TCNZ Finance Limited

Annual Report

For the year ended 30 June 2010

Directors' Report

For the year ended 30 June 2010

TCNZ Finance Limited ('TCNZ Finance') is a wholly-owned subsidiary of Telecom Corporation of New Zealand Limited ('Telecom') and is the principal finance company for the Telecom group. TCNZ Finance was incorporated in 1991, established an Australian branch in 2001 and a Bermudian branch in 2004.

Principal activities

TCNZ Finance raises debt funding in New Zealand, and internationally. The majority of these funds are then advanced to other members of the Telecom group in order to assist in funding their operations.

Principal risks and uncertainties

The key risks to TCNZ Finance are foreign exchange rate, interest rate, credit, liquidity, and equity risks. A summary of those risks and TCNZ Finance's risk management objectives and policies are set out in notes 13 to 15 of these financial statements. The directors of TCNZ Finance do not believe there is any significant net risk to TCNZ Finance as financial assets are matched by financial liabilities with similar characteristics. There have been no material events or circumstances that have occurred subsequent to balance date that require disclosure.

TCNZ Finance enters into derivative financial instruments in order to manage the foreign exchange and interest rate risk associated with its borrowings as well as to manage the foreign exchange risk associated with the operations of the Telecom group. As the proceeds of debt are advanced to other members of the Telecom group, the ability of TCNZ Finance to meet its obligations under the debt issues depends upon the payment of the principal and the interest due from the other Telecom group companies.

Business review

TCNZ Finance recorded a net profit for the year ended 30 June 2010 of $139 million compared to a net profit of $26 million for the year ended 30 June 2009. The volatility in earnings is primarily caused by TCNZ Finance's exposure to movements in foreign exchange rates, which principally led to the $113 million increase in net earnings. The net foreign exchange loss for the year ended 30 June 2010 was $13 million, compared to a net loss of $126 million in the year ended 30 June 2009.

The net assets of TCNZ Finance as at 30 June 2010 were $1,526 million compared to $1,643 million as at 30 June 2009. The share capital of TCNZ Finance is $883 million (30 June 2009: $883 million), consisting of 882,872,600 issued and fully paid shares, of which 342,872,600 are ordinary shares. TCNZ Finance did not acquire any of its own shares during the year ended 30 June 2010 (30 June 2009: nil).

The directors of TCNZ Finance consider the results of the company to be satisfactory and the company to be in a sound financial position.

Directors' Report

For the year ended 30 June 2010

TCNZ Finance solely lends to other companies within the Telecom group and accordingly, its financial performance should be considered in conjunction with the financial performance of the Telecom group. A copy of the Telecom group's results for the year ended 30 June 2010 can be found at http://investor.telecom.co.nz or a copy can be requested from the registered office of TCNZ Finance.

General

Based on current expectations, TCNZ Finance will continue to operate as the principal finance company for the Telecom group. TCNZ Finance does not engage in research and development activities.

On behalf of the Board

Nicholas Olson
DIRECTOR
24 August 2010

Anthony Parker
DIRECTOR

Directors' Report
For the year ended 30 June 2010

Declaration pursuant to Article 3 (2) (c) of the Transparency Law dated 11 January 2008

We, Mr Nicholas Olson and Mr Anthony Parker, both directors of TCNZ Finance (herein after the 'Issuer'), hereby declare that, to the best of our knowledge, the financial statements for the year ended 30 June 2010, which have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards give a true and fair view of the assets, liabilities, financial position and profit or loss of the Issuer and that the directors' report includes a fair review of the development and performance of the business and the position of the Issuer, together with a description of the principal risks and uncertainties that the Issuer faces.

Nicholas Olson
DIRECTOR
24 August 2010

Anthony Parker
DIRECTOR

Other Information

For the year ended 30 June 2010

Directors

The directors of TCNZ Finance as at 30 June 2010 were:

Paul Reynolds	Chief Executive Officer, Telecom Corporation of New Zealand Limited
Tristan Gilbertson	Group General Counsel, Telecom Corporation of New Zealand Limited
Russ Houlden	Chief Financial Officer, Telecom Corporation of New Zealand Limited
Nicholas Olson	Group Controller, Telecom Corporation of New Zealand Limited
Anthony Parker	General Manager Finance, Telecom Corporation of New Zealand Limited

The directors of TCNZ Finance are all employees of the Telecom group.

Corporate governance

The board of Telecom is committed to ensuring that the Telecom group maintains international best practice governance structures and adheres to the highest ethical standards. TCNZ Finance operates within the corporate governance policies, practices and processes of the Telecom group. A full description of these are provided in the corporate governance section of the Telecom group annual report, that can be found at: http://investor.telecom.co.nz and can also be found on the website www.telecom.co.nz.

Interest register

Deeds of indemnity have been given to the directors of TCNZ Finance in relation to potential liabilities and costs that they may incur for acts or omissions in their capacities as directors of TCNZ Finance and as employees of the Telecom group. In addition, the directors of Telecom have approved directors and officers liability insurance to cover risks normally covered by such policies arising out of acts or omissions of directors of Telecom and of its subsidiaries, including TCNZ Finance and of employees of the Telecom group. The insurance does not cover dishonest, fraudulent, malicious or wilful acts.

Credit rating

Telecom (which guarantees TCNZ Finance's debt) has credit ratings from Standard & Poor's and Moody's Investors Service on its indebtedness. Details of current ratings as at 30 June 2010 are as follows:

Standard & Poor's
Long-term senior debt: A
Short-term debt: A-1
Outlook: negative

Moody's Investors Service
Long-term senior debt: A3
Short-term debt: P-2
Outlook: stable

On 4 August 2010, Standard & Poor's placed Telecom on credit watch with negative implications.

Other Information continued

For the year ended 30 June 2010

Other statutory information

None of the directors received any remuneration or other benefits from TCNZ Finance.

The Australian branch of TCNZ Finance has one employee. TCNZ Finance has no other employees.

TCNZ Finance made no charitable donations during the year.

As at 30 June 2010 no TCNZ Finance director held any TeleBonds. No TCNZ Finance director acquired or disposed of TeleBonds during the financial year.

TeleBond holder analysis as at 30 June 2010

Holding range	Holder count	Holder count %	Holding quantity $	Holding quantity %
2,000 to 4,999	33	1.1	93,992	0.0
5,000 to 9,999	360	11.8	2,253,076	0.4
10,000 to 49,999	1,712	55.9	36,715,857	6.5
50,000 to 99,999	506	16.5	29,654,359	5.2
100,000 to 499,999	377	12.3	60,784,572	10.7
500,000 to 999,999	37	1.2	22,447,355	3.9
1,000,000 and over	36	1.2	417,629,180	73.3
Total	3,061	100.0	569,578,391	100.0

The TeleBonds are issued pursuant to a trust deed dated 25 October 1988 between Telecom and the New Zealand Guardian Trust Company Limited.

Net tangible assets per security

Net tangible assets per security as at 30 June 2010 is $1.73 (30 June 2009: $1.86).

Income Statement

For the years ended 30 June 2010 and 2009

Year ended 30 June	Notes	2010 $m	2009 $m
Finance income	2	892	1,116
Finance expense	2	(660)	(894)
Net finance income		**232**	**222**
Other income	3	8	–
Other expenses	3	(35)	(164)
Net earnings before income tax		205	58
Income tax expense	4	(66)	(32)
Net earnings for the year		**139**	**26**

Statement of Comprehensive Income

For the years ended 30 June 2010 and 2009

Year ended 30 June	2010 $m	2009 $m
Net earnings for the year	139	26
Other comprehensive income		
Translation of foreign branches	1	(2)
Cash flow hedges	(6)	(28)
Income tax relating to components of other comprehensive income	(1)	5
Other comprehensive income/(loss) for the year net of tax	(6)	(25)
Total comprehensive income for the year	**133**	**1**

The accompanying notes form part of and are to be read in conjunction with these financial statements

Statement of Changes in Equity

For the years ended 30 June 2010 and 2009

	Contributed capital Number (m)	Contributed capital $m	Retained earnings $m	Hedge reserve $m	Foreign currency translation reserve $m	Total equity $m
Balance as at 1 July 2009	**883**	**883**	**757**	**(17)**	**20**	**1,643**
Net earnings for the year	–	–	139	–	–	139
Other comprehensive income for the year[1]	–	–	–	(4)	(2)	(6)
Total recognised income and expenses	–	–	139	(4)	(2)	133
Dividend paid	–	–	(250)	–	–	(250)
Balance as at 30 June 2010	**883**	**883**	**646**	**(21)**	**18**	**1,526**

	Contributed capital Number (m)	Contributed capital $m	Retained earnings $m	Hedge reserve $m	Foreign currency translation reserve $m	Total equity $m
Balance as at 1 July 2008	**883**	**883**	**731**	**3**	**25**	**1,642**
Net earnings for the year	–	–	26	–	–	26
Other comprehensive income for the year[1]	–	–	–	(20)	(5)	(25)
Total recognised income and expenses	–	–	26	(20)	(5)	1
Balance as at 30 June 2009	**883**	**883**	**757**	**(17)**	**20**	**1,643**

[1] Other comprehensive income components are shown net of tax.

