Auditors' report

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 combined management report for Deutsche Telekom AG and the Group is consistent with the consolidated financial statements.

Frankfurt am Main, March 31, 1998

C&L Deutsche Revision
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Dickmann	Dr. Kutzenberger
Wirtschaftsprüfer	Wirtschaftsprüfer

Consolidated statement of income

	Note	1997 millions of DM	1996 millions of DM	1995 millions of DM
Net revenue	(1)	**67,552**	63,075	66,135
Changes in inventories and other own capitalized costs	(2)	2,960	3,454	3,320
Total operating performance		**70,512**	66,529	69,455
Other operating income	(3)	3,746	3,905	2,138
Goods and services purchased	(4)	(12,137)	(10,224)	(9,506)
Personnel costs	(5)	(18,340)	(18,777)	(18,502)
Depreciation and amortization	(6)	(18,597)	(17,653)	(15,377)
Other operating expenses	(7)	(10,161)	(9,455)	(9,685)
Financial income (expense) net	(8)	(7,827)	(7,714)	(8,211)
Results from ordinary business activities		**7,196**	6,611	10,312
Extraordinary income (losses)	(9)	–	(2,475)	(1,264)
Taxes, Levy to the Federal Republic of Germany	(10)	(3,608)	(2,215)	(3,778)
Income after taxes		**3,588**	1,921	5,270
(Income) losses applicable to minority shareholders	(11)	(285)	(163)	2
Net income	(12)	**3,303**	1,758	5,272
Unappropriated net income carried forward from previous year		1	91	–
Transfer to retained earnings		–	(202)	(3,981)
Unappropriated net income (unappropriated net income of Deutsche Telekom AG)		**3,304**	1,647	1,291
Earnings per share in DM		**1.20**	0.83	2.60

Consolidated balance sheet

Assets	Note	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Noncurrent assets			
Intangible assets	(13)	1,676	1,429
Property, plant and equipment	(14)	127,861	134,588
Financial assets	(15)	7,480	8,282
		137,017	144,299
Current assets			
Inventories, materials and supplies	(16)	1,281	2,098
Receivables	(17)	8,231	7,465
Other assets	(18)	1,497	1,018
Marketable securities	(19)	3,590	4
Liquid assets	(20)	9,258	17,852
		23,857	28,437
Prepaid expenses, deferred charges and deferred taxation	(21)	**1,944**	1,589
		162,818	174,325

Shareholders' equity and liabilities			
Shareholders' equity	(22)		
Capital stock	(23)	13,719	13,719
Additional paid-in capital	(24)	27,869	27,869
Retained earnings (deficit)	(25)	1,802	2,171
Unappropriated net income		3,304	1,647
Minority interest	(26)	1,450	1,193
		48,144	46,599
Accruals			
Pensions and similar obligations	(27)	6,052	6,293
Other accruals	(28)	8,942	8,637
		14,994	14,930
Liabilities	(29)		
Debt		87,891	99,888
Other		10,741	12,115
		98,632	112,003
Deferred income		**1,048**	793
		162,818	174,325

Consolidated noncurrent assets

millions of DM	Acquisition or production cost: Jan. 1, 1997	Translation adjustment	Additions	Disposals	Reclassi-fications	Dec. 31, 1997	Depreciation, amortization and write-downs: Jan. 1, 1997	Translation adjustment	Additions	Disposals	Reclassi-fications	Dec. 31, 1997	Net carrying amount: **Dec. 31, 1997**	Dec. 31, 1996
Intangible assets														
Concessions, industrial and similar rights and assets, and licenses in such rights and assets	1,823	(11)	475	332	542	2,497	939	(4)	573	255	14	1,267	1,230	884
Goodwill														
from individual company financial statements	1	0	1	0	0	2	0	0	1	0	0	1	1	1
arising from consolidation	606	(6)	11	81	0	530	150	(6)	58	18	0	184	346	456
Advance payments	88	0	98	1	(86)	99	0	0	0	0	0	0	99	88
	2,518	**(17)**	**585**	**414**	**456**	**3,128**	**1,089**	**(10)**	**632**	**273**	**14**	**1,452**	**1,676**	**1,429**
Property, plant and equipment														
Land and equivalent rights, and buildings including buildings on land owned by third parties	39,566	(33)	612	234	(1,092)	38,819	2,626	(3)	1,115	51	(372)	3,315	35,504	36,940
Technical equipment and machinery	115,037	(231)	8,744	2,348	4,649	125,851	27,307	(54)	15,249	1,247	(44)	41,211	84,640	87,730
Other equipment, plant and office equipment	5,779	(26)	1,369	356	1,736	8,502	2,152	(9)	1,601	327	402	3,819	4,683	3,627
Advance payments and construction in progress	6,291	(17)	2,575	66	(5,749)	3,034	0	0	0	0	0	0	3,034	6,291
	166,673	**(307)**	**13,300**	**3,004**	**(456)**	**176,206**	**32,085**	**(66)**	**17,965**	**1,625**	**(14)**	**48,345**	**127,861**	**134,588**
Financial assets														
Investments in unconsolidated subsidiaries	12	0	6	0	0	18	12	0	0	0	0	12	6	0
Loans to unconsolidated subsidiaries	0	0	22	0	8	30	0	0	0	0	0	0	30	0
Investments in associated companies	2,981	(666)	288	845	0	1,758	325	(286)	559	0	0	598	1,160	2,656
Other investments in related companies	3,617	0	122	67	0	3,672	0	0	76	0	0	76	3,596	3,617
Long-term loans to associated and related companies	149	0	235	11	(13)	360	1	0	0	0	0	1	359	148
Other investments in noncurrent securities	337	0	877	3	0	1,211	0	0	0	0	0	0	1,211	337
Other long-term loans	1,525	0	30	441	5	1,119	1	0	1	1	0	1	1,118	1,524
	8,621	**(666)**	**1,580**	**1,367**	**0**	**8,168**	**339**	**(286)**	**636**	**1**	**0**	**688**	**7,480**	**8,282**
	177,812	**(990)**	**15,465**	**4,785**	**0**	**187,502**	**33,513**	**(362)**	**19,233**	**1,899**	**0**	**50,485**	**137,017**	**144,299**

Consolidated statement of cash flows

	Note	1997 millions of DM	1996 millions of DM	1995 millions of DM
Net income		3,303	1,758	5,272
Income (losses) applicable to minority shareholders		285	163	(2)
Income after taxes		**3,588**	1,921	5,270
Depreciation and amortization		18,597	17,653	15,377
Income tax expense		2,958	1,385	614
Net interest expense		6,368	7,270	8,197
Net losses from the disposition of noncurrent assets		1,165	1,026	1,337
Accruals for personnel restructuring measures		–	1,388	785
Increase/(decrease) in pension accruals		(241)	264	185
Results from associated companies		1,520	556	190
Other noncash income and expense		(79)	(422)	17
(Increase)/decrease in trade accounts receivable		(421)	(298)	(815)
(Increase)/decrease in inventories		243	283	234
Increase/(decrease) in trade accounts payable		(758)	(164)	(351)
Changes in other current assets and liabilities		(140)	1,544	627
Income taxes paid		(3,574)	(2,166)	(32)
Dividends received		173	152	8
Cash generated from operations		**29,399**	30,392	31,643
Interest paid		(7,344)	(8,773)	(8,804)
Interest received		586	640	848
Net cash provided by operating activities	(30)	**22,641**	22,259	23,687
Capital expenditures		(13,282)	(16,885)	(14,574)
Purchase of subsidiaries, associated and related companies, net of cash acquired		(1,567)	(5,221)	(1,980)
Proceeds from sale of noncurrent assets		643	656	390
Net change in short-term investments and marketable securities		3,383	(4,037)	2,843
Other		254	162	–
Net cash used for investing activities	(31)	**(10,569)**	(25,325)	(13,321)
Change in short-term borrowing		(2,445)	(128)	(954)
Issuance in long-term debt		266	101	–
Repayments of medium and long-term debt		(9,934)	(12,035)	(14,280)
Dividends		(1,646)	(1,210)	–
Proceeds from share offering		–	20,146	–
Net cash provided by (used for) financing activities	(32)	**(13,759)**	6,874	(15,234)
Effect of foreign exchange rate changes on cash and cash equivalents		(6)	–	(89)
Net increase (decrease) in cash and cash equivalents		**(1,693)**	3,808	(4,957)
Cash and cash equivalents, at beginning of year		**7,316**	3,508	8,465
Cash and cash equivalents, at end of year		**5,623**	7,316	3,508
Liquid assets as shown in the balance sheet				
Cash and cash equivalents, Dec. 31		5,623	7,316	3,508
Temporary cash investments, Dec. 31		3,635	10,536	6,500
Total		**9,258**	17,852	10,008

Consolidated statement of shareholders' equity

				Retained earnings						
millions of DM	Shares issued and outstanding (in thousands)	Capital stock nominal value	Additional paid-in capital	Difference from currency translation	Treasury stock	Other retained earnings (deficit)	Total	Unappro-priated net income	Minority interest	**Total**
Balance at Jan. 1, 1995	**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)**
Shares 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**
Changes in the composition of the Deutsche Telekom group				74			74		68	**142**
Dividends for 1996								(1,646)		**(1,646)**
Net income								3,303	285	**3,588**
Difference from currency translation				(443)			(443)		(96)	**(539)**
Balance at Dec. 31, 1997	**2,743,700**	**13,719**	**27,869**	**(719)**	**2**	**2,519**	**1,802**	**3,304**	**1,450**	**48,144**

Notes to the consolidated financial statements
Summary of accounting policies

Description of business and relationship with the Federal Republic of Germany

The Deutsche Telekom group (Deutsche Telekom) is a full-service telecommunications provider whose major lines of business include providing fixed-network communications, mobile-network communications, broadband cable and broadcasting services for television and radio stations, special value-added services as well as international activities. Deutsche Telekom also supplies and services 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 according to Statement of Financial Accounting Standards (SFAS) 14 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 both 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. In January 1998, the Federal Republic transferred a 13.5 % shareholding in Deutsche Telekom AG to a federal corporation, the Kreditanstalt für Wiederaufbau (KfW). As a result, the Federal Republic's direct shareholding as of 1998 amounts to approximately 60.5 %. 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 Agency), which, following the dissolution of the Federal Ministry of Posts and Telecommunications (BMPT) on December 31, 1997, is subject to supervision by the Federal Ministry of Finance (BMF). The Regulatory Authority for Telecommunications and Posts (the Regulatory Authority) commenced its activities on January 1, 1998. The Regulatory Authority, which is under the authority of the Federal Ministry of Economics, has thus taken the place of the dissolved Federal Ministry of Posts and Telecommunications in supervising the telecommunications sector in Germany, and in this capacity will regulate the business activities of Deutsche Telekom.

