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Nancy M. Morris  
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Your reference

Our reference

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Date

Re

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September 18, 2006

SEC File Number S7-11-06

Concept Release Concerning Management's Reports on Internal Control over  
Financial Reporting

Dear Ms. Morris:

We very much appreciate the opportunity to provide comments and recommendations to you with respect to internal control assessment and reporting requirements, including how the efficiency and effectiveness of management assessments and evaluations could be improved.

As a large accelerated foreign filer, we support your intent that the planned guidance should be sensitive to the substantial resources that many companies have already invested to establish and document programs and procedures to perform their assessments.

We also agree that the SEC should coordinate with PCAOB to ensure that audit standards and guidance are consistent with any issued management guidance.

We have organized our remarks among the four general topics of the concept release. We have focused on key areas where we believe that additional guidance to management or a refining of existing guidance could not only reduce the current burdens in complying with Section 404 of the Sarbanes-Oxley Act, but could also become a catalyst for improved transparency and quality in financial reporting.

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## **Risk and Control Identification**

Effectively identifying risks is critical to reliable financial reporting and performance of internal control functions. To ensure consistent application of standards, keeping in mind the risk-based, top-down approach to management's assessment, company level controls and scoping considerations, as well as materiality standards, should be reviewed and improved where appropriate.

## **Scoping threshold and materiality**

Current market practice in scoping is based on a determination of locations, significant accounts and disclosures as of the financial statement year end. Additionally, materiality determinations for planning and evaluation purposes are directly tied to financial statement measures, such as income before tax. Since markets are constantly changing, quantitative measures will change accordingly. This can result in frequent changes of scope due to the volatility of such measures, particularly those that are related to earnings. Since an early scoping determination is critical for those entities that are within scope (due to scheduling and commitment of time, personnel and other resources), management should be allowed, and encouraged, to update its scoping and materiality determinations based on its knowledge at the beginning of the year (e.g. based on 1<sup>st</sup> or 2<sup>nd</sup> quarter results) when such planning decisions must be made. Of course, management may have to revisit some areas as circumstances change during the course of a given year, but absent a significant change in circumstance, management must be allowed to make the risk-based determinations on scoping and materiality early to ensure that any deficiencies and weaknesses identified can be remediated expeditiously.

We believe additional guidelines and guidance can improve the scoping process in terms of effectiveness and efficiency. We recommend a calculation of materiality based on an average of multi-year figures, e.g. actual and past two years, should be discussed. To establish the as-of year end basis for the management assessment, an additional qualitative risk review in the fourth quarter should be conducted. This review would consider changes in business performance and processes and the financial impact of those in a "big picture" manner, thus covering major risks and not diluting management assessment results.

## **Significant Disclosures Determination**

Since significant accounts related to balance sheet and profit and loss positions primarily reflect historical and "as-is" performance data and evaluations, significant disclosures sometimes relate to information that cannot be directly tied to current or

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future performance and results. Currently, materiality determinations do not take these factors into consideration. Therefore we recommend disclosure specifics, for example it shouldn't be sufficient to apply materiality based on profit before tax equally to the issue of capitalizing costs and to the disclosure of contingent liabilities.

Our experience shows, that both, management and auditors have no common and sufficient concept how to determine significance of disclosures, other than applying an analogy to significant accounts determination or directly link disclosures to accounts or, even less effective and efficient, stating that all disclosures are equally important.

We see a need for guidance on how to differentiate between significant accounts and significant disclosures. This should also include reasonable expectations regarding the process of determination of significance of disclosures and applicable concepts of materiality. Cost benefit considerations should drive that discussion.

## **Company Level Controls**

We are aware that many companies have devoted a substantial amount of resources and efforts to document, test and improve company level controls (CLCs). We believe that this effort is a wise investment and will aid in achievement of the objectives of enhanced reliability of financial reporting and improved investors confidence. Moreover, well designed and effective CLCs also improve a company's management and governance structures and performance. CLCs constitute a major component of a top-down, risk-based approach to management's assessment on internal controls, which was emphasized by the Commission in its statements of May 16, 2005.

We request additional guidance by the SEC to encourage greater reliance on CLCs, which should then reduce the number of other controls that require testing on an annual basis. If sufficient and effective high-level management controls exist that cover significant risks, there should be a major impact on scoping, documentation and testing on subsequent levels in the organization. It is inconsistent with the Sarbanes-Oxley Act and any measure of reasonableness to have identified thousands of "key" controls requiring testing on an annual basis. Additional guidance might address how performance and quality of CLCs can impact controls and activities on the transaction level and might suggest the conditions for such an approach. One goal should be to enable a company to significantly reduce the number of transaction controls and the extent of testing by implementing strong company level controls.

As an example, we believe that we have strong and effective Human Resources policies and procedures regarding compensation and benefits, including requirements defining how these policies and procedures should be implemented.