The accompanying notes form part of and are to be read in conjunction with these financial statements

Statement of Financial Position

As at 30 June 2010 and 2009

As at 30 June	Notes	2010 $m	2009 $m
ASSETS			
Current assets:			
Cash		216	83
Accounts receivable		–	1
Income tax receivable		–	17
Due from other Telecom group companies	5	2,029	3,869
Short-term derivative assets	6	19	32
Total current assets		2,264	4,002
Non-current assets:			
Due from other Telecom group companies	5	11,469	11,559
Long-term derivative assets	6	109	97
Investments	7	540	540
Total non-current assets		12,118	12,196
Total assets		**14,382**	**16,198**
LIABILITIES AND EQUITY			
Current liabilities:			
Income tax payable		27	–
Due to other Telecom group companies	8	9,995	11,447
Short-term derivative liabilities	6	25	44
Debt due within one year	9	191	390
Accrued interest		38	36
Total current liabilities		10,276	11,917
Non-current liabilities:			
Long-term derivative liabilities	6	439	343
Long-term debt	10	2,137	2,288
Deferred tax liability	11	4	7
Total non-current liabilities		2,580	2,638
Total liabilities		**12,856**	**14,555**
Equity:			
Share capital		883	883
Reserves		(3)	3
Retained earnings		646	757
Total equity	12	1,526	1,643
Total liabilities and equity		**14,382**	**16,198**

On behalf of the Board of TCNZ Finance Limited

Nicholas Olson
DIRECTOR

Anthony Parker
DIRECTOR

Authorised for issue on 24 August 2010

The accompanying notes form part of and are to be read in conjunction with these financial statements

Statement of Cash Flow

For the years ended 30 June 2010 and 2009

Year ended 30 June	Note	2010 $m	2009 $m
Cash flows from operating activities			
Interest income		892	1,116
Interest paid on debt		(652)	(887)
Net cash flows from operating activities	21	240	229
Cash flows from investing activities			
Net advances to/(from) other Telecom group companies		378	325
Payments on settlement of forward exchange contracts		(36)	(98)
Receipts from settlement of forward exchange contracts		12	12
Net cash flow applied to investing activities		354	239
Cash flows from financing activities			
Proceeds from long-term debt		–	400
Repayment of long-term debt		(20)	(771)
Proceeds from short-term debt		1,651	1,587
Repayment of short-term debt		(1,842)	(1,626)
Dividend paid		(250)	–
Net cash flow applied to financing activities		(461)	(410)
Net cash flow		133	58
Net cash at beginning of period		83	25
Net cash position at end of period		**216**	**83**

The accompanying notes form part of and are to be read in conjunction with these financial statements

Notes to the Financial Statements

For the year ended 30 June 2010

Note 1 Statement of accounting policies

(a) Constitution, ownership and activities

TCNZ Finance is a profit-oriented company and was incorporated in New Zealand on 19 July 1991 in the name of Randori Holdings Limited as a wholly-owned subsidiary of Telecom Corporation of New Zealand Limited (the 'parent company'). Randori Holdings Limited changed its name to TCNZ Finance Limited effective 18 September 1991 and re-registered under the Companies Act 1993 on 31 January 1997. TCNZ Finance Limited Australian Branch ('Australian Branch') was established on 13 July 2001. On 7 December 2004 TCNZ Finance established TCNZ Finance Bermudian Branch ('Bermudian Branch'). These financial statements include the activities of TCNZ Finance, the Australian Branch and the Bermudian Branch and have been prepared in accordance with the Financial Reporting Act 1993, the Securities Act 1978 and the Securities Regulations 1983.

The principal activity of TCNZ Finance is that of a finance company for the parent company and its subsidiaries (the 'Telecom group'). In these accounts the term fellow subsidiaries is used to describe other subsidiaries of the parent company.

These financial statements are expressed in New Zealand dollars, which is the Company's functional currency. References in these financial statements to '$' and 'NZ$' are to New Zealand Dollars, references to 'US$' and 'USD' are to US Dollars, references to 'A$' and 'AUD' are to Australian Dollars, references to 'CAD' are to Canadian Dollars, references to 'EUR' are to Euros, references to 'GBP' are to Pounds Sterling, references to 'JPY' are to Japanese Yen and references to 'CHF' are to Swiss Francs. All financial information presented in New Zealand dollars, US Dollars, Australian Dollars, Swiss Francs, Euros, Pounds Sterling and Japanese Yen have been rounded to the nearest million, unless otherwise stated.

(b) Basis of preparation

These financial statements comply with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board. They have been prepared in accordance with the Financial Reporting Act 1993, which requires compliance with generally accepted accounting practice in New Zealand. They comply with New Zealand equivalents to International Financial Reporting Standards ('NZ IFRS') as appropriate for profit-oriented entities.

The measurement basis adopted in the preparation of these financial statements is historical cost, modified by the revaluation of financial instruments as identified in the specific accounting policies below and the accompanying notes.

The financial statements were approved by the directors of TCNZ Finance on 24 August 2010.

(c) Specific accounting policies

As described below, these accounting policies have been applied consistently to all periods presented in these financial statements.

Finance income and expense

Interest income and expense is recognised on an effective interest rate method.

Notes to the Financial Statements

For the year ended 30 June 2010

Note 1 Statement of accounting policies (continued)

Accounts receivable

Accounts receivable are recorded initially at fair value and subsequently measured at amortised cost using the effective interest method, less any provision for impairment losses due to bad and doubtful accounts. The provision for doubtful debts is based on management's assessment of amounts considered uncollectable for specific customers or groups of customers based on age of debt, history of payments, account activity, economic factors and other relevant information. The amount of the provision is the difference between the asset's unamortised cost and the present value of estimated future cash flows, discounted at the effective interest rate. Any provision is recognised in the income statement.

Bad debts are written off against the provision for doubtful accounts in the period in which it is determined that the debts are uncollectable. If those debts are subsequently collected, then a gain is recognised in the income statement.

Cash

Cash is considered to be cash on hand, in banks, restricted cash pledged as collateral and short-term investments or deposits with an original maturity date of less than three months. Bank overdrafts that are repayable on demand and form an integral part of TCNZ Finance's cash management are included as a component of cash and cash equivalents for the purpose of the cash flow statement. Cash and cash equivalents are recorded initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

In addition, cash flows from certain items are disclosed net, due to the short-term maturities and volume of transactions involved, or where right of set-off is available.

Investments

Investments fall into the following categories: loans and receivables or available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired and is re-evaluated by management at each reporting date.

Investments are initially recognised at fair value plus transaction costs. Subsequent to initial recognition, investments in fellow subsidiaries (classified as available for sale) are held at cost and tested for impairment on an annual basis.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not traded in an active market. These assets are carried at amortised cost using the effective interest method.

Debt

Debt is recognised initially at fair value less attributable transactions costs. Subsequent to initial recognition, debt is stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate method, unless the debt is in a designated fair value relationship, in which case it is carried at fair value.

Notes to the Financial Statements

For the year ended 30 June 2010

Note 1 Statement of accounting policies (continued)

Taxation

The taxation expense charged to earnings includes both current and deferred tax. Current tax is calculated on the basis of the tax laws enacted, or substantively enacted at the balance sheet date.

Deferred taxation is recognised, using the liability method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Future tax benefits are recognised where realisation of the asset is probable.

Current tax and deferred tax are recognised in the income statement except when the tax relates to items charged or credited directly to other comprehensive income or equity, in which case the tax is also recognised in other comprehensive income or equity.

Impairment of non-derivative financial assets

The carrying amount of TCNZ Finance's non-derivative financial assets is reviewed at each balance sheet date to determine whether there is any objective evidence of impairment.

