Condensed consolidated income statement
For the period ended 30 June 2011

		Six months ended 30 June		Year ended 30 June	
		2011	2010	2011	2010
		Unaudited	Unaudited	Audited	Audited
(Dollars in millions, except per share amounts)	*notes*	NZ$	NZ$	NZ$	NZ$
Operating revenues and other gains					
Local service		482	510	981	1,026
Calling		449	485	928	1,003
Interconnection		95	95	195	178
Mobile		420	400	825	826
Data		293	314	592	638
Broadband and internet		291	297	581	594
IT services		287	252	561	486
Resale		111	131	235	278
Other operating revenue	*3*	80	89	179	215
Other gains	*4*	13	27	45	27
		2,521	**2,600**	**5,122**	**5,271**
Operating expenses					
Labour		(430)	(436)	(869)	(893)
Intercarrier costs		(449)	(464)	(939)	(957)
Other operating expenses	*5*	(709)	(808)	(1,495)	(1,657)
Asset impairments	*11*	(257)	-	(257)	-
Other expenses	*4*	(55)	-	(71)	-
Earnings before interest, taxation, depreciation and amortisation		**621**	**892**	**1,491**	**1,764**
Depreciation		(344)	(381)	(733)	(757)
Amortisation		(153)	(141)	(294)	(275)
Earnings before interest and taxation		**124**	**370**	**464**	**732**
Finance income		5	5	15	22
Finance expense		(104)	(100)	(203)	(202)
Share of associates' profits		-	1	1	1
Earnings before income tax		**25**	**276**	**277**	**553**
Income tax expense	*10*	(24)	(137)	(111)	(171)
Net earnings for the period		**1**	**139**	**166**	**382**
Net earnings attributable to equity holders of the Company		-	138	164	380
Net earnings attributable to non controlling interest		1	1	2	2
		1	**139**	**166**	**382**
Basic net earnings per share (in cents)		-	7	9	20
Diluted net earnings per share (in cents)		-	7	9	20
Weighted average number of ordinary shares outstanding (in millions)		1,925	1,909	1,924	1,891

See accompanying notes to the financial statements.

Condensed consolidated statement of comprehensive income
For the period ended 30 June 2011

	Six months ended 30 June		Year ended 30 June	
	2011	2010	2011	2010
	Unaudited	Unaudited	Audited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Net earnings for the period	**1**	**139**	**166**	**382**
Other comprehensive income[1]:				
Translation of foreign operations	(10)	(1)	(8)	(6)
Net investment hedges	4	2	(11)	10
Revaluation of investments	(56)	(1)	(48)	30
Cash flow hedges	(14)	(1)	(27)	9
Other comprehensive income / (loss) for the period	(76)	(1)	(94)	43
Total comprehensive income / (loss) for the period	**(75)**	**138**	**72**	**425**
Total comprehensive income / (loss) attributable to equity holders of the Company	(74)	137	70	423
Total comprehensive income / (loss) attributable to non controlling interest	(1)	1	2	2
	(75)	**138**	**72**	**425**

[1] Components of other comprehensive income are shown net of tax.

See accompanying notes to the financial statements.

Condensed consolidated statement of changes in equity
For the period ended 30 June

