	(32)	(58)
Dividends received		152	8	–
Cash generated from operations		30,392	31,643	31,090
Interest paid		(8,773)	(8,804)	(7,509)
Interest received		640	848	533
Net cash provided by operating activities	(31)	22,259	23,687	24,114
Capital expenditures		(16,885)	(14,574)	(19,253)
Purchase of subsidiaries and affiliates, net of cash acquired		(5,221)	(1,980)	(771)
Proceeds from sale of noncurrent assets		656	390	421
Net change in short-term investments		(4,037)	2,843	(9,342)
Other		162	–	–
Net cash used for investing activities	(32)	(25,325)	(13,321)	(28,945)
Change in short-term borrowing		(128)	(954)	471
Issuance of long-term debt		101	–	17,275
Repayments of medium and long-term debt		(12,035)	(14,280)	(6,679)
Dividends		(1,210)	–	–
Proceeds from share offering		20,146	–	–
Net cash provided by (used for) financing activities	(33)	6,874	(15,234)	11,067
Effect of foreign exchange rate changes on cash and cash equivalents		–	(89)	–
Net increase (decrease) in cash and cash equivalents		3,808	(4,957)	6,236
Cash and cash equivalents, at beginning of year		3,508	8,465	2,229
Cash and cash equivalents, at end of year		7,316	3,508	8,465
Liquid assets as shown in the balance sheet				
Cash and cash equivalents, Dec. 31,		7,316	3,508	8,465
Temporary cash investments, Dec. 31,		10,536	6,500	9,342
Other		–	–	1
Total		17,852	10,008	17,808

Consolidated statement of shareholders' equity

millions of DM	Shares issued and outstanding (in thousands)	Capital stock nominal value	Additional paid-in capital	Difference from currency translation	Retained earnings Treasury stock	Other retained earnings (deficit)	Total	Unappropriated net income	Minority interest	Total
Balance at Jan. 1, 1995 ¹⁾	2,000,000	10,000	10,976	(134)		(1,512)	(1,646)		2	19,332
Retained levy			316							316
Net income						3,981	3,981	1,291	(2)	5,270
Difference from currency translation				(191)			(191)			(191)
Capital contributions									5	5
Balance at Dec. 31, 1995	2,000,000	10,000	11,292	(325)		2,469	2,144	1,291	5	24,732
Changes in the composition of the Deutsche Telekom group									1,144	1,144
Dividends for 1995								(1,200)	(10)	(1,210)
Share issued from retained earnings	30,000	150				(150)	(150)			–
Proceeds from share offering	713,700	3,569	16,577							20,146
Transfer to reserve for treasury stock					2	(2)	–			–
Net income						202	202	1,556	163	1,921
Difference from currency translation				(25)			(25)		(109)	(134)
Balance at Dec. 31, 1996	2,743,700	13,719	27,869	(350)	2	2,519	2,171	1,647	1,193	46,599

¹⁾The development of the consolidated statement of shareholders' equity from Jan.1, 1994 to Dec. 31, 1994 is shown in note (23).

Notes to the consolidated financial statements

Summary of accounting policies

Description of business and relationship with the Federal Republic of Germany

Deutsche Telekom group (Deutsche Telekom) is a full-service telecommunications group whose major lines of business include providing public fixed-network voice telephony, mobile communications services, cable transmission services, leased lines, text and data services, on-line services, corporate network design and supply, and network management services within the German market and in certain international markets. Deutsche Telekom also provides broadcasting services for television and radio stations, supplies and services telecommunications terminal equipment and publishes telephone directories.

Deutsche Telekom's principal business is providing telecommunications services, comprising more than 90 % of total operating revenues, operating profits and identifiable assets. Deutsche Telekom's business is conducted predominantly in Germany and is, therefore, within a single geographic area for reporting purposes. None of Deutsche Telekom's customers account for 10 % or more of total consolidated operating revenues. For these reasons, no segment reporting section has been included.

As part of Postreform II (second reform of German posts and telecommunications), Deutsche Bundespost TELEKOM, which operated as a public enterprise until the end of 1994, was transformed into a stock corporation at the beginning of

1995. The new company, Deutsche Telekom AG was registered with the Commercial Registry of the Bonn District Court (Amtsgericht – HRB 6794) on January 2, 1995.

In November 1996 Deutsche Telekom AG made an initial public offering increasing the number of shares issued and outstanding as well as the number of shareholders. The Federal Republic of Germany (the Federal Republic), formerly the sole shareholder of Deutsche Telekom AG, did not participate in the capital increase and its shareholding fell to approximately 74 % of the shares outstanding. The Federal Republic administers its shareholding and exercises its rights as a shareholder through a public law entity, the Bundesanstalt für Post und Telekommunikation Deutsche Bundespost (the Federal Institute). The Federal Institute is subject to supervision by the Federal Ministry of Posts and Telecommunications (BMPT), which also at present acts as the federal telecommunications regulatory authority. The Federal Republic and various government departments and agencies are collectively the largest customer of Deutsche Telekom. Charges for services provided to the Federal Republic and such departments and agencies are based on Deutsche Telekom's commercial pricing policies. Services provided to any one department or a gency do not represent a significant component of Deutsche Telekom's net revenues.

Monopoly rights

Deutsche Telekom essentially has the exclusive right to provide public fixed-network voice telephony services in Germany until December 31, 1997. On that date, the provision of these services will be fully liberalized in accordance with EU regulations and the Telecommunications Act (TKG), and the Company will face competition in this area. Since August 1, 1996 competitors of Deutsche Telekom have been able to freely obtain licenses to build and operate telecommunications transmission lines including broadband cable trans-

mission lines in Germany, which may be used to provide public telecommunications services other than public fixed-network voice telephony. Previously Deutsche Telekom had an exclusive right to build and operate such networks, subject to certain exceptions. The Company has been subject to competition for several years in a number of areas, primarily mobile communications services, data transmission and the supply of terminal equipment.

Summary of significant accounting principles

The annual financial statements and the management report of the Deutsche Telekom group have been prepared in accordance with the requirements of the German Commercial Code (Handelsgesetzbuch – HGB) and German Stock Corporation Law (Aktiengesetz – AktG).

The listing of its shares on the New York Stock Exchange and the related requirement for Deutsche Telekom to file with the U.S. Securities and Exchange Commission (SEC) an annual report on Form 20-F, have led the Company to prepare its consolidated financial statements, to the extent possible, in conformity with international financial reporting norms. The SEC rules for annual reports allow the Company to prepare financial statements in accordance with German GAAP (principally laid down in the HGB), but require a reconciliation of net income and shareholders' equity to amounts determined in accordance with U.S. GAAP. The Company provides uniform financial reporting to the extent possible, by using accounting policies where options exist under German GAAP, to conform to U.S. GAAP. This also serves to minimize differences between results reported in the reconciliation of German GAAP and U.S. GAAP.

The contents of these consolidated financial statements differ from financial statements prepared in accordance with U.S. GAAP only in those instances where the accounting and disclosure requirements of the HGB cannot be conformed to U.S. GAAP. These differences between German GAAP and U.S. GAAP are shown in the reconciliation.

Whereas the HGB requires only one year of comparative figures for the statement of income, the SEC requires the two previous years. The SEC also requires three years of cash flow statements and statements of shareholders' equity. Upon the transformation of the Deutsche Bundespost TELEKOM into a stock corporation, Deutsche Telekom was first legally required by German law to prepare and publish consolidated financial statements and a group management report. For purposes of this report, the income statement for 1994 was derived from the audited consolidated financial statements for 1994 of the former Deutsche Bundespost TELEKOM. These consolidated financial statements, which were not published, but prepared on the basis of regulations for consolidated financial statements under the German Commercial Code and taking applicable provisions of the Postreform I into consideration, received an unqualified audit opinion.

Certain provisions of Postreform II (which came into effect on January 1, 1995) affected the preparation of Deutsche Telekom AG's financial statements and consequently the consolidated financial statements. As a result of the appli-

cable accounting regulations and the related elective provisions of Postreform II which varied from those under Postreform I, together with certain changes in accounting policies effected in 1995, the opening balance sheet on a non-consolidated basis of Deutsche Telekom AG did not fully carry forward the book values of Deutsche Bundespost TELEKOM's financial statements. Key items include:

- Revaluation of fixed assets
- Recognition of special charges to other Post entities
- Accrual for indirect pensions
- Accrual for deficits of the Civil Service Health Insurance Fund (Postbeamtenkrankenkasse)
- Capitalization of interest during the construction period for property, plant and equipment
- Capitalization of leased assets and
- Deferred taxes

Accordingly, and due to the significance of Deutsche Telekom AG in relation to the consolidated group, the consolidated financial statements of Deutsche Telekom for 1996 and 1995 are not comparable to the consolidated financial statements of Deutsche Bundespost TELEKOM for 1994. For comparison purposes consolidated financial statements for 1994 were derived from audited financial statements of Deutsche Bundespost TELEKOM for 1994 and are prepared on a consistent basis with those from 1996 and 1995.

The consolidated balance sheet and the consolidated statement of income are prepared in accordance with the classification requirements of § 298 HGB, in combination with § 266 and § 275 HGB. The income statement is prepared using the total cost method. All amounts shown, except per share amounts, are in millions of Deutsche Marks (DM). Certain items have been combined in order to enhance the informative value and understanding of the consolidated financial statements. These items are shown separately in the notes. The consolidated accounts also include a consolidated statement of cash flows and consolidated statement of shareholders' equity. In conformity with international practice, reporting begins with the income statement, and the statement of cash flows and the statement of shareholders' equity precede the notes.

The consolidated financial statements are prepared in accordance with uniform accounting and valuation principles. The accounting policies used in the consolidated financial statements differ from those used in the parent company's unconsolidated financial statements. Such differences, applied to conform with U.S. GAAP, include the following:

- Property, plant and equipment leased under contracts for which the risks and rewards of ownership have been assumed are capitalized. Scheduled depreciation is recorded over the useful economic life of the asset or over the term of the lease. The present value of payment obligations resulting from future lease payments are included as liabilities.
- Interest incurred during the construction period for constructed assets has been capitalized.
- Direct pension obligations are measured in accordance with SFAS No. 87, using valuation methods consistent with those used for indirect pension obligations in the unconsolidated financial statements of Deutsche Telekom AG.

- Accruals for the internal costs of preparing annual financial statements are not recorded.
- Investment grants received are recorded as reductions of the acquisition costs of assets.

The unconsolidated financial statements of Deutsche Telekom AG, which have an unqualified audit opinion from C&L TREUARBEIT DEUTSCHE REVISION Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt am Main, are published in the Federal Gazette (Bundesanzeiger) and filed under HRB 6794 with the Commercial Registry of the Bonn District Court. This annual report and the Annual Report on Form 20-F, filed with the SEC due to Deutsche Telekom's listing on the NYSE, are available upon request from Deutsche Telekom AG.