Derivative financial instruments

TCNZ Finance uses derivative financial instruments to reduce the Telecom group's exposure to fluctuations in foreign currency exchange rates and interest rates.

Cash flow hedges are designated as hedges of highly probable forecast transactions.

Gains and losses on fair value hedges are included in the income statement together with any changes in the fair value of the hedged asset or liability.

Derivatives are initially recognised at fair value. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are initially recognised in other comprehensive income and held in the hedge reserve in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified in the income statement in the periods when the hedged item will affect profit or loss. When a hedging instrument expires or is sold, or a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in the cash flow hedge reserve at that time remains in the hedge reserve until the underlying physical exposure occurs.

For an instrument to qualify as a hedge, at the inception of the derivative transaction the relationship between hedging instruments and hedged items must be documented, as must the Company's risk management objective and strategy for undertaking various hedge transactions. On an ongoing basis the Company must document whether the hedges are highly effective in offsetting changes in fair values of cash flows or hedged items.

The movement in the fair value of derivative financial instruments that do not qualify, or no longer qualify, as hedges is recognised in the income statement.

Notes to the Financial Statements

For the year ended 30 June 2010

Note 1 Statement of accounting policies (continued)

The foreign exchange gains and losses on the principal value of cross-currency swaps are reflected in the income statement using the spot rate, which offsets the foreign exchange gains and losses recorded on the underlying hedged transaction.

Cash flows from derivatives are recognised in the statement of cash flow in the same category as that of the hedged item.

Foreign currencies

Transactions denominated in a foreign currency are converted at the exchange rate at the date of the transaction. Foreign currency receivables and payables at balance date are translated at exchange rates current at balance date. Unrealised and realised exchange gains and losses are brought to account in determining the net earnings for the year.

Translation of foreign branches

Assets and liabilities of the Australian and Bermudian branches are translated at exchange rates current at balance date. Revenues and expenses are translated at rates approximating the exchange rates at the dates of the transactions. The exchange gain or loss arising on translation of the Australian branch is recorded in the foreign currency translation reserve.

Comparatives

Certain comparative information has been reclassified to conform with the current year's presentation.

(d) Use of estimates and judgement

The principal areas of judgement in preparing these financial statements are set out below.

Valuation of investments

Management performs an assessment of the carrying value of long-term investments at least annually. In assessing whether there has been impairment, consideration is given to the financial performance of the investee and other factors that impact management's expectation of recovering the value of the investment. This assessment also requires management to make judgements about the expected future performance and cash flows of the investee in order to determine the fair value of investments.

(e) Changes in accounting policies

TCNZ Finance has adopted NZ IAS 1 'Presentation of Financial Statements (revised 2007)' ('IAS 1') with effect from 1 July 2009. The revised Standard has introduced a number of terminology changes (including revised titles for the financial statements) and has resulted in a number of changes in presentation and disclosure. The amendments to NZ IFRS 7 'Financial Instruments' ('IFRS 7') have expanded the disclosures required in respect of fair value measurements and liquidity risk. TCNZ Finance has elected not to provide comparative information for these expanded disclosures in the current year in accordance with the transitional relief offered in these amendments.

Notes to the Financial Statements

For the year ended 30 June 2010

2 Finance income and expense

Year ended 30 June	2010 $m	2009 $m
Finance income:		
Interest income on loans to other Telecom group companies	887	1,091
Interest income from deposits	4	12
Other interest income	1	13
Total finance income	**892**	**1,116**
Finance expense:		
Finance expense on long-term debt:		
– Euro Medium Term Notes ('EMTN')[1]	154	187
– TeleBonds	43	44
Revaluation of interest rate derivative	2	(5)
Interest expense on loans from other Telecom group companies	439	639
Other interest and finance expense	22	29
Total finance expense	**660**	**894**

[1] Includes $68 million reclassified from the cash flow hedge reserve for the year ended 30 June 2010 (30 June 2009:$66 million).

3 Other income and expenses

Year ended 30 June	2010 $m	2009 $m
Other income:		
Net realised foreign exchange gains	8	–
Total other income	**8**	**–**
Other expenses:		
Net unrealised foreign exchange losses	21	30
Net realised foreign exchange losses	–	96
Revaluation of derivatives	13	35
Other operating expenses	1	3
Total other expenses	**35**	**164**

Administration costs, including audit fees for the period of $27,788 (30 June 2009: $29,250) have been recorded by a fellow subsidiary company.

No fees or other remuneration have been paid to the directors by TCNZ Finance in respect of services provided by the directors to TCNZ Finance. The directors of TCNZ Finance receive remuneration from a fellow subsidiary company.

Notes to the Financial Statements

For the year ended 30 June 2010

4 Income tax

Year ended 30 June	2010 $m	2009 $m
Current tax expense/(credit)	67	40
Deferred tax expense/(credit)	(1)	(8)
	66	**32**
Reconciliation of income tax expense:		
Net earnings before income tax	205	58
Tax at current rate of 30%	61	17
Adjustments to taxation:		
Non-taxable foreign exchange losses	8	13
Adjustment in respect of prior periods	–	2
Adjustment in respect of change in tax legislation	(3)	–
Income tax expense	**66**	**32**

5 Due from other Telecom group companies

30 June	2010 $m	2009 $m
Current assets:		
Advances to the parent company	285	281
Advances to fellow subsidiaries	1,744	3,588
	2,029	**3,869**
Non-current assets:		
Advances to the parent company	3,972	3,972
Debentures issued by fellow subsidiary	3,157	3,190
Advances to fellow subsidiaries	4,340	4,397
	11,469	**11,559**
Total due from other Telecom group companies	**13,498**	**15,428**

Current amounts due from fellow Australian subsidiary companies have interest rates of 3.8% (30 June 2009: 3.6%). Current amounts due from the parent company and New Zealand subsidiary companies have interest rates of 10% for all periods disclosed above. These amounts are repayable at the option of TCNZ Finance and the parent company and fellow subsidiary companies.

The term advances to the parent company and fellow subsidiary companies have interest rates between 3.2% and 10.0% (30 June 2009: 2.7% and 10.0%). These advances can be redeemed at book value at the option of either party. For purposes of classification between current and non-current assets in the balance sheet these items have been allocated based upon expected realisation.

Notes to the Financial Statements

For the year ended 30 June 2010

5 Due from other Telecom group companies (continued)

The debentures pay interest according to either the profitability of the fellow subsidiary or the payment of dividends on certain classes of shares issued by the fellow subsidiary. The debentures are denominated in Australian dollars and are redeemable at the option of TCNZ Finance.

6 Derivative assets and liabilities

30 June	2010 Fair value $m	2009 Fair value $m
Short-term derivative assets:		
Forward exchange contracts	19	32
	19	**32**
Long-term derivative assets:		
Forward exchange contracts	9	8
Cross-currency interest rate swaps	100	89
	109	**97**
Short-term derivative liabilities:		
Forward exchange contracts	20	44
Interest rate swaps	5	–
	25	**44**
Long-term derivative liabilities:		
Forward exchange contracts	4	7
Cross-currency interest rate swaps	294	212
Interest rate swaps	141	124
	439	**343**

Notional amounts of derivative financial instruments:

30 June	Currency	Maturities	2010 $m	2009 $m
Cross-currency interest rate swaps	AUD:USD	2011	594	600
	NZD:GBP	2018-2020	1,082	1,082
	NZD:CAD	2013	378	378
	NZD:CHF	2012	258	258
Interest rate swaps	AUD	2011	458	463
	NZD	2010-2020	1,739	1,729

Notes to the Financial Statements

For the year ended 30 June 2010

6 Derivative assets and liabilities (continued)

30 June	Currency	Maturities	2010 $m	2009 $m
Forward exchange contracts	NZD:AUD	2010-2011	342	334
	NZD:USD	2010-2013	311	652
	NZD:EUR	2010-2011	175	94
	Other	2009-2010	156	79
Currency options	NZD:EUR	2009-2010	22	42
	NZD:USD	–	–	81
	NZD:AUD	–	–	23

Certain derivatives are in cash flow hedging relationships where those derivatives meet certain criteria and are deemed an effective hedge. The change in the mark-to-market fair value of these derivatives is recognised directly in the hedge reserve within other comprehensive income. The movement in the fair value of all other derivatives has been recognised in the income statement.

All derivative financial assets and liabilities are expected to be held to maturity. As at 30 June 2010 the expected net contractual settlement, being the contractual amounts at current foreign exchange and interest rates, was a liability of $326 million compared to a fair value liability of $336 million.

