TCNZ Finance Limited

Annual Report

For the year ended 30 June 2011

Directors' report

For the year ended 30 June 2011

TCNZ Finance Limited ('TCNZ Finance' or 'the Company') 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 to 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. However, refer to 'Proposed demerger' below.

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.

Proposed demerger

Telecom's participation in the ultra-fast broadband 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. Subject to the outcome of the proposed demerger, as the proposed demerger is planned to take place within twelve months of the balance sheet date, it is possible that the Telecom Group may repay more of the debt held within TCNZ Finance Limited within twelve months than it is contractually obliged to as part of a wider debt restructuring programme.

Business review

TCNZ Finance recorded a net profit for the year ended 30 June 2011 of $303 million compared to a net profit of $139 million for the year ended 30 June 2010. The volatility in earnings is primarily caused by TCNZ Finance's exposure to movements in foreign exchange rates, which principally led to the $164 million increase in net earnings. The net foreign exchange gain for the year ended 30 June 2011 was $115 million, compared to a net loss of $13 million in the year ended 30 June 2010.

The net assets of TCNZ Finance as at 30 June 2011 were $1,808 million compared to $1,526 million as at 30 June 2010. The share capital of TCNZ Finance is $883 million (30 June 2010: $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 2011 (30 June 2010: 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.

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 2011 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. However, refer to 'Proposed demerger' above. TCNZ Finance does not engage in research and development activities.

On behalf of the Board

John van Woerkom	Nick Olson
DIRECTOR	DIRECTOR
29 August 2011	

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

We, John van Woerkom and Nick Olson, 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 2011, 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 income statement 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.

John van Woerkom DIRECTOR	Nick Olson DIRECTOR

29 August 2011

Other information

For the year ended 30 June 2011

Directors

The directors of TCNZ Finance as at 30 June 2011 were:

Paul Reynolds	Telecom's Chief Executive Officer
Tristan Gilbertson	Telecom's Group General Counsel
Nick Olson	Telecom's Chief Financial Officer
John van Woerkom	Telecom's Group Controller
Anthony Parker	Telecom's General Manager Finance (resigned 8 August 2011)

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 2011 are as follows:

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

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

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 2011 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 2011

Holding range	Holder count	Holder count %	Holding quantity $	Holding quantity %
2,000 to 4,999	27	1.0	80,992	0.0
5,000 to 9,999	312	11.2	1,986,191	0.4
10,000 to 49,999	1,590	56.8	34,436,332	6.4
50,000 to 99,999	471	16.8	27,496,301	5.1
100,000 to 499,999	329	11.8	53,810,783	9.9
500,000 to 999,999	34	1.2	21,466,855	4.0
1,000,000 and over	35	1.2	402,046,687	74.2
Total	2,798	100.0	541,324,141	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 2011 are $2.05 (30 June 2010: $1.73).

Income Statement

For the years ended 30 June 2011 and 2010

Year ended 30 June	Notes	2011 $m	2010 $m
Finance income	2	902	892
Finance expense	2	(648)	(660)
Net finance income		**254**	**232**
Other income	3	132	8
Other expenses	3	(12)	(35)
Net earnings before income tax		374	205
Income tax expense	4	(71)	(66)
Net earnings for the year		**303**	**139**

Statement of Comprehensive Income

For the years ended 30 June 2011 and 2010

Year ended 30 June	2011 $m	2010 $m
Net earnings for the year	303	139
Other comprehensive income		
Translation of foreign branches	(2)	1
Cash flow hedges	(44)	(6)
Income tax relating to components of other comprehensive income	25	(1)
Other comprehensive income/(loss) for the year, net of tax	(21)	(6)
Total comprehensive income for the year	**282**	**133**

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

TCNZ FINANCE LIMITED

Statement of Changes in Equity

For the years ended 30 June 2011 and 2010

	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 2010	**883**	**883**	**646**	**(21)**	**18**	**1,526**
Net earnings for the year	-	-	303	-	-	303
Other comprehensive income for the year[1]	-	-	-	(31)	10	(21)
Total recognised income and expenses	-	-	303	(31)	10	282
Balance as at 30 June 2011	**883**	**883**	**949**	**(52)**	**28**	**1,808**