Consolidated group

The consolidated financial statements are comprised of the accounts of Deutsche Telekom AG (in 1994 the financial statements of its legal predecessor Deutsche Bundespost TELEKOM) and its subsidiaries.

The subsidiaries, associated companies and other related companies have been included in the consolidated financial statements in accordance with the following criteria:

- Subsidiaries are companies in which Deutsche Telekom directly or indirectly has majority voting rights or management control.
- Associated companies are companies in which Deutsche Telekom directly or indirectly holds between 20 % and 50 % of the voting rights and exercises a significant influence. Such companies are generally included in the consolidated financial statements using the equity method.
- Companies in which Deutsche Telekom holds less than 20 % of the voting rights are carried in the consolidated financial statements at the lower of acquisition cost or market value and classified as other investments in related companies.

The consolidated financial statements include the individual company financial statements of the parent company, Deutsche Telekom AG, as well as 42 (Dec. 31, 1995: 46) domestic and 40 (Dec. 31, 1995: 11) foreign subsidiaries, in which Deutsche Telekom AG has a direct or indirect controlling interest.

Nineteen (Dec. 31, 1995: 5) subsidiaries were not included because they were not material to the net worth, financial position and results of the Deutsche Telekom group. These subsidiaries accounted for less than 1 % of consolidated revenue.

In accordance with § 311 paragraph 1 HGB, 46 (Dec. 31, 1995: 33) companies over which Deutsche Telekom exercises significant influence have been classified as associated companies and are accounted for using the equity method.

Thirteen (Dec. 31, 1995: 11) associated companies which have little or no effect on the net worth, financial position and results of the Deutsche Telekom group were classified as other investments in related companies at acquisition cost less applicable write-downs. The full list of investment holdings, which is available upon request, is filed with the Commercial Registry of the Bonn District Court (HRB 6794).

Principal subsidiaries and associated companies

Name and registered office	Deutsche Telekom share Dec. 31, 1996 (%)	Shareholders' equity Dec. 31, 1996 millions of DM	Revenue 1996 millions of DM	Income after taxes 1996 millions of DM	Employees 1996 (Annual average)
Subsidiaries					
DeTe Immobilien Deutsche Telekom Immobilien und Service GmbH, Münster	100.00	101	7,072	41	10,503
DeTeMobil Deutsche Telekom MobilNet GmbH, Bonn	100.00	2,317	5,413	67	4,860
MATAV Magyar Távközlési Rt, Budapest, Hungary ^{1, 2}	67.35	1,714	1,938	269	20,014
DeTeSystem Deutsche Telekom Systemlösungen GmbH, Frankfurt/Main	100.00	19	1,735	(13)	1,005
DeTeMedien Deutsche Telekom Medien GmbH, Frankfurt/Main	100.00	51	677	104	432
DeTeLine Deutsche Telekom Telekommunikationsnetze GmbH, Berlin, Rastatt	100.00	7	329	12	558
DeTeKabel Service Deutsche Telekom Kabel Service Gesellschaft mbH, Bonn ^{1, 3}	99.78	84	206	25	393
Associated companies					
Atlas S.A., Brussels, Belgium ¹	50.00	1,011	1,091	(510)	3,660
TRI Technology Resources Industries Berhad, Kuala Lumpur, Malaysia ¹	21.00	1,147	980	158	4,016
Satelindo PT Satelit Palapa Indonesia, Jakarta, Indonesia ⁴	25.00	908	420	20	928
Isla Communications Co., Inc. Metro Manila, Philippines ⁶	10.42	168	38	(51)	1,025
Asiacom Philippines, Inc. Metro Manila, Philippines	49.88	103	1	(29)	–
Other companies					
Sprint Corporation, Westwood, Kansas, U.S.A. ¹	10.00	13,247	21,119	1,779	48,133

¹Consolidated subgroup financial statements

²Held through MagyarCom, Cayman Islands (Deutsche Telekom AG share: 50 %)

³Formerly TKS Telepost Kabel-Servicegesellschaft mbH, Bonn

⁴Held through DeTeMobil Deutsche Telekom MobilNet GmbH, Bonn

⁵Held directly by Deutsche Telekom AG, additional indirect holding through Asiacom (share: 28.87 %)

Consolidation principles

Capital consolidation is performed following the book value method under German GAAP. Under this method, the purchase consideration for an acquisition is allocated to the assets and liabilities acquired based on their fair values. Any resulting excess of the purchase consideration over the parent's interest in the fair value of net assets acquired is capitalized as goodwill. Negative goodwill from capital consolidation is included under other accruals.

Profits or losses generated by subsidiaries during their period of affiliation with the group are included in retained earnings (deficit). The unappropriated net income reported in the consolidated financial statements represents the unappropriated net income of Deutsche Telekom AG. Accordingly, the effects of consolidation and the net income of subsidiaries are included in retained earnings (deficit).

Revenue, income and expenses as well as receivables and liabilities between the consolidated companies are eliminated. Intercompany profits and losses and income effects from the consolidation of intercompany debt are eliminated in the consolidated financial statements.

The consolidated balance sheets include deferred taxes from the effects of consolidation, provided the tax expense is expected to reverse in later years except where the effects of consolidation relate to the parent company during the periods prior to the end of 1995, when it was essentially exempt from taxation.

The investments in associated companies included at equity are accounted for using the book value method by applying Deutsche Telekom's uniform principles of valuation. This method is similar to the method described above for consolidated subsidiaries. The principles used for full consolidation are also applied in treating the differences resulting from the initial consolidation. It was not necessary to eliminate intercompany profits and losses with associated companies, as they were insignificant.

Joint ventures are included in the consolidated financial statements using the equity method.

into DM is performed using middle rates on the balance sheet date. Gains and losses resulting from translation are recorded, without affecting net income, directly to retained earnings (deficit).

The income statements of foreign subsidiaries are translated at the average annual exchange rate.

The exchange rates of certain significant currencies are as follows:

	Average annual rate			Rate at balance sheet date	
	1996 DM	1995 DM	1994 DM	Dec. 31, 1996 DM	Dec. 31, 1995 DM
100 Belgian Francs (BEF)	4.8592	4.8605	4.8530	4.8540	4.8686
100 Swiss Francs (CHF)	121.8850	121.2550	118.7120	115.0000	124.5400
1 ECU (XEU)	1.8837	1.8669	1.9245	1.9270	1.8393
100 French Francs (FRF)	29.4070	29.7130	29.2380	29.6380	29.2530
1 Pound Sterling (GBP)	2.3478	2.2610	2.4816	2.6267	2.1350
100 Hungarian Forints (HUF)	0.9862	1.1481	1.5388	0.9419	1.0397
100 Indonesian Rupies (IDR)	0.0646	0.0638	0.0751	0.0658	0.0626
100 Japanese Yen (JPY)	1.3838	1.5309	1.5870	1.3408	1.3908
100 Singapore Dollars (SGD)	106.7900	100.8800	106.0200	110.1700	101.6100
100 Malaysian Ringgit (MYR)	59.5745	59.1960	61.7900	61.5762	61.0016
1 US-Dollar (USD)	1.5037	1.4261	1.6119	1.5548	1.4345

Accounting and valuation

Net revenues consist of goods and services sold in connection with the ordinary business activities of Deutsche Telekom. Net revenues are recorded net of VAT and sales-related reductions. Revenues due from foreign carriers for international incoming calls are included in revenues in the period in which the calls occur. Revenues from other operating activities are recognized in the period when earned by the delivery of goods or the rendering of services.

Research and development costs are expensed as incurred.

Pension costs for defined benefit plans are actuarially computed using the projected unit credit method which is consistent with SFAS No. 87, Employers' Accounting for Pensions, and include current service cost, interest cost, return on plan assets and amortization of actuarial gains/losses and prior service costs. Prior service cost is amortized over the future service period of employees active at the date of the plan amendment. Unrecognized gains and losses exceeding 10 % of the greater of the projected benefit obligation or the market-related value of the plan assets are amortized over the average expected service period of active employees who are to receive benefits under the plan.

The Company is required to make contributions to a pension fund for current and former civil servant employees in annual amounts established by Postreform II rather than by annual actuarial valuations. The amounts currently due in each period are recognized as an expense in that period. The pension costs are accrued in the balance sheet in accordance with SFAS No. 87, whereby the accrual is increased by the expense recognized and decreased by payments made during the year.

Advertising costs are charged to expenses as incurred.

Income tax expense includes current payable taxes on income as well as deferred income taxes. Deferred income taxes are recorded for the expected future tax effects attributable to temporary differences in the balance sheets prepared for tax reporting and for financial reporting purposes, except for the effects of those differences that are not expected to reverse in the foreseeable future. Such differences may arise at the individual taxable entity level as well as in consolidation.

Deferred taxes on temporary differences relating to Deutsche Telekom AG have not been included in the consolidated financial statements for periods prior to January 1, 1996 as Deutsche Telekom AG was not taxable prior to January 1, 1995 and benefited from an essentially complete exemption from tax in 1995.

Earnings per share for each period are calculated by dividing net income by the weighted average number of ordinary bearer shares outstanding during that period after giving retroactive effect to the ten-to-one stock split and the issuance of shares by way of an increase in capital stock from retained earnings on July 31, 1996. Pro forma earnings per share are presented for 1994 based on the assumption that all shares issued upon the incorporation of Deutsche Telekom AG, as adjusted for the stock split, were outstanding during all periods presented.

Purchased intangible assets are valued at acquisition cost and are amortized on a straight-line basis over their estimated useful lives. Acquired goodwill, including goodwill resulting from capital consolidation, is amortized on a straight-line basis over its useful life.

As permitted by Postreform II, property, plant and equipment transferred to Deutsche Telekom AG on January 1, 1995 were recorded in the opening balance sheet of Deutsche Telekom AG at fair market values at that date. However, due to the short period of time between the acquisition dates and January 1, 1995, property, plant and equipment acquired during 1993 and 1994 were valued at their remaining book value. The remaining useful lives and the depreciation methods applicable to these assets were not changed. The fair market values shown in the opening balance sheet have been carried forward as the acquisition costs.

Other property, plant and equipment is valued at acquisition or construction cost, less scheduled depreciation. Construction costs include directly allocable costs, an appropriate allocation of material and production overhead and interest accruing during construction. However, general administration expenses are not capitalized.

Nonscheduled depreciation is provided when an impairment of the value of assets occurs. In order to increase the informative value of financial statements, accelerated depreciation recorded in the individual company financial statements to increase tax-deductions has not been recognized in the consolidated financial statements.

Notes to the consolidated statement of income

Depreciation of noncurrent assets is carried out using the straight-line method over the following useful lives:

	Years
Intangible assets	3 to 4
Goodwill	5 to 12
Buildings	
Office and residential buildings	50
Telecommunications buildings and towers	25 to 30
Workshop buildings, outdoor installations and facilities	10
Telephone facilities and terminal equipment	5 to 10
Data communication equipment, telephone network and ISDN switching equipment, transmission equipment, radio transmission equipment and technical equipment for broadband distribution networks	5 to 20
Broadband distribution networks, outside plant networks and cable conduit lines	15 to 20
Telecommunications power facilities and other	3 to 10
Other equipment, plant and office equipment	3 to 20

Additions to real estate property are depreciated beginning in the month the building is placed into service. For assets other than buildings acquired in the first half of a year, a full year of depreciation is provided in the year of acquisition and, for those assets acquired in the second half of the year, a half year of depreciation is provided.