30 June *(Dollars in millions)*	Share capital NZ$	Retained earnings NZ$	Hedge reserve NZ$	Deferred compensation NZ$	Revaluation reserve NZ$	Foreign currency translation reserve NZ$	Total equity holders of the Company NZ$	Non controlling interest NZ$	Total equity NZ$
Balance at 1 July 2009	1,384	1,369	(41)	11	(263)	(24)	2,436	5	2,441
Net earnings for the period	-	380	-	-	-	-	380	2	382
Other comprehensive income[1]	-	-	9	-	30	4	43	-	43
Total comprehensive income for the period, net of tax	-	380	9	-	30	4	423	2	425
Contributions by and distributions to owners:									
Ordinary dividends	-	(453)	-	-	-	-	(453)	(1)	(454)
Dividend reinvestment plan	128	-	-	-	-	-	128	-	128
Issuance of shares under share schemes	3	-	-	2	-	-	5	-	5
Total transactions with owners	131	(453)	-	2	-	-	(320)	(1)	(321)
Balance at 30 June 2010	**1,515**	**1,296**	**(32)**	**13**	**(233)**	**(20)**	**2,539**	**6**	**2,545**
Balance at 1 July 2010	1,515	1,296	(32)	13	(233)	(20)	2,539	6	2,545
Net earnings for the period	-	164	-	-	-	-	164	2	166
Other comprehensive income[1]	-	-	(27)	-	(48)	(19)	(94)	-	(94)
Transfer to retained earnings on disposal of long-term investments[2]	-	64	-	-	(64)	-	-	-	-
Total comprehensive income for the period, net of tax	-	228	(27)	-	(112)	(19)	70	2	72
Contributions by and distributions to owners:									
Ordinary dividends	-	(317)	-	-	-	-	(317)	(3)	(320)
Supplementary dividends	-	(28)	-	-	-	-	(28)	-	(28)
Tax credit on supplementary	-	28	-	-	-	-	28	-	28
Dividend reinvestment plan	7	-	-	-	-	-	7	-	7
Issuance of shares under share schemes	6	-	-	1	-	-	7	-	7
Total transactions with owners	13	(317)	-	1	-	-	(303)	(3)	(306)
Balance at 30 June 2011	**1,528**	**1,207**	**(59)**	**14**	**(345)**	**(39)**	**2,306**	**5**	**2,311**

[1] Other comprehensive income is presented net of tax.
[2] Relates to the sale of Telecom's investments in iiNet Limited and Macquarie Telecom Group Limited shares transferred from revaluation reserve to retained earnings (refer note 4).

See accompanying notes to the financial statements.

Condensed consolidated statement of financial position
As at 30 June 2011

	30 June	
	2011	2010
	Audited	Audited
(Dollars in millions)	NZ$	NZ$
ASSETS		
Current assets:		
Cash	324	339
Collateral funds	110	21
Short-term derivative assets	2	4
Receivables and prepayments	701	702
Inventories	60	61
Total current assets	1,197	1,127
Non-current assets:		
Long-term investments	125	276
Long-term receivables	44	31
Long-term derivative assets	40	51
Intangibles	1,094	1,314
Property, plant and equipment	3,892	4,066
Total non-current assets	5,195	5,738
Total assets	**6,392**	**6,865**
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accruals	991	1,171
Taxation payable	31	15
Short-term derivative liabilities	333	22
Short-term provisions	38	19
Debt due within one year	397	184
Total current liabilities	1,790	1,411
Non-current liabilities:		
Deferred tax liability	226	285
Long-term derivative liabilities	330	440
Long-term provisions	35	47
Long-term debt	1,700	2,137
Total non-current liabilities	2,291	2,909
Total liabilities	4,081	4,320
Equity:		
Share capital	1,528	1,515
Reserves	(429)	(272)
Retained earnings	1,207	1,296
Total equity attributable to equity holders of the Company	**2,306**	**2,539**
Non-controlling interest	5	6
Total equity	2,311	2,545
Total liabilities and equity	**6,392**	**6,865**

See accompanying notes to the financial statements.

Condensed consolidated statement of cash flows
For the period ended 30 June 2011

		Year ended 30 June	
		2011	2010
		Audited	Audited
(Dollars in millions)	*note*	NZ$	NZ$
Cash flows from operating activities			
Cash received from customers		5,008	5,257
Interest income		15	21
Payments to suppliers and employees		(3,421)	(3,389)
Income tax (paid) / refunded		(127)	1
Interest paid on debt		(197)	(195)
Dividend income		71	66
Net cash flow from operating activities	*7*	**1,349**	**1,761**
Cash flows from investing activities			
Sale of property, plant and equipment		3	3
Sale of business	*4*	76	-
Sale of long-term investments	*4*	107	6
Purchase of property, plant and equipment and intangibles		(1,005)	(1,080)
Capitalised interest paid		(16)	(20)
Net cash flow from investing activities		**(835)**	**(1,091)**
Cash flows from financing activities			
Repayment of long-term debt		(21)	(15)
Repayment of derivatives		(13)	(34)
Proceeds from derivatives		2	12
Increase in collateral funds		(89)	(21)
Repayment of short-term debt		(749)	(1,270)
Proceeds from short-term debt		663	1,079
Dividends paid		(313)	(327)
Net cash flow from financing activities		**(520)**	**(576)**
Net cash flow		(6)	94
Opening cash position		339	261
Foreign exchange movement		(9)	(16)
Closing cash position		**324**	**339**

See accompanying notes to the financial statements.