7 Investments

30 June	2010 $m	2009 $m
Redeemable shares held in fellow subsidiary	540	540
	540	**540**

The redeemable shares held in a fellow subsidiary company do not confer voting rights to TCNZ Finance and are redeemable at the option of TCNZ Finance. The investment has been classified as a non-current asset based upon expected realisation.

Notes to the Financial Statements

For the year ended 30 June 2010

8 Due to other Telecom group companies

30 June	2010 $m	2009 $m
Due to the parent company	1,626	476
Due to fellow subsidiary companies	8,369	10,971
	9,995	**11,447**

Current amounts due to Australian subsidiary companies have interest rates of 2.8% (30 June 2009: 2.7%). Current amounts due to the parent company and New Zealand subsidiary companies have interest rates of 6.0% for all periods disclosed above. The amounts due to the parent company and the balance due to fellow subsidiary companies are repayable at book value at the option of either the parent company, fellow subsidiary companies or TCNZ Finance.

9 Debt due within one year

30 June	2010 $m	2009 $m
Long-term debt maturing within one year *(see Note 10)*	28	20
Promissory notes	30	179
Commercial paper	24	93
European commercial paper	109	98
	191	**390**

At 30 June 2010 the promissory notes had a weighted average interest rate of 3.6% (30 June 2009: 3.5%). Notes are issued under TCNZ Finance's $500 million Note Facility.

At 30 June 2010 commercial paper had a weighted average interest rate of 5.3% (30 June 2009: 3.9%). The commercial paper was issued under TCNZ Finance's A$1.5 billion Short Term Note and Medium Term Note Programme.

At 30 June 2010 European commercial paper had a weighted average interest rate of 0.7%. (30 June 2009: 1.7%). The European commercial paper was issued under TCNZ Finance's US$1 billion European Commercial Paper programme.

Notes to the Financial Statements

For the year ended 30 June 2010

10 Long-term debt

30 June	2010 $m	2009 $m
TeleBonds	570	589
European Medium Term Notes ('EMTN')	1,603	1,728
	2,173	2,317
Less unamortised discount	(8)	(9)
	2,165	2,308
Less long-term debt maturing within one year *(see Note 9)*	(28)	(20)
	2,137	**2,288**

None of Telecom's debt is secured and all rank equally with other liabilities. There are no financial covenants over TCNZ Finance's debt. TCNZ Finance's debt contains certain event of default triggers, as defined in the various debt agreements. There have been no events of default over TCNZ Finance's debt in the years ended 30 June 2010 and 30 June 2009.

TeleBonds

TeleBonds are issued under a trust deed between the parent company and The New Zealand Guardian Trust Company Limited dated 25 October 1988, pursuant to which the parent company, TCNZ Finance and certain of TCNZ Finance's fellow subsidiaries (the 'Guaranteeing Group') have given a negative pledge that while any of the stock issued under that trust deed remains outstanding they will not, subject to certain exceptions, create or permit to exist any charge or lien over any of their respective assets. Each member of the Guaranteeing Group has guaranteed the payment of the TeleBond debt, including interest.

TeleBonds are denominated in New Zealand dollars and have interest rates ranging from 6.9% to 8.7% (30 June 2009: 6.9% to 8.7%) and maturity dates between September 2010 and April 2016.

During the year ended 30 June 2010, $20 million of TeleBonds matured and were repaid (30 June 2009: $41 million).

TCNZ Finance issued no long-term debt during the year ending 30 June 2010.

Euro Medium Term Notes

TCNZ Finance Limited launched a US$1 billion Euro Medium Term Notes ('EMTN') programme in March 2000. In May 2001 the programme was increased to US$2 billion. In 2001 the Australian branch was added as an issuer under the programme and the Bermudian branch was added in 2005. Both public debt transactions and private placements can be issued under the programme.

Notes to the Financial Statements

For the year ended 30 June 2010

10 Long-term debt (continued)

Interest rate	Due	Face Value	Currency	Hedged currency rate	30 June 2010 $m	30 June 2009 $m
6.8%	14 Dec 2011	250m	USD	0.42	361	383
4.4%	6 Aug 2012	200m	CHF	0.77	267	283
4.8%	11 Oct 2013	275m	CAD	0.73	377	364
5.6%	14 May 2018	125m	GBP	0.36	272	317
5.8%	6 Apr 2020	150m	GBP	0.39	326	381
					1,603	1,728

Cross-currency and interest rate swaps have been entered into to manage the currency and interest rate risk exposures from EMTN issues. The effective New Zealand dollar interest rates range from 7.2% to 8.9%.

The US$250 million issue maturing December 2011 has pricing triggers in the event of a rating downgrade. These triggers would require Telecom's long-term ratings from Standard & Poor's/ Moody's Investors Service to fall below A-/A3 before increased interest rates would apply.

On 6 August 2008 TCNZ Finance issued a four-year CHF200 million bond (NZ$258 million) under the US$2 billion EMTN Programme. The bond has an effective hedged fixed interest rate of 8.9%.

TCNZ Finance repaid GBP200 million (NZ$690 million) and JPY2 billion (NZ$41 million) during the year ended 30 June 2009.

Notes to the Financial Statements

For the year ended 30 June 2010

11 Deferred tax

30 June	2010 $m	2009 $m
Balance at beginning of the year	(7)	(8)
Amounts recognised in profit and loss:		
Relating to current period	1	8
Amounts recognised in equity:		
Relating to current period	2	(7)
Deferred tax asset/(liability)	**(4)**	**(7)**
The deferred tax balance consists of:		
Fair value of derivatives	(4)	(7)

TCNZ Finance has not recognised in its deferred taxation balance the tax effect of accumulated losses amounting to $286 million at 30 June 2010 (30 June 2009: $244 million) based on the relevant corporation tax rate, because future realisation of the asset is not considered probable.

On 27 May 2010 the New Zealand Government enacted the Taxation (Budget Measures) Act 2010, which changes the effective rate at which Telecom's temporary differences will reverse, from 30% to 28%, effective from the year beginning 1 July 2011. Deferred tax assets and liabilities that will reverse on or after this date have been revalued accordingly. The impact on the deferred tax balance as at 30 June 2010 was nil.

Notes to the Financial Statements

For the year ended 30 June 2010

12 Equity

Contributed capital

As at 30 June 2010 contributed capital consisted of 882,872,600 issued and fully paid shares, of which 342,872,600 were ordinary shares. Each of the shares confers on the holder the right to vote at any general meeting of TCNZ Finance. 540,000,000 of the shares are redeemable at the option of TCNZ Finance, in accordance with the terms of its constitution. No other conditions are attached to the ordinary and redeemable shares. There is no par value on the ordinary shares issued by TCNZ Finance.

Hedging reserve

The hedging reserve is used to record changes in fair value of derivatives that are designated as cash flow hedges. Amounts accumulated in equity are reclassified in the income statement in the periods when the hedged item will affect profit or loss.

Foreign currency translation reserve

Exchange differences arising on translation of foreign branches are taken to the foreign currency translation reserve, as described in Note 1.

Dividend

TCNZ Finance paid a dividend of $250 million to the parent company during the year ending 30 June 2010.

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management

TCNZ Finance manages its treasury activities through Telecom Corporation of New Zealand Limited's board-approved treasury constitution consisting of treasury governance and policy frameworks. TCNZ Finance is exposed to foreign currency, interest rate, credit, liquidity and equity risks. Each of these risks, the associated financial instruments and the management of those risks are detailed in this note.