Items with a low acquisition cost are expensed in the year of their purchase.

Maintenance and repairs are charged to expenses when incurred.

Upon sale or disposal of noncurrent assets, the related cost and accumulated depreciation are removed from the balance sheet, and a gain or loss is recognized for the difference between the proceeds from the sale and the net carrying amount of the assets.

Financial assets are valued at the lower of cost or market value. Low-interest or non-interest bearing loan receivables are recorded at net present value.

Raw materials and supplies, and merchandise purchased and held for resale are valued at acquisition cost, while work in process and finished goods are stated at production cost (directly allocable costs plus an appropriate allocation of material and production overhead). The carrying amount of inventories at the balance sheet date is reduced to the lower of cost or market value at the balance sheet date. To the extent that inventory values are impaired, obsolescence provisions are made.

Receivables and other assets are shown at their nominal value. Known individual risks are accounted for through appropriate individual valuation adjustments, and general credit risks through general valuation adjustments of receivables. Low-interest and non-interest bearing items with more than one year remaining to maturity are discounted.

Marketable securities are stated at the lower of cost or market value at the balance sheet date.

Pensions and annuity obligations are calculated in accordance with the internationally accepted Projected Unit Credit Method, which is consistent with SFAS No. 87.

Provisions for taxes and other accruals including those for loss contingencies and environmental liabilities are recorded using best estimates. Deferred taxes are calculated for the expected tax effects of temporary differences between the balance sheets prepared for financial reporting and tax reporting purposes, as well as for the temporary differences arising from consolidation entries. Deferred taxes are netted and either a net deferred tax asset or net deferred tax liability is recorded. For purposes of computing deferred taxes, Deutsche Telekom uses the German income tax rate for undistributed earnings for domestic companies and the respective local tax rate for foreign companies.

As required by German GAAP, accruals for the costs of maintenance performed within the first three months following the period end have been accrued at each period end.

Liabilities are recorded at their repayment amount. In instances where the repayment amount of a liability is greater than the principal amount, the difference is recorded as an asset and recognized as an adjustment to interest expense over the term of the liability.

Unrealized losses relating to derivative financial instruments, including swaps, forward exchange contracts and options are recognized when incurred whereas unrealized gains are deferred until realized.

The preparation of consolidated financial statements requires the Company to make estimates and assumptions that affect the reported carrying amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the amounts of revenues and expenses recognized during the reporting period. Actual results could differ from those estimates.

(1) Net revenue

Revenue was generated in the following areas of business:	1996 millions of DM	1995 millions of DM	1994 millions of DM
Fixed-network telephony services	44,537	50,443	47,912
Leased lines	1,211	1,305	1,232
Text and data services	3,237	2,807	3,389
Supply and service of telecommunications equipment	4,134	4,007	4,071
Other services	1,217	827	742
Mobile communications services	3,719	3,115	2,765
Cable transmission and broadcasting services	3,104	3,631	3,703
International activities (MATAV)	1,916	–	–
	63,075	66,135	63,814

Revenue by geographic area:			
Domestic	59,031	64,043	61,613
International	4,044	2,092	2,201
	63,075	66,135	63,814

Breakdown of international revenues:			
European Union (excluding Germany)	1,085	901	877
Rest of Europe	2,267	430	341
North America	243	271	512
Latin America	70	71	86
Other	379	419	385
	4,044	2,092	2,201

Fixed-network telephony services includes revenues from domestic and international traffic. Other services include revenue from services ancillary to the basic telephone services of Deutsche Telekom such as telephone directory publishing, advertising and for the first time in 1996 revenue from rental activities. International revenue is derived from fixed-network international incoming traffic and internationally generated revenues from other business areas.

The decrease in net revenue in 1996 as compared with 1995 resulted from the Company's decision to reduce its tariffs for certain services in response to the imposition of VAT on its monopoly services effective January 1, 1996. By assuming that the tariff change implemented in response to the VAT had been effective January 1, 1995 and holding all other factors constant, consolidated revenue would have increased by 5.9 % from DM59.6 billion in 1995 to DM 63.1 billion in 1996.

(2) Increase in inventories and other own capitalized costs

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Increase in inventories of finished products and work in process	51	45	225
Own capitalized costs	3,403	3,275	3,479
	3,454	3,320	3,704

Own capitalized costs comprise mainly construction costs. They include interest incurred during the construction

period of DM 407 million (1995: DM 509 million, 1994: DM 378 million).

(3) Other operating income

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Refund of value-added tax (§ 15a UStG)	1,516	–	–
Other value-added tax refunds	662	–	–
Reversal of accruals	678	907	212
Cost reimbursements	294	247	611
Insurance compensation	152	126	139
Foreign currency transaction gains	68	84	37
Other income	535	774	922
	3,905	2,138	1,921

Deutsche Telekom AG received a refund of VAT in accordance with § 15a Umsatzsteuergesetz (Value-Added Tax Act) of DM 1,516 million in 1996. The Company recognized depreciation of DM 1,305 million on nondeductible VAT capitalized during tax-free periods. In 1996 the Company recognized a one-time VAT refund of DM 662 million which relates to assets purchased before January 1, 1996 and placed into service during 1996. As a result of a 1996 agreement with the German tax authorities as to the recovery of VAT paid, VAT paid on construction in

progress and inventory purchased prior to January 1, 1996 was booked as expense in the year paid. Since January 1, 1996, the date on which the Company became fully subject to VAT, the VAT paid in prior years with respect to such assets has been booked as operating income at the time such assets were placed into service.

Of the total amount of other operating income, DM 703 million (1995: DM 933 million, 1994: DM 771 million) relate to estimates made in other financial years.

(4) Goods and services purchased

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Goods purchased	2,317	1,883	1,845
Services purchased	7,907	7,623	7,440
of which: domestic network access charges	1,019	581	299
of which: international network access charges	2,730	2,766	3,216
of which: other services	4,158	4,276	3,925
	10,224	9,506	9,285

Repairs and maintenance expense amounts to DM 1,154 million (1995: DM 1,363 million, 1994: DM 1,368 million) and is included in other services. In 1996 and 1995 other services also included costs relating to the maintenance of Deutsche Telekom's fleet of vehicles, other machinery and

equipment, payroll processing and miscellaneous sales services performed by Deutsche Post AG. In 1994 such services were billed under flat rate cost reimbursement agreements and classified as other operating expenses.

(5) Personnel costs/Average number of employees

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Wages and salaries:			
Civil servants	6,576	6,872	6,760
Non-civil servants	6,634	6,325	6,339
	13,210	13,197	13,099
Social security contributions and expenses for pension plans and benefits:			
Social security costs	1,331	1,255	1,188
Civil servant pension and retiree healthcare costs	2,900	2,900	2,539
Non-civil servant pension costs	693	609	550
Pension and retiree healthcare costs	3,593	3,509	3,089
Active civil servant healthcare costs	625	518	673
Other employee benefits	18	23	108
	5,567	5,305	5,058
	18,777	18,502	18,157

	1996 Number	1995 Number	1994 Number
Number of employees (average for the year)			
Civil servants	110,269	117,138	119,311
Salaried employees	44,884	45,246	49,624
Wage earners	52,616	57,368	62,359
Deutsche Telekom ¹⁾	207,769	219,752	231,294
Changes in the composition of the Deutsche Telekom group (MATAV and others)	20,040	–	–
Trainees/student interns	9,003	11,968	16,420
	236,812	231,720	247,714

¹⁾ Before changes in the composition of the Deutsche Telekom group

Pension cost amounts to DM 3,593 million (1995: DM 3,509 million, 1994: DM 2,806 million). Civil servant pension and retiree healthcare costs in 1994 relate to amounts paid directly to retired civil servants under the pension arrangements applicable at that time.

Since 1995 these payments are made in accordance with the provisions of Postreform II. In 1996 personnel costs include DM 337 million relating to MATAV.

(6) Depreciation and amortization

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Amortization of intangible assets	516	349	261
Depreciation on property, plant and equipment	17,137	15,028	14,328
	17,653	15,377	14,589

The increase of depreciation and amortization of DM 2,276 million is mainly attributable to the investment activity associated with the digitalization of the networks, and depreciation of DM 1,305 million in 1996 on the

nondeductible VAT capitalized prior to 1996. Nonscheduled depreciation of DM 83 million has been recognized for the impairment of satellite equipment.

(7) Other operating expenses

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Marketing expenses	1,593	935	539
Rental and leasing expenses	1,159	1,252	1,062
Losses on disposition of noncurrent assets	1,066	1,390	964
Legal and consulting fees	803	630	410
Losses on accounts receivable and provision for doubtful accounts	709	593	669
Other employee-related costs	490	726	261
Litigation and other risk provisions	425	637	51
Travel expenses	414	415	391
Administrative expenses	306	256	208
Foreign currency transaction losses	182	115	30
Reimbursements	91	100	1,103
Nondeductible value-added taxes paid	35	972	665
Other expenses	2,182	1,664	1,915
	9,455	9,685	8,268

The increase in marketing expenses is mainly due to consumer incentive programs initiated in 1996 and sales provisions. The losses on disposition of noncurrent assets are mainly due to the continuing digitalization of Deutsche Telekom's network. Other employee-related costs include approximately DM 206 million for services provided by the Federal Institute under provisions of a contract for the year 1996. Reimbursements include charges from Deutsche Post AG for postal services and from Deutsche Postbank AG for banking services.

Expenses relating to nondeductible VAT have not been incurred to any significant extent after 1995. Prior to Deutsche Telekom AG's services becoming fully subject to VAT in 1996, a large part of VAT paid by Deutsche Telekom AG to its suppliers was not recoverable.

Of the total amount of other operating expenses, DM 1,071 million relates to estimates made in other financial years.

(8) Financial income (expense) net

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Dividend income from investments	123	49	44
Loss related to companies accounted for under the equity method (including amortization of goodwill)	(556)	(190)	(121)
Income (loss) related to subsidiary, associated and related companies	(433)	(141)	(77)
Income from debt securities and long-term loan receivables	122	130	1
Interest and similar income	467	988	533
Interest and similar expense	(7,858)	(9,185)	(8,381)
Net interest expense	(7,269)	(8,067)	(7,847)
Write-downs on financial assets	(12)	(3)	(3)
	(7,714)	(8,211)	(7,927)

Income from debt securities and long-term loan receivables consists primarily of interest on receivables from Deutsche Post AG. The write-downs on financial assets, which were

nonscheduled, relate to loans made to unconsolidated subsidiaries.