Notes to the Condensed consolidated financial statements

NOTE 1 FINANCIAL STATEMENTS

The condensed consolidated financial statements of Telecom Corporation of New Zealand Limited ('the Company') together with its subsidiaries and associates ('Telecom'), as at and for the year ended 30 June 2011, have been prepared in accordance with the New Zealand Equivalent to International Accounting Standard No. 34: "Interim Financial Reporting", issued by the New Zealand Institute of Chartered Accountants. These financial statements also comply with International Accounting Standard IAS 34, Interim Financial Reporting.

On 24 May 2011 Telecom reached an agreement for Chorus, one of its segments, to take the cornerstone role in the Government's ultra-fast broadband ('UFB') initiative. Chorus was chosen as Crown Fibre Holdings ('CFH') Limited's UFB provider in 24 of the 33 available regions. The agreement is subject to certain conditions, including structural separation, which itself is contingent upon certain factors such as obtaining court, shareholder, debtholder, regulatory and other approvals, as well as relief from key revenue authorities. Telecom's participation in the UFB initiative is predicated on the structural separation of Telecom through a demerger into two companies – New Telecom and New Chorus. Telecom intends to achieve this demerger via a court approved scheme of arrangement and requires 75% of the shares that are voted by shareholders to be in favour of the demerger proposal. This demerger would give rise to a new and entirely standalone company, New Chorus, which would deliver UFB and comprise the existing Chorus business and parts of Telecom Wholesale. This change will significantly transform the telecommunications sector in New Zealand.

Furthermore, the Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011 (the Telecommunications Amendment Act) establishes a substantially revised regulatory regime that will apply to New Telecom and New Chorus upon completion of the proposed demerger. It also includes certain regulatory changes which will take effect irrespective of whether the proposed demerger proceeds.

Both the proposed demerger and the new regulatory regime will have significant impacts on Telecom's future consolidated financial statements. Telecom's current financial performance or financial position is therefore not indicative of Telecom's results when considering these potential changes. The structural separation of Telecom into two companies will be achieved by the distribution of New Chorus shares to the shareholders of the company. This will be reflected in the financial statements of Telecom only once the Group is committed to the distribution of shares, which only arises upon obtaining sufficient votes in support of the proposed demerger, as described above.

In addition, the business to be demerged will be classified as a 'discontinued operation' by Telecom when the criteria set out in the Group's accounting policy entitled 'discontinued operations' have been met, This will only occur once the distribution of New Chorus is highly probable which will only arise upon obtaining sufficient votes in support of the proposed demerger. Accordingly, the effect of the proposed demerger reflected in these financial statements is limited to the recognition of demerger costs incurred up to 30 June 2011.

Notwithstanding these proposed changes, Telecom has assessed the impact of CFH selecting its UFB partners and their imminent deployment of fibre and the impacts on Telecom's copper based regulatory assets. This assessment concluded that, given the longer-term move to a fibre based national infrastructure and regulatory developments, $257 million of copper-based and Wholesale FMO regulatory assets were impaired at 30 June 2011 and were therefore written off. The planned changes in terms of the regulatory and operating environment on both Telecom and the demerged business may result in further asset impairments, to be recognised in future periods, or the shortening of asset lives, irrespective of whether Telecom demerges or not.

Telecom has restated its comparative segment results to reflect changes during the current year to its internal trading and internal reporting. There is no change to the underlying segments or to the overall Group reported result. Certain other comparative information has also been reclassified to conform with the current period's presentation.