	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**

[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 2011 and 2010

As at 30 June	**Notes**	**2011 $m**	**2010 $m**
ASSETS			
Current assets:			
Cash		207	195
Collateral funds		110	21
Due from other Telecom Group companies	5	2,269	2,029
Short-term derivative assets	6	15	19
Total current assets		2,601	2,264
Non-current assets:			
Due from other Telecom Group companies	5	11,430	11,469
Long-term derivative assets	6	132	109
Deferred tax asset	11	25	-
Investments	7	540	540
Total non-current assets		12,127	12,118
Total assets		**14,728**	**14,382**
LIABILITIES AND EQUITY			
Current liabilities:			
Income tax payable		26	27
Due to other Telecom Group companies	8	10,099	9,995
Short-term derivative liabilities	6	334	25
Debt due within one year	9	397	191
Accrued interest		35	38
Total current liabilities		10,891	10,276
Non-current liabilities:			
Long-term derivative liabilities	6	329	439
Long-term debt	10	1,700	2,137
Deferred tax liability	11	-	4
Total non-current liabilities		2,029	2,580
Total liabilities		**12,920**	**12,856**
Equity:			
Share capital		883	883
Reserves		(24)	(3)
Retained earnings		949	646
Total equity	12	1,808	1,526
Total liabilities and equity		**14,728**	**14,382**

On behalf of the Board

J van Woerkom

John van Woerkom
DIRECTOR
Authorised for issue on 29 August 2011

Nick Olson
DIRECTOR

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 2011 and 2010

Year ended 30 June	Note	2011 $m	2010 $m
Cash flows from operating activities			
Interest income		902	892
Interest paid on debt		(640)	(652)
Net cash flows from operating activities	20	262	240
Cash flows from investing activities			
Net advances (to)/from other Telecom Group companies		(40)	378
Payments on settlement of forward exchange contracts		(13)	(36)
Receipts from settlement of forward exchange contracts		2	12
Net cash flow applied (to)/from investing activities		(51)	354
Cash flows from financing activities			
Increase in collateral funds		(89)	(21)
Repayment of long-term debt		(28)	(20)
Proceeds from short-term debt		663	1,078
Repayment of short-term debt		(749)	(1,269)
Dividend paid		-	(250)
Net cash flow applied to financing activities		(203)	(482)
Net cash flow		8	112
Foreign exchange movements		4	-
Net cash at beginning of period		195	83
Net cash position at end of period		**207**	**195**

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

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 TCNZ Finance'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 and references to 'CHF' are to Swiss Francs. All financial information presented in New Zealand dollars, US Dollars, Australian dollars, Swiss Francs, Euros and Pounds Sterling 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 29 August 2011.

Telecom's participation in the ultra-fast broadband 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. Subject to the outcome of the proposed demerger, TCNZ Finance could be impacted by this transaction, which may include a restructuring of debt arrangements.

(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.

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.

Note 1 Statement of accounting policies (continued)

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 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.

Cash excludes collateral pledged, which is separately disclosed as collateral funds. Collateral funds represent funds deposited by TCNZ Finance with counterparties of certain derivatives in accordance with the terms of certain bilateral credit support agreements. These funds are held in accounts to which Telecom's access is restricted and are therefore shown separately from cash.

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 annually.

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.

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.

Note 1 Statement of accounting policies (continued)

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.

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
There have been no changes in accounting policies during the year ended 30 June 2011.

Note 2 Finance income and expense

Year ended 30 June	**2011 $m**	**2010 $m**
Finance income:		
Interest income on loans to other Telecom Group companies	897	887
Interest income from deposits	5	4
Other interest income	-	1
Total finance income	**902**	**892**
Finance expense:		
Finance expense on long-term debt:		
- Euro Medium Term Notes ('EMTN') [1]	157	154
- TeleBonds	41	43
Revaluation of interest rate derivatives	3	2
Interest expense on loans from other Telecom Group companies	434	439
Other interest and finance expense	13	22
Total finance expense	**648**	**660**

[1] Includes $73 million reclassified from the cash flow hedge reserve for the year ended 30 June 2011 (30 June 2010: $68 million).

Note 3 Other income and expenses

Year ended 30 June	**2011 $m**	**2010 $m**
Other income:		
Net realised foreign exchange gains	-	8
Net unrealised foreign exchange gains	126	-
Revaluation of derivatives	6	-
Total other income	**132**	**8**
Other expenses:		
Net unrealised foreign exchange losses	-	21
Net realised foreign exchange losses	11	-
Revaluation of derivatives	-	13
Other operating expenses	1	1
Total other expenses	**12**	**35**

Administration costs, including audit fees for the period of $26,399 (30 June 2010: $27,788) 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.

