

TELECOM SOUTH LIMITED

NOTES TO THE FINANCIAL STATEMENTS

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1 STATEMENT OF ACCOUNTING POLICIES

(a) CONSTITUTION, OWNERSHIP AND ACTIVITIES

Telecom South Limited (the "Company"), was incorporated on 6th December 1988 and is a wholly-owned subsidiary of Telecom Corporation of New Zealand Limited (the "parent company" or "Telecom").

With effect from 1 April 1989 Telecom was restructured into a number of Regional Operating and New Venture companies and as a result, transferred to certain subsidiaries, including Telecom South Limited, at net book value, the telecommunication equipment and other assets and liabilities relating to business previously conducted by Telecom. Telecom and its subsidiaries now together form the Telecom "Group".

The parent company was wholly-owned by Her Majesty the Queen in Right of New Zealand (the "Crown") until 12 September 1990, when, pursuant to an agreement dated 14 June 1990, the Crown sold its shares to subsidiaries of two American companies, Ameritech Corporation ("Ameritech") and Bell Atlantic Corporation ("Bell Atlantic"). Ameritech and Bell Atlantic then agreed to sell a combined 10% interest to a company (Carla Nominees Limited) controlled by two New Zealand companies, Freightways Holdings Ltd ("Freightways") and Midavia Holdings Ltd ("Midavia"), formerly Fay, Richwhite Holdings Ltd. To comply with their agreement with the Crown, Ameritech and Bell Atlantic are obligated to reduce their combined ownership of Telecom to not more than 49.9% of the outstanding share capital by September 1993 (or, under certain circumstances and with the consent of the New Zealand government, by September 1994). At the completion of this transaction period, Ameritech and Bell Atlantic will each own not more than 24.95% of Telecom.

In July 1991, to satisfy partially this obligation, Ameritech and Bell Atlantic sold 724.5 million shares in Telecom (representing approximately 31% of the then outstanding share capital) to the public and institutions in a worldwide offering.

At 30 September 1991, Ameritech and Bell Atlantic held a combined 1,614,441,112 ordinary shares (68.4% of the outstanding share capital) and Carla Nominees Limited held 11,058,888 ordinary shares (0.5%).

The Crown holds, and will continue to hold, one special rights convertible preference share (the "Kiwi Share") in Telecom which assures that:

- A local free-calling option will be maintained for all residential customers.
- The standard residential rental for ordinary residential telephone service will not rise faster than the cost of living as measured by the New Zealand Consumer Price Index unless Telecom's regional operating company profits are unreasonably impaired.
- Line rentals for residential customers in rural areas will be no higher than the standard residential rental, and ordinary residential telephone service will remain as widely available as it was as at 11 September 1990.

The principal activity of Telecom South Limited is the provision of telecommunication services in the South Island.