(9) Extraordinary income (losses)

This item represents personnel restructuring measures of DM 1,758 million (1995: DM 1,264 million, 1994: DM 357 million) as well as share offering costs of DM 717 million.

(10) Special charge relating to other Post entities

In accordance with Article 1 Postreform I (Postverfassungsgesetz) specifically § 37 paragraph 3, Deutsche Bundespost TELEKOM was obligated through December 31, 1994 to incur special charges to Deutsche Bundespost POSTBANK and Deutsche Bundespost POSTDIENST to cover the losses

of those entities. This charge amounted to DM 2,320 million in 1994. As of January 1, 1995, pursuant to Postreform II, Deutsche Telekom is not required to incur any further charges under these arrangements.

(11) Taxes, Levy to the Federal Republic of Germany

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Income taxes	1,385	614	64
Other taxes	830	66	(283)
Levy to the Federal Republic of Germany	—	3,098	5,164
	2,215	3,778	4,945

Income taxes

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Current income taxes	2,042	582	65
Deferred income taxes	(657)	32	(1)
	1,385	614	64

Commencing January 1, 1995 the Company became subject to normal corporate taxation in Germany, although it benefited from an essentially complete exemption from tax in 1995. The combined statutory income tax rate, currently approximately 57 %, includes corporate income taxes at a rate of 45 % for undistributed earnings, trade income taxes at an average German national rate, and the solidarity surcharge of 7.5 % on corporate income tax (Solidaritätszuschlag). When earnings are distributed, the corporate income tax imposed on such earnings is reduced to 30 %. Corporate income tax refunds resulting from dividends are reflected in the period for which the dividend is paid. Taxable income was earned primarily in Germany.

Significant differences between actual tax expense of DM 1,385 million for 1996 and the expected corporate income tax expense (computed using 45 %, the statutory corporate income tax rate for undistributed earnings) are as follows:

	1996 millions of DM
Expected corporate income tax at the tax rate applicable for retained earnings	1,487
Increase (decrease) in corporate income tax due to:	
Nondeductible items	(45)
Trade income taxes	676
Taxation on foreign operations	(120)
Utilization of net operating loss carryforwards	(31)
Tax credit on dividends	(315)
Temporary differences and loss carryforwards for which deferred taxes are not recorded	(190)
Other	(77)
Income taxes	1,385
Effective income tax rate	42 %

The differences in 1995 and 1994 between the effective income tax rate and the German corporate and trade income tax rate are primarily attributable to the income earned by Deutsche Telekom AG, which was exempt from income taxes prior to 1996. Income taxes in 1995 include DM 524 million of taxes resulting from the proposed dividend of DM 1.1 billion from 1995 earnings.

Deferred tax assets and liabilities result primarily from the elimination of intercompany profits and from temporary differences between income determined under German GAAP and under applicable tax law.

At December 31, 1996 Deutsche Telekom had corporate income tax net operating loss carryforwards amounting to approximately DM 1,003 million (1995: DM 1,041 million). Deutsche Telekom also had trade income tax net operating

loss carryforwards amounting to DM 494 million (1995: DM 702 million). Substantially all of the net operating loss carryforwards have an unlimited carry forward period under German tax law.

Levy to the Federal Republic of Germany

The levy to the Federal Republic of Germany which, pursuant to Postreform II, was payable for the last time in 1995, resulted from § 63 paragraphs 1 to 4 of Article 1 of Postreform I and regulations under the German Budget Acts (Haushaltsgesetze). The components of the levy due as a result of revenues earned in eastern Germany have been retained and have been recorded, as required by each annual German Budget Act, as an increase in additional paid-in capital of DM 316 million and DM 716 million in 1995 and 1994, respectively.

(12) (Income) losses applicable to minority shareholders
The income applicable to minority shareholders includes DM 173.3 million (1995: DM 0.5 million, 1994: DM 0.1 million) in gains and DM 10.5 million (1995: DM 2.2 million,

1994: DM 3.7 million) in losses. The gains in 1996 relate mainly to MATAV.

(13) Net income

The consolidated net income of DM 1,758 million was generated primarily by Deutsche Telekom AG.

Notes to the consolidated balance sheet

(14) Intangible assets

	Dec. 31, 1996 Net carrying amount millions of DM	Dec. 31, 1995 Net carrying amount millions of DM
Concessions, industrial and similar rights and assets and licenses in such rights and assets	884	748
Goodwill		
from individual company financial statements	1	1
arising from capital consolidation	456	41
Advance payments	88	6
	1,429	796

(15) Property, plant and equipment

	Dec. 31, 1996 Net carrying amount millions of DM	Dec. 31, 1995 Net carrying amount millions of DM
Land and equivalent rights and buildings including buildings on land owned by third parties	36,940	36,714
Technical equipment and machinery	87,730	88,952
Other equipment, plant and office equipment	3,627	3,321
Advance payments and construction in progress	6,291	4,768
	134,588	133,755

The increase in property, plant and equipment amounts to DM 16,582 million in 1996. The increase relates mainly to Deutsche Telekom AG. Capital expenditure in 1996 and 1995 relates primarily to the digitalization of the switching and transmission equipment.

In addition, the net carrying amount of property, plant and equipment increased by DM 2,782 million due to changes in the composition of the Deutsche Telekom group. This change results mainly from the inclusion of MATAV.

Prior to January 1, 1996, Deutsche Telekom's monopoly services were not subject to VAT. Accordingly, the Company was not able to reclaim, in the normal manner, the full amount of VAT paid on goods and services purchased. Instead, the Company was allowed to immediately reclaim 20 % of the VAT paid on goods and services purchased. The VAT paid on capitalized items has been capitalized to

The increase in concessions, industrial and similar rights and assets and licenses in such rights and assets is mainly attributable to the consolidation of MATAV for the first time. The increase in goodwill arising from capital consolidation also relates to MATAV. The increase in advance payments is mainly due to payments for network control and administration software and customer administration software which is being developed.

The development of intangible assets is shown in the table of consolidated noncurrent assets.

the extent recoverable under German tax law (§ 15a Umsatzsteuergesetz) beginning January 1, 1996. As at the balance sheet date capitalized VAT, after reduction of scheduled depreciation of DM 1.3 billion, amounted to DM 3.9 billion. Other operating income includes the DM 1.5 billion refunds of VAT.

The development of property, plant and equipment is shown in the table of consolidated noncurrent assets.

Leasing

Minimum lease payments under leases expiring subsequent to December 31, 1996 are shown below (millions of DM):

Year	Capital leases	Operating leases
1997	83	1,120
1998	84	1,106
1999	86	1,100
2000	86	1,099
2001	90	1,099
after 2001	1,778	491
Total minimum lease payments	2,207	6,015
Imputed interest	(1,103)	
Present value of net minimum lease payments	1,104	

Capital leases are primarily for office buildings and have terms of up to 25 years.

(16) Financial assets

	Dec. 31, 1996 Net carrying amount millions of DM	Dec. 31, 1995 Net carrying amount millions of DM
Loans to unconsolidated subsidiaries	—	1
Investments in associated companies	2,656	2,020
Other investments in related companies	3,617	799
Long-term loans to associated and related companies	148	114
Other investments in noncurrent securities	337	12
Other long-term loans	1,524	1,718
	8,282	4,664

Additions to investments in associated companies of DM 2,173 million include DM 900 million related to the acquisition of shares in TRI Technology Resources Industries Berhad, Kuala Lumpur, DM 661 million to the capital increase of Atlas S.A., as well as DM 306 million for the acquisition of shares in RADIOMOBIL a.s., Prague. This amount also includes the acquisition of shares in the Philippine companies, Isla Communications Company Inc. and Asiacom Philippines Inc., totaling DM 120 million.

These additions were offset by changes in the composition of the Deutsche Telekom group amounting to DM 1,015 million. This amount relates mainly to the full consolidation of MATAV in the group financial statements. The increase in other investments in related companies of DM 2,595 million relates primarily to the acquisition of 10 % of the shares in Sprint Corporation, Westwood, the third largest long distance telecommunications provider in the United States.

Name	Percentage owned	Dec. 31, 1996		Percentage owned	Dec. 31, 1995	
		Carrying amount	Net difference between carrying value and equity in net assets		Carrying amount	Net difference between carrying value and equity in net assets
	(in %)	millions of DM	millions of DM	(in %)	millions of DM	millions of DM
Satelindo	25.00	904	684	25.00	934	732
TRI	21.00	811	595	—	—	—
Atlas S.A.	50.00	420	18	—	—	—
Asiacom	49.88	88	39	—	—	—
ISLACOM	10.42	22	6	—	—	—
MATAV (MagyarCom)	67.35	—	—	50.00	1,024	—
Other		411	143		62	10
		2,656	1,485		2,020	742

This acquisition was approved, as is required by § 52 AktG, during the Deutsche Telekom special shareholders' meeting held on November 14, 1996. At the time of preparation of the financial statements, the required registration in the Commercial Register had not taken place, but Deutsche Telekom expects that, after the translation of the agreement has been filed with the Commercial Registry, the required registration will take place. Although the acquisition is not officially registered, the stake in Sprint is shown as an investment in related companies. In connection with the purchase of the Sprint shares, the Company has contractually agreed not to dispose of its stake before the end of 2001.

Long term loans include 9 loans to associated and related companies.

Other investments in noncurrent securities include federal bonds, other debt securities, bonds of Deutsche Bundespost and bonds of Deutsche Bundesbahn. Deutsche Telekom AG has also invested in investment funds which are included under this item at their acquisition cost of DM 327 million.

Other long-term loans include a loan to Deutsche Post AG, loans for construction of hostels and other buildings as well as loans to employees.

The development of financial assets is shown in the table of consolidated noncurrent assets.

The full list of investment holdings is filed with the Commercial Registry of the Bonn District Court.

Significant investments in associated companies are shown below:

(17) Inventories, materials and supplies

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Raw materials and supplies	648	875
Work in process	892	841
Finished goods	527	587
Advance payments	31	2
	2,098	2,305

Raw materials and supplies include data communication equipment and telecommunications cable as well as spare parts and components which are intended for capital improvements.

Inventories of telecommunications terminal equipment held both for resale and leasing are included under finished goods.

Advance payments are comprised mainly of payments which have been received for telecommunications terminal equipment.

(18) Receivables

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Trade accounts receivable	7,368	6,820
Receivables from unconsolidated subsidiaries	5	0
Receivables from associated and related companies	92	32
	7,465	6,852

Trade accounts receivable relate primarily to the billing of telecommunications services.

All receivables are due within one year with the exception of DM 39 million.

The allowance for doubtful accounts and changes therein are in millions of DM as follows:

	1996	1995	1994
January 1,	989	858	623
Charged to costs and expenses	319	157	366
Amounts written off	(45)	(2)	(11)
Released	(25)	(24)	(120)
December 31,	1,238	989	858

The Company directly wrote off accounts receivable balances of DM390 million in 1996 (Dec. 31, 1995: DM436 million).