Note 4 Income tax

Year ended 30 June	2011 $m	2010 $m
Current tax expense/(credit)	75	67
Deferred tax expense/(credit)	(4)	(1)
	71	**66**
Reconciliation of income tax expense:		
Net earnings before income tax	374	205
Tax at current rate of 30%	112	61
Adjustments to taxation:		
Non-taxable foreign exchange (gains)/losses	(41)	8
Adjustment in respect of change in tax legislation[1]	-	(3)
Income tax expense	**71**	**66**

[1] The company tax rate changed in New Zealand from 30% to 28%, effective for Telecom from 1 July 2011. A NZ$3 million tax credit in relation to the reduction in the company tax rate in New Zealand was recognised in the year ended 30 June 2010.

Note 5 Due from other Telecom Group companies

30 June	2011 $m	2010 $m
Current assets:		
Advances to the parent company	480	285
Advances to fellow subsidiaries	1,789	1,744
	2,269	**2,029**
Non-current assets:		
Advances to the parent company	3,781	3,972
Debentures issued by fellow subsidiary	3,322	3,157
Advances to fellow subsidiaries	4,327	4,340
	11,430	**11,469**
Total due from other Telecom Group companies	**13,699**	**13,498**

Current amounts due from fellow Australian subsidiary companies have interest rates of 5.3% (30 June 2010: 3.8%). 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 2.9% and 10.0% (30 June 2010: 3.2% 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.

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.

Subject to the outcome of the proposed demerger, refer note 1(b), amounts due from other Telecom Group companies are expected to be held to maturity.

Note 6 Derivative assets and liabilities

30 June	2011 Fair value $m	2010 Fair value $m
Short-term derivative assets:		
Forward exchange contracts	14	19
Currency options	1	-
	15	**19**
Long-term derivative assets:		
Forward exchange contracts	4	9
Cross-currency interest rate swaps	128	100
	132	**109**
Short-term derivative liabilities:		
Forward exchange contracts	14	20
Cross-currency interest rate swaps	317	-
Interest rate swaps	2	5
Currency options	1	-
	334	**25**
Long-term derivative liabilities:		
Forward exchange contracts	4	4
Cross-currency interest rate swaps	176	294
Interest rate swaps	149	141
	329	**439**

Notional amounts of derivative financial instruments:

30 June	Currency	Maturities	2011 $m	2010 $m
Cross-currency interest rate swaps	AUD:USD	2011	624	594
	NZD:GBP	2018-2020	1,082	1,082
	NZD:CAD	2013	378	378
	NZD:CHF	2012	258	258
Interest rate swaps	AUD	2011	1,428	458
	NZD	2012-2020	482	1,739
Forward exchange contracts	NZD:AUD	2011-2012	337	342
	NZD:USD	2011-2013	290	311
	NZD:EUR	2011-2012	83	175
	Other	2011	46	156
Currency options	NZD:EUR	2011-2012	43	22
	NZD:USD	2011-2012	63	-
	NZD:AUD	2011-2012	21	-

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.

Subject to the outcome of the proposed demerger, refer note 1(b), derivative financial assets and liabilities are expected to be held to maturity. As at 30 June 2011 the expected net contractual settlement, being the contractual amounts at current foreign exchange and interest rates, was a liability of $456 million compared to a fair value liability of $517 million.

Note 7 Investments

30 June	2011 $m	2010 $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.

Note 8 Due to other Telecom Group companies

30 June	2011 $m	2010 $m
Due to the parent company	1,609	1,626
Due to fellow subsidiary companies	8,490	8,369
	10,099	**9,995**

Current amounts due to Australian subsidiary companies have interest rates of 4.3% (30 June 2010: 2.8%). Current amounts due to the parent company and fellow subsidiary companies have interest rates between 2.7% and 8.1% (30 June 2010: 6%). 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.

Subject to the outcome of the proposed demerger, refer note 1(b), amounts due to other Telecom Group companies are expected to be held to maturity.

Note 9 Debt due within one year

30 June	2011 $m	2010 $m
Long-term debt maturing within one year (see Note 10)	304	28
Promissory notes	80	30
Commercial paper	13	24
European commercial paper	-	109
	397	**191**

At 30 June 2011 the promissory notes had a weighted average interest rate of 2.9% (30 June 2010: 3.6%). Notes are issued under TCNZ Finance's $500 million Note Facility.