Notes to the Condensed consolidated financial statements (continued)

NOTE 1 FINANCIAL STATEMENTS (continued)

Except for the adoption of the Standards and Interpretations described below, these condensed consolidated financial statements of Telecom have been prepared using the same accounting policies and methods of computation as, and should be read in conjunction with, the financial statements and related notes included in Telecom's annual report for the year ended 30 June 2011. The preparation of financial statements also requires management to make judgements, estimates and assumptions. Telecom has been consistent in applying the judgements, estimates and assumptions adopted in the annual report for the year ended 30 June 2011.

NZ IFRS 2 'Group cash settled share based payment transactions' and NZ IFRS 5 'Non current assets held for sale and discontinued operations'
These revised standards have been adopted prospectively from 1 July 2010, but have had no impact on the condensed consolidated financial statements.

The presentation currency of the financial statements is New Zealand dollars which is also the Company's functional currency. References in these financial statements to '$' or 'NZ$' are to New Zealand dollars. All financial information has been rounded to the nearest million, unless otherwise stated. These condensed consolidated financial statements were approved by the board of directors on 18 August 2011 and are unaudited. However, the results for the full year and statement of financial position information as at 30 June have been extracted from the Group's audited financial statements. The Group's audited financial statements will be available on Telecom's website: http://investor.telecom.co.nz.

NOTE 2 SEGMENTAL REPORTING

Telecom's segments comprise Chorus, Retail, Wholesale & International, Gen-i, AAPT and Technology and Shared Services ('T&SS').

Segmental information for the Year ended 30 June 2011

Audited *(Dollars in millions)*	Chorus NZ$	Wholesale & International NZ$	Retail NZ$	Gen-i NZ$	T&SS NZ$	AAPT NZ$	Total NZ$
External revenue and other gains	56	873	1,893	1,342	31	834	5,029
Internal revenue	1,045	467	122	80	558	66	2,338
Total revenue and other gains	1,101	1,340	2,015	1,422	589	900	7,367
Segment result	806	119	493	237	4	90	1,749

Segmental information for the year ended 30 June 2010

Audited *Restated* *(Dollars in millions)*	Chorus NZ$	Wholesale & International NZ$	Retail NZ$	Gen-i NZ$	T&SS NZ$	AAPT NZ$	Total NZ$
External revenue and other gains	44	789	1,960	1,368	18	1,011	5,190
Internal revenue	1,006	503	116	81	585	98	2,389
Total revenue and other gains	1,050	1,292	2,076	1,449	603	1,109	7,579
Segment result	767	206	406	223	(2)	136	1,736

Notes to the Condensed consolidated financial statements (continued)

NOTE 2 SEGMENTAL REPORTING (continued)

The segment results disclosed are based on those reported to Telecom's Chief Executive Officer and are how Telecom analyses its business results. Segment result is measured based on net earnings before depreciation, amortisation, other gains and expenses not allocated to segments, finance income and costs, associates' profits / losses and taxation expense. None of these other items are assessed on a segment basis by Telecom's Chief Executive Officer.

Included within the segment results disclosed above for AAPT are the results of its consumer division, which was disposed of in the year ended 30 June 2011 (refer to note 4).

Reconciliation from segment result to earnings before income tax

		Year ended 30 June	
		2011	2010
		Audited	Audited
(Dollars in millions)	*notes*	NZ$	NZ$
Segment result		1,749	1,736
Net result of Corporate revenue and expenses		47	28
Other gains not allocated to segments	*4*	23	-
Other expenses	*4*	(71)	-
Depreciation		(733)	(757)
Amortisation		(294)	(275)
Finance income		15	22
Finance expense		(203)	(202)
Asset impairments not allocated for segmental reporting	*11*	(257)	-
Share of associates' profits		1	1
Earnings before income tax		**277**	**553**

NOTE 3 OTHER OPERATING REVENUE

	Six months ended 30 June		Year ended 30 June	
	2011	2010	2011	2010
	Unaudited	Unaudited	Audited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Other operating revenue				
Dividends	32	21	71	66
Equipment	6	11	18	36
Miscellaneous other	42	57	90	113
	80	**89**	**179**	**215**

Dividend income includes dividends received from Southern Cross Cables Holdings Limited, a related party by way of Telecom's 50% shareholding in the company.