(19) Other assets

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Tax receivables	356	147
Receivables from employees	122	114
Accrued interest	90	142
Receivables from reimbursements	47	128
Loans receivable	16	—
Miscellaneous	387	322
	1,018	853

Other assets amounting to DM 1,003 million are due within one year. Of the balance at December 31, 1996, DM 173 million first became legally due after the balance sheet date.

(20) Marketable securities

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Treasury shares	2	—
Other securities	2	—
	4	—

In connection with the Company's global offering, Deutsche Telekom also introduced an Employee Stock Purchase Plan. DG-Bank Deutsche Genossenschaftsbank, Frankfurt am Main underwrote the related capital increase of 23,700,000 bearer shares, each with a nominal value of DM 5. In accordance with § 71 paragraph 1 No. 2 AktG, Deutsche

Telekom purchased these shares from DG-Bank on November 15, 1996 at a cost of DM 5 per share, DM 118.5 million in total. These shares represented 0.86 % of total capital stock.

Deutsche Telekom employees purchased 3,918,642 shares at a price of DM 16.80 and 19,320,590 shares at a price of DM 28, representing total consideration of DM 65.8 million and DM 541 million respectively from the Company. The excess of the proceeds over the nominal value, DM 490.6 million is recorded as additional paid-in capital. The remaining 460,768 shares not purchased by employees have been included in marketable securities and valued at their acquisition cost of DM 2.3 million (DM 5 per share). These shares represent 0.02 % of capital stock.

(21) Liquid assets

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Checks	2	2
Petty cash and deposits at the Bundesbank	24	18
Deposits at Deutsche Postbank AG	2,899	1,903
Cash in banks	14,927	8,085
	17,852	10,008

Cash and cash equivalents with original maturity of less than 3 months consist primarily of fixed-term bank deposits, checking account balances, deposits at the Bundesbank and Deutsche Postbank AG and petty cash. Temporary cash investments consist of fixed-term bank deposits.

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Cash and cash equivalents (original maturity less than 3 months)	7,316	3,508
Temporary cash investments (original maturity longer than 3 months)	10,536	6,500
	17,852	10,008

(22) Prepaid expenses, deferred charges and deferred taxation

Prepaid expenses and deferred charges of DM 1,589 million (Dec. 31, 1995: DM 1,014 million) primarily relate to prepaid personnel costs of DM 776 million (Dec. 31, 1995: DM 673 million) at Deutsche Telekom AG. Also included are discounts on loans of DM 228 million (Dec. 31, 1995: DM 283 million) which are amortized on a straight-line basis

over the terms of the related liabilities. In addition, a deferred tax asset of DM 549 million has been included. In the previous year a deferred tax liability of DM 108 million was included under other accruals.

(23) Shareholders' equity

Prior to January 1, 1995, the total capital represented the investment of the Federal Republic in the net assets of Deutsche Bundespost TELEKOM. A schedule reflecting the development of the consolidated stockholders' equity of Deutsche Telekom AG in accordance with commercial and stock corporation law can only be prepared from the date of incorporation of Deutsche Telekom. Deutsche Telekom AG

was formed on January 1, 1995, the date on which Deutsche Bundespost TELEKOM was transformed into a corporation under German Law.

The following table shows the development of the capital of Deutsche Bundespost TELEKOM in 1994 as well as the reconciliation to the capital of Deutsche Telekom at January 1, 1995:

	Total	Capital	Capital stock nominal value	Additional paid-in capital	Retained Earnings		Total	Unappropriated net income	Minority interest
					Difference from currency translation	Other retained earnings			
millions of DM									
Balance at Jan. 1, 1994	15,159	15,159							
Net income	3,595	3,595							
Losses applicable to minority shareholders	(4)	(4)							
Difference from currency translation	(134)	(134)							
Retained levy	716	716							
Balance at Dec. 31, 1994	19,332	19,332							
Transformation into a stock corporation	–	(19,332)	10,000	10,976	(134)	(1,512)	(1,646)	–	2
Balance after transformation into a stock corporation									
at Jan. 1, 1995	19,332	–	10,000	10,976	(134)	(1,512)	(1,646)	–	2

The allocation of assets, liabilities and operations to Deutsche Bundespost TELEKOM and the subsequent transfer as of January 1, 1995 to Deutsche Telekom AG were accounted for as transfers between entities under common control using the "as if" pooling method. In exchange for the transfer of assets and liabilities, the Federal Republic received 200 million bearer shares with a par value of DM 50. The net assets of Deutsche Telekom AG at incorporation were DM 20,976 million, of which DM 10,000 million was credited as capital stock in accordance with §5 paragraph 1 of the Articles of Incorporation and DM 10,976 million was credited as additional paid-in capital pursuant to § 272 paragraph 2 No. 1 HGB. The consolidated net asset value was reduced by DM 1,646 million, primarily due to the elimination of intercompany profits resulting from the transfer of mobile phone services from the parent company to a subsidiary. This amount was charged directly against retained

earnings; DM 134 million was recorded as a cumulative loss in the foreign currency translation account and DM 1,512 million was recorded as a deficit in the other retained earnings account. On November 9, 1995, at a special shareholders' meeting, a ten-for-one stock split was declared with the effect that Deutsche Telekom had 2 billion bearer shares, par value of DM 5 each outstanding at December 31, 1995. All applicable share and per share data has been adjusted for the stock split. Under the Articles of Incorporation, the Board of Management is authorized to increase the capital stock of the Company by a further DM 5 billion, to a maximum of DM 15 billion, by issuing new shares with a par value of DM 5 for cash or noncash consideration through January 2, 2000.

The development of consolidated stockholders' equity for the years 1995 and 1996 is presented in a separate table.

(24) Capital stock

The capital stock of Deutsche Telekom AG represents the capital stock of the consolidated group. Deutsche Telekom AG is authorized by its Articles of Incorporation to increase its capital stock by up to DM 5,000 million. Following its initial public offering the Company can increase its capital stock by a further DM1,431.5 million through January 2, 2000.

On July 1, 1996, a capital increase was approved by the shareholders' meeting. This involved the issue of 30 million bearer shares to the Federal Republic as the sole shareholder, at a par value of DM 5 per share. At December 31, 1996, the Federal Republic held a total of 2,030 million Deutsche Telekom shares each with a par value of DM 5. Through the initial public offering of Deutsche Telekom AG shares an additional 713.7 million new shares, each with a

par value of DM 5, were issued. The Federal Republic forewent its pre-emptive rights and did not participate in this capital increase. As a result, in accordance with Article 5 paragraph 1 of the Articles of Incorporation Deutsche Telekom AG's capital stock totaled DM 13,719 million at December 31, 1996, representing 2,743.7 million bearer shares with a nominal value of DM 5 each. Following deduction of treasury stock held by the Company, capital stock with dividend entitlement amounted to DM 13,716 million.

The Federal Institute informed Deutsche Telekom AG in a letter dated July 10, 1995, making specific reference to § 20 paragraph 4 AktG, that the Federal Republic holds a majority interest in Deutsche Telekom AG pursuant to § 16 paragraph 1 AktG.

(25) Additional paid-in capital

The additional paid-in capital of Deutsche Telekom AG represents the additional paid-in capital of the consolidated group.

In accordance with § 272 paragraph 2 No. 1 HGB, the proceeds of the share issue in excess of capital stock totaling DM 16,577 million was recorded as additional paid-in capital.

In 1995, DM 316 million was transferred to the additional paid-in capital of Deutsche Telekom AG pursuant to § 272 paragraph 2 No. 4 HGB. This transfer was made in accordance with § 32 paragraph 1 of the Haushaltsgesetz 1995 (German Budget Act), which required Deutsche Telekom AG to use the levy payable to the Federal Republic arising from operating revenue generated in eastern Germany to increase shareholders' equity.

(26) Retained earnings (deficit)

In addition to the transfers from Deutsche Telekom AG's net income for the year, retained earnings (deficit) include the consolidated group's share of the consolidated subsidiaries' net income or losses, provided they were generated by such subsidiaries since being included in the consolidated group, as well as a reserve for treasury shares held by the Company in accordance with § 272 paragraph 4 HGB. This item also

includes the cumulative effects of consolidation entries, while translation adjustments are recorded in a separate component of retained earnings.

Retained earnings (deficit) were reduced by DM 150 million as a result of the shares issued from Company reserves.

(27) Minority interest

Minority interest represents the minority shareholders' proportionate share of the equity of the consolidated subsid-

aries, and relates primarily to MATAV which was consolidated for the first time in 1996.

(28) Pensions and similar obligations

Non-civil servant pension plans

The pension obligations of Deutsche Telekom for non-civil servants are provided for by a range of defined benefit plans. These pensions include direct obligations of Deutsche Telekom and indirect pension commitments made to employees through the VAP, as well as obligations under Article 131 of the Basic Law (Grundgesetz – GG) as shown in the following table:

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Pension obligations		
– Direct	208	123
– Indirect	6,045	5,866
Obligations under Article 131 GG	40	40
	6,293	6,029

These pension obligations are fully accrued net of the VAP assets.

The amount of the accrual was determined using actuarial principles that are consistent with U.S. GAAP (SFAS No. 87) and using the assumptions shown in the following table:

	1996	1995	1994
Discount rate	6.5 %	7.0 %	7.0 %
Projected salary increase	3.0 %	3.0 %	3.0 %
Expected return on assets	6.4 %	7.0 %	7.0 %
Projected pension increase	2.0 %	2.5 %	2.5 %

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Actuarial present value of benefits:		
Vested	6,189	6,342
Nonvested	766	195
Accumulated benefit obligation	6,955	6,537
Effect of projected future salary increases	513	595
Projected benefit obligation	7,468	7,132
Plan assets at fair value	(669)	(793)
Projected benefit obligation in excess of plan assets	6,799	6,339
Unrecognized net gains (losses)	(506)	(310)
Accrual for pensions	6,293	6,029

The VAP plan assets consist principally of fixed-interest bonds, valued at the lower of acquisition cost or market value, and cash in banks.

The corresponding pension accruals measured in accordance with § 6a of the Income Tax Law (EStG) is DM 5,532 million (Dec. 31, 1995: DM 5,497 million).

The VAP benefits, which supplement national social security retirement benefits up to the level specified in the pension benefit formula, are generally calculated on the basis of the level of employee compensation during specific periods of employment, but are limited to the difference between the amount determined by the benefit formula and social security benefits. Benefits relating to other direct pension plans are generally determined on the basis of salary levels and years of service.

The VAP is funded by Deutsche Telekom, Deutsche Post AG and Deutsche Postbank AG and certain other governmental entities that also provide benefits to current and former employees through the VAP. Annual funding for each of the participating enterprises is set at a percentage of the net personnel costs for active employees covered by the plan. The pension obligation and the plan assets relating to retirees have been calculated in total, and allocated using an index which the Company believes reflects the share of the ultimate obligation of Deutsche Telekom for that group of employees. This index (41 %) is based on the historical share of compensation of Deutsche Telekom for the employee group in comparison with the total of such compensation.