Financial Instruments

TCNZ Finance's financial instruments are classified under NZ IFRS as follows:

30 June 2010	Held for trading $m	Available for sale $m	Loans and receivables $m	Held to maturity $m	Designated in hedging relationships $m	Amortised cost $m	Total carrying amount $m
Assets							
Current assets							
Cash	–	–	–	216	–	–	216
Due from other Telecom group companies	–	–	2,029	–	–	–	2,029
Short-term derivative assets	19	–	–	–	–	–	19
	19	**–**	**2,029**	**216**	**–**	**–**	**2,264**
Non-current assets							
Due from other Telecom group companies	–	–	11,469	–	–	–	11,469
Long-term derivative assets	62	–	–	–	47	–	109
Investments	–	540	–	–	–	–	540
	62	**540**	**11,469**	**–**	**47**	**–**	**12,118**
Liabilities							
Current liabilities							
Due to other Telecom group companies	–	–	–	–	–	(9,995)	(9,995)
Short-term derivative liabilities	(20)	–	–	–	(5)	–	(25)
Short-term debt	–	–	–	–	–	(163)	(163)
Long-term debt due within one year	–	–	–	–	–	(28)	(28)
	(20)	**–**	**–**	**–**	**(5)**	**(10,186)**	**(10,211)**
Non-current liabilities							
Long-term derivative liabilities	(53)	–	–	–	(386)	–	(439)
Long-term debt	–	–	–	–	–	(2,137)	(2,137)
	(53)	**–**	**–**	**–**	**(386)**	**(2,137)**	**(2,576)**

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

30 June 2009	Held for trading $m	Available for sale $m	Loans and receivables $m	Held to maturity $m	Designated in hedging relationships $m	Amortised cost $m	Total carrying amount $m
Assets							
Current assets							
Cash	–	–	–	83	–	–	83
Due from other Telecom group companies	–	–	3,869	–	–	–	3,869
Short-term derivative assets	32	–	–	–	–	–	32
	32	**–**	**3,869**	**83**	**–**	**–**	**3,984**
Non-current assets							
Due from other Telecom group companies	–	–	11,559	–	–	-	11,559
Long-term derivative assets	29	–	–	–	68	–	97
Investments	–	540	–	–	–	–	540
	29	**540**	**11,559**	**–**	**68**	**–**	**12,196**
Liabilities							
Current liabilities							
Due to other Telecom group companies	–	–	–	–	–	(11,447)	(11,447)
Short-term derivative liabilities	(44)	–	–	–	–	–	(44)
Short-term debt	–	–	–	–	–	(20)	(20)
Long-term debt due within one year	–	–	–	–	–	(370)	(370)
	(44)	**–**	**–**	**–**	**–**	**(11,837)**	**(11,881)**
Non-current liabilities							
Long-term derivative liabilities	(50)	–	–	–	(293)	–	(343)
Long-term debt	–	–	–	–	–	(2,288)	(2,288)
	(50)	**–**	**–**	**–**	**(293)**	**(2,288)**	**(2,631)**

Reclassifications

There have been no reclassifications between financial instrument categories during the years ended 30 June 2010 and 30 June 2009.

Fair value of financial instruments

Under IFRS, financial instruments are either carried at cost or amortised cost, less any provision for impairment, or fair value. The only significant variances between amortised cost and fair value relate to long-term debt and long-term investments.

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

The table below categorises Telecom's financial assets and liabilities that are measured at fair value by the significance of the inputs used in making the measurements, as prescribed in IFRS 7:

Level 1: fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

Level 3: fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Group	**Level 1**	**Level 2**	**Level 3**	**Total**
30 June 2010	**$m**	**$m**	**$m**	**$m**
Financial Assets				
Short-term derivative assets	–	19	–	19
Long-term derivative assets	–	109	–	109
	–	**128**	**–**	**344**
Financial Liabilities				
Short-term derivative liabilities	–	(25)	–	(25)
Long-term derivative liabilities	–	(439)	–	(439)
	–	**(464)**	**–**	**(464)**

There were no transfers between level 1 and level 2 in the period.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Long-term investments

Long-term investments held in a fellow subsidiary company are carried at $540 million (30 June 2009: $540 million) and consisted of investments in equity.

The fair value of TCNZ Finance's long-term investment is difficult to value considering there is no active market price. As the Telecom group's telecommunications network is highly integrated it is difficult to separately identify and measure the cash flows of the investment in the fellow subsidiary company. The range of fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed and therefore the company is precluded from measuring its investment at fair value. Given the lack of a reliable fair value, TCNZ Finance continues to hold its investment at cost.

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

Long-term debt

The fair value of long-term debt (calculated based on the present value of future principal and interest cash flows, discounted at market interest rates at balance date) was $2,293 million compared to a carrying value of $2,165 million (30 June 2009: fair value of $2,253 million compared to a carrying value of $2,308 million).

In addition to the above carrying value of long-term debt, accrued interest payable of $38 million (30 June 2009: $36 million) is recorded in the statement of financial position.

Based on currently available information, TCNZ Finance anticipates that long-term debt will remain outstanding until maturity and, accordingly, settlement at the reported fair value of these financial instruments is unlikely.

Cash, short-term investments, short-term debt and amounts due to/from other Telecom group companies

The carrying amounts of these balances are approximately equivalent to their fair value because of the short term to maturity.

Cross-currency interest rate swaps, interest rate swaps, forward exchange contracts and currency options

The fair values are estimated on the basis of the quoted market prices of these instruments. If a listed market price is unavailable, then a fair value is estimated by discounting the future cash flows of the derivative using an applicable forward rate (for the relevant interest rate, foreign exchange rate or commodity price), discount rates and market accepted valuation models as appropriate.

Other assumptions

NZD forward interest rates used to determine fair values range from 2.9% to 7.1%.

Guarantees

TCNZ Finance has issued bank guarantees totalling A$8 million as at 30 June 2010 (30 June 2009: A$5 million) in relation to the lease payments of another Telecom group company. As at 30 June 2010 it is considered unlikely that this guarantee will be called upon.

Risk management

TCNZ Finance is exposed to market risk due to foreign currency, interest rates, credit risk, liquidity risk and equity price risk.

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

Market risk

TCNZ Finance is exposed to market risk primarily from changes in foreign currency exchange rates and interest rates. TCNZ Finance employs risk management strategies, including the use of derivatives, such as interest rate swaps, forward exchange contracts, foreign currency options and cross-currency interest rate swaps to manage these exposures. TCNZ Finance monitors the use of derivative financial instruments through the use of well-defined market and credit risk limits and timely reports to senior management. TCNZ Finance does not hold or issue derivative financial instruments for trading purposes. All contracts have been entered into with major creditworthy financial institutions and the risk associated with these transactions is the cost of replacing these agreements at the current market rates in the event of default by the counterparts. TCNZ Finance's financial instruments do not have significant concentration of risk with any single party.

Currency risk

The majority of TCNZ Finance's long-term debt has been issued in foreign currencies. TCNZ Finance enters into cross-currency interest rate swaps to convert issue proceeds into a floating rate New Zealand dollar or Australian dollar exposure.

TCNZ Finance enters into forward exchange contracts and foreign currency options to protect the Telecom group from the risk that the eventual New Zealand dollar net cash flows will be adversely affected by changes in foreign currency exchange rates. Forward exchange contracts and foreign currency options are used to hedge the Telecom group's forecast transactions that have a high probability of occurrence and firm purchase commitments in fellow subsidiaries (mainly denominated in US dollars). Forward exchange contracts are also used to hedge foreign currency assets and net investments in foreign operations held by the Telecom group. These foreign currency options and forward exchange contracts are not designated as hedging instruments and are therefore classified as held for trading.

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

TCNZ Finance's exposures to foreign currencies arising from financial instruments is:

30 June 2010	AUD NZ$m	USD NZ$m	GBP NZ$m	CAD NZ$m	CHF NZ$m	EUR NZ$m	Total NZ$m
Exposures							
Cash	5	45	–	–	–	–	50
Short-term debt	(25)	–	–	–	–	(109)	(134)
Long-term debt	–	(360)	(595)	(376)	(266)	–	(1,597)
Due from other Telecom group companies	3,258	9	270	–	–	–	3,537
Due to other Telecom group companies	(177)	(34)	–	–	–	–	(211)
Total exposure from non-derivative financial instruments	**3,061**	**(340)**	**(325)**	**(376)**	**(266)**	**(109)**	**1,645**
Hedging instruments							
Foreign exchange contracts	(418)	–	–	–	–	109	(309)
NZD cross-currency interest rate swaps	–	–	325	376	266	–	967
AUD cross-currency interest rate swaps	(593)	360	–	–	–	–	(233)
Total exposure from hedging instruments	**(1,011)**	**360**	**325**	**376**	**266**	**109**	**425**

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

30 June 2009	AUD NZ$m	USD NZ$m	GBP NZ$m	CAD NZ$m	CHF NZ$m	EUR NZ$m	Total NZ$m
Exposures							
Cash	9	28	–	–	–	–	37
Short-term debt	(93)	(38)	–	–	–	(60)	(191)
Long-term debt	–	(381)	(694)	(363)	(282)	–	(1,720)
Due from other Telecom group companies	3,190	9	315	–	–	–	3,514
Due to other Telecom group companies	(57)	–	–	–	–	–	(57)
Net balance sheet exposure	**3,049**	**(382)**	**(379)**	**(363)**	**(282)**	**(60)**	**1,583**
Hedging instruments							
Foreign exchange contracts	(371)	(15)	–	–	–	60	(326)
NZD cross-currency interest rate swaps	–	–	379	363	282	–	1,024
AUD cross-currency interest rate swaps	(600)	381	–	–	–	–	(219)
Total exposure from hedging instruments	**(971)**	**366**	**379**	**363**	**282**	**60**	**479**

Certain Australian dollar-denominated assets of the Telecom group are hedged by TCNZ Finance.

