SUPPLEMENT TO

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# POWERCO LIMITED

## INFORMATION FOR DISCLOSURE

PURSUANT TO THE GAS (INFORMATION DISCLOSURE) REGULATIONS 1997

## POWERCO LIMITED

## GAS (INFORMATION DISCLOSURE) REGULATIONS 1997

## CERTIFICATION OF FINANCIAL STATEMENTS, PERFORMANCE MEASURES, AND STATISTICS DISCLOSED BY PIPELINE OWNERS OTHER THAN THE CORPORATION

We, Sriyan Elanga Ekanayake, director, and Richard Euan Krogh, director of Powerco Limited certify that, having made all reasonable enquiry, to the best of our knowledge:

(a) The attached audited financial statements of Powerco Limited, prepared for the purposes of regulation 6 of the Gas (Information Disclosure) Regulations 1997, comply with the requirements of that regulation; and

(b) The attached information, being financial performance measures, efficiency performance measures, energy delivery performance measures and statistics, and reliability performance measures in relation to Powerco Limited, and having been prepared for the purposes of regulations 15 to 19 of the Gas (Information Disclosure) Regulations 1997, complies with the requirements of those regulations.

Date: 27th November 2008

## POWERCO LIMITED

### GAS (INFORMATION DISCLOSURE) REGULATONS 1997

### STATUTORY DECLARATION IN RESPECT OF STATEMENTS AND INFORMATION SUPPLIED TO SECRETARY OF COMMERCE

I, Sriyan Elanga Ekanayake, of Level 2, Civic Centre Building, New Plymouth, being a director of Powerco Limited, solemnly and sincerely declare that having made all reasonably enquiry, to the best of my knowledge, the information attached to this declaration is a true copy of information made available to the public under the Gas (Information Disclosure) Regulations 1997.

And I make this solemn declaration conscientiously believing the same to be ~~true~~ and by virtue of the Oaths and Declarations Act 1957.

Declared at New Plymouth this 27th day of November 2008

Goodeve

Justice of the Peace (or Solicitor or other person authorised to take a statutory declaration)

Paul Goodeve
Solicitor
New Plymouth.

POWERCO

GAS DIVISION

## Income Statement
## For the year ended 30 June 2008

| | Notes | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
|---|---|---|---|
| **Revenue** | 1 | 50,565 | 54,563 |
| Cost of goods sold | | - | - |
| **Gross profit** | | 50,565 | 54,563 |
| Other (losses)/gains | 1 | (3,040) | 5,350 |
| Operating expenses | 1 | (5,780) | (8,158) |
| Administration expenses | 1 | (8,549) | (7,584) |
| Other expenses | 1 | (10,876) | (11,343) |
| **Earnings before interest and taxation** | | 22,320 | 32,828 |
| Finance costs | 1 | (21,547) | (19,660) |
| **Operating Surplus before Taxation** | | 773 | 13,168 |
| Taxation expense / (benefit) | 2 | 795 | (1,073) |
| **OPERATING SURPLUS/(DEFICIT) AFTER TAXATION** | | (22) | 14,241 |

The accompanying notes form part of these financial statements.

POWERCO

GAS DIVISION

## Statement of Changes in Equity
## For the year ended 30 June 2008

| | | Contributed Capital NZ$000 | Retained Earnings NZ$000 | Hedge Reserve NZ$000 | TOTAL NZ$000 |
|---|---|---|---|---|---|
| **Balance as at 30 June 2006** | | 119,080 | (34,926) | (1,618) | 82,536 |
| Cash flow hedges - gain/(loss) taken to equity | | - | - | 3,091 | 3,091 |
| Income tax on items taken directly to equity | 2 | - | - | (486) | (486) |
| **Net income recognised directly in equity** | | - | - | 2,605 | 2,605 |
| Profit for the period | | - | 14,241 | - | 14,241 |
| **Total recognised income and expense** | | - | 14,241 | 2,605 | 16,846 |
| Dividends | | - | (12,902) | - | (12,902) |
| Increase in contributed capital | 11 | 2,322 | - | - | 2,322 |
| **Balance as at 30 June 2007** | | 121,402 | (33,587) | 987 | 88,802 |
| Cash flow hedges - gain/(loss) taken to equity | | - | - | (1,537) | (1,537) |
| Income tax on items taken directly to equity | 2 | - | - | 319 | 319 |
| **Net income recognised directly in equity** | | - | - | (1,218) | (1,218) |
| Loss for the period | | - | (22) | - | (22) |
| **Total recognised income and expense** | | - | (22) | (1,218) | (1,240) |
| Dividends | | - | (8,373) | - | (8,373) |
| **Balance as at 30 June 2008** | | 121,402 | (41,982) | (231) | 79,189 |

The accompanying notes form part of these financial statements.