The Federal Republic and various government departments and agencies are collectively Deutsche Telekom's largest customer. 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 agency do not represent a significant component of Deutsche Telekom's net revenues.

Competitive situation

Deutsche Telekom has been subject to competition in a number of areas for several years, primarily satellite and mobile communications services, data transmission and the sale of terminal equipment. Since August 1, 1996, the Company's competitors have also been able to freely obtain licenses to build and operate telecommunications transmission lines (including broadband cable transmission lines) in Germany, for the purpose of providing public telecommunications services other than public fixed-network voice telephony.

Deutsche Telekom essentially had the exclusive right to provide public fixed-network voice telephony services in Germany until December 31, 1997. Since January 1, 1998, the provision of these services has been fully liberalized in accordance with EU regulations and the German Telecommunications Act (TKG), which came into force on August 1, 1996. Thus, the final stage in the process of liberalizing the German telecommunications market, which began in 1989, has now been completed, and Deutsche Telekom is now subject to full competition in all lines of business as of January 1998.

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 in November 1996 and the related requirement for Deutsche Telekom to file financial statements with the U.S. Securities and Exchange Commission (SEC), have led the Company to prepare its consolidated financial statements in conformity with international financial reporting norms. Accordingly, the Company uses accounting and valuation principles in line with those of U.S. GAAP applicable at the balance sheet date, provided options exist under German GAAP to permit such an approach. This also serves to minimize differences between results reported in the reconciliation of German GAAP to 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 a separate 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.

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 to the consolidated financial statements.

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 while items included in property, plant and equipment were under construction has been added to construction costs.
- Direct pension obligations are measured in accordance with SFAS No. 87 and No. 88, 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 financial statements of Deutsche Telekom AG as well as the financial statements of the Deutsche Telekom group, which have an unqualified audit opinion from C&L 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 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 changes in the composition of the Deutsche Telekom group in 1997 are presented in the following table:

	Domestic	International	Total
Consolidated subsidiaries			
Jan. 1, 1997	42	40	**82**
Additions	–	1	**1**
Disposals	8	7	**15**
Reclassifications	–	1	**1**
Dec. 31, 1997	34	35	**69**
Associated companies included at equity			
Jan. 1, 1997	27	19	**46**
Additions	11	2	**13**
Disposals	2	2	**4**
Reclassifications	1	(1)	**–**
Dec. 31, 1997	37	18	**55**
Other unconsolidated subsidiaries and other investments in related companies (greater than 20 %)			
Jan. 1, 1997	16	16	**32**
Additions	2	6	**8**
Disposals	–	2	**2**
Reclassifications	(1)	–	**(1)**
Dec. 31, 1997	17	20	**37**
Total			
Jan. 1, 1997	85	75	**160**
Additions	13	9	**22**
Disposals	10	11	**21**
Reclassifications	–	–	**–**
Dec. 31, 1997	**88**	**73**	**161**

The consolidated financial statements include the individual company financial statements of the parent company, Deutsche Telekom AG, as well as 34 (Dec. 31, 1996: 42) domestic and 35 (Dec. 31, 1996: 40) foreign subsidiaries in which Deutsche Telekom AG has a direct or indirect controlling interest. Nine (Dec. 31, 1996: -) subsidiaries are included in the group financial statements using the equity method.

The changes in the composition of the Deutsche Telekom group have not had a material effect on the 1997 group financial statements.

Twenty-one (Dec. 31, 1996: 19) 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, results and balance sheet total of the Deutsche Telekom group.

In accordance with § 311 paragraph 1 HGB, 46 (Dec. 31, 1996: 46) companies over which Deutsche Telekom exercises significant influence have been classified as associated companies and are accounted for using the equity method.

Sixteen (Dec. 31, 1996: 13) 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 is filed with the Commercial Registry of the Bonn District Court (HRB 6794).

Principal subsidiaries and associated companies

The principal subsidiaries and associated companies whose revenues and results, together with Deutsche Telekom AG, account for more than 90 % of the Group are shown in the table below:

Name and registered office	Deutsche Telekom share Dec. 31, 1997 (%)	Shareholders' equity Dec. 31, 1997 millions of DM	Revenue 1997 millions of DM	Income after taxes 1997 millions of DM	Employees 1997 (Annual average)
Subsidiaries					
DeTe Immobilien Deutsche Telekom Immobilien und Service GmbH, Münster	100.00	300	7,816	68	10,821
DeTeMobil Deutsche Telekom MobilNet GmbH, Bonn	100.00	2,276	6,600	5	5,244
MATAV Magyar Távközlési Rt, Budapest, Hungary[1, 2]	59.58	1,986	2,360	406	19,094
De.Te.System Deutsche Telekom Systemlösungen GmbH, Frankfurt/Main	100.00	81	2,017	61	1,348
T-Data Gesellschaft für Datenkommunikation mbH, Bonn	100.00	1,048	993	76	670
DeTeMedien Deutsche Telekom Medien GmbH, Frankfurt/Main	100.00	51	714	94	389
Online Pro Dienste GmbH & Co. KG, Darmstadt	100.00	210	472	16	412
DeTeLine Deutsche Telekom Telekommunikationsnetze GmbH, Berlin	100.00	50	385	(30)	665
De.Te.CSM Deutsche Telekom ComputerService Magdeburg GmbH Magdeburg	100.00	225	313	71	500
DeTeKabel Service Deutsche Telekom Kabel Service Gesellschaft mbH, Bonn[1]	99.78	108	227	25	349
Associated companies					
ATLAS TELECOMMUNICATIONS S.A. Brussels, Belgium[1]	50.00	95	1,652	(786)	3,690
Technology Resources Industries Bhd. Kuala Lumpur, Malaysia[1]	20.99	654	1,288	(401)	4,726
PT Satelit Palapa Indonesia Satelindo, Jakarta, Indonesia[3]	25.00	306	747	(263)	1,860
Isla Communications Co., Inc., Makati City Manila, Philippines[4]	10.42	260	40	(65)	1,327
Asiacom Philippines, Inc. Makati City Manila, Philippines	49.88	159	1	(37)	–
Other companies					
Sprint Corporation, Westwood, Kansas, USA[1]	10.00	16,174	25,803	1,652	51,000

[1] Consolidated subgroup financial statements
[2] Held through MagyarCom Holding GmbH, Bonn (Deutsche Telekom AG share: 50 %)
[3] Held through DeTeMobil Deutsche Telekom MobilNet GmbH, Bonn
[4] Held 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 and amortized over its useful life. 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 resulting 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.

Foreign currency translation

In the individual company financial statements, foreign currency receivables, cash in banks and liabilities are translated at the exchange rate applicable on the transaction date. Unrealized foreign currency losses due to exchange rate fluctuations through the balance sheet date are recognized in the income statement while unrealized foreign currency gains are not recognized. Where foreign currency items have been hedged by forward exchange contracts, they are valued at the corresponding hedge rate.

Currency translation of foreign subsidiaries is made in accordance with the functional currency method. Thus, the functional currency is the currency in which the foreign subsidiary performs its principal operations. The activities and financial structure as reported in this currency should be reflected in the group accounts. Generally, the functional currency of dependent subsidiaries is identical with that of the parent company. Dependent subsidiaries are translated according to the temporal method. On the other hand, the functional currency of independent subsidiaries is the local currency. Currently all consolidated foreign subsidiaries of Deutsche Telekom conduct their operations independently of the parent company, therefore currency translation is performed according to the modified current rate method.

Therefore, in the consolidated financial statements, the translation of all items shown in balance sheets of foreign subsidiaries from foreign currencies 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	
	1997	1996	1995	Dec. 31, 1997	Dec. 31, 1996
	DM	DM	DM	DM	DM
100 Belgian Francs (BEF)	4.8464	4.8592	4.8605	4.8478	4.8540
100 Swiss Francs (CHF)	119.5045	121.8850	121.2550	123.2500	115.0000
1 ECU (XEU)	1.9585	1.8837	1.8669	1.9790	1.9270
100 French Francs (FRF)	29.7049	29.4070	29.7130	29.8830	29.6380
1 Pound Sterling (GBP)	2.8412	2.3478	2.2610	2.9820	2.6267
100 Hungarian Forints (HUF)	0.9301	0.9862	1.1481	0.8795	0.9419
100 Indonesian Rupiah (IDR)	0.0631	0.0646	0.0638	0.0319	0.0658
100 Japanese Yen (JPY)	1.4379	1.3838	1.5309	1.3838	1.3408
100 Singapore Dollars (SGD)	117.0160	106.7900	100.8800	106.9950	110.1700
100 Malaysian Ringgit (MYR)	62.7530	59.5745	59.1960	46.4110	61.5762
100 Philippine Pesos (PHP)	5.9559	5.7384	5.5780	4.4305	5.9118
1 U.S. Dollar (US$)	1.7348	1.5037	1.4261	1.7921	1.5548

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 and No. 88. This method presupposes the total present value of the benefit obligations accumulated during the reporting period and takes into consideration the expected increases in wages and salaries and in retirement benefits. By contrast, the minimum accrual method in accordance with § 6a of the German Income Tax Act (Einkommensteuergesetz) is aimed at the recognition of the expense over the employees' entire working lives and does not take the expected increases in wages and salaries and in retirement benefits into account.

Pension costs include current service cost, interest cost, return on plan assets and amortization of actuarial gains/losses and prior service costs. In addition, the impact of the realignment of the company pension plan on net income must be taken into consideration in accordance with SFAS No. 88. The pension costs are accrued in the balance sheet in accordance with SFAS No. 87 and No. 88, whereby the accrual is increased by the expense recognized and decreased by payments made during the year.