Notes to the Condensed consolidated financial statements (continued)

NOTE 4 OTHER GAINS & OTHER EXPENSES

	Six months ended 30 June		Year ended 30 June	
	2011	2010	2011	2010
	Unaudited	Unaudited	Audited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Other gains				
Gain on sale of business	5	-	23	-
Various resolutions and settlements with supplier	8	27	22	27
	13	**27**	**45**	**27**
Other expenses				
Costs relating to UFB process	17	-	29	-
Natural disaster costs	38	-	42	-
	55	**-**	**71**	**-**

In the six months ended 30 June 2011, other gains of $13 million represented:

- $5 million (A$4 million) gain on the sale of Yahoo!Xtra Limited in April 2011; and
- $8 million relating to a resolution and settlement reached with a supplier.

In the year ended 30 June 2011, other gains of $45 million represented:

- $18 million (A$15 million) gain on the sale of AAPT's consumer division to iiNet Limited for $76 million (A$60 million) in September 2010; and
- $5 million (A$4 million) gain on the sale of Yahoo!Xtra Limited in April 2011; and
- $22 million relating to a resolution and settlement reached with a supplier.

In the year ended 30 June 2010, other gains of $27 million represented various resolutions and settlements reached with a supplier.

Telecom also sold its investments in Macquarie Telecom Group Limited and iiNet Limited for cash of $100 million (A$80 million). This has no impact on the condensed consolidated income statement due to the movements in fair value of these investments (including the difference between sales proceeds and carrying value) being recognised directly in equity in accordance with IFRS 9.

In the six months ended 30 June 2011, other expenses of $55 million represented:

- $17 million of costs incurred in relation to Telecom's proposal for the Government's UFB initiative and process; and
- $38 million of costs recognised in relation to the Canterbury earthquakes.

In the year ended 30 June 2011, other expenses of $71 million represented:

- $29 million of costs incurred in relation to Telecom's proposal for, and involvement with, the Government's UFB initiative and process; and
- $42 million of costs recognised in relation to the Canterbury earthquakes, comprised of incremental operational costs incurred, customer credits and asset impairments. Parts of these costs were covered by Telecom's reinsurance arrangements. However, no receivable from Telecom's reinsurers has been able to be recognised in the year ended 30 June 2011, due to these proceeds not yet being virtually certain.

Notes to the Condensed consolidated financial statements (continued)

NOTE 5 OTHER OPERATING EXPENSES

	Six months ended 30 June		Year ended 30 June	
	2011	2010	2011	2010
	Unaudited	Unaudited	Audited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Provisioning	22	20	42	40
Network support	42	34	89	81
Maintenance and other direct costs	94	86	181	168
Mobile acquisitions, upgrades and dealer commissions	118	127	244	295
Procurement and IT services	173	152	337	292
Broadband, internet and other	35	51	78	93
Computer costs	61	96	162	200
Advertising, promotions and communications	27	37	69	99
Accommodation costs	79	77	152	146
Outsourcing	10	16	22	36
Travel	7	11	20	24
Bad debts	8	10	18	17
Other expenses	33	91	81	166
	709	**808**	**1,495**	**1,657**

NOTE 6 DIVIDENDS AND EQUITY

Shares Issued in Lieu of Dividends

In respect of the year ended 30 June 2011, 3,388,197 shares with a total value of $7 million were issued in lieu of a cash dividend (year ended 30 June 2010: 55,196,482 shares with a total value of $128 million).