As at 30 June 2010 a movement of 10% in the New Zealand dollar would impact TCNZ Finance's income statement and statement of changes in equity as detailed in the table below:

30 June	2010		2009	
	-10%	+10%	-10%	+10%
Impact on:	$m	$m	$m	$m
Net earnings before tax	253	(201)	242	(190)
Equity (before income tax)	(19)	18	(7)	8

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

This analysis assumes a movement in the New Zealand dollar across all currencies and only includes the effect of foreign exchange movements on financial instruments. All other variables remain constant.

The effects of foreign exchange movements on certain financial instruments before tax were as follows:

Year ended 30 June	2010		2009	
	Recognised in the income statement $m	Recognised in equity $m	Recognised in the income statement $m	Recognised in equity $m
Foreign exchange was recognised on the following financial instruments gain/(loss):				
Cash	–	–	4	(4)
Currency options	(2)	–	13	–
Forward exchange contracts	12	(20)	(98)	(7)
Due from other Telecom group companies	(71)	(7)	(55)	(15)
Due to other Telecom group companies	1	3	–	1
Short-term debt	1	19	1	12
Foreign exchange on cross-currency interest rate swaps	(80)	6	101	11
Long-term debt	126	–	(92)	–
	(13)	**1**	**(126)**	**(2)**

Interest rate risk

TCNZ Finance employs the use of derivative financial instruments for the purpose of reducing its exposure to fluctuations in interest rates.

TCNZ Finance has used cross-currency interest rate swaps with a contract value of $1,718 million (30 June 2009: $1,718 million) to hedge long-term debt denominated in Pounds Sterling, Canadian dollars, US dollars and Swiss Francs into New Zealand dollar exposures. At 30 June 2010 TCNZ Finance had used cross-currency interest rate swaps with a contract value of A$483 million (30 June 2009: A$483 million) to hedge long-term debt denominated in US dollars into Australian dollars for the purpose of funding Telecom's Australian operations.

New Zealand dollar and Australian dollar interest rate swaps have been used to convert the majority of floating rate positions into fixed rate positions. As a consequence, TCNZ Finance's interest rate positions are limited to New Zealand and Australian yield curves.

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

TCNZ Finance's objectives of interest rate risk management are to minimise the cost of net borrowings and to minimise the impact of interest rate movements on TCNZ Finance's interest expense and net earnings while acting within policies approved by the board of the parent company.

The treasury constitution of the parent company requires that TCNZ Finance's interest rate repricing be spread over a 10-year horizon and a maximum of $800 million or 20% (whichever is greater) of gross debt to mature within any calendar period.

Interest rate repricing profile

The following table indicates the effective interest rates and the earliest period in which recognised financial instruments reprice. Fixed rate balances are presented, including the effect of derivative financial instruments, hedging both interest rates and foreign exchange.

	Weighted average interest rate %	Within 1 year $m	1-2 years $m	2-3 years $m	3-4 years $m	4-5 years $m	Greater than 5 years $m	Total $m
30 June 2010								
Floating								
Cash	2.4%	216	–	–	–	–	–	216
Long-term debt	6.2%	(135)	–	–	–	–	–	(135)
Short-term debt	1.9%	(135)	–	–	–	–	–	(135)
Fixed								
Due from other Telecom group companies	7.1%	13,498	–	–	–	–	–	13,498
Due to other Telecom group companies	5.2%	(9,995)	–	–	–	–	–	(9,995)
Long-term debt	7.8%	(21)	(460)	(569)	(381)	(73)	(882)	(2,386)
Short-term debt	4.7%	(7)	(17)	(4)	–	–	–	(28)
		3,421	**(477)**	**(573)**	**(381)**	**(73)**	**(882)**	**1,035**

Telecom has entered into $28 million (30 June 2009: $18 million) of interest rate swaps to hedge interest payments of short-term debt.

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

	Weighted average interest rate %	Within 1 year $m	1-2 years $m	2-3 years $m	3-4 years $m	4-5 years $m	Greater than 5 years $m	Total $m
30 June 2009								
Floating								
Cash	3.2%	83	–	–	–	–	–	83
Long-term debt	4.6%	(136)	–	–	–	–	–	(136)
Short-term debt	3.1%	(352)	–	–	–	–	–	(352)
Fixed								
Due from other Telecom group companies	7.6%	15,428	–	–	–	–	–	15,428
Due to other Telecom group companies	5.9%	(11,447)	–	–	–	–	–	(11,447)
Long-term debt	7.7%	(20)	(28)	(464)	(569)	(381)	(955)	(2,417)
Short-term debt	4.7%	–	(7)	(11)	–	–	–	(18)
		3,556	**(35)**	**(475)**	**(569)**	**(381)**	**(955)**	**1,141**

Financial instruments with rates fixed for 90 days or less are included as floating rate exposures.

As at 30 June 2010 a movement of 100 basis points would impact TCNZ Finance's income statement and statement of changes in equity (after hedging) as detailed in the table below:

30 June	**2010**		**2009**	
	-100bp	**+100bp**	**-100bp**	**+100bp**
Impact on:	**$m**	**$m**	**$m**	**$m**
Net earnings before income tax	(20)	18	(24)	21
Equity (before income tax)	(7)	7	10	(8)

This analysis assumes all other variables remain constant.

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

Liquidity risk

Liquidity risk represents TCNZ Finance's ability to meet its contractual obligations. TCNZ Finance evaluates its liquidity requirements on an ongoing basis. TCNZ Finance generates sufficient cash flows from its operating activities to meet financing costs on external debt. TCNZ Finance would have to recall funds advanced to other Telecom group companies in order to repay its short and long-term debt.

In the event of any shortfalls, TCNZ Finance has three short-term financing programmes in place; a US$1 billion European commercial paper programme, a NZ$500 million Note facility and a A$1.5 billion Short Term Note and Medium Term Note Programme.

In addition to the short-term financing programmes at 30 June 2010, TCNZ Finance had a committed stand-by facility of NZ$700 million (30 June 2009: NZ$800 million) with a number of creditworthy banks. As at 30 June 2010, TCNZ Finance also had committed overdraft facilities of NZ$20 million with New Zealand banks and A$20 million with Australian banks. There are no compensating balance requirements associated with these facilities.

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

In the event that TCNZ Finance is liquidated or ceases to trade, all external creditors rank equally in their claims to the financial assets of TCNZ Finance.

TCNZ Finance's maximum exposure to liquidity risk based on contractual cash flows relating to financial instruments is summarised below:

30 June 2010	Carrying amount $m	Contractual cash flows $m	0-6 months $m	6-12 months $m	1-2 years $m	2-3 years $m	3-4 years $m	4-5 years $m	5+ years $m
Non-derivative financial assets									
Cash	216	216	216	–	–	–	–	–	–
Due from other Telecom group companies	13,498	13,498	13,498	–	–	–	–	–	–
Investments	540	540	540	–	–	–	–	–	–
	14,254	14,254	14,254	–	–	–	–	–	–
Derivative financial assets									
Cross-currency interest rate swaps -(gross settled)									
Inflows	100	1,263	28	18	49	317	408	23	420
Outflows		(1,127)	(13)	(30)	(49)	(298)	(404)	(15)	(318)
Forward exchange contracts -(gross settled)									
Inflows	28	656	261	55	331	8	1	–	–
Outflows		(627)	(249)	(48)	(323)	(6)	(1)	–	–
	128	165	27	(5)	8	21	4	8	102
Non-derivative financial liabilities									
Due to other Telecom group companies	(9,995)	(9,995)	(9,995)	–	–	–	–	–	–
Short-term debt	(163)	(163)	(163)	–	–	–	–	–	–
Long-term debt	(2,165)	(2,794)	(81)	(76)	(491)	(683)	(440)	(124)	(899)
	(12,323)	(12,952)	(10,239)	(76)	(491)	(683)	(440)	(124)	(899)
Derivative financial liabilities									
Interest rate swaps -(net settled)	(146)	(186)	(31)	(23)	(39)	(31)	(17)	(12)	(33)
Cross-currency interest rate swaps -(gross settled)									
Inflows		1,317	24	34	419	34	34	34	738
Outflows	(294)	(1,804)	(34)	(36)	(652)	(43)	(46)	(48)	(945)
Forward exchange contracts -(gross settled)									
Inflows		303	235	45	16	6	1	–	–
Outflows	(24)	(327)	(248)	(51)	(19)	(8)	(1)	–	–
	(464)	(697)	(54)	(31)	(275)	(42)	(29)	(26)	(240)
Total	**1,595**	**770**	**3,988**	**(112)**	**(758)**	**(704)**	**(465)**	**(142)**	**(1,037)**