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, which came into force in 1995, rather than by annual actuarial valuations. The amounts currently due in each period are recognized as an expense in that period.

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. The weighted average number of ordinary bearer shares in 1995 and 1996 was ascertained after giving retroactive effect to the ten-for-one stock split and the issuance of shares by way of an increase in capital stock from retained earnings on July 31, 1996.

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 was 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 was valued at its 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.

Property, plant and equipment includes nondeductible capitalized VAT amounts at the level of expected refunds from VAT adjustments pursuant to § 15a of the German Value-Added Tax Act (Umsatzsteuergesetz - UStG) resulting from Deutsche Telekom's full liability for VAT as of 1996. Capitalized VAT is depreciated over a period of four years, starting in 1996.

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

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	3 to 10
Data communications 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 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. Nonscheduled write-downs are provided only if impairment of financial assets is assumed to be permanent.

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. Based on normal capacity utilization, production cost includes directly allocable costs such as material and labor costs as well as special production costs plus an appropriate allocation of material and production overhead and straight-line depreciation. General administration and selling costs, social amenities expenses as well as voluntary benefits to personnel including pensions are not included in production cost. The carrying amount of inventories 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.

Pension obligations are calculated using actuarial methods in accordance with the internationally accepted Projected Unit Credit Method, which is consistent with U.S. GAAP (SFAS No. 87 and No. 88).

Provisions for taxes and other **accruals** including those for loss contingencies and environmental liabilities are recorded using best estimates. Sufficient allowance was made for all possible risks when assessing these provisions and accruals.

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 separately under tax accruals. 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.

Cost accruals are only made by Deutsche Telekom when there is an obligation to carry such liabilities on the balance sheet pursuant to § 249 paragraph 1 HGB. This refers mainly to accruals for costs of maintenance related to the financial year, but only incurred within the first three months of the following year. As required by German GAAP, these accruals have been accrued at each period end, which is different to U.S. GAAP requirements.

Accruals, with the exception of pensions and similar obligations as well as civil service health insurance fund accruals for future shortfalls, are not discounted.

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 which do not qualify for hedge accounting are recognized when incurred whereas unrealized gains are deferred until realized.

The preparation of consolidated financial statements in accordance with German GAAP 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.

Notes to the consolidated statement of income

(1) Net revenue[1]

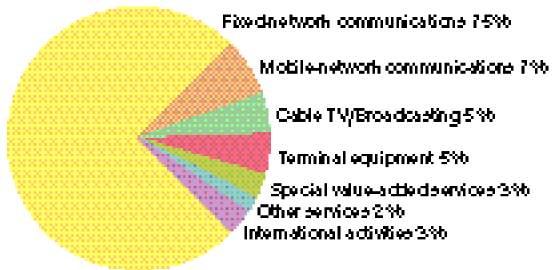
	1997 millions of DM	1996 millions of DM	1995 millions of DM
Fixed-network communications	50,493	47,368	52,800
Mobile-network communications	4,975	4,181	3,450
Network communications	55,468	51,549	56,250
Cable TV / Broadcasting	3,124	2,998	3,463
Terminal equipment	3,219	3,397	3,419
Special value-added services	2,302	2,311	2,325
Other services	1,082	894	671
International activities	2,357	1,926	7
	67,552	63,075	66,135

[1] Since the beginning of the 1997 financial year, revenues have been reported in line with the new organizational structure of group business areas. The prior year figures have been restated to reflect the new structure.

Revenue by geographic area:			
Domestic	62,982	59,031	64,043
International	4,570	4,044	2,092
	67,552	63,075	66,135

Breakdown of international revenues:			
European Union (excluding Germany)	1,071	1,085	901
Rest of Europe	2,764	2,267	430
North America	246	243	271
Latin America	62	70	71
Other	427	379	419
	4,570	4,044	2,092

The percentage of the individual revenue segments in relation to net revenue is as follows:



Network communications includes revenues from domestic and international traffic, from network interconnections, and from data communications and systems solutions. Other services include revenue from multimedia services and services ancillary to the basic telephone services of Deutsche Telekom, such as rental activities. Special value-added services include public telephone and operator services as well as telephone directory publishing.

International revenue is derived from fixed-network international incoming telephone traffic and internationally generated revenues from other business areas.

The significant increase in net revenue in 1997, as compared with 1996, of approximately DM 4.5 billion or 7.1 % is a result of the positive development in network communications. The key factor for this in fixed-network communications was the telephone network service, where the number of ISDN access lines increased considerably and traffic volume also showed strong growth.

The increase in the mobile-networks communications group business area is mainly attributable to large increases in revenue within the T-D1 network.

(2) Changes in inventories and other own capitalized costs

	1997 millions of DM	1996 millions of DM	1995 millions of DM
(Decrease)/Increase in inventories of finished products and work in process	(613)	51	45
Own capitalized costs	3,573	3,403	3,275
	2,960	3,454	3,320

Own capitalized costs comprise mainly planning and construction costs. They include interest incurred during the construction period of DM 371 million (1996: DM 407 million, 1995: DM 509 million).

(3) Other operating income

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Refund of value-added tax (§15a UStG)	1,299	1,516	–
Other value-added tax refunds	–	662	–
Reversal of accruals	969	678	907
Cost reimbursements	577	396	295
Ancillary services	154	110	216
Insurance compensation	122	152	126
Income from the disposition of noncurrent assets (including sale of investments)	109	39	53
Reversal of valuation adjustments of accounts receivable and doubtful accounts	108	25	25
Other income	408	327	516
	3,746	3,905	2,138

Deutsche Telekom AG received a refund of VAT in accordance with § 15a Umsatzsteuergesetz- UStG (Value-Added Tax Act) of DM 1,299 million in 1997. The Company recognized depreciation of DM 1,305 million on nondeductible VAT capitalized during tax-free periods prior to 1996.

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. Income from the reversal of accruals includes a one-time reversal of pension provisions due to the new VAP structure in accordance with SFAS No. 88.

Of the total amount of other operating income, DM 1,186 million (1996: DM 703 million, 1995: DM 933 million) relate to changes in estimates made in other financial years.

(4) Goods and services purchased

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Goods purchased	**2,950**	2,317	1,883
Services purchased	**9,187**	7,907	7,623
of which: domestic network access charges	1,568	1,019	581
of which: international network access charges	3,170	2,730	2,766
of which: other services	4,449	4,158	4,276
	12,137	10,224	9,506

Repairs and maintenance expense amounts to DM 1,022 million (1996: DM 1,154 million, 1995: DM 1,363 million) and is included in other services. Other services also include costs relating to the maintenance of Deutsche Telekom's fleet of vehicles, other machinery and equipment, as well as expenses for software maintenance and utilization of computer power from computer companies.

(5) Personnel costs/Average number of employees

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Wages and salaries:			
Civil servants	5,788	6,576	6,872
Non-civil servants	7,167	6,634	6,325
	12,955	13,210	13,197
Social security contributions and expenses for pension plans and benefits:			
Social security costs	**1,382**	1,331	1,255
Civil servant pension costs	2,900	2,900	2,900
Non-civil servant pension costs	683	693	609
Pension costs	**3,583**	3,593	3,509
Active civil servant healthcare costs	**400**	625	518
Other employee benefits	**20**	18	23
	5,385	5,567	5,305
	18,340	18,777	18,502

Number of employees (average for the year)	**1997 Number**	1996 Number	1995 Number
Civil servants	95,855	110,269	117,138
Salaried employees	51,783	44,884	45,246
Wage earners	49,305	52,616	57,368
Deutsche Telekom group[1]	**196,943**	207,769	219,752
Changes in the composition of the Deutsche Telekom group of prior years (in particular MATAV)	19,138	20,040	–
Trainees/student interns	6,178	9,003	11,968
Total Deutsche Telekom group	**222,259**	236,812	231,720

[1] Before changes in the composition of the Deutsche Telekom group of prior years

Pension cost amounts to DM 3,583 million (1996: DM 3,593 million, 1995: DM 3,509 million). Civil servant pension costs are made in accordance with the provisions of Postreform II. The decrease in personnel costs in 1997 is mainly attributable to the planned reduction of the workforce. This decrease was partly offset by remuneration adjustments as well as by the increase in other employee-related costs.

(6) Depreciation and amortization

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Amortization of intangible assets	632	516	349
Depreciation of property, plant and equipment	17,965	17,137	15,028
	18,597	17,653	15,377

The increase of depreciation and amortization of DM 944 million is mainly attributable to the investment activity associated with the digitization of the networks, which was completed in 1997. As a result of digitization, depreciation of switching equipment and transmission equipment has increased. The increase in the amortization of intangible assets is primarily attributable to investments made by Deutsche Telekom AG in software products for invoicing and customer administration. Depreciation of DM 1,305 million, as was also the case in 1996, which is related to nondeductible VAT capitalized prior to 1996, is also included under depreciation and amortization.

Nonscheduled write-downs of DM 40 million have been recognized for a mobile data network as well as for telex, switching and transmission equipment.

(7) Other operating expenses

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Marketing expenses	1,357	1,593	935
Losses on disposition of noncurrent assets	1,202	1,066	1,390
Rental and leasing expenses	1,048	1,159	1,252
Provisions	1,038	425	637
Losses on accounts receivable and provision for doubtful accounts	796	709	593
Legal and consulting fees	726	803	630
Postal charges	686	656	665
Other employee-related costs	604	490	726
Advertising gifts and commissions	454	440	333
Travel and transport expenses	385	448	426
Administrative expenses	366	353	295
Foreign currency transaction losses	223	182	115
Postal and banking services	186	91	100
Loan employment and temporary employment expenses	94	82	29
Nondeductible value-added taxes paid	–	35	972
Other expenses	996	923	587
	10,161	9,455	9,685

The decrease in marketing expenses is mainly due to the completion of the ISDN promotion program as well as the elimination of marketing and public relations costs related to the initial public offering of Deutsche Telekom AG in 1996.