At 30 June 2011 commercial paper had a weighted average interest rate of 5.2% (30 June 2010: 5.3%). The commercial paper was issued under TCNZ Finance's A$1.5 billion Short Term Note and Medium Term Note Programme.

At 30 June 2011 all European commercial paper had matured. The weighted average interest rate at 30 June 2010 was 0.7%. This European commercial paper was issued under TCNZ Finance's US$1 billion European Commercial Paper programme.

Note 10 Long-term debt

30 June	2011 $m	2010 $m
TeleBonds	542	570
Euro Medium Term Notes ('EMTN')	1,468	1,603
	2,010	2,173
Less unamortised discount	(6)	(8)
	2,004	2,165
Less long-term debt maturing within one year (see Note 9)	(304)	(28)
	1,700	**2,137**

None of Telecom's debt is secured and all rank equally with other liabilities. There are no financial covenants over TCNZ Finance's debt. Telecom's debt contains certain triggers in the event of default, as defined in the various debt agreements. As at 30 June 2011 no events of default are considered to have been triggered. As such NZ$1,700 million of long-term debt has been classified as due after one year in the financial statements. However, as a proposed demerger may take place within twelve months of the balance sheet date, refer to note 1(b), it is possible that Telecom may repay more of the debt within twelve months than it is contractually obliged to as part of a wider debt restructuring programme.

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 2010: 6.9% to 8.7%) and maturity dates between April 2012 and April 2016.

During the year ended 30 June 2011, $28 million of TeleBonds matured and were repaid (30 June 2010: $20 million).

TCNZ Finance issued no long-term debt during the year ending 30 June 2011 (30 June 2010: nil).

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.

Interest rate	Due	Face value $m	Currency	Hedged Currency rate	30 June 2011 $m	30 June 2010 $m
6.8%	14 Dec 2011	250	USD	0.42	302	361
4.4%	6 Aug 2012	200	CHF	0.77	290	267
4.8%	11 Oct 2013	275	CAD	0.73	343	377
5.6%	14 May 2018	125	GBP	0.36	242	272
5.8%	6 Apr 2020	150	GBP	0.39	291	326
					1,468	**1,603**

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%.

Note 10 Long-term debt (continued)

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.

Note 11 Deferred tax

30 June	**2011 $m**	**2010 $m**
Balance at beginning of the year	(4)	(7)
Amounts recognised in profit and loss:		
Relating to current period	4	1
Amounts recognised in equity:		
Relating to current period	25	2
Deferred tax asset/(liability)	**25**	**(4)**
The deferred tax balance consists of:		
Fair value of derivatives	25	(4)

In its deferred taxation balance TCNZ Finance has not recognised the tax effect of accumulated tax loss carry forwards in its Australian Branch amounting to $358 million at 30 June 2011 (30 June 2010: $286 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 changed 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.

Note 12 Equity

Contributed capital

As at 30 June 2011 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

During the year ending 30 June 2011 TCNZ Finance paid no dividends to the parent company (30 June 2010: $250 million). No imputation credits were attached to the dividends paid in the year ending 30 June 2010.

Note 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 2011	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	-	-	-	207	-	-	207
Collateral funds	-	-	-	110	-	-	110
Due from other Telecom Group companies	-		2,269				2,269
Short-term derivative assets	15	-	-	-	-	-	15
	15	**-**	**2,269**	**317**	**-**	**-**	**2,601**
Non-current assets							
Due from other Telecom Group companies	-	-	11,430	-	-	-	11,430
Long-term derivative assets	92	-	-	-	40	-	132
Investments	-	540	-	-	-	-	540
	92	**540**	**11,430**	**-**	**40**	**-**	**12,102**
Liabilities							
Current liabilities							
Due to other Telecom Group companies	-	-	-	-	-	(10,099)	(10,099)
Short-term derivative liabilities	(86)	-	-	-	(248)	-	(334)
Long-term debt due within one year	-	-	-	-	-	(397)	(397)
	(86)	**-**	**-**	**-**	**(248)**	**(10,496)**	**(10,830)**
Non-current liabilities							
Long-term derivative liabilities	(4)	-	-	-	(325)	-	(329)
Long-term debt	-	-	-	-	-	(1,700)	(1,700)
	(4)	**-**	**-**	**-**	**(325)**	**(1,700)**	**(2,029)**

Note 13 Financial instruments and risk management (continued)

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	-	-	-	195	-	-	195
Collateral funds	-	-	-	21	-	-	21
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)**

Reclassifications

There have been no reclassifications between financial instrument categories during the years ended 30 June 2011 and 30 June 2010.