Dividends paid

The following dividends have been paid in the year ended 30 June 2011:

Approval date	Dividends per share	Total paid
(Dollars in millions)	cents	NZ$
19 August 2010	6.0	115
4 November 2010	3.5	67
4 November 2010 (supplementary)	0.6	10
10 February 2011	3.5	67
10 February 2011 (supplementary)	0.6	9
5 May 2011	3.5	68
5 May 2011 (supplementary)	0.6	9
		345

Notes to the Condensed consolidated financial statements (continued)

NOTE 6 DIVIDENDS AND EQUITY (continued)

Declaration of dividend

On 18 August 2011, the Board of Directors approved the payment of a fourth quarter dividend of $144 million, representing 7.5 cents per share, and a special dividend of $38 million, representing 2.0 cents per share. The dividends have been fully imputed (at a ratio of 28/72) in line with the corporate income tax rate. In addition, supplementary dividends totalling approximately $19 million and $5 million respectively will be payable to shareholders who are not resident in New Zealand. In accordance with the Income Tax Act 2007, Telecom will receive a tax credit from the Inland Revenue Department equivalent to the amount of supplementary dividends paid.

NOTE 7 RECONCILIATION OF NET EARNINGS ATTRIBUTABLE TO SHAREHOLDERS TO NET CASH FLOWS FROM OPERATING ACTIVITIES

	Year ended 30 June	
	2011	2010
	Audited	Audited
(Dollars in millions)	NZ$	NZ$
Net earnings for the period	166	382
Adjustments to reconcile net earnings to net cash flows from operating activities:		
Depreciation and amortisation	1,027	1,032
Bad and doubtful accounts	21	22
Increase / (decrease) in deferred income tax liability	(46)	104
Share of associates' (profits) / losses	(1)	(1)
Asset impairments	257	-
Other	(8)	(8)
Changes in assets and liabilities net of effects of non-cash and investing and financing activities:		
Decrease / (increase) in accounts receivable and related items	(27)	56
Decrease / (increase) in inventories	1	36
Decrease / (increase) in current taxation	30	67
Increase / (decrease) in accounts payable and related items	(71)	71
Net cash flows from operating activities	**1,349**	**1,761**

NOTE 8 CONTINGENCIES & COMMITMENTS

For further historic detail on the specific matters referred to below, please refer to Telecom's 2010 Annual Report, as well as the previously published versions of the condensed consolidated financial statements, all of which are available online at: http://investor.telecom.co.nz

New Zealand Commerce Act Litigation

The proceeding brought by the Commerce Commission under section 36 of the Commerce Act in relation to Telecom's implementation and maintenance of high speed data transmission service pricing remains active. In September 2010, Telecom filed its proposed evidence on data revenue for the penalty hearing in the High Court, and the Commerce Commission subsequently advised that it does not object to that evidence. The penalty hearing took place in December 2010, and a reserve judgment was delivered on 19 April 2011 ordering that Telecom pay a pecuniary penalty of $12 million. Telecom has paid this penalty but has also appealed the penalty judgment to the Court of Appeal. The liability and penalty appeal hearing has been set down for 26 September 2011 to 4 October 2011.

Notes to the Condensed consolidated financial statements (continued)

NOTE 8 CONTINGENCIES & COMMITMENTS (continued)

The proceeding commenced by the Commerce Commission in relation to Telecom's introduction of the 0867 service under section 36 of the Commerce Act was concluded with the delivery of the Supreme Court judgment on 1 September 2010, following a hearing in June 2010. The Supreme Court dismissed the Commerce Commission's appeal from the lower Courts' finding that Telecom had not breached section 36, and ordered the Commerce Commission to pay Telecom costs of $50,000 in the Supreme Court. Telecom is seeking to resolve its claim for High Court costs with the Commerce Commission.

Telecommunications Act Litigation

On 2 August 2011 Telecom and Vodafone announced that they had entered a full and final settlement of the various proceedings that they had initiated in relation to the Commerce Commission's TSO determinations for FY04, FY05, FY06, FY07 and FY08. The terms of the settlement are confidential to the parties. The settlement followed the Supreme Court hearing in February 2011 of Telecom's and Vodafone's appeals in respect of the determinations for FY04, FY05, and FY06. Telecom and Vodafone have advised the Commerce Commission and the Supreme Court of the settlement and now await the Commerce Commission's advice on whether the Commerce Commission wishes to proceed with its appeal, and the Supreme Court's decision on whether it will deliver a judgment in relation to the Commerce Commission's appeal (the Court has already indicated that it is unlikely to issue a judgment in respect of the Telecom and Vodafone appeals). Once the Supreme Court's decision and the Commerce Commission's position are known, Telecom will determine how to deal with any residual issues arising from the High Court's decision directing that the Commerce Commission re-determine the FY05 and FY06 determinations and the FY09 and FY10 determinations which are pending, awaiting the outcome of the Supreme Court proceedings.