The losses on disposition of noncurrent assets are mainly due to the completed digitization of Deutsche Telekom's network and relate to scrapping of long-distance cable and analog switching systems. The increase in provisions comprise mainly provisions for risks arising from inherited burdens, legal proceedings and construction projects. Other employee-related costs include approximately DM 206 million for services provided by the Federal Agency as a result of the business contracts for services or works completed for the 1997 year.

Of the total amount of other operating expenses, DM 1,405 million relates to other accounting periods.

(8) Financial income (expense) net

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Dividend income from investments	156	123	49
Results related to companies accounted for under the equity method (including amortization of goodwill)	(1,520)	(556)	(190)
Income (loss) related to subsidiaries, associated and related companies	**(1,364)**	(433)	(141)
Income from debt securities and long-term loan receivables	196	122	130
Interest and similar income	686	467	988
Interest and similar expense	(7,250)	(7,858)	(9,185)
Net interest expense	**(6,368)**	(7,269)	(8,067)
Write-downs on financial assets and marketable securities	**(95)**	(12)	(3)
	(7,827)	(7,714)	(8,211)

The increase of approximately DM 1 billion to DM 1,520 million in losses from companies accounted for under the equity method results mainly from the joint venture Atlas/Global One where the proportionate loss of DM 367 million was due to startup costs and necessary structural measures. The negative economic development and the currency decline in Southeast Asia also led to considerable losses in the investments in this region, of which DM 408 million negatively affected the results and financial position of Deutsche Telekom. In addition, scheduled goodwill amortization of DM 242 million as well as nonscheduled amortization of 317 million have been made in order to cover these risks.

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 related companies.

(9) Extraordinary (losses)

This item represents personnel restructuring measures of DM 1,758 million in 1996 and DM 1,264 million in 1995 as well as share offering costs of DM 717 million for 1996.

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

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Income taxes	2,958	1,385	614
Other taxes	650	830	66
Levy to the Federal Republic of Germany	–	–	3,098
	3,608	2,215	3,778

Income taxes

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Current income taxes	3,102	2,042	582
Deferred income taxes	(144)	(657)	32
	2,958	1,385	614

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 just under 57 %, includes corporate income taxes at a rate of 45 % for undistributed earnings, trade taxes at an average German national rate, and the solidarity surcharge of 5.5 % on corporate income tax (Solidaritätszuschlag). When earnings are distributed, the corporate income tax imposed on such earnings is reduced to 30 %. Taxable income was earned primarily in Germany. Corporate income tax refunds resulting from dividends are reflected in the period for which the dividend is paid.

Significant differences between actual tax expense of DM 2,958 million and DM 1,385 million for 1997 and 1996 respectively, and the expected corporate income tax expense (computed using 45 %, the statutory corporate income tax rate for undistributed earnings) are as follows:

	1997 millions of DM	1996 millions of DM
Expected corporate income tax		
at the tax rate applicable		
for retained earnings	2,946	1,487
Increase (decrease) in corporate		
income tax due to:		
Nondeductible items	(68)	(45)
Trade income taxes	879	676
Taxation on foreign operations	(349)	(120)
Utilization of net operating		
loss carryforwards	(33)	(31)
Tax credit on dividends	(526)	(315)
Tax effects due to		
restructuring of companies	402	–
Temporary differences and loss		
carryforwards for which		
deferred taxes are not recorded	(196)	(190)
Other	(97)	(77)
Income taxes	**2,958**	1,385
Effective income tax rate	45.2 %	42.0 %

In its tax return Deutsche Telekom AG has recognized a goodwill (residual difference between the market value of the Company and the fair value of the individual assets as valued as of January 1, 1996) that is - based on § 7 paragraph 1 EStG - amortized over a period of 15 years.

Assuming the fiscal administration approves this approach, a lower tax expense would be realized in future years. In line with the principle of prudence, goodwill amortization has not been recognized for accounting purposes in the year under review.

Deferred tax assets and liabilities result primarily from temporary differences between income determined under German GAAP and under applicable tax law.

At December 31, 1997 Deutsche Telekom had corporate income tax net operating loss carryforwards amounting to approximately DM 543 million (1996: DM 1,003 million). Deutsche Telekom also had trade tax net operating loss carryforwards amounting to DM 85 million (1996: DM 494 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 in 1995.

(11) (Income) losses applicable to minority shareholders
The income applicable to minority shareholders includes DM 290.9 million (1996: DM 173.3 million, 1995: DM 0.5 million) in gains and DM 5.4 million (1996: DM 10.5 million, 1995: DM 2.2 million) in losses. The gains in 1997 relate, as was also the case in 1996, mainly to MATAV.

(12) Net income
The consolidated net income of DM 3,303 million was generated primarily by Deutsche Telekom AG.

(13) Intangible assets

	Dec. 31, 1997 Net carrying amount millions of DM	Dec. 31, 1996 Net carrying amount millions of DM
Concessions, industrial and similar rights and assets, and licenses in such rights and assets	1,230	884
Goodwill		
from individual company financial statements	1	1
arising from capital consolidation	346	456
Advance payments	99	88
	1,676	1,429

The increase in concessions, industrial and similar rights and assets and licenses in such rights and assets is mainly attributable to the capitalization of network control and administration software, as well as customer administration and invoicing software.

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

(14) Property, plant and equipment

	Dec. 31, 1997 Net carrying amount millions of DM	Dec. 31, 1996 Net carrying amount millions of DM
Land and equivalent rights, and buildings including buildings on land owned by third parties	35,504	36,940
Technical equipment and machinery	84,640	87,730
Other equipment, plant and office equipment	4,683	3,627
Advance payments and construction in progress	3,034	6,291
	127,861	134,588

Additions in property, plant and equipment amount to DM 13,300 million in 1997. The increase relates mainly to Deutsche Telekom AG. Capital expenditure in 1997 and 1996 relates primarily to the digitization of the switching and transmission equipment, which was completed in 1997. The decrease in advance payments and construction in progress can be attributed to the digitization of switching equipment being completed.

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 extent recoverable under German tax law (§ 15a UStG) beginning January 1, 1996. At the balance sheet date capitalized VAT, after reduction of scheduled depreciation of DM 1.3 billion, amounted to DM 2.6 billion. Other operating income includes the DM 1.3 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, 1997 are shown below (millions of DM):

Year	Capital leases	Operating leases
1998	83	1,048
1999	86	866
2000	86	743
2001	90	673
2002	90	584
after 2002	1,689	2,634
Total minimum lease payments	**2,124**	6,548
Imputed interest	**(1,030)**	
Present value of net minimum lease payments	1,094	

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

(15) Financial assets

	Dec. 31, 1997 Net carrying amount millions of DM	Dec. 31, 1996 Net carrying amount millions of DM
Investments in unconsolidated subsidiaries	6	–
Loans to unconsolidated subsidiaries	30	–
Investments in associated companies	1,160	2,656
Other investments in related companies	3,596	3,617
Long-term loans to associated and related companies	359	148
Other investments in noncurrent securities	1,211	337
Other long-term loans	1,118	1,524
	7,480	8,282

Additions to investments in associated companies of DM 288 million mainly relate to payments for the second tranche of the investment in the Philippine companies, Isla Communications Company Inc. and Asiacom Philippines Inc., both in Manila, totaling DM 164 million. Additional shares totaling DM 12 million were acquired in DETECON Deutsche Telepost Consulting GmbH, Bonn.

The decrease of DM 1,496 million in the net carrying amount of investments in associated companies results from foreign currency effects not affecting net income of DM 380 million, due largely to the exchange rate fluctuations in Southeast Asia, which in return affected the investments in this region, and nonscheduled amortization of goodwill totaling DM 317 million, as well as the net losses related to associated companies.

The increase in other investments in related companies of DM 122 million relates primarily to the acquisition of DIAL The Israeli Company for International Communications Services Ltd., Tel Aviv, ESMF European Satellite Multimedia Services Finance S.A., Betzdorf, TEGARON Telematics GmbH, Bonn and DDG Gesellschaft für Verkehrsdaten mbH, Düsseldorf. Furthermore, additions were recorded in respect of three international satellite organizations.

Significant reductions in other investments in related companies result from the fact that Deutsche Telekom's investments in the capital of the satellite companies EUTELSAT and INTELSAT are re-valued annually in accordance with utilization.

Long-term loans mainly include twelve loans to associated and related companies.

Other investments in noncurrent securities mainly include federal bonds, other debt securities, bonds of Deutsche Bundespost and bonds of Deutsche Bundesbahn. In 1997, Deutsche Telekom AG increased its investment in fixed-income securities (annuity funds) and mixed funds, as well as share-based investment funds of DM 874 million, which are intended to optimize income from medium and long-term liquid reserves.

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 under HRB 6794 with the Commercial Registry of the Bonn District Court.

Significant investments in associated companies are shown below:

Name	Dec. 31, 1997 Deutsche Telekom share (%)	Dec. 31, 1997 Net carrying amount millions of DM	Dec. 31, 1997 of which: Net difference between carrying value and equity in net assets millions of DM	Dec. 31, 1996 Deutsche Telekom share (%)	Dec. 31, 1996 Net carrying amount millions of DM	Dec. 31, 1996 of which: Net difference between carrying value and equity in net assets millions of DM
Satelindo	25.00	248	248	25.00	904	684
TRI	20.99	385	285	20.99	811	595
Atlas S. A.	50.00	74	0	50.00	420	18
Asiacom	49.88	78	0	49.88	88	39
Islacom	10.42	17	0	10.42	22	6
Other		358	124		411	143
		1,160	**657**		2,656	1,485

(16) Inventories, materials and supplies

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Raw materials and supplies	429	648
Work in process	166	892
Finished goods and merchandise	659	527
Advance payments	27	31
	1,281	2,098

Raw materials and supplies include data communications equipment, spare parts for transmission equipment, telecommunications cable as well as spare parts and components for other telecommunications equipment. The decrease in raw materials and supplies is mainly attributable to the completion of the modernization of the telephone network in eastern Germany; this has also reduced the requirement of raw materials and supplies.

The decrease in work in process is mainly related to capitalization of DM 639 million in 1997, which is shown in the item construction in progress.