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

30 June 2009	Carrying amount $m	Contractual cash flows $m	0-6 months $m	6-12 months $m	1-2 years $m	2-3 years $m	3-4 years $m	4-5 years $m	5+ years $m
Non-derivative financial assets									
Cash	83	83	83	–	–	–	–	–	–
Due from other Telecom group companies	15,428	15,428	15,428	–	–	–	–	–	–
Investments	540	540	540	–	–	–	–	–	–
	16,051	16,051	16,051	–	–	–	–	–	–
Derivative financial assets									
Cross-currency interest rate swaps -(gross settled)									
Inflows	89	919	21	13	34	34	317	377	123
Outflows		(833)	(14)	(16)	(27)	(27)	(278)	(387)	(84)
Forward exchange contracts -(gross settled)									
Inflows	40	551	265	75	30	172	8	1	–
Outflows		(507)	(237)	(69)	(26)	(168)	(6)	(1)	–
	129	130	35	3	11	11	41	(10)	39
Non-derivative financial liabilities									
Due to other Telecom group companies	(11,447)	(11,447)	(11,447)	–	–	–	–	–	–
Short-term debt	(370)	(372)	(372)	–	–	–	–	–	–
Long-term debt	(2,308)	(3,104)	(65)	(91)	(161)	(463)	(719)	(427)	(1,178)
	(14,125)	(14,923)	(11,884)	(91)	(161)	(463)	(719)	(427)	(1,178)
Derivative financial liabilities									
Interest rate swaps	(124)	(413)	(34)	(34)	(67)	(59)	(48)	(34)	(137)
Cross-currency interest rate swaps -(gross settled)									
Inflows		940	26	18	44	427	18	18	389
Outflows	(212)	(1,142)	(21)	(21)	(42)	(628)	(14)	(14)	(402)
Forward exchange contracts -(gross settled)									
Inflows		559	289	69	26	168	6	1	–
Outflows	(51)	(615)	(330)	(75)	(30)	(171)	(8)	(1)	–
	(387)	(671)	(70)	(43)	(69)	(263)	(46)	(30)	(150)
Total	**1,668**	**587**	**4,132**	**(131)**	**(219)**	**(715)**	**(724)**	**(467)**	**(1,289)**

Carrying amounts are as disclosed on the balance sheet statement of financial position as per TCNZ Finance's accounting policies. Contractual cash flows include undiscounted principal and interest payments and are presented at the earliest date on which the entity could be required to repay contractually.

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

Equity risk

Investments that subject TCNZ Finance to equity risk include long-term investments in a fellow subsidiary company. TCNZ Finance's exposure to equity risk at 30 June 2010 was $540 million (30 June 2009: $540 million).

Hedging activities

Derivative financial instruments

Each derivative that is designated as a hedge is classified as a hedge of a highly probable forecast transaction (a cash flow hedge). TCNZ Finance does not currently hold or issue derivative financial instruments for trading purposes, although under the classifications of IFRS derivative financial instruments are classified as 'held for trading' unless they are designated hedges. Currency options and certain cross-currency interest rate swaps held by TCNZ Finance are classified under IFRS as held for trading. All other derivative financial instruments classified as held for trading are designated hedges of exposures in other Telecom group companies.

The fair values of derivatives are as follows:

30 June	2010		2009	
	Assets	Liabilities	Assets	Liabilities
	$m	$m	$m	$m
Cash flow hedges				
Interest rate swaps	–	(146)	–	(124)
Cross-currency interest rate swaps	47	(245)	68	(169)
	47	(391)	68	(293)
Designated as held for trading				
Forward exchange contracts	28	(24)	40	(50)
Cross-currency interest rate swaps	53	(49)	21	(44)
	81	(73)	61	(94)
Total net derivatives	**128**	**(464)**	**129**	**(387)**

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

Cash flow hedges

TCNZ Finance uses cross-currency interest rate swaps and interest rate swaps to manage interest and foreign exchange risk on foreign denominated debt. These swaps are jointly designated as hedges of the forecast interest and principal cash flows of the debt.

The fair value of interest rate derivatives deferred in equity will be reclassified to finance expense as interest payments occur over the remaining life of the swaps. The fair values by maturity are as follows:

30 June	2010 $m	2009 $m
Maturity:		
Less than 1 year	(5)	–
1 – 2 years	9	(18)
2 – 3 years	(3)	13
3 – 4 years	(2)	(4)
4 – 5 years	–	3
Maturity thereafter	(30)	(12)
	(31)	**(18)**

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are initially recognised in equity. The gain or loss relating to any ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods when the hedged item will affect profit or loss. When a hedging instrument expires or is sold, or a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity until the underlying physical exposure occurs. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately reclassified to the income statement.

During the period there were no hedged forecast transactions that were expected to occur which did not eventuate. There has been no material ineffectiveness on cash flow hedging relationships during the period (30 June 2009: nil).

Notes to the Financial Statements

For the year ended 30 June 2010

13 Financial instruments and risk management (continued)

Reconciliation of movements in the hedge reserve as follows:

Year ended 30 June	2010			2009		
	Before tax $m	Tax (expense)/ credit $m	Net of tax $m	Before tax $m	Tax (expense)/ credit $m	Net of tax $m
Balance at the beginning of the year			(17)			3
Gain/(loss) recognised in other comprehensive income	62	(18)	44	38	(12)	26
Amount reclassified from cash flow hedge reserve to finance expense	(68)	20	(48)	(66)	20	(46)
Balance at the end of the year			**(21)**			**(17)**

14 Concentration of funding

30 June	2010 $m	2009 $m
Funding consists of:		
Debt due within one year	191	390
Due to other Telecom group companies	9,995	11,447
Long-term debt	2,137	2,288
Total funding	**12,323**	**14,125**
Concentration of funding by economic sector:		
Commercial and financial	2,328	2,678
Due to other Telecom group companies	9,995	11,447
Total funding	**12,323**	**14,125**
Concentration of funding by geographical areas:		
Within New Zealand	8,150	9,257
Overseas:		
Australia	201	150
Bermuda	1,358	2,016
Europe	1,744	1,779
Other	870	923
Total funding	**12,323**	**14,125**

Notes to the Financial Statements

For the year ended 30 June 2010

15 Concentration of credit exposures

In the normal course of its business, TCNZ Finance incurs credit risk from financial instruments, including cash, advances to subsidiary companies, trade receivables and derivative financial instruments.

TCNZ Finance has a credit policy that is used to manage this exposure to credit risk. As part of this policy, limits on exposures with counterparties have been set and approved by the board of Telecom and are monitored on a regular basis.

TCNZ Finance has certain derivative transactions that are subject to bilateral credit support agreements that require TCNZ Finance or the counterparty to post collateral to support mark-to-market valuation differences. As at 30 June 2010, NZ$21 million collateral was posted (30 June 2009: nil). Collateral calls can be made by either party if the fair value of the agreement changes due to market conditions.

30 June	2010 $m	2009 $m
Credit exposures consist of:		
Cash	216	83
Due from other Telecom group companies	10,341	12,238
Debentures issued by fellow subsidiary	3,157	3,190
Derivative financial instruments	128	129
Total credit exposure	**13,842**	**15,640**
Credit exposures by economic sector:		
Commercial and financial	344	212
Due from other Telecom group companies	13,498	15,428
Total credit exposure	**13,842**	**15,640**
Credit exposures by geographical areas:		
New Zealand	10,197	11,978
Australia	3,534	3,556
USA	34	51
Other	77	55
Total credit exposure	**13,842**	**15,640**

TCNZ Finance has no financial assets that are overdue and not impaired.