In October 2010 the Commerce Commission announced the commencement of an investigation into Telecom's alleged breach of the Operational Separation Undertakings (the obligation not to discriminate) in respect of Chorus' provision of Sub Loop Extension Services ('SLES') and Telecom Wholesale's failure to provide Unbundled Bitstream Access ('UBA') with Sub Loop Unbundling ('SLU') and SLES. On 26 May 2011, the Commerce Commission announced that it had decided to issue enforcement proceedings alleging that Telecom is likely to have discriminated in breach of the Operational Separation Undertakings by failing to provide other telecommunications service providers with UBA in conjunction with SLES, when it provided an equivalent service to its own retail business. Any enforcement proceedings could include the Commerce Commission seeking compensation on behalf of other service providers. On 19 July 2011, CallPlus Limited and Kordia Limited lodged claims with Telecom (based on contract, estoppel and the Fair Trading Act) in relation to the same matter, although they have not commenced proceedings. The quantum of the claims is stated to be $65 million and $74 million respectively, but the claims would overlap with any service provider compensation that may be included in enforcement proceedings issued by the Commerce Commission.

Other litigation and investigations

The proceeding brought by Asia Pacific Telecommunications Limited ('APT') was settled in April 2011. The terms of the settlement are confidential to the parties. As a result of the settlement APT has discontinued its proceedings against Telecom.

Under New Zealand law and Inland Revenue Department ('IRD') practice, tax positions taken by Telecom remain subject to review and possible adjustment by the IRD, generally for a period of four years from the end of the tax year or return period in which the relevant tax return was provided. The IRD has reviewed Telecom's tax position with reference to interest income earned by Telecom subsidiaries tax resident outside of New Zealand. The IRD has taken the position (in a Notice of Proposed Adjustment ('NOPA') issued on 11 August 2011 in respect of the 2008 income year) that the income in question should be taxed as if it had been earned by a New Zealand tax resident. Telecom will be responding to the IRD NOPA by challenging the IRD position. If Telecom's position is not accepted by the IRD, amended assessments will be issued by the IRD, in which case it will be necessary for Telecom to bring proceedings before the Court seeking to have the amended assessments set aside. The amount of the tax liability contended for in the NOPA is around $23 million plus penalties of approximately $11 million. If the IRD is correct, Telecom would also be liable to use of money interest.

Notes to the Condensed consolidated financial statements (continued)

NOTE 8 CONTINGENCIES & COMMITMENTS (continued)

Effect of outstanding claims

Telecom has other ongoing claims, investigations and inquiries, none of which it currently believes are expected to have significant effect on the financial position or profitability of Telecom.

Telecom cannot reasonably estimate the adverse effect (if any) on Telecom if any of the foregoing outstanding claims or inquiries are ultimately resolved against Telecom's interests. There can be no assurance that such litigation or inquiries will not have a significant effect on Telecom's business, financial condition, position, results of operations or profitability.

Operating commitments

At 30 June 2011, capital expenditure amounting to $81 million (30 June 2010: $163 million) had been committed under contractual arrangements, with substantially all payments due within one year. The capital expenditure commitments principally relate to telecommunications network equipment.

At 30 June 2011, Telecom had other supplier commitments of $87 million, $105 million and $126 million for the years ending 30 June 2012, 2013 and 2014 respectively.

Collateral requirements

Telecom is required to post collateral to support the value of certain derivatives. As at 30 June 2011, US$91 million (NZ$110 million) of collateral was posted (30 June 2010: NZ$21 million) and is restricted in use by Telecom as collateral. In the event of a downgrade of Telecom’s credit rating to either Baa1 (Moody’s Investors Service), or BBB+ (Standard & Poor’s) US$65 million of additional collateral would be required to be posted.