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We can provide substantial evidence of implementation of those policies and procedures and all relevant IT general controls relating to such implementation. Accordingly, testing of transaction level controls relating to the evaluation and accuracy of personnel expense policies and procedures on the subsidiary or individual level may not be necessary. This will be different for personnel accruals, as this is an area of non-routine transactions and estimates, where professional judgement is required. Although additional guidance cannot address all specific topics, it should be sufficient to identify certain examples to illustrate the general principles to be followed.

Additionally, we would recommend considering effective CLC to allow for a certain degree of coverage of significant accounts and line items. Besides any potential rationale for a lump-sum provision for coverage, it should at least be discussed, if for business units and locations considered "significant when aggregated" the significant account and line item portions covered by those entities can be considered for overall coverage.

## **Management's Evaluation**

### **IT-General Controls**

We believe that the reliability of financial reporting is heavily dependent on a well-controlled IT environment. Accordingly, companies must manage the relevant IT controls properly.

Although the COSO and COBIT do a good job of establishing principles for reliable internal controls, they do not contain the practical guidance necessary to put those principles into practice in a wide variety of business situations.

In today's environment, most of the routine business transactions are heavily supported and tracked by IT systems. Therefore, IT is the foundation of an effective system of internal control over financial reporting. Since many of the IT professionals responsible for the quality and integrity of information generated by IT systems are not familiar with internal control concepts, this creates a unique challenge requiring a practical solution. We recommend focusing the documentation and evaluation of IT controls on the relevant control objectives in the key areas of 'Access to Programs and Data' and 'Program Change Management'. The relationship between IT general controls and application controls in these two areas are critical for ensuring complete and accurate information processing. It could be helpful to develop an accepted IT control program, focusing on the specific control objectives in these two areas.

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It would be helpful for management to have more guidance on the necessity and use of IT-System Reviews as well as alternative test procedures.

### **Integrated Audit of internal control over financial reporting and Financial Statements**

We support the concept of an integrated audit for both internal control and financial statement reporting. We believe that the integrated audit will yield benefits for both management and auditors. However, we believe that effectiveness and efficiency can be improved significantly. Historically, the auditor has always tested and relied on certain internal controls to reduce the extent and nature of substantive audit procedures in larger and more complex companies. Although this concept is not new, the guidelines set forth in Auditing Standard Number 2 (AS2) and related statements by the PCAOB do not always reflect that far-reaching experience. To the contrary, we believe that since adoption of AS2, there has been less reliance by auditors on the internal control structure and an increase in audit procedures. Accordingly, we believe that additional guidance relating to the integrated audit, its purposes and practical application will help in reducing overall audit procedures and expenses from current levels.

### **Combined Audit Opinion**

In order to fully integrate the internal control and financial statement audit processes and the related audit opinions, we suggest to issue more guidance to the auditors on how to use evidence gathered on either the financial statement or internal control audit for a really combined audit opinion. This will significantly enhance the effectiveness and efficiency of both audits, reduce the audit costs and will restore investor's confidence.

### **Large portion testing requirement**

As required by AS2, the auditor is required to test a large portion of a company's operations and financial position and must obtain reasonable assurance as a basis for its opinion on internal controls over financial reporting as of the date specified in management's assessment. The combination of the "as-of" date and the "large portion" requirements set forth in AS2 have resulted in extensive testing and increased audit costs each year, without, in our opinion, providing greater documentary evidence necessary for the auditor to obtain reasonable assurance of effectiveness of management's assessment. One reason for this is that many controls do not change from year to year, however, auditors have been insistent on retesting all such controls on an annual basis.



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We believe that audits based on risk-based sample sizes and not covering a large portion of processes and controls every year can provide the auditor with sufficient (reasonable) assurance on internal controls and on management's assessment process. While we agree that identified high-risk areas should be tested annually, auditors should select and test key controls in low risk areas over a period of three years. This approach will also result in greater efficiencies as envisioned by the Commission's statements in its May 16, 2005 guidance.

Auditors have argued that their liability has increased as a result of the Sarbanes Oxley Act and PCAOB Auditing Standards. Again, we urge review of existing laws and regulations in order to alleviate the perceived legal burden on auditors and enable them to embrace the concept of sample-size testing on an annual basis.

## **Conclusion**

We believe that the concepts espoused in Section 404 of the Sarbanes-Oxley Act will help to achieve the objectives of enhanced reliability of financial reporting and improved investors' confidence. The implementation experience of almost three years has offered additional insights into the benefits and critical factors for successful implementation of these concepts. Reflecting that experience, we applaud the SEC's proposal for additional management guidance, particularly in the areas specified above. The implementation of S-OX 404 principles should focus more on relevant information needs of investors and other stakeholders than on the requests of auditors. We are convinced that the former would appreciate taking cost-benefit considerations into account when determining the how implementation of the concepts set forth in Section 404 will yield greater reliability of financial reporting.

Again, we appreciate the initiatives of the SEC and its proposed additional guidance for management. We would be pleased to discuss further any of the matters referenced in this letter.

Respectfully submitted,

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signed Jürgen Johnen

Senior Vice President  
Corporate Control