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

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

(17) Receivables

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Trade accounts receivable	7,801	7,368
Receivables from unconsolidated subsidiaries	10	5
Receivables from associated and related companies	420	92
	8,231	7,465

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

All receivables, with the exception of DM 2 million, are due within one year.

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

	1997	1996	1995
January 1,	1,238	989	858
Charged to costs and expenses	357	319	157
Amounts written off/released	(951)	(70)	(26)
December 31,	**644**	1,238	989

The Company directly wrote off accounts receivable balances of DM 439 million in 1997 (Dec. 31, 1996: DM 390 million).

(18) Other assets

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Tax receivables	399	356
Accrued interest	385	90
Receivables from employees	120	122
Receivables from reimbursements and loans receivable	97	63
Miscellaneous	496	387
	1,497	1,018

Other assets amounting to DM 1,475 million are due within one year. Of the balance at December 31, 1997, DM 463 million became legally due only after the balance sheet date and relate to accrued interest and nonchargeable VAT.

(19) Marketable securities

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Treasury shares	2	2
Other marketable securities	3,588	2
	3,590	4

In connection with the Company's global offering in 1996, Deutsche Telekom also introduced an Employee Stock Purchase Plan. In 1997, the Company bought back 252 shares with a nominal value of DM 5 per share and issued 1,120 shares at a corresponding issue price of DM 28 and DM 28.50, respectively. Additional paid-in capital has, as was the case in 1996, been adjusted for the amount received on the issuance of share in excess of nominal value, taking the discounts granted into consideration. The remaining 459,900 shares on the balance sheet date 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. Any balance remaining thereafter is to be used for a new employee stock purchase plan.

Other marketable securities relate to own bonds held (DM 1,988 million) to maintain favorable trading conditions as well as securities primarily secured by loans within the scope of a direct investment portfolio (DM 1,529 million). On August 1, 1997, Deutsche Telekom AG took over the price maintenance activities for bonds and treasury notes of the former Deutsche Bundespost. For this purpose, a separate intervention securities account was set up for price maintenance of Telekom bonds at the Deutsche Bundesbank.

(20) Liquid assets

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Checks	3	2
Petty cash and deposits at the Bundesbank	18	24
Deposits at Deutsche Postbank AG	9	2,899
Cash in banks	9,228	14,927
	9,258	17,852

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Cash and cash equivalents (original maturity less than 3 months)	5,623	7,316
Temporary cash investments (original maturity longer than 3 months)	3,635	10,536
	9,258	17,852

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.

(21) Prepaid expenses, deferred charges and deferred taxation

Prepaid expenses and deferred charges of DM 1,944 million (Dec. 31, 1996: DM 1,589 million) primarily relate to prepaid personnel costs of DM 1,023 million (Dec. 31, 1996: DM 776 million) at Deutsche Telekom AG. Also included are discounts on loans of DM 181 million (Dec. 31, 1996: DM 228 million) which are amortized on a straight-line basis over the terms of the related liabilities. In addition, a deferred tax asset of DM 693 million (Dec. 31, 1996: DM 549 million) has been included.

(22) Shareholders' equity

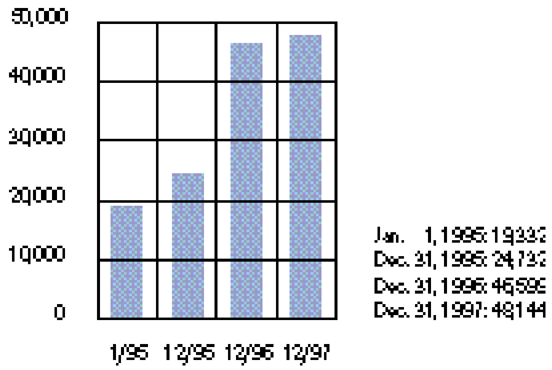
Prior to January 1, 1995, the total capital represented the investment of the Federal Republic in the net assets of Deutsche Bundespost TELEKOM. It was only possible to prepare a schedule reflecting the development of the consolidated shareholders' equity of Deutsche Telekom AG in accordance with commercial and stock corporation law 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 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. 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 Article 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. In exchange for the transfer of assets and liabilities, the Federal Republic received 200 million bearer shares with a par value of DM 50; this reflected capital stock of DM 10,000 million.

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 per share 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 per share for cash or noncash consideration through January 2, 2000.

A detailed account of the development of the consolidated shareholders' equity for the years 1995, 1996 and 1997 is presented in a separate table before the notes to the consolidated financial statements.

The development of the consolidated shareholders' equity from January 1, 1995 to December 31, 1997 is as follows (millions of DM):



(23) Capital stock

The capital stock of the consolidated group represents the capital stock of Deutsche Telekom AG. Deutsche Telekom AG is authorized by its Articles of Incorporation to increase the capital stock by up to DM 5,000 million. Following its initial public offering, the Company can increase its capital stock by a further DM 1,431.5 million through January 2, 2000.

In accordance with Article 5 paragraph 1 of the Articles of Incorporation, Deutsche Telekom AG's capital stock was unchanged and totaled DM 13,719 million at December 31, 1997, representing 2,743.7 million bearer shares with a nominal value of DM 5 per share. Each DM 5 share entitles the bearer to one vote and to receive payment for a full dividend for the 1997 financial year. After deducting treasury shares held by the Company, capital stock with a dividend entitlement amounted to DM 13,716 million.

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. In 1996, 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 per share, were issued. The Federal Republic forewent its pre-emptive rights and did not participate in this capital increase. At December 31, 1997, the Federal Republic held a total of 2,030 million Deutsche Telekom AG shares each with a nominal value of DM 5 per share (DM 10,150 million). The remaining shares are widely held.

The Federal Agency 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.

(24) Additional paid-in capital

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

Changes in the number of treasury shares held led to a slight increase in additional paid-in capital of DM 20,546.40.

In accordance with § 272 paragraph 2 No. 1 HGB, the proceeds from the share issue in excess of capital stock totaling DM 16,577 million was recorded in 1996 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.

(25) Retained earnings (deficit)

In addition to the transfers made from Deutsche Telekom AG's net income in previous years, 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.

In 1996, retained earnings (deficit) were reduced by DM 150 million as a result of the shares issued from Company reserves.

(26) Minority interest

Minority interest represents the minority shareholders' proportionate share of the equity of the consolidated subsidiaries and relates primarily to MATAV.

(27) 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 (Versorgungsanstalt der Deutschen Bundespost) and the DTBS (Deutsche Telekom Betriebsrenten-Service) as well as obligations under Article 131 of the Basic Law (Grundgesetz - GG) as shown in the following table:

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Pension obligations:		
– Direct	322	208
– Indirect	5,695	6,045
Obligations under Article 131 GG	35	40
	6,052	6,293

These pension obligations are fully accrued net of the plan assets at fair value.

The amount of the accrual was determined using actuarial principles that are consistent with U.S. GAAP (SFAS No. 87 and No. 88) and using the assumptions shown in the following table:

	1997	1996	1995
Discount rate	6.5 %	6.5 %	7.0 %
Projected salary increase	3.0 %	3.0 %	3.0 %
Expected return on assets	6.4 %	6.4 %	7.0 %
Projected pension increase	2.0 %	2.0 %	2.5 %

The corresponding pension accruals measured in accordance with § 6a of the Income Tax Law (Einkommensteuergesetz - EStG) are DM 5,240 million (Dec. 31, 1996: DM 5,532 million).

In 1997, Deutsche Telekom fundamentally changed the structure of the company pension plans. Previously, the pension benefits were mainly provided by VAP, which was jointly financed by the successor companies of Deutsche Bundespost and other related entities. In a segmentation agreement concluded on December 19, 1997, the current and future benefit recipients were individually allocated to the companies. The assets of VAP, which consist primarily of fixed-interest bonds and cash in banks, were also distributed under this agreement. As a result, the actuarial losses reported in previous years were largely eliminated.

The VAP benefits, which supplement national social security retirement benefits up to the level specified in the pension benefits formula, are generally calculated on the basis of the level of employee compensation during specific periods of employment. Within the scope of the negotiations on the realignment of the company pension plan, the employer and the trade unions have agreed on arrangements for the protection of vested VAP benefits. Pursuant to this agreement, the benefit obligations due to retirees and employees approaching retirement will remain unchanged. In the case of younger employees with vested benefits, the obligations will be converted into an initial amount reflecting the number of years covered. This amount will be credited to a capital account held by the employer. Deutsche Telekom will credit further amounts to this account in the future; when the insured event occurs, the account balance will be paid out in full, in installments or converted into a pension. If the relevant employees have not reached the age of 35 or have been insured for less than ten years, their benefit obligations are due directly from Deutsche Telekom. In 1997, the DTBS was founded for processing the remaining obligations.

Benefits relating to other direct pension plans are generally determined on the basis of salary levels and years of service.

	Dec. 31, 1997 millions of DM	Dec. 31,1996 millions of DM
Actuarial present value of benefits:		
Vested	5,342	6,189
Nonvested	728	766
Accumulated benefit obligation	**6,070**	6,955
Effect of projected future salary increases	266	513
Projected benefit obligation	**6,336**	7,468
Plan assets at fair value	(266)	(669)
Projected benefit obligation in excess of plan assets	**6,070**	6,799
Unrecognized net gains (losses)	(18)	(506)
Accrual for pensions	**6,052**	6,293

Net periodic pension cost is summarized as follows:

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Service cost	173	214	217
Interest cost on projected benefit obligation	469	464	448
Actual return on plan assets	41	15	(56)
Periodic pension cost	**683**	693	609
Actual return on plan assets (new VAP arrangement pursuant to SFAS No. 88)	(426)	–	–
Net periodic pension cost	**257**	693	609

Civil servant retirement arrangements

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 a special pension fund of DM 2.9 billion for the years 1995 through 1999, and in subsequent years, annual contributions 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, amounts received from Deutsche Telekom AG and returns on assets, and guarantees that the special pension fund is always in a position to fulfill the obligations it has assumed. The Federal Republic cannot require reimbursement from Deutsche Telekom AG for amounts paid by it to the special fund.