TCNZ Finance has certain derivative and debt agreements that are subject to bilateral credit support agreements that require TCNZ Finance or the counterparty to post collateral to support the value of certain derivatives. As at 30 June 2010, US$15 million (NZ$21 million) of collateral was posted (30 June 2009: nil). In the event of a downgrade of Telecom's credit rating to either Baa1 (Moody's Investors Services) or BBB+ (Standard & Poor's) TCNZ Finance would be required to post US$194 million (based on rates at 30 June 2010) of additional collateral.

Notes to the Financial Statements

For the year ended 30 June 2010

16 Related party transactions

TCNZ Finance provides financing for the Telecom group of companies. These entities are all related parties by virtue of their common control. Transactions and amounts owing to and from these companies are separately disclosed throughout these financial statements.

TCNZ Finance also enters into derivative financial instruments with fellow subsidiaries. These arrangements are matched with similar derivative financial instruments obtained from the external market.

The notional principal or contract amounts outstanding are as follows:

30 June	2010	2009
	$m	$m
Cross-currency interest rate swaps	346	346
Forward exchange contracts	281	344

Notes to the Financial Statements

For the year ended 30 June 2010

17 Fellow subsidiary companies

At 30 June 2010 the significant fellow subsidiaries of TCNZ Finance were as follows:

	Country	Ownership	Principal activity
TCNZ Australia Investments Pty Limited	Australia	100%	A holding company.
Telecom New Zealand International Australia Pty Limited	Australia	100%	Provides international wholesale telecommunications services.
Gen-i Australia Pty Limited	Australia	100%	Provides outsourced telecommunications services.
AAPT Limited	Australia	100%	Provides value-added telecommunications services.
PowerTel Limited	Australia	100%	Provides wholesale telecommunications services.
Telecom New Zealand Finance (No.2) Limited	Bermuda	100%	A group finance company.
TCNZ (Bermuda) Limited	Bermuda	100%	A holding company.
Telecom Southern Cross Finance Limited	Bermuda	100%	A group finance company.
Telecom Cook Islands Limited	Cook Islands	60%	Provides telecommunications services in the Cook Islands.
Telecom New Zealand Japan Kabushiki Kaisha	Japan	100%	Provides international wholesale telecommunications services.
Telecom New Zealand Limited	New Zealand	100%	Provides local, national, and international telephone and data services.
Telecom Mobile Limited	New Zealand	100%	Provides mobile telecommunications services.
Xtra Limited	New Zealand	100%	Internet service provider.
Telecom Retail Holdings Limited	New Zealand	100%	Retailer of telecommunications products and services.
Telecom IP Limited	New Zealand	100%	Owns group intellectual property.
Telecom New Zealand Finance Limited	New Zealand	100%	A group finance company.
Telecom Southern Cross Limited	New Zealand	100%	A holding company.
Telecom New Zealand UK Limited	United Kingdom	100%	Provides international wholesale telecommunications services.
Telecom New Zealand USA Limited	United States	100%	Provides international wholesale telecommunications services.

Notes to the Financial Statements

For the year ended 30 June 2010

18 Segmental reporting

TCNZ Finance operates with one operating segment. The principal activity of TCNZ Finance is that of a finance company for the Telecom group. TCNZ Finance's financial statements are reviewed by the directors of TCNZ Finance in assessing the company's performance. The geographical information below is not used by the directors to decide how to allocate resources or to assess performance.

Geographical information

30 June 2010	New Zealand operations $m	Australian operations $m	Other operations $m	Consolidated $m
Finance income	773	19	100	892
Net earnings for the year	181	(46)	4	139
Investments	540	–	–	540
Total assets	10,925	1,095	2,362	14,382
Total liabilities	(9,419)	(1,164)	(2,273)	(12,856)

30 June 2009	New Zealand operations $m	Australian operations $m	Other operations $m	Consolidated $m
Finance income	905	23	188	1,116
Net earnings for the year	63	(40)	3	26
Investments	540	–	–	540
Total assets	12,086	1,092	3,020	16,198
Total liabilities	(10,884)	(1,116)	(2,555)	(14,555)

19 Dividends

TCNZ Finance declared and paid a dividend of $250 million to the parent company during the year ended 30 June 2010. No imputation credits were attached to this dividend.

20 Imputation credit account

Dividends paid by New Zealand resident companies may include imputation credits representing the taxation already paid by the company on the profits distributed. New Zealand resident shareholders may claim a tax credit equal to the value of the imputation credit attached to dividends.

In 2005 TCNZ Finance elected to become a member of the Telecom Imputation Group with effect from 1 April 2004. As a result, the imputation credit was transferred to the Telecom Imputation Group imputation credit account in 2005. As at 30 June 2010, the Telecom Imputation Group account had a closing credit balance of $3 million (30 June 2009: credit balance of $5 million). Any imputation credits within the Telecom Imputation Group would be available to be attached to dividends paid by TCNZ Finance.

Notes to the Financial Statements

For the year ended 30 June 2010

21 Reconciliation of net earnings to net cash flows from operating activities

Year ended 30 June	2010 $m	2009 $m
Net earnings	139	26
Adjustments to reconcile net earnings to net cash flows from operating activities		
Amortisation of discount	8	9
Foreign exchange (gain)/loss	13	126
Revaluation of derivatives	13	30
Other	1	1
Changes in assets and liabilities net of effects of non-cash and investing and financing activities		
Increase in interest payable	–	5
Increase in current taxation	66	32
Net cash flows from operating activities	**240**	**229**

22 Commitments and Contingencies

There are no commitments or contingencies other than those outlined in the above notes.

23 Significant events after balance date

On 4 August 2010 Standard & Poor's Ratings placed Telecom's ratings of 'A/A-1' on credit watch with negative implications.

24 New accounting standards

Certain new accounting standards, amendments and interpretations to existing accounting standards have been published that are mandatory for TCNZ Finance's accounting periods beginning on or after 1 July 2010, but which TCNZ Finance has not yet adopted. TCNZ Finance does not consider any other accounting standards or interpretations issued, but not yet applicable, to have a significant impact on its financial statements. Those which are relevant to TCNZ Finance are as follows:

Amendment to NZ IAS 39: Financial instruments: Recognition and measurement: eligible hedged items

Effective for periods beginning on or after 1 July 2010

This clarifies two aspects of hedge accounting relating to hedging with options and the identification of inflation as a hedged risk.

Notes to the Financial Statements

For the year ended 30 June 2010

24 New accounting standards (continued)

NZ IAS 24 Related party disclosures

Effective for periods beginning on or after 1 July 2011

This amendment simplifies the definition of a related party, clarifying its intended meaning and eliminating inconsistencies from the definition, particularly in relation to significant influence and joint control.

NZ IFRS 9 Financial Instruments

Effective for periods beginning on or after 1 January 2013

IFRS 9 is the first part of phase 1 of IASB's project to replace IAS 39. The first part of phase 1 relates to the recognition and measurement of financial assets.

Auditors' Report

To the shareholder of TCNZ Finance Limited

We have audited the financial statements on pages 6 to 44. The financial statements provide information about the past financial performance of the company and its financial position as at 30 June 2010. This information is stated in accordance with the accounting policies set out on pages 10 to 13.

Directors' responsibilities

The Directors are responsible for the preparation of financial statements which give a true and fair view of the financial position of the company as at 30 June 2010 and the results of its operations and cash flows for the year ended on that date.

Auditors' responsibilities

It is our responsibility to express an independent opinion on the financial statements presented by the Directors and report our opinion to you.

Basis of opinion

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgements made by the Directors in the preparation of the financial statements;
- whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with New Zealand Auditing Standards. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to obtain reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Other than in our capacity as auditors we have no relationship with or interests in the company.

Auditors' Report

Unqualified opinion

We have obtained all the information and explanations we have required.

In our opinion:

- proper accounting records have been kept by the company as far as appears from our examination of those records;
- the financial statements on pages 6 to 44:
  - comply with New Zealand generally accepted accounting practice;
  - comply with International Financial Reporting Standards;
  - give a true and fair view of the financial position of the company as at 30 June 2010 and the results of its operations and cash flows for the year ended on that date.

Our audit was completed on 24 August 2010 and our unqualified opinion is expressed as at that date.

KPMG

Wellington

Contact Information

Registered office

The registered office of TCNZ Finance is:

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Inquiries

TeleBond holders with inquiries about transactions, changes of address or interest payments should contact:

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Inquiries about the operating and financial performance of TCNZ Finance or the Telecom Group can be emailed to *investor-info@telecom.co.nz* or addressed to:

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