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.

The table below categorises TCNZ Finance'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 (ie, as prices) or indirectly (ie, 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).

Note 13 Financial instruments and risk management (continued)

30 June 2011	Level 1 $m	Level 2 $m	Level 3 $m	Total $m
Financial Assets				
Short-term derivative assets	-	15	-	15
Long-term derivative assets	-	132	-	132
	-	**147**	**-**	**147**
Financial Liabilities				
Short-term derivative liabilities	-	(334)	-	(334)
Long-term derivative liabilities	-	(329)	-	(329)
	-	**(663)**	**-**	**(663)**

30 June 2010	Level 1 $m	Level 2 $m	Level 3 $m	Total $m
Financial Assets				
Short-term derivative assets	-	19	-	19
Long-term derivative assets	-	109	-	109
	-	**128**	**-**	**128**
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 2010: $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.

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 $2,128 million compared to a carrying value of $2,004 million (30 June 2010: fair value of $2,293 million compared to a carrying value of $2,165 million).

In addition to the above carrying value of long-term debt, accrued interest payable of $35 million (30 June 2010: $38 million) is recorded in the statement of financial position.

As described in note 1, subject to the outcome of the proposed demerger, TCNZ Finance could be impacted by this transaction, which may include a restructuring of debt arrangements. For the purpose of these financial statements non-current debt is still classified as long-term.

Cash, collateral funds, 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.

Note 13 Financial instruments and risk management (continued)

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 2.6% to 7.2%.

Guarantees
TCNZ Finance has issued bank guarantees totalling A$13 million as at 30 June 2011 (30 June 2010: A$8 million) in relation to the lease payments of another Telecom Group company. As at 30 June 2011 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.

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.

Note 13 Financial instruments and risk management (continued)

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

30 June 2011	AUD NZ$m	USD NZ$m	GBP NZ$m	CAD NZ$m	CHF NZ$m	EUR NZ$m	Total NZ$m
Exposures							
Cash	13	-	-	-	-	1	14
Collateral funds	-	110	-	-	-	-	110
Short-term debt	(13)	-	-	-	-	-	(13)
Long-term debt	-	(301)	(530)	(343)	(289)	-	(1,463)
Due from other Telecom Group companies	3,442	-	240	-	-	-	3,682
Due to other Telecom Group companies	(388)	(16)	-	-	-	-	(404)
Total exposure from non-derivative financial instruments	**3,054**	**(207)**	**(290)**	**(343)**	**(289)**	**1**	**1,926**
Hedging instruments							
Foreign exchange contracts	(306)	(94)	-	-	-	-	(400)
NZD cross-currency interest rate swaps	-	-	290	343	289	-	922
AUD cross-currency interest rate swaps	(624)	301	-	-	-	-	(323)
Total exposure from hedging instruments	**(930)**	**207**	**290**	**343**	**289**	**-**	**199**

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	24	-	-	-	-	29
Collateral funds	-	21	-	-	-	-	21
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 swap	(593)	360	-	-	-	-	(233)
Total exposure from hedging instruments	**(1,011)**	**360**	**325**	**376**	**266**	**109**	**425**

Note 13 Financial instruments and risk management (continued)

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

As at 30 June 2011 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	2011		2010	
	-10%	+10%	-10%	+10%
Impact on:	$m	$m	$m	$m
Net earnings before income tax	267	(213)	253	(201)
Equity (before income tax)	(16)	14	(19)	18

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	2011		2010	
	Recognised in the income statement	Recognised in equity	Recognised in the income statement	Recognised in equity
	$m	$m	$m	$m
Foreign exchange was recognised on the following financial instruments gain/(loss):				
Cash	(11)	4	-	-
Currency options	-	-	(2)	-
Forward exchange contracts	(3)	(1)	12	(20)
Due from other Telecom Group companies	99	37	(71)	(7)
Due to other Telecom Group companies	3	(5)	1	3
Short-term debt	(3)	(6)	1	19
Foreign exchange on cross-currency interest rate swaps	(105)	(31)	(80)	6
Long-term debt	135	-	126	-
	115	**(2)**	**(13)**	**1**

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 2010: $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 2011 TCNZ Finance had used cross-currency interest rate swaps with a contract value of A$483 million (30 June 2010: 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.

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.