NOTE 9 SIGNIFICANT EVENTS AFTER BALANCE DATE

On 8 June 2011, Telecom announced the sale of Gen-i’s Software Solutions business to Infosys for $5 million with the transaction completing in July 2011. The Software Solutions business had revenue of approximately $13 million for the year ended 30 June 2011.

As described in Note 6, Telecom has declared a dividend in respect of the three months ended 30 June 2011.

NOTE 10 TAXATION

The tax charge for the year ended 30 June 2011 of $111 million was $60 million lower than the tax charge of $171 million for the year ended 30 June 2010 and was primarily due to:

- an $83 million decrease in the current year tax charge as a result of the tax effect of lower earnings before income tax;
- an $18 million increase in the current year tax charge due to a reduction in the value of certain tax credits following changes in tax legislation in the year ended 30 June 2011.
- a $43 million reduction in tax charge in the prior year when these credits were recognised following the abolition of the conduit relief regime;
- a $38 million increase in tax charge in the prior year as a result of tax changes following the Taxation (Budget Measures) Act 2010 (being a $56 million increase relating to the future removal of tax depreciation on certain buildings partially offset by an $18 million decrease from the future reduction in the New Zealand company tax rate from 30% to 28%); and
- a number of offsetting other items including fewer Australian tax losses which do not give rise to a tax impact, a greater number of expenses that are not deductible for tax and the impact of Southern Cross dividends not subject to tax.

Notes to the Condensed consolidated financial statements (continued)

NOTE 10 TAXATION (continued)

The tax charge of $24 million for the six months ended 30 June 2011 was $113 million less than the charge of $137 million in the six months ended 30 June 2010. This is primarily due to a decrease in profit before tax in the current period, the Taxation (Budget Measures) Act 2011 and a greater number of expenses that are not deductible for tax which affected the six months ended 30 June 2010 as mentioned above.

NOTE 11 ASSET IMPAIRMENTS

	Six months ended 30 June		Year ended 30 June	
	2011	2010	2011	2010
	Unaudited	Unaudited	Audited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Impairment of telecommunications equipment	63	-	63	-
Impairment of software	194	-	194	-
	257	**-**	**257**	**-**

In the year ended 30 June 2011 there were non-cash impairment charges totalling $257 million resulting in the write-off of the carrying value of certain property, plant and equipment and intangible assets as presented above.

These impairments arose following Telecom's assessment of the Government's May 2011 announcement of the selection of parties for the FTTP UFB programme and the subsequent passing of the Telecommunications Amendment Act in June 2011, which seeks to ultimately move the New Zealand industry from a regulated copper path to a new fibre future. Management concluded that it was appropriate to impair certain assets that are expected to be stranded as a result of this longer-term change. Furthermore, regarding the commitment to Variation Four outcomes for Telecom Wholesale's FMO programme, management determined that the changes arising from Telecom's proposals relating to Variation Four have resulted in certain Wholesale regulatory assets also being impaired.

Certain material assets from the following programmes were assessed as being impaired at 30 June 2011:

- FNT - a regulatory programme to replace traditional PSTN voice with a VoIP service over copper broadband, which is no longer appropriate in a fibre-oriented world and is not expected to be launched to market.
- Retail NGT Stage 1 – Telecom's Retail NGT programme related to the delivery of a new customer relationship management and billing capability system. The stage 1 systems and processes were intended to allow customers to utilise the Primary Line VoIP service and were delivered by FNT. This is now not expected to be launched.
- Wholesale FMO assets – based on Telecom's expectation that the service improvement programme proposal under Variation Four will proceed, certain regulatory assets are now considered stranded.

Other than these impaired assets, which were fully written off, the remaining assets in these programmes have been identified for ongoing use, or reuse, by Telecom within the business. No other assets have been identified as being impaired in the year ended 30 June 2011.

No impairment arose as a result of the impairment review for the year ended 30 June 2010.