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Net periodic pension cost is summarized as follows:		

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Service cost	214	217	152
Interest cost on projected benefit obligation	464	448	452
Actual return on plan assets	15	(56)	(54)
Net periodic pension cost	693	609	550

Civil servant retirement arrangement

Deutsche Telekom AG maintains a special pension fund (Unterstützungskasse) for its civil servants. Deutsche Telekom AG is required to assist in funding the German Government's pension and healthcare obligations to Deutsche Telekom AG's current and former civil servant staff and their surviving dependents. Deutsche Telekom AG is legally obligated to make annual contributions to the special pension fund of DM 2.9 billion for the years 1995 through 1999, and in subsequent years, annual contribution equal to 33 % of the gross salaries of active civil servants (including civil servants

on unpaid leave). Under Postreform II, the Federal Republic compensates the special pension fund for differences between the ongoing payment obligations of the special pension fund, on the one hand, and amounts received from Deutsche Telekom AG and returns on assets, on the other hand, and guarantees that the special pension fund is always in a position to fulfil the obligations it has assumed. The Federal Republic cannot require reimbursement from Deutsche Telekom AG for amounts paid by it to the special fund.

(29) Other accruals

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Taxes		
Current taxes	971	596
Deferred taxes	–	108
	971	704

Accruals other than taxes		
Employee benefits		
Civil Service Health Insurance Fund	1,356	1,483
Personnel restructuring	1,977	785
Other obligations	768	627
	4,101	2,895
Litigation risks	767	713
Outstanding invoices	737	721
Unearned telephone charge		
units	459	352
Environmental remediation	413	448
Deferred maintenance	98	151
Other	1,091	980
	7,666	6,260
	8,637	6,964

The increase in provisions for taxes is primarily due to the fully taxable status of Deutsche Telekom, effective January 1, 1996. The income tax effect of the proposed dividend of

DM 1,646 million has been provided for in the calculation of corporation tax.

When Postreform II came into effect, the Civil Service Health Insurance Fund was closed to new members. Due to the ageing of the group of people insured, there is an expected shortfall between the fund's sources of regular income and benefits paid. Deutsche Telekom AG has accrued the actuarially determined present value of this future deficit.

Deutsche Telekom has, due to future competition, announced its intention to reduce its workforce by approximately 60,000 to 170,000 full-time equivalent employees by the end of the year 2000 (excluding employees of subsidiaries first consolidated after January 1, 1995) through natural attrition, early retirement and other programs. The planned reductions include an estimated 38,300 non-civil servants expected to leave under voluntary separation agreements. In 1996 approximately 3,000 (1995: 4,200) civil servants and 3,800 (1995: 10,400) non-civil servants accepted the Company's offer for early retirement and severance. While the early retirement program for civil servants and natural attrition do not result in incremental costs for Deutsche Telekom AG, in 1996 the other instruments led to DM 1,758 million in costs recorded as extraordinary losses. Unpaid restructuring costs amounting to DM 1,977 million are included in accruals and DM 114 million are included in other accounts payable.

The table below sets forth the expense recognized, payments made, and the related accruals/payables for future

payments in respect of these staff reduction measures for the years 1995 and 1996:

	1996 millions of DM	1995 millions of DM
Accruals/payables, beginning of period	857	349
Expense recognized ¹⁾	1,758	1,264
Payments made ²⁾	(524)	(756)
Accruals/payables, end of period	2,091	857

¹⁾This includes additions to accruals/payables in 1996: DM 1,403 million, 1995: DM 857 million.

²⁾This includes payments against accruals/payables in 1996: DM 169 million, 1995: DM 349 million.

Accruals for environmental remediation of DM 413 million (Dec. 31, 1995: DM 448 million) were established for site clean-up costs and asbestos removal costs. There are no material contingencies as a result of these risks. Deutsche Telekom expects to incur these costs over the next 3 to 5 years.

Other accruals include a difference of DM 8 million at December 31, 1996 arising from the capital consolidation.

(30) Liabilities

millions of DM	Dec. 31, 1996	Dec. 31, 1995						
	Total	of which due			Total	of which due		
		within one year	in one to five years	after five years		within one year	in one to five years	after five years
Debt								
Bonds and debentures	87,089	9,526	37,862	39,701	96,386	9,412	36,933	50,041
Commercial paper	2	2						
Liabilities to banks	12,797	3,223	4,343	5,231	14,001	1,765	6,215	6,021
	99,888	12,751	42,205	44,932	110,387	11,177	43,148	56,062
Other								
Advances received	178	176	2		143	143		
Trade accounts payable	4,460	4,175	285		4,359	4,325	34	
Liabilities on bills accepted and drawn	4	3	1					
Liabilities to unconsolidated subsidiaries	15	15						
Liabilities to other companies in which an equity interest is held	368	368			104	104		
Other liabilities	7,090	4,672	291	2,127	7,040	4,825	282	1,933
of which: from taxes	(839)	(839)			(266)	(266)		
of which: from social security	(129)	(129)			(59)	(59)		
	12,115	9,409	579	2,127	11,646	9,397	316	1,933
Total liabilities	112,003	22,160	42,784	47,059	122,033	20,574	43,464	57,995

Bonds and debentures consist primarily of bonds issued by Deutsche Bundespost.
Breakdown of bonds and debentures (millions of DM) is as follows:

effective interest rate	up to 6 %	up to 7 %	up to 8 %	up to 9 %	over 9 %	Total
Due in						
1997	–	8,489	1,000	–	37	9,526
1998	–	7,199	–	–	–	7,199
1999	150	3,500	6,802	–	1	10,453
2000	2,100	–	637	637	6,420	9,794
2001	2,050	–	–	7,250	1,116	10,416
after 2001	24	11,400	18,275	10,000	2	39,701
	4,324	30,588	26,714	17,887	7,576	87,089

Notes to the consolidated statement of cash flows

Liabilities to banks due in the next 5 years and thereafter are as follows (in millions of DM):

due in	Amounts
1997	3,223
1998	1,979
1999	685
2000	655
2001	1,024
after 2001	5,231
	12,797

The average effective interest rate of total debt is for:

Bonds and debentures	7.46 % p. a.	(1995: 7.19 % p. a.)
Liabilities to banks	7.17 % p. a.	(1995: 7.01 % p. a.)

At December 31, 1996 Deutsche Telekom had reached agreements with a number of banks pursuant to which it can draw on short-term revolving credit facilities up to DM 8.0 billion at interest rates ranging from 5.5 % to 6.0 % or at the daily interbank rate plus 0.25 %. At December 31, 1996 these credit lines had been drawn upon to only a limited extent.

During 1996, financial liabilities with a nominal value of DM 1.2 billion were repaid ahead of schedule.

The Company's debt was raised principally to finance the development of the telecommunications network in eastern Germany.

Other liabilities

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Interest	2,856	3,813
Loan notes	1,357	1,589
Rental and leasing obligations	1,068	751
Liabilities to employees	362	371
Other	1,447	516
	7,090	7,040

Other liabilities includes taxes of DM 839 million (Dec. 31, 1995: DM 266 million) and social security liabilities of DM 129 million (Dec. 31, 1995: DM 59 million).

Liabilities include borrowings of DM 747 million in foreign currencies.

Liabilities in the amount of DM 262 million (Dec. 31, 1995: DM 175 million) payable by subsidiary companies to banks and third parties are collateralized. Deutsche Telekom AG has provided no collateral against its liabilities. In accordance with Postreform II (§ 2 paragraph 4 PostUmwG), the Federal Republic is guarantor of all Deutsche Telekom AG's liabilities which were outstanding at January 1, 1995.

The consolidated statement of cash flows has been prepared in conformity with International Accounting Standard No. 7, Cash Flow Statements. Liquid assets and short-term investments with original maturities of less than 3 months at

the date of purchase are considered cash equivalents for cash flow reporting purposes. These cash and cash equivalents increased by DM 3,808 million in 1996 to DM 7,316 million at December 31, 1996.

(31) Net cash provided by operating activities
Net cash provided by operating activities decreased in 1996 by only DM 1,428 million to DM 22,259 million despite a decrease of DM 3,349 million in net income.

This is primarily attributable to higher noncash charges including depreciation expense and increases in accruals.

(32) Net cash used for investing activities
Net cash used for investing activities increased to DM 25,325 million in 1996 as a result of an increased level of capital expenditure in network and particularly in financial investments (including investments in Sprint, TRI Technology Resources Industries Berhad as well as the capital increase effected by Atlas S.A.). As in previous years, it was

possible to finance these investments, totaling DM 22,106 million, from cash provided by operating activities. The increase of DM 4,037 million in short-term investments and marketable securities represents the temporary investment of the proceeds of the share offering.

(33) Net cash provided by (used for) financing activities
The increase in cash provided by financing activities of DM 22,108 million to DM 6,874 million in 1996 is primarily attributable to the inclusion of the proceeds of the Company's global offering in November 1996 amounting to

DM20,146 million. This positive impact is partly offset by the net repayment of debt of DM 12,062 million and the first-time dividend payment to the Federal Republic in respect of the financial year 1995.

(34) Guarantees and commitments, and other financial obligations

Guarantees and commitments

	Dec. 31, 1996 millions of DM
Guarantees	302
Collateral granted against liabilities of nonconsolidated companies	27
Liabilities arising from warranty agreements	4
	333

Other financial obligations

	Dec. 31, 1996 millions of DM
Present value of payments to special pension fund	25,300
Obligations under rental and lease agreements	6,015
Purchase commitments for capital projects in progress	4,851
Purchase commitments for interests in other companies	579
Contingent obligations arising from Public Law	7
	36,752

The present value of payments required to be made by Deutsche Telekom AG, in accordance with Postreform II, to the special pension fund for civil servants amounted to DM 25.3 billion at December 31, 1996, of which DM 10.0 billion relates to future years of service of the active civil servants. Upon the withdrawal of the last civil servant from active service the requirement for Deutsche Telekom to contribute to the civil servant pension fund expires. The

reduction in the present value of DM 4.5 billion in comparison to the previous year resulted from the payment of DM 2.9 billion in 1996 and the separation of civil servants under the personnel reduction measures.

As part of the MagyarCom joint venture agreement, Ameritech Corporation has the option during the term of agreement to sell certain of its shares in the joint venture to Deutsche Telekom. The exercise price of the put option is the fair market value of the corresponding MATAV shares plus a \$60 million control premium; provided that, until March 31, 1998, the exercise price is subject to a floor equal to \$210 per share plus the \$60 million control premium, plus accrued interest from the date of the original share purchase. Should the option be exercised, the minimum range of total payments required would be between \$270 million and \$465 million plus interest. The possible commitment arising from this option is not included in purchase commitments for interests in other companies of DM 579 million shown in the table above.