Note 13 Financial instruments and risk management (continued)

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 30% (whichever is greater) of gross debt to mature within any calendar period. Net debt must have a weighted average life between 3.75 and 5.25 years. Management has deferred any new debt facility renegotiations until the proposed demerger takes effect, which has led to a reported breach of Telecom's treasury constitution at 30 June 2011. This related to the required average life of net debt falling below agreed levels. Other than this, as at 30 June 2011, Telecom management considered that it was in compliance with its liquidity policy as reported to Telecom's board of directors.

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.

30 June 2011	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
Floating								
Cash and collateral funds	1.7%	317	-	-	-	-	-	317
Long-term debt	6.3%	(142)	-	-	-	-	-	(142)
Short-term debt	3.0%	(35)	-	-	-	-	-	(35)
Fixed								
Due from other Telecom Group companies	6.1%	13,699	-	-	-	-	-	13,699
Due to other Telecom Group companies	5.6%	(10,099)	-	-	-	-	-	(10,099)
Long-term debt	7.7%	(485)	(570)	(380)	(73)	(150)	(733)	(2,391)
Short-term debt	4.7%	(11)	(10)	(8)	(6)	(22)	-	(57)
		3,244	**(580)**	**(388)**	**(79)**	**(172)**	**(733)**	**1,292**

Telecom has entered into $57 million (30 June 2010: $28 million) of interest rate swaps to hedge interest payments of short-term debt.

30 June 2010	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
Floating								
Cash and collateral funds	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**

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

Note 13 Financial instruments and risk management (continued)

As at 30 June 2011 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	2011		2010	
	-100 bp	+100 bp	-100 bp	+100 bp
Impact on:	$m	$m	$m	$m
Net earnings before income tax	(16)	15	(20)	18
Equity (before income tax)	(15)	14	(7)	7

This analysis assumes all other variables remain constant.

Credit risk

In the normal course of its business, TCNZ Finance incurs credit risk from financial instruments, including cash, short-term investments, advances to associate companies 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 significant counterparties have been set and approved by the board of directors and are monitored on a regular basis. TCNZ Finance's financial instruments do not have significant concentration of risk with any single party.

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 funds to support the value of certain derivatives. As at 30 June 2011, US$91 million (NZ$110 million) of collateral funds were posted (30 June 2010: US$15 million (NZ$21 million)). The 2010 comparative has been restated to disclose the US$15 million as collateral funds previously included in cash and disclosed as restricted cash in the notes to the financial statements. In the event of a downgrade of TCNZ Finance's credit rating to either Baa1 (Moody's Investors Service) or BBB+ (Standard & Poor's) US$65 million (based on rates at 30 June 2011) of additional collateral would be required to be posted.

TCNZ Finance places its cash, short-term investments and derivative financial instruments with high credit quality financial institutions and sovereign bodies and limits the amount of credit exposure to any one financial institution. These limits are monitored daily.

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 2011 TCNZ Finance had a committed stand-by facility of NZ$700 million (30 June 2010: NZ$700 million) with a number of credit-worthy banks. As at 30 June 2011 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.

As the proposed demerger may take place within twelve months of the balance sheet date, it is possible that Telecom may repay more of the debt within twelve months than it is contractually obliged to as part of a wider debt restructuring programme.

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.

Note 13 Financial instruments and risk management (continued)

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

30 June 2011	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 and collateral funds	317	317	317	-	-	-	-	-	-
Due from other Telecom Group companies	13,699	13,699	13,699	-	-	-	-	-	-
Investments	540	540	540	-	-	-	-	-	-
	14,556	14,556	14,556	-	-	-	-	-	-
Derivative financial assets									
Cross-currency interest rate swaps-(gross settled)									
Inflows	128	829	19	7	323	24	27	28	401
Outflows		(578)	(5)	(20)	(269)	(7)	(7)	(7)	(263)
Forward exchange contracts-(gross settled)									
Inflows	18	513	459	40	13	1	-	-	-
Outflows		(497)	(452)	(35)	(9)	(1)	-	-	-
Currency options									
Inflows	1	1	-	1	-	-	-	-	-
	147	268	21	(7)	58	17	20	21	138
Non-derivative financial liabilities									
Due to other Telecom Group companies	(10,099)	(10,099)	(10,099)	-	-	-	-	-	-
Short-term debt	(93)	(93)	(93)	-	-	-	-	-	-
Long-term debt	(2,004)	(2,465)	(363)	(62)	(701)	(402)	(120)	(190)	(627)
	(12,196)	(12,657)	(10,555)	(62)	(701)	(402)	(120)	(190)	(627)
Derivative financial liabilities									
Interest rate swaps-(net settled)	(151)	(185)	(33)	(30)	(45)	(25)	(15)	(12)	(25)
Cross-currency interest rate swaps-(gross settled)									
Inflows		1,413	353	29	29	374	16	16	596
Outflows	(493)	(2,215)	(664)	(22)	(59)	(437)	(55)	(59)	(919)
Forward exchange contracts-(gross settled)									
Inflows		225	180	35	9	1	-	-	-
Outflows	(18)	(243)	(189)	(40)	(13)	(1)	-	-	-
Currency options									
Outflows	(1)	(1)	-	(1)	-	-	-	-	-
	(663)	(1,006)	(353)	(29)	(79)	(88)	(54)	(55)	(348)
Total	**1,844**	**1,161**	**3,669**	**(98)**	**(722)**	**(473)**	**(154)**	**(224)**	**(837)**