(28) Other accruals

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Taxes		
Current taxes	**637**	971
Accruals other than taxes		
Employee benefits		
Civil Service Health Insurance Fund	1,489	1,356
Personnel restructuring	1,451	1,977
Other obligations	805	768
	3,745	4,101
Outstanding invoices	882	737
Litigation risks	717	767
Environmental remediation	411	413
Risks related to real estate	400	–
Unused telephone units on phone cards sold	243	459
Investment risks	239	86
Restoration commitments	163	72
Deferred maintenance	59	98
Other	1,446	933
	8,305	7,666
	8,942	8,637

The decrease in provisions for taxes is primarily due to the utilization and reversal of corporate income tax and trade tax provisions accrued for in prior years. The income tax effect of the proposed dividend of Deutsche Telekom AG of DM 3,292 million has been provided for in the calculation of corporate income 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, in anticipation of 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 1997, approximately 2,100 (1996: 3,000) civil servants and 2,600 (1996: 3,800) non-civil servants accepted the Company's offer for early retirement and severance. The early retirement program for civil servants and natural attrition do not result in incremental costs for Deutsche Telekom AG. In 1997, unpaid restructuring costs amounting to DM 1,451 million are included in accruals and DM 63 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 1997 and 1996:

	1997 millions of DM	1996 millions of DM
Accruals/payables, beginning of period	**2,091**	857
Expense recognized [1]	–	1,758
Payments made [2]	(577)	(524)
Accruals/payables, end of period	**1,514**	2,091

[1] This includes additions to accruals/payables in 1997: -, 1996: DM 1,403 million

[2] This includes payments against accruals/payables in 1997: DM 577 million, 1996: DM 169 million

Accruals for environmental remediation of DM 411 million (Dec. 31, 1996: DM 413 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 1 to 4 years.

Other accruals include a difference of DM 7 million (Dec. 31, 1996: DM 8 million) arising from the capital consolidation.

(29) Liabilities

	Dec. 31, 1997				Dec. 31, 1996			
	Total	of which due			Total	of which due		
millions of DM		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	**77,619**	7,199	46,059	24,361	**87,089**	9,526	37,862	39,701
Commercial paper	–				**2**	2		
Liabilities to banks	**10,272**	2,550	3,172	4,550	**12,797**	3,223	4,343	5,231
	87,891	**9,749**	**49,231**	**28,911**	**99,888**	**12,751**	**42,205**	**44,932**
Other								
Advances received	**124**	111	13		**178**	176	2	
Trade accounts payable	**3,570**	3,535	35		**4,460**	4,175	285	
Liabilities on bills accepted and drawn	**2**	2			**4**	3	1	
Payables to unconsolidated subsidiaries	**4**	4			**15**	15		
Liabilities to other companies in which an equity interest is held	**122**	122			**368**	368		
Other liabilities	**6,919**	4,792	40	2,087	**7,090**	4,672	291	2,127
of which: from taxes	**(736)**	(736)			**(839)**	(839)		
of which: from social security	**(123)**	(123)			**(129)**	(129)		
	10,741	**8,566**	**88**	**2,087**	**12,115**	**9,409**	**579**	**2,127**
Total liabilities	**98,632**	**18,315**	**49,319**	**30,998**	**112,003**	**22,160**	**42,784**	**47,059**

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						
1998	3	7,196	–	–	–	**7,199**
1999	150	3,500	6,800	–	–	**10,450**
2000	2,100	–	637	637	6,420	**9,794**
2001	2,050	–	–	7,250	1,116	**10,416**
2002	–	–	5,399	10,000	–	**15,399**
after 2002	27	11,400	12,934	–	–	**24,361**
	4,330	**22,096**	**25,770**	**17,887**	**7,536**	**77,619**

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

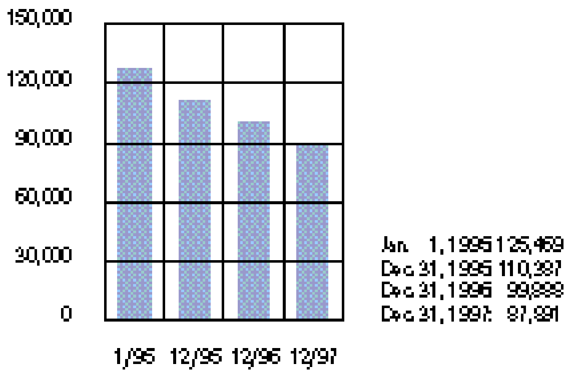
Due in	**Amounts**
1998	2,550
1999	653
2000	516
2001	1,190
2002	813
after 2002	4,550
	10,272

The average effective interest rate of total debt is for:

Bonds and debentures	7.57 % p.a. (1996: 7.46 % p.a.)
Liabilities to banks	7.53 % p.a. (1996: 7.17 % p.a.)

Deutsche Telekom has agreements with a number of banks pursuant to which it can draw on short-term revolving credit facilities up to DM 8.5 billion at interest rates ranging from 5.5 % to 6.0 % or at the daily interbank rate plus 0.25 %. At December 31, 1997, these credit lines had been drawn upon to only a limited extent.

The decrease in debt from January 1, 1995 to December 31, 1997 is as follows (in millions of DM):



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

Other liabilities

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Interest	2,714	2,856
Loan notes	1,188	1,357
Rental and leasing obligations	1,141	1,068
Liabilities to employees	297	362
Other	1,579	1,447
	6,919	7,090

Other liabilities include taxes of DM 736 million (Dec. 31, 1996: DM 839 million) and social security liabilities of DM 123 million (Dec. 31, 1996: DM 129 million).

Liabilities include borrowings of DM 833 million in foreign currencies.

Liabilities in the amount of DM 219 million (Dec. 31, 1996: DM 262 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.

Notes to the consolidated statement of cash flows

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 decreased by DM 1,693 million in 1997 to DM 5,623 million at December 31, 1997.

The decrease is a result of the following developments:

(30) Net cash provided by operating activities
Net cash provided by operating activities increased slightly in 1997 to DM 22,641 million. The increase in net income and depreciation was offset by a decrease in trade accounts payable and the expense for personnel restructuring measures which was accrued in 1996 and 1995.

(31) Net cash used for investing activities
Net cash used for investing activities decreased to DM 10,569 million in 1997 as a result of a decreased level of capital expenditure in network and in financial investments. As in previous years, it was possible to finance such investments, totaling approximately DM 15 billion, from cash provided by operating activities. The decrease of net DM 3,383 million in short-term investments and marketable securities is due to the partial re-investments in marketable securities.

(32) Net cash provided by (used for) financing activities
The decrease in cash provided by (used for) financing activities of DM 20,633 million to DM (13,759) million in 1997 is primarily attributable to the proceeds from the Company's global offering amounting to DM 20,146 million which occurred in 1996 as well as the dividend payment of DM 1,646 million, which is an increase of DM 436 million as compared with the previous year.

(33) Guarantees and commitments, and other financial obligations

Guarantees and commitments

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Guarantees	**446**	302
Collateral granted against liabilities of nonconsolidated companies	**89**	27
Liabilities arising from warranty agreements	**64**	4
	599	333

Other financial obligations

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Present value of payments to special pension fund	**23,600**	25,300
Obligations under rental and lease agreements	**6,548**	6,015
Purchase commitments for capital projects in progress	**3,422**	4,851
Commitments arising from transactions not yet settled including purchase commitments for interests in other companies	**203**	579
Contingent obligations arising from Public Law	**2**	7
	33,775	36,752

Guarantees and commitments of Deutsche Telekom mainly serve day-to-day business activities and securement of loans.

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 23.6 billion at December 31, 1997. Upon the withdrawal of the last civil servant from active service, the requirement for Deutsche Telekom to contribute to the civil servant pension fund will expire. The reduction in the present value of DM 1.7 billion resulted from the payment of DM 2.9 billion in 1997 to the special pension fund and from the increasing effect of the years of service extension for civil servants from the retirement age of 62 to 63.

As part of the MagyarCom joint venture agreement, Ameritech, U.S.A., has the option during the term of the agreement to sell certain or all 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 US$ 60 million control premium. Had the option been exercised, the maximum required at the balance sheet date would have been approximately DM 3,054 million. The possible commitment arising from this option is not included in purchase commitments for interests in other companies. If the possible commitment arising from the aforementioned option were included, then the total amount of other financial obligations would be DM 36,829 million.

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 accruals include the costs of litigation and any probable losses. The Company does not believe that any additional costs will have a material adverse effect on the net worth, financial position and results of the Deutsche Telekom group.

(34) 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, 1997 Fair value millions of DM	Dec. 31, 1997 Net carrying amount millions of DM	Dec. 31, 1996 Fair value millions of DM	Dec. 31, 1996 Net carrying amount millions of DM
Assets				
Other long-term loans	1,118	1,118	1,524	1,524
Other investments in noncurrent securities	1,349	1,211	356	337
Receivables	8,231	8,231	7,465	7,465
Liquid assets	9,258	9,258	17,852	17,852
Other investments in marketable securities	3,627	3,590	4	4
Liabilities				
Bonds and debentures	84,793	77,619	94,959	87,089
Liabilities to banks	10,272	10,272	12,799	12,799
Other	10,741	10,741	12,115	12,115
Derivative financial instruments[1]				
Interest rate swaps	76	62	52	2
Interest rate caps	15	18	–	–
Futures contracts	–	1	–	–
Swaptions	(1)	(2)	–	–
Foreign currency forward exchange contracts	56	–	13	–

[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 other investments in marketable securities is based on quoted market prices for those instruments or similar instruments. The net carrying amount is adjusted to market value where market value is less than the original investment.

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 5,145 million and DM 6,421 million at December 31, 1997 and 1996, 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, U.S.A., because the option provides for the purchase of the shares by Deutsche Telekom at market value plus a US$ 60 million control premium.

Derivative financial instruments

The Company uses derivative financial instruments for the purpose of hedging interest rate and currency exposures which arise from its ongoing business operations. The Company's policy is to hold or issue financial instruments for other than trading purposes. Derivative financial instruments are subject to internal controls. Derivatives classified as other than trading are those entered into for the purpose of matching or eliminating risk from potential movements in interest rates and foreign exchange rates inherent in the Company's assets, liabilities and positions. A derivative is designated as a hedge where there is an offset between the effects of potential movements in the derivative and designated underlying asset, liability or position being hedged. Such derivatives are reviewed regularly for their effectiveness as hedges. Derivative instruments designated as hedges are accounted for on the same basis as the underlying position.