Deutsche Telekom is a party to a number of lawsuits and other proceedings arising out of the general conduct of its business, including proceedings under laws and regulations related to environmental and other matters. Litigation costs have been accrued for the costs of litigation and for any probable losses. The Company does not believe that any additional costs will have a material adverse effect on its net worth, financial position and results.

(35) Financial instruments

Fair value
The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The following is a summary of the estimated fair value of Deutsche Telekom's financial instruments:

	Dec. 31, 1996		Dec. 31, 1995	
	Fair value millions of DM	Net carrying amount millions of DM	Fair value millions of DM	Net carrying amount millions of DM
Assets				
Other investments in noncurrent securities	356	337	12	12
Receivables	7,465	7,465	6,852	6,852
Liquid assets	17,852	17,852	10,008	10,008
Liabilities				
Bonds and debentures	94,959	87,089	101,135	96,386
Liabilities to banks	12,799	12,799	14,001	14,001
Other	12,115	12,115	11,646	11,646
Derivative financial instruments¹⁾				
Interest rate swaps	52	2	123	—
Foreign currency forward exchange contracts	13	—	30	—
Forward rate agreements	—	—	1	—
Swaptions	—	—	(2)	(2)
¹⁾ Non-bracketed amounts represent assets, bracketed amounts represent liabilities				

Fair values were determined as follows:

The fair value of other investments in noncurrent securities is based on quoted market prices for those instruments or similar instruments. The net carrying amounts of trade accounts receivable approximate their fair values, due to the short period to maturity. The net carrying amounts of liquid assets also reflect reasonable estimates of fair value due to the relatively short period to maturity of the instruments.

The fair value of debt which is publicly traded, primarily bonds and debentures, is estimated based on quoted market prices at year end. The book values of commercial paper, liabilities to banks, and other liabilities approximate their fair values.

The fair value of off-balance sheet financial instruments generally reflects the estimated amount the Company would receive or pay to terminate the contracts at the reporting date, thereby taking into account the current unrealized

gains and losses of open contracts. The estimated fair values of derivatives used to hedge or modify the Company's risk will vary substantially with future changes in interest rates or with fluctuations in foreign exchange rates. These fair values should not be viewed in isolation, but rather in relation to the fair values of the underlying hedged transactions and the overall reduction in the Company's exposure to adverse fluctuations in interest and foreign exchange rates.

The fair values of investments in associated and related companies which have carrying values of DM 6,850 million and DM 2,934 million at December 31, 1996 and 1995, respectively, were not practicably determinable because they are not publicly traded or cannot be sold due to contractual restrictions at this point in time. Due to the unique nature of the individual other financial guarantees, estimation of their fair values is not practicable. It is not practicable to estimate a fair value for the put option held by Ameritech Corporation because the shares of MATAV are not publicly traded.

Derivative financial instruments

In the normal course of business, Deutsche Telekom is exposed to risks relating to changes in interest rates and foreign exchange rates. To manage exposure to such risks, the Company uses certain types of derivative financial instruments. Interest rate swaps, forward rate agreements and swaptions are entered into with the aim of synthetically altering the Company's exposure to interest rate risk and seek to reduce its overall costs of finance. The foreign currency swap contracts outstanding at December 31, 1996 and 1995 were principally established to hedge dollar commitments related to acquisitions. The derivative financial instruments are subject to internal controls.

Amounts payable and receivable on interest rate swaps and forward rate agreements are accrued and recognized as an adjustment to net interest expense. Gains and losses on forward foreign exchange contracts offset gains and losses resulting from the underlying transactions. Gains and losses on contracts that hedge specific foreign currency commitments are deferred and included in the measurement of the related foreign currency transaction. Premiums paid or received on options are included in the basis of the underlying transactions.

The following is a summary of the contract or notional principal amounts outstanding at December 31, 1996 and 1995:

	Dec. 31, 1996		Dec. 31, 1995	
	Maturity	Notional amount millions of DM	Maturity	Notional amount millions of DM
Interest rate swaps	1997–2001	5,850	1998–2000	2,500
Foreign currency forward exchange contracts	1997	250	1996	1,404
Forward rate agreements	–	–	1996	500
Swaptions	–	–	1996	500

The terms of the interest rate swaps provide for Deutsche Telekom to receive interest at fixed rates (weighted average of 4.3 % and 6.0 % at December 31, 1996 and 1995, respectively) and pay interest at variable rates (generally based on the six-month LIBOR rate). Amounts received and paid under interest rate swaps, which are dependent on the notional amounts and the contractual interest rates, are settled either annually or semi-annually.

The forward foreign exchange contracts fix amounts the Company is required to pay in the future in DM for a contractually fixed amount of foreign currencies, generally US dollars. The forward rate agreements generally require the Company to pay (or receive) an amount for the excess (or shortfall) of the difference in the specified interest rate (weighted aver-

age of 4.1 % at December 31, 1995) at the instrument strike date and an agreed-upon reference rate. The swaptions sold all had three month terms with the underlying interest rate swaps all having a three-year term. The swaptions expired unexercised by the holders during 1996.

The notional amounts of the derivative financial instruments do not necessarily represent amounts exchanged by the parties and, therefore are not a direct measure of the exposure of the Company through its use of derivatives. The amounts exchanged are calculated by reference to the notional amounts and by the other terms of the derivatives, such as interest rates, exchange rates or other indices.

(36) Information on the Board of Management and the Supervisory Board of Deutsche Telekom AG
Remuneration was paid to members of the Supervisory Board of Deutsche Telekom AG in 1996 in the amount of DM 561,500, inclusive of meeting expenses of DM 34,750. Provided that the 1996 financial statements of Deutsche Telekom AG are approved in their current form, the remuneration of the Board of Management of Deutsche Telekom AG will amount to DM 10,353,208. The remuneration to be

paid to former members of the Board of Management of Deutsche Telekom AG and their surviving dependents amounts to DM 670,029. Pension accruals totaling DM 6,683,968 have been established for this group of persons at December 31, 1996. Pension obligations to such persons for which no reserve had to be established amounted to DM 3,038,959 at that date.

(37) Proposal for appropriation of net income of Deutsche Telekom AG
The income statement of Deutsche Telekom AG reflects net income of DM 1,556,245,388. Following inclusion of the unappropriated net income from 1995, this gives rise to total unappropriated net income of DM 1,647,409,853. The Supervisory Board and the Board of Management propose, subject to the approval of the shareholders' meeting, the

payment of a dividend of DM 1,645,943,539 from unappropriated net income of DM 1,647,409,853. This represents a dividend of DM 0.60 per share with nominal value of DM 5 on the capital stock of DM 13,716,196,160. The remaining balance of DM 1,466,314 will be carried forward as part of unappropriated net income.

Reconciliation
to U.S. GAAP

Due to the listing on the New York Stock Exchange, Deutsche Telekom AG is required to submit, in addition to its local financial statements, annual financial statements in the format of Form 20-F to the SEC. This procedure is in accordance with the foreign integrated disclosure system for foreign companies listed on the stock exchange. In addition to the adjustments which have already been made in the consolidated balance sheet and statement of income in order

to comply with U.S. GAAP, further adjustments are required in order to meet the requirements of U.S. accounting law and of Form 20-F. These adjustments refer to those cases where application of U.S. GAAP is not permissible under German GAAP. The reconciliation to U.S. GAAP explains how the corresponding values of the German consolidated financial statements after U.S. GAAP adjustments comply with U.S. reporting requirements.

(38) Significant differences between German and United States generally accepted accounting principles
Certain property, plant and equipment on hand as of December 31, 1992 have been valued at fair values rather than at historical cost less depreciation, which is required by U.S. GAAP. The Company has not been able to quantify the effect of the difference in accounting treatment because, prior to January 1, 1993, the predecessor company did not maintain sufficiently detailed historical cost records. The fair market values recorded in the opening balance sheet of Deutsche Telekom AG at January 1, 1995 have been carried forward as the acquisition costs.

(a) Personnel restructuring
Under German GAAP, the estimated costs of employee separations have been accrued on the basis of the Company's announced intention to reduce its workforce. Under U.S. GAAP, these costs are accrued in the period that the employee accepts the offer of termination. The Company has agreed pursuant to its collective bargaining agreements with the unions that, prior to January 1, 1998, it will not unilaterally terminate the employment of its non-civil servant employees due to business reasons. Civil servants may not be involuntarily terminated under the terms of their conditions of employment.

(b) Share offering costs
In 1996, the Company incurred costs in connection with its initial public offering. Such costs are recorded as extraordinary expenses in the income statement in accordance with German GAAP. Under U.S. GAAP, specific incremental costs directly attributable to an offering are charged against the proceeds of the offering.

(c) Levy to the Federal Republic of Germany
In accordance with German GAAP, Deutsche Telekom has recorded a direct contribution to additional paid-in capital for the portion of the levy payable to the Federal Republic of Germany relating to revenues from services generated in eastern Germany. Under U.S. GAAP, the amount retained would not be recognized as an expense in the income statement.

(d) Maintenance accruals
As required by German GAAP, the costs of maintenance performed within the first three months following the year end, have been accrued at each period end. Under U.S. GAAP, the cost of maintenance is recognized in the periods incurred.

(e) Value-added tax
As of December 31, 1996 Deutsche Telekom had non-deductible capitalized VAT amounting to DM 3,915 million, net of depreciation in 1996 of DM 1,305 million, recorded as property, plant and equipment. In addition, in 1996 Deutsche Telekom recovered DM 1,516 million of VAT previously paid. German GAAP requires the capitalized VAT to be depreciated and the VAT recoveries to be recorded as other operating income. Under U.S. GAAP the capitalized VAT is treated as a long-term receivable rather than property, plant and equipment. Therefore, neither depreciation nor other operating income are recognized.

(f) Interest rate swaps
Under German GAAP, gains and losses resulting out of the termination of interest rate swaps are recognized in the year of termination. Under U.S. GAAP, gains and losses on interest rate swaps accounted for as hedges are amortized over the remaining outstanding period of the interest rate swap or the remaining life of the hedged position, whichever is shorter. During the course of the year, interest rate swap contracts with a notional amount of DM 2,450 million and maturities between 1998 and 2000 were terminated resulting in a gain of DM 116 million.

(g) Employee share purchase plans
Employees who participated in an employee share purchase plan bought shares at a discount of approximately 40 %. Under German GAAP, the proceeds of the offering were recorded net of such discounts. Under U.S. GAAP, the discount is treated as compensation expense.

Employees could also participate in a financed share purchase plan. In connection with this plan Deutsche Telekom agreed to pay a bank for its services on a monthly basis through December 31, 2001. Under German GAAP, the costs of this plan are recognized as they are paid. Under U.S. GAAP, the costs are fully recognized in 1996.

(h) Unrealized gains on marketable securities
Under German GAAP, marketable debt and equity securities are generally carried at historical cost. Under U.S. GAAP, marketable debt and equity securities, other than investments accounted for by the equity method, are categorized as either trading, available for sale, or held to maturity. Securities classified as trading or available for sale are reported at fair value at the balance sheet date. Unrealized gains and losses on trading securities are recorded in net income while unrealized gains and losses on securities categorized as available for sale are recorded, net of income tax, in shareholders' equity.