Note 13 Financial instruments and risk management (continued)

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 and collateral funds	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	(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)**

Carrying amounts are as disclosed on the balance sheet 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.

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 2011 was $540 million (30 June 2010: $540 million).

Note 13 Financial instruments and risk management (continued)

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	2011		2010	
	Assets	Liabilities	Assets	Liabilities
	$m	$m	$m	$m
Cash flow hedges				
Interest rate swaps	-	(151)	-	(146)
Cross-currency interest rate swaps	40	(422)	47	(245)
Currency options	1	(1)	-	-
	41	(574)	47	(391)
Designated as held for trading				
Forward exchange contracts	18	(17)	28	(24)
Cross-currency interest rate swaps	88	(72)	53	(49)
	106	(89)	81	(73)
Total net derivatives	**147**	**(663)**	**128**	**(464)**

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. As the proposed demerger is planned to take place within twelve months of the balance sheet date, it is possible that Telecom may repay more of its debt within twelve months than it is contractually obliged to as part of a wider debt restructuring programme. Such repayment would result in related forecast interest payments no longer occurring. Any corresponding interest rate derivatives would be accounted for as described below. The fair values by maturity are as follows:

30 June	2011	2010
	$m	$m
Maturity:		
Less than 1 year	2	(5)
1 – 2 years	(4)	9
2 – 3 years	(10)	(3)
3 – 4 years	-	(2)
4 – 5 years	(1)	-
Maturity thereafter	(61)	(30)
	(74)	**(31)**

Note 13 Financial instruments and risk management (continued)

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, all hedged forecast transactions occurred as expected. There has been no material ineffectiveness on cash flow hedging relationships during the period (30 June 2010: nil).

Reconciliation of movements in the hedge reserve are as follows:

Year ended 30 June	2011			2010		
	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			(21)			(17)
Gain/(loss) recognised in other comprehensive income	(117)	35	(82)	62	(18)	44
Amount reclassified from cash flow hedge reserve to finance expense	73	(22)	51	(68)	20	(48)
Balance at the end of the year			**(52)**			**(21)**

Note 14 Concentration of funding

30 June	2011 $m	2010 $m
Funding consists of:		
Debt due within one year	397	191
Due to other Telecom Group companies	10,099	9,995
Long-term debt	1,700	2,137
Total funding	**12,196**	**12,323**
Concentration of funding by economic sector:		
Commercial and financial	2,097	2,328
Due to other Telecom Group companies	10,099	9,995
Total funding	**12,196**	**12,323**
Concentration of funding by geographical areas:		
Within New Zealand	8,008	8,150
Overseas:		
Australia	412	201
Bermuda	1,376	1,358
Europe	1,627	1,744
Other	773	870
Total funding	**12,196**	**12,323**

Note 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.

30 June	2011 $m	2010 $m
Credit exposures consist of:		
Cash	207	195
Collateral funds	110	21
Due from other Telecom Group companies	10,377	10,341
Debentures issued by fellow subsidiary	3,322	3,157
Derivative financial instruments	147	128
Total credit exposure	**14,163**	**13,842**
Credit exposures by economic sector:		
Commercial and financial	464	344
Due from other Telecom Group companies	13,699	13,498
Total credit exposure	**14,163**	**13,842**
Credit exposures by geographical areas:		
New Zealand	10,545	10,197
Australia	3,455	3,534
USA	113	34
Other	50	77
Total credit exposure	**14,163**	**13,842**

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

TCNZ Finance has certain derivative transactions and debt agreements 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 2011, US$91 million (NZ$ 110 million) of collateral was posted (30 June 2010: US$ 15 million, or NZ$ 21 million). 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$65 million (based on rates at 30 June 2011) of additional collateral. Collateral calls can be made by either party if the fair value of the agreement changes due to market conditions.