The Company uses interest rate swaps, forward rate agreements, purchased swaptions and exchange traded futures to reduce its exposure to interest rate and market value volatility on certain debt issues and deposit instruments and manage its interest expense by setting an optimal mix of floating and fixed rate debt and deposit instruments. Interest rate swaps are designated as micro hedges (coupled with individual financial instruments) and macro hedges (coupled with a portfolio of financial instruments).

Gains or losses related to changes in the value of interest rate swaps are generally not recognized. Macro interest rate swaps related to deposit instruments are marked to market and resultant negative values are accrued and included as a component of net interest expense; gains are recognized upon realization. Interest rate swaps which are not designated as either micro or macro hedges are assigned to the interest instrument valuation portfolio. Unrealized losses from changes in market value are netted and resultant net losses are recognized as a component of net interest expense.

The interest differential to be paid or received on interest rate swaps is recognized in the statement of earnings, as incurred, as a component of net interest expense. Gains or losses on interest rate swaps terminated prior to their maturity, or on interest rate swaps hedging an underlying asset, liability or position which has been derecognized, are recognized currently as a decrease or increase in net interest expense.

The Company enters into Forward Rate Agreements (FRAs) to manage the interest performance of its deposit portfolios. Deposit portfolio FRAs are marked to market and resultant negative values are accrued. The interest differential paid or received is recognized in the statement of earnings, as incurred, as a component of net interest expense.

Written swaptions are assigned to the interest instrument valuation portfolio. Unrealized gains or losses from changes in market value are netted and resultant net losses are recognized as a component of net interest expense.

The Company acquired futures contracts during the year under review to hedge fixed interest investments. Unrealized losses on futures contracts are recognized currently.

The Company uses foreign currency forward contracts to reduce fluctuations in foreign currency cash flows related to revenue and capital expenditure and payments to international third party telecommunications carriers. Foreign currency forward contracts hedging firm commitments to invest in a foreign entity are not valued at the balance sheet date. The investment in the purchased entity is booked using the foreign exchange rate fixed by the foreign currency forward contract. Foreign currency forward exchange contracts hedging other payments and receipts are assigned to foreign currency portfolios categorized by foreign currency type with the related financial instruments. These portfolios are marked to market at the balance sheet date and resultant negative portfolio values are accrued under other liabilities.

The Company purchases options to hedge investments in foreign entities. An option purchased to hedge a firm commitment to invest in a foreign entity is included in other assets and valued at purchase cost. Upon exercise of the option the premium is included in the purchase cost of the asset. An option purchased which hedges a planned transaction is included in foreign currency portfolios referred to above. Upon exercise the option premium is included in the underlying transaction. Options expiring unexercised are recognized currently and assigned to other operating costs or revenues.

The following is a summary of the contract or notional principal amounts outstanding at December 31, 1997 and 1996:

	Dec. 31, 1997		Dec. 31, 1996	
	Maturity	Notional amount millions of DM	Maturity	Notional amount millions of DM
Interest rate swaps (DM)				
Pay variable / receive fixed (receiver)	1998-2002	5,750	1997–2001	5,850
Fixed to variable (payer)	2002-2007	2,200	–	–
Forward interest rate swaps (DM)				
Fixed to variable (payer)	2008	500	–	–
Interest rate swaps (US$)				
Fixed to variable (payer)	2002-2007	448	–	–
Interest rate cap purchased	2002	300	–	–
Future contracts	1998	331	–	–
Swaptions sold	1998	300	–	–
Foreign currency forward exchange contracts	1998	446	1997	250

The terms of the receiver interest rate swaps provide for Deutsche Telekom to receive interest at fixed rates (weighted average of 4.6 % and 4.3 % at December 31,1997 and 1996, respectively) and pay interest at variable rates (generally based on the six-month LIBOR rate). The terms of the payer interest rate swaps outstanding at December 31, 1997 provide for Deutsche Telekom to pay interest at fixed rates (weighted average of 5.6 %) and receive interest at variable rates (generally based on the six-month LIBOR rate). The terms of the payer forward interest rate swaps provide for Deutsche Telekom to pay interest at fixed rates (weighted average of 5.8 %) and receive 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 interest rate caps purchased have five-year terms and provide for Deutsche Telekom to pay or receive excesses over a specified reference interest rate.

The swaptions sold all have nine-month terms. The underlying interest rate swaps with a nominal value of DM 200 million have a two-year term and interest rate swaps with a nominal value of DM 100 million have a three-year term.

The terms of the futures contracts require Deutsche Telekom to pay to or receive from the counterparty losses or gains arising on movements in the quoted contract prices at specified intervals.

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.

(35) Information on the Board of Management and the Supervisory Board of Deutsche Telekom AG

No remuneration was paid to members of the Supervisory Board of Deutsche Telekom AG in 1997. The Supervisory Board only received meeting attendance fees amounting to DM 29,000. Subject to the approval of the shareholders' meeting, Supervisory Board remuneration is to amount to DM 478,700.

Provided that the 1997 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 12,753,651. The remuneration to be paid to former members of the Board of Management of Deutsche Telekom AG and their surviving dependents amounts to DM 688,944.

Pension accruals totaling DM 6,998,197 have been established for this group of persons at December 31, 1997. Pension obligations to such persons for which no reserve had to be established amounted to DM 4,209,231 at that date.

The members of the Board of Management and former members of the Board of Management, respectively, have not received any loans from the Company.

(36) Proposal for appropriation of net income of Deutsche Telekom AG

The income statement of Deutsche Telekom AG reflects net income of DM 3,302,850,601.29. Following inclusion of the unappropriated net income carried forward from 1996, this gives rise to total unappropriated net income of DM 3,304,316,916.85.

The Supervisory Board and the Board of Management propose, subject to the approval of the shareholders' meeting, the payment of a dividend of DM 3,291,888,120. This represents a dividend of DM 1.20 per share with nominal value of DM 5 on the capital stock of DM 13,716,200,500. The remaining balance of DM 12,428,796.85 will be carried forward as part of unappropriated net income.

Reconciliation to U.S. GAAP

Due to its 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. GAAP and 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.

(37) 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, 2001, 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 1995, 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 related to the financial year but only incurred within the first three months of the following year 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, 1997 Deutsche Telekom had nondeductible capitalized VAT amounting to DM 2,610 million, net of depreciation in 1997 of DM 1,305 million, recorded as property, plant and equipment. In addition, in 1997 Deutsche Telekom recovered DM 1,299 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/Deferred income

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 1996, 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 125 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 were 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 and held to maturity securities are reported at historical cost. 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 other derivative financial instruments and unrealized gains on foreign currency receivables and payables that are not deferred under U.S. GAAP. Other differences also include the different treatment under German GAAP of foreign currency effects not affecting net income arising from the deconsolidation of subsidiaries.

(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.

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 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:

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Current income taxes	–	(524)	524
Deferred taxes from the application of U.S. GAAP	(691)	580	(579)
Deferred taxes on U.S. GAAP/German GAAP differences	267	(315)	(322)
	(424)	(259)	(377)

(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	1997 millions of DM	1996 millions of DM	1995 millions of DM
Net income as reported in the consolidated financial statements under German GAAP		**3,303**	1,758	5,272
Personnel restructuring accrual	(a)	(492)	960	548
Share offering costs	(b)	–	564	–
Levy to the Federal Republic of Germany	(c)	–	–	316
Maintenance accruals	(d)	(41)	(56)	(181)
Value-added tax	(e)	6	(211)	–
Interest rate swaps/Deferred income	(f)	9	(116)	–
Employee share purchase plans	(g)	5	(73)	–
Other differences	(i)	90	7	(15)
Income taxes	(j)	(424)	(259)	(377)
Net income in accordance with U.S. GAAP		**2,456**	2,574	5,563

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

	Note	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Shareholders' equity in accordance with German GAAP		**48,144**	46,599
Accrual for personnel restructuring measures	(a)	1,016	1,508
Maintenance accruals	(d)	53	94
Value-added tax	(e)	(205)	(211)
Interest rate swaps/Deferred income	(f)	(107)	(116)
Employee share purchase plans	(g)	(23)	(28)
Unrealized gains on marketable securities	(h)	138	19
Other differences	(i)	45	31
Income taxes	(j)	3,508	3 998
Minority interest	(k)	(1,450)	(1,193)
Shareholders' equity in accordance with U.S. GAAP		**51,119**	50,701

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

	Dec. 31, 1997 millions of DM	Dec. 31,1996 millions of DM
Shareholders' equity, beginning of year	**50,701**	29,475
Net income in accordance with U.S. GAAP	2,456	2,574
Differences from currency translation	(443)	(25)
Proceeds from share offering (after share offering costs, net of tax)	–	19,869
Dividends for 1996 and 1995 respectively	(1,646)	(1,200)
Net change in unrealized gain on marketable securities, net of deferred taxes	51	8
Shareholders' equity, end of year	**51,119**	50,701

(38) 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, 1997 millions of DM	Dec. 31, 1996 millions of DM
Deferred tax assets in accordance with U.S. GAAP		
Current deferred tax assets		
Net operating loss carryforwards	180	175
Other	49	5
Noncurrent deferred tax assets		
Property, plant and equipment	868	93
Net operating loss carryforwards	64	319
Personnel restructuring accrual	493	–
Pension accruals	3,190	3,455
Civil servant health insurance accrual	849	788
Other accruals	835	694
Other	173	66
Deferred tax assets in accordance with U.S. GAAP	**6,701**	5,595
Deferred tax liabilities in accordance with U.S. GAAP		
Current deferred tax liabilities		
Accruals	–	(134)
Other	(10)	(46)
Noncurrent deferred tax liabilities		
Property, plant and equipment	(1,369)	–
Personnel restructuring accrual	(579)	(191)
Other	(535)	(463)
Deferred tax liabilities in accordance with U.S. GAAP	**(2,493)**	(834)
Net current deferred tax asset (liability)	219	–
Net noncurrent deferred tax asset	3,989	4,761
Valuation allowance	(7)	(214)
Net deferred tax asset under U.S. GAAP	**4,201**	4,547

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

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Net deferred taxes under German GAAP	693	549
U.S. GAAP adjustments:		
Application of U.S. GAAP	4,047	4,737
U.S./German GAAP differences	(539)	(739)
Net deferred asset under U.S. GAAP	**4,201**	4,547

(39) 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.