(i) Other differences
Other differences consist primarily of the miscellaneous valuation differences that are not individually significant, including the treatment of derivative financial instruments and unrealized gains on foreign currency receivables and payables that are not deferred under U.S. GAAP.

(j) Income taxes
The determination of income tax expense under German GAAP differs from U.S. GAAP as follows:

- Under U.S. GAAP, in contrast to German GAAP, deferred tax assets are recognized for the estimated future tax effects attributable to tax loss carryforwards.
- Under German GAAP, deferred taxes are not recorded for temporary differences which arose during tax free periods. Under U.S. GAAP, the estimated future tax effects related to those temporary differences are recognized.

– Under German GAAP, deferred taxes have not been recognized for those temporary differences which are not expected to reverse in the foreseeable future. Under U.S. GAAP, deferred taxes are generally recognized for all temporary differences.

On July 1, 1996, the shareholders' meeting declared a dividend distribution out of income earned during 1995. Under German GAAP, the income tax effect of this distribution was recorded as current income tax in 1995. Under U.S. GAAP, the estimated tax effects of expected distributions from 1995 earnings have been recorded as deferred tax expense in 1995.

Deferred taxes are also provided for the income tax effects of differences between U.S. GAAP and German GAAP. Deferred taxes are measured based on enacted tax law and reduced by a valuation allowance when, in the opinion of the management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The following table shows the differences between income tax expense determined in accordance with U.S. GAAP and German GAAP:

millions of DM	1996	1995	1994
Current income taxes	(524)	524	–
Deferred taxes from the application of U.S. GAAP	580	(579)	(35)
Deferred taxes on U.S. GAAP / German GAAP differences	(315)	(322)	(2)
	(259)	(377)	(37)

During 1994 legislation was enacted to make Deutsche Telekom AG subject to ordinary corporate taxation from January 1, 1995; however, the Company benefited from an essentially complete exemption from taxation in 1995 and instead was required to pay a final levy to the Federal Republic in the amount of DM 3.1 billion. Under U.S. GAAP, deferred taxes amounting to DM 3,783 million have been recognized during 1994 for those temporary differences that existed when such tax legislation was enacted.

(k) Minority interest
Under U.S. GAAP, minority interest is not included in shareholders' equity.

Reconciliation of net income from German GAAP to U.S. GAAP:

	Note	1996 millions of DM	1995 millions of DM	1994 millions of DM
Net income as reported in the consolidated financial statements under German GAAP		1,758	5,272	3,595
Personnel restructuring accrual	(a)	960	548	–
Share offering costs	(b)	564	–	–
Levy to the Federal Republic of Germany	(c)	–	316	716
Maintenance accruals	(d)	(56)	(181)	(12)
Value-added tax	(e)	(211)	–	–
Interest rate swaps	(f)	(116)	–	–
Employee share purchase plans	(g)	(73)	–	–
Other differences	(i)	7	(15)	(91)
Income taxes	(j)	(259)	(377)	(37)
Net income in accordance with U.S. GAAPbefore effects of the change in tax status		2,574	5,563	4,171
Deferred income taxes recognized as a result of change in tax status	(j)	–	–	3,783
Net income in accordance with U.S. GAAP		2,574	5,563	7,954

Reconciliation of shareholders' equity from German GAAP to U.S. GAAP:

	Note	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Shareholders' equity in accordance with German GAAP		46,599	24,732
Accrual for personnel restructuring measures	(a)	1,508	548
Maintenance accruals	(d)	94	151
Value-added tax	(e)	(211)	–
Interest rate swaps	(f)	(116)	–
Employee share purchase plans	(g)	(28)	–
Unrealized gains on marketable securities	(h)	19	–
Other differences	(i)	31	25
Income taxes	(j)	3,998	4,024
Minority interest	(k)	(1,193)	(5)
Shareholders' equity in accordance with U.S. GAAP		50,701	29,475

Changes in shareholders' equity in accordance with U.S. GAAP:

	1996 millions of DM	1995 millions of DM
Shareholders' equity, beginning of year	29,475	24,103
Net income in accordance with U.S. GAAP	2,574	5,563
Differences from currency translation	(25)	(191)
Proceeds from share offering (after share offering costs, net of tax)	19,869	–
Dividends for 1995	(1,200)	–
Net change in unrealized gain on marketable securities, net of deferred taxes	8	–
Shareholders' equity, end of year	50,701	29,475

(39) Deferred taxes in accordance with U.S. GAAP:

Deferred tax assets and liabilities arising from temporary differences and net operating losses are as follows:

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Deferred tax assets in accordance with U.S. GAAP		
Current deferred tax assets		
Net operating loss carryforwards	175	104
Other	5	–
Noncurrent deferred tax assets		
Property, plant and equipment	93	194
Net operating loss carryforwards	319	432
Pension accruals	3,455	3,333
Civil servant health insurance accrual	788	845
Other accruals	694	–
Other	66	83
Deferred tax assets in accordance with U.S. GAAP	5,595	4,991
Deferred tax liabilities in accordance with U.S. GAAP		
Current deferred tax liabilities		
Accruals	(134)	(647)
Other	(46)	–
Noncurrent deferred tax liabilities		
Personnel restructuring accrual	(191)	(127)
Other	(463)	(825)
Deferred tax liabilities in accordance with U.S. GAAP	(834)	(1,599)
Net current deferred tax asset (liability)	–	(543)
Net noncurrent deferred tax asset	4,761	3,935
Valuation allowance	(214)	–
Net deferred tax asset under U.S. GAAP	4,547	3,392

The following table shows the development of deferred taxes from German GAAP to U.S. GAAP:

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Net deferred taxes under German GAAP	549	(108)
U.S. GAAP adjustments:		
Application of U.S. GAAP	4,737	3,912
U.S./German GAAP differences	(739)	(412)
Net deferred asset under U.S. GAAP	4,547	3,392

(40) Additional income statement and balance sheet information in accordance with U.S. GAAP

Consolidated statement of income
Certain items in the total cost income statement would be classified differently under U.S. GAAP. These items include, in particular, reversals of accruals and allowances for doubtful

accounts that would generally be recorded as reductions to the original expense lines under U.S. GAAP rather than separately as income.

	1996 millions of DM	1995 millions of DM	1994 millions of DM
Results from ordinary business activities	4,429	9,493	11,036
Special charge relating to other Post entities	–	–	(2,320)
Levy to the Federal Republic of Germany	–	(2,782)	(4,448)
Income before income taxes	4,429	6,711	4,268
Income taxes	(1,665)	(991)	(101)
Deferred income taxes recognized as a result of change in tax status	–	–	3,783
Income before extraordinary losses and income (losses) applicable to minority shareholders	2,764	5,720	7,950
Extraordinary loss (net of income tax of DM 21 million in 1996 and DM – million in 1995)	(27)	(159)	–
(Income)/losses applicable to minority shareholders	(163)	2	4
Net income in accordance with U.S. GAAP	2,574	5,563	7,954
Earnings per share/ADS in accordance with U.S. GAAP (in DM):			
Before extraordinary losses	1.23	2.82	3.92
Extraordinary losses	(0.01)	(0.08)	–
Net income	1.22	2.74	3.92
Weighted average shares outstanding (in millions)	2,110	2,030	2,030

Balance sheet presentation under U.S. GAAP
German GAAP does not require presentation of a classified balance sheet. Under U.S. GAAP, all receivables due after one year and all liabilities payable after one year are classi-

fied as noncurrent. Summarized balance sheet information measured and classified in accordance with U.S. GAAP is as follows:

	Dec. 31, 1996 millions of DM	Dec. 31, 1995 millions of DM
Assets:		
Current assets:		
Cash and cash equivalents	7,316	3,508
Other current assets	20,953	17,171
	28,269	20,679
Noncurrent assets	150,554	144,226
	178,823	164,905
Shareholders' equity and liabilities:		
Current liabilities:		
Trade accounts payable	10,319	9,881
Short-term debt and current portion of long-term debt	12,716	11,177
Accruals	3,553	3,865
	26,588	24,923
Long-term liabilities:		
Long-term debt	86,944	98,926
Other noncurrent liabilities	13,397	11,576
	100,341	110,502
Minority interest	1,193	5
Shareholders' equity	50,701	29,475
	178,823	164,905

(41) Other matters

Effective January 1, 1996, the Company adopted SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. This statement requires that assets to be disposed of be valued at the lower of carrying amount or fair value less cost to sell. Furthermore, an entity is required to review long-lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The effect of adopting this standard on the financial statements was immaterial.

In 1997 the Financial Accounting Standards Board issued SFAS No. 128, Earnings per Share, which specifies the computation, presentation, and disclosure requirements for earnings per share. This standard is required to be adopted in 1997. Deutsche Telekom estimates that there will be no effect on reported earnings per share as a result of adopting this standard.

In October 1996, the AICPA's Accounting Standards Executive Committee issued Statement of Position No. 96-1, Environmental Remediation Liabilities, which requires adoption by the Company on January 1, 1997. The Company estimates that the effect of adoption will not be material.

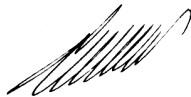
The consolidated financial statements, which we have audited in accordance with professional standards, comply with the legal provisions. With due regard to the generally accepted accounting principles the consolidated financial statements give a true and fair view of the net worth, financial position and results of the Group. The management report of the Group is consistent with the consolidated financial statements.

Frankfurt am Main, April 7, 1997

C&L TREUARBEIT
DEUTSCHE REVISION
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Bonn, April 4, 1997

Deutsche Telekom AG
Board of Management



Dr. Ron Sommer



Detlev Buchal



Dr. Hagen Hultzs



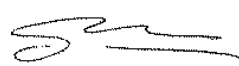
Dr. Heinz Klinkhammer



Dr. Joachim Kröske



Dr. Hart May



Erik Jan Nederkoorn



Gerd Tenzer

Dickmann
Wirtschaftsprüfer

Dr. Kutzenberger
Wirtschaftsprüfer

Information for our shareholders

1996 T-Aktie figures:
Consolidated net income: DM 0.83 per share
Net cash provided by
operating activities: DM 10.55 per share
DVFA/SG earnings: DM 1.13 per share
Dividend proposal: DM 0.60 per share
Shareholders' equity (Dec. 31): DM 16.55 per share

No. of T-Aktie shares issued (millions) (Dec. 31): 2,743
Return on shareholders' equity: 6.43 %
Market value (year-end): DM 88.1 bn

Financial dates 1997:
Press conference on the
financial statements: May 13, 1997
Analysts' meeting: May 14, 1997
Shareholders' meeting: June 26, 1997
Dividend due date: June 27, 1997
1997 half-yearly report on Group: September 18, 1997

For further information, please refer to the chapter
"The T-Aktie" on page 20/21.

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