Note 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	2011 $m	2010 $m
Cross-currency interest rate swaps	346	346
Forward exchange contracts	179	281

Note 17 Fellow subsidiary companies

At 30 June 2011 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 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.*
Easycall 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.*

Note 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 2011	**New Zealand operations $m**	**Australian operations $m**	**Other operations $m**	**Consolidated $m**
Finance income	794	22	86	902
Net earnings for the year	367	(68)	4	303
Investments	540	-	-	540
Total assets	11,136	1,131	2,461	14,728
Total liabilities	(9,263)	(1,266)	(2,391)	(12,920)

Note 18 Segmental reporting (continued)

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)

Note 19 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.

TCNZ Finance has elected to be a member of the Telecom Imputation Group. As at 30 June 2011 the Telecom Imputation Group account had a closing credit balance of $34 million (30 June 2010: credit balance of $3 million). Any imputation credits within the Telecom Imputation Group are available to be attached to dividends paid by TCNZ Finance.

Note 20 Reconciliation of net earnings to net cash flows from operating activities

Year ended 30 June	2011 $m	2010 $m
Net earnings	303	139
Adjustments to reconcile net earnings to net cash flows from operating activities		
Amortisation of discount	6	8
Foreign exchange (gain)/loss	(115)	13
Revaluation of derivatives	(5)	13
Other	4	1
Changes in assets and liabilities net of effects of non-cash and investing and financing activities		
Increase in interest payable	(2)	-
Increase in current taxation	71	66
Net cash flows from operating activities	**262**	**240**

Note 21 Commitments and Contingencies

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

Note 22 Significant events after balance date

There were no significant events after balance date.

Note 23 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 2011 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:

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 July 2013

The standard adds the requirements related to the classification and measurement of financial assets and liabilities and derecognition of financial assets and liabilities.

NZ IFRS 7 Amendments to financial instruments: disclosures

Effective for periods beginning on or after 1 July 2011

These amendments are intended to provide greater transparency around risk exposures when a financial asset transferred by the transferor retains some level of continuing exposure in the asset.

IFRS 10 Consolidated financial statements

Effective for periods beginning on or after 1 July 2013

The standard builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company and provides additional guidance to assist in the determination of control where this is difficult to assess.

IFRS 12 Disclosure of involvement with other entities

Effective for periods beginning on or after 1 July 2013

The standard applies to entities that have an interest in subsidiaries, joint arrangements, associates or unconsolidated structured entities. It establishes disclosure objectives and specifies minimum disclosures that an entity must provide to meet those objectives.

IFRS 13 Fair value measurement

Effective for periods beginning on or after 1 July 2013

The standard establishes a single framework for measuring fair value where that is required by other standards and is applicable to both financial and non-financial items.

To the Shareholder of TCNZ Finance Limited

We have audited the accompanying financial statements of TCNZ Finance Limited ('the Company') on pages 5 to 33. The financial statements comprise the statement of financial position as at 30 June 2011, the income statement and statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation of the financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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

Basis of opinion

In our opinion the financial statements on pages 5 to 33:

- comply with generally accepted accounting practice in New Zealand;
- give a true and fair view of the financial position of the Company as at 30 June 2011 and of its financial performance and cash flows for the year then ended.

Report on Other Legal and Regulatory Requirements

In accordance with the requirements of sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993, we report that:

- we have obtained all the information and explanations that we have required; and
- in our opinion, proper accounting records have been kept by TCNZ Finance Limited as far as appears from our examination of those records.

KPMG

29 August 2011
Wellington

Contact Information

Registered office
The registered office of TCNZ Finance is:

Level 2
Telecom Place
167 Victoria Street West
Auckland, 1142

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

Computershare Investor Services
Private Bag 92119
Auckland, 1142
Ph:0-9-488 8777
Fax:0-9-488 8788
NZ Toll Free: 0800 737 100
Email: enquiry@computershare.co.nz
Website: www.computershare.com

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:

Investor Relations Manager
Telecom New Zealand
Private Bag 92028
Auckland, 1011
New Zealand

Visit the Telecom website at www.telecom.co.nz telecom[nz]

http://investor.telecom.co.nz