	1997 millions of DM	1996 millions of DM	1995 millions of DM
Results from ordinary business activities	6,055	4,429	9,493
Levy to the Federal Republic of Germany	–	–	(2,782)
Income before income taxes	6,055	4,429	6,711
Income taxes	(3,382)	(1,665)	(991)
Income before extraordinary losses and income (losses) applicable to minority shareholders	2,673	2,764	5,720
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	(217)	(163)	2
Net income in accordance with U.S. GAAP	**2,456**	2,574	5,563
Earnings per share/ADS in accordance with U.S. GAAP (in DM):			
Before extraordinary losses	0.90	1.23	2.82
Extraordinary losses	–	(0.01)	(0.08)
Net income	0.90	1.22	2.74
Weighted average shares outstanding (in millions)	2,743	2,110	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 classified as noncurrent. Summarized balance sheet information measured and classified in accordance with U.S. GAAP is as follows:

	Dec. 31, 1997 millions of DM	Dec. 31, 1996 millions of DM
Assets:		
Current assets:		
Cash and cash equivalents	5,630	7,316
Other current assets	19,505	20,953
	25,135	**28,269**
Noncurrent assets	140,966	150,554
	166,101	**178,823**
Shareholders' equity and liabilities:		
Current liabilities:		
Trade accounts payable	9,801	10,319
Short-term debt and current portion of long-term debt	9,749	12,716
Accruals	5,459	3,553
	25,009	**26,588**
Long-term liabilities:		
Long-term debt	77,961	86,944
Other noncurrent liabilities	10,630	13,397
	88,591	**100,341**
Minority interest	**1,382**	1,193
Shareholders' equity	**51,119**	50,701
	166,101	178,823

(40) Other matters

In 1996, 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 was effective for the financial year ended on Dec. 31, 1997. Deutsche Telekom adopted this statement for the current financial year. There have been no effects on reported earnings per share as a result of adopting this standard.

In June 1997, the Financial Accounting Standards Board issued SFAS No. 130, Reporting Comprehensive Income, requiring that components of comprehensive income be reported in a financial statements. The Company intends to adopt this standard for the 1998 financial year.

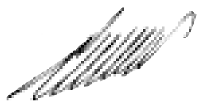
In June 1997, the Financial Accounting Standards Board issued SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, which specifies the reporting of financial and descriptive information on the basis that is used internally for evaluating segment performance and deciding how to allocate resources to segments. This standard is required to be adopted in 1998. The Company is currently evaluating the disclosures required by this standard.

In October 1996, the AICPA's Accounting Standards Executive Committee issued Statement of Position No. 96-1, Environmental Remediation Liabilities, which was adopted by the Company on January 1, 1997. The effect on the financial statements of the adoption of this standard was immaterial.

In February 1998, the Financial Accounting Standards Board issued SFAS No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits. This standard, which is required to be adopted in 1998, does not change the measurement or recognition of costs for pensions or other postretirement benefits but rather standardizes disclosures and eliminates those that are no longer useful. The Company intends to adopt this standard in 1998.

Bonn, March 30, 1998

Deutsche Telekom AG
Board of Management


Dr. Ron Sommer

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Detlev Buchal


Dr. Hagen Hultzsch


Dr. Heinz Klinkhammer


Dr. Joachim Kröske


Dr. Herbert May


Gerd Tenzer

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Glossary

ADSL – Asymmetric Digital Subscriber Line
Technology for high-speed transmission (download at 16 kbit/s to 640 kbit/s; upload at 2 Mbit/s to 8 Mbit/s) via a standard copper twin wire, in the local loop and over a distance of up to three kilometers.

ATM – Asynchronous Transfer Mode
New, internationally standardized technology for broadband data transmission. It provides flexible transmission rates of up to 155 Mbit/s. Deutsche Telekom's ATM services are offered under the brand name "T-Net-ATM".

Backbone
The main part, within a supra-regional or global network configuration, that connects local subnetworks; backbones are normally very high-speed links (155 Mbit/s).

Broadband service
Service that features fast digital transmission (in the Mbit/s range) and/or broadband analog transmission (MHz range). (Deutsche Telekom's broadband products include: T-Net-ATM, FrameLink Plus, videoconference services, Business TV and T-Media-Net)

Call center
A company, or department of a company, that offers operator-supported voice services; call centers normally have large numbers of operators who handle inbound (hotline) or outbound (direct marketing) calls.

Call-by-call
Dialing procedure that enables a telephone customer to use the carrier (the long-distance operator) of his or her choice for every long-distance call (i.e. the customer can change carriers for every call).

Carrier selection code
Dialing prefix/code, in the telephone service, used to select a long-distance carrier; the code for Germany is 010xy.

City Networks
Network platforms, located in major population centers, that support a range of different high-speed services that can be used in customized applications packages; City Networks only use optical fiber links, with speeds of up to 155 Mbit/s.

Corporate Network
Telecommunications network, for a defined group of users, with communications services that are especially tailored to the requirements of companies or affiliated-company groups.

Datex-M
Deutsche Telekom's national public broadband service that conforms to the SMDS standard, which is used primarily for linking LANs.

Datex-P
Deutsche Telekom's brand name for packet-switched data communications via virtual links, in keeping with the X.25, X.28 and X.31 international standards.

DCS 1800
– Digital Cellular System 1800
Technical specifications for mobile communications networks that operate in the frequency range around 1800 MHz. DCS 1800 is based on GSM technology.

DSL
Digital Subscriber Line, a sophisticated technology for data transport via copper wires. Also known as "technology for the last mile", since it can be used to transport data from existing networks to the subscriber's premises. See ADSL.

FrameLink Plus
Deutsche Telekom's Frame Relay service.

Frame Relay
One type of Fast Packet Switching technology: transparent, connection-oriented layer 2 packet protocol with variable packet length. Frame Relay permits considerably higher throughput and lower delays than Datex-P. Used for applications that require fast transmission rates (2 Mbit/s or faster), especially for LAN-coupling (WAN backbone) and host-computer applications.

GSM
Global System for Mobile Communications, a pan-European mobile communications standard for the 900-MHz frequency range.

Interconnection
Term used for linking networks of different providers, as regulated by the Telecommunications Act.

Internet protocol (IP)
Nonproprietary transport protocol in layer 3 of the OSI reference model for inter-network communications.

ISDN – Integrated Services Digital Network
Largely services-neutral digital switched network with 64-kbit/s connections conforming to international and European standards; also provides packet-switched services (virtual connections) for data communications.

Information Network Berlin-Bonn (IVBB)
Multimedia communications network of the Federal Government and top-level federal authorities; the IVBB is currently being implemented by Deutsche Telekom.

LeasedLink
Deutsche Telekom's service in the area of fixed connections (leased lines, point-to-point circuits): fixed physical transmission path between two data terminal devices that always remain operational.

Local Area Network (LAN)
Local network that covers a short distance region; LANs usually have decentralized network management.

Multimedia
Term used for integration of text with still images and graphics, video and sound.

Number portability
Legally permitted option in which subscribers can retain their telephone numbers when they switch carriers.

Optical fiber cable
Data-transmission medium consisting of ultra-pure quartz glass. Optical fiber cables, which transport digital light-pulse signals, have higher transmission capacity and lower signal distortion than copper cables.

Overlay network
Additional transmission network that is installed over an existing network structure and that normally uses a different transmission medium from that used by the existing network (for example, optical fiber).

Paging (pager)
Generic term for telecommunications services for unidirectional radio-based transmission of short messages to small pagers. In German-speaking areas, the term "paging" is applied to services such as Cityruf and Scall.

PCS – Personal Communication Service
Services that integrate the fixed network with mobile communications services.

Preselection
Procedure in which the customer selects a certain provider – known as the long-distance carrier – for all of his or her long-distance calls.

Roaming
A feature of cellular mobile communications networks: activated mobile stations remain accessible, regardless of location, in all radio cells of the entire area served by the network. Roaming can also include similar networks of different network operators, as is the case with international roaming in the pan-European GSM system.

T-Berkom
The short name for one of Deutsche Telekom's subsidiaries: Deutsche Telekom Berkom Gesellschaft für Forschung und Entwicklung von Anwendungen in der Telekommunikation mbH (Deutsche Telekom Berkom company for research and development of applications in telecommunications).

T-C-Tel
Deutsche Telekom's analog mobile communications service.

T-D1
Deutsche Telekom's GSM-standard mobile communications service.

T-Media-Net
New product name for Deutsche Telekom's cable access (television and radio).

T-Net
Name for Deutsche Telekom's digital telephone network with intelligent functions.

T-Net-ATM
Name for Deutsche Telekom's ATM services (see also ATM).

T-Net-Box
Answering machine in Deutsche Telekom's T-Net.

T-Net-Call
Pilot IP-based telephone service in Deutsche Telekom's T-Net.

T-Online
Deutsche Telekom's online service, which offers both fast Internet access and a broad spectrum of content for business and residential customers. Began as Btx/Datex-J.

"T-Punkt" sales outlets
Deutsche Telekom's outlets for selling its products – primarily to residential customers.

TDN
Telekom Designed Network – Deutsche Telekom's customized system solutions (Corporate Networks); TDNs can transport voice, data, and video in both national and international networks.

Teleworking/telecommuting
Online work, supported by IT/network links, carried out by personnel at locations other than those of their employers/customers.

Telelearning
Computer-based learning in which programs and lessons are downloaded from online services.

Telematics
Integration of information and telecommunications technology.

Vanity numbers
Telephone numbers that can be expressed as easy-to-remember words, through letters printed on modern telephone keypads.

Virtual Private Network
In general: value-added service in a public, intelligent network. Deutsche Telekom's line of VPNs consists of national and international private networks with individual numbering plans.

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