POWERco

GAS DIVISION

## Balance Sheet
## As at 30 June 2008

| | Notes | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
|---|---|---|---|
| **Equity** | | | |
| Contributed capital | | 121,402 | 121,402 |
| Retained earnings | | (41,982) | (33,587) |
| Reserves | | (231) | 987 |
| | | 79,189 | 88,802 |
| **Non Current Liabilities** | | | |
| Borrowings | 3 | 239,016 | 187,032 |
| Other financial liabilities | 4 | 18,190 | 24,485 |
| Inter-division account | | 16,896 | 18,496 |
| Deferred tax liability | 2 | 37,561 | 31,745 |
| | | 311,663 | 261,758 |
| **Current Liabilities** | | | |
| Borrowings | 3 | 9 | 42,803 |
| Provisions | 6 | 259 | 264 |
| Trade and other payables | | 3,827 | 3,213 |
| | | 4,095 | 46,280 |
| **Total Equity and Liabilities** | | 394,947 | 396,840 |
| **Non Current Assets** | | | |
| Property, plant and equipment | 7 | 380,262 | 379,105 |
| Other intangibles | 8 | 192 | 471 |
| Other financial assets | 4 | 3,895 | 8,634 |
| | | 384,349 | 388,210 |
| **Current Assets** | | | |
| Trade and other receivables | | 3,990 | 4,678 |
| Income tax receivable | | 6,000 | 3,952 |
| Other financial assets | 4 | 608 | - |
| | | 10,598 | 8,630 |
| **Total Assets** | | 394,947 | 396,840 |

The accompanying notes form part of these financial statements.

# POWERCO LIMITED

## Gas Division

## Statement of Accounting Policies for the Financial Statements for the Year ended 30 June 2008

### Reporting Entity

These financial statements represent the performance and position of Powerco Limited's gas business (Powerco gas division).

The financial statements are presented in accordance with the Gas (Information Disclosure) Regulations 1997.

The financial statements have been derived from the audited financial statements of Powerco Limited and Group, which were prepared in accordance with New Zealand equivalents to financial reporting standards (NZ IFRS), as appropriate for profit-orientated entities.

Due to the absence of a Gas Information Disclosure Handbook, the Electricity Information Disclosure Handbook has been used as a guide in the preparation of these financial statements.

The avoidable cost allocation methodology (ACAM) has been used to allocate costs, assets and liabilities between the gas business and other businesses of Powerco Limited.

The financial statements were approved for issue on 27 November 2008.

### Critical accounting estimates and judgements

In the process of applying the division's accounting policies management have made no judgements that have had a significant effect on the amounts recognised in the financial statements.

The key assumptions concerning the future and other key sources of estimation uncertainty at 30 June 2008, that have had a significant risk of causing a material adjustment to the carrying amount of assets and liabilities are discussed below:

> Useful lives of property, plant and equipment
> The Division reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period. In this financial year it was deemed that no change to the estimated useful lives was needed.
>
> Impairment of Network Assets
> Determining whether the network assets are impaired requires an estimation of the value in use of the cash-generating units to which the networks have been allocated. The value in use calculation requires the directors to estimate the future cash flows expected to arise from the cash generating unit and a suitable discount rate in order to calculate present value.

### Basis of preparation

The financial statements have been prepared on the historical cost basis, except for certain borrowings and financial instruments. Financial derivatives are carried at fair value and borrowings which have effective fair value hedges are carried at amortised cost adjusted for the fair value of interest rate risk covered by the effective hedge. The principal accounting policies adopted are set out below.

**a) Cash and cash equivalents**

Cash and cash equivalents comprise cash in hand, cash in banks and investments in money market instruments. Bank overdrafts are shown within borrowings in current liabilities in the Balance Sheet.

**b) Property, plant and equipment**

All items of property, plant and equipment are initially recognised at cost in the Balance Sheet. Cost includes the value of consideration exchanged, or fair value in the case of donated or subsidised assets, and those costs directly attributable to bringing the item to working condition for its intended use.

Land and buildings are revalued from time to time for insurance purposes only. Any impairment is recognised for accounting purposes and recognised in the Income Statement.

The gain or loss on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the profit and loss.

**c) Depreciation of property, plant and equipment**

Depreciation is calculated on a straight-line basis for Network Systems and on diminishing value basis for all other assets, to write off the cost of the assets (other than land) over the life of the assets.

Depreciation rates based on remaining useful life, for major classes of asset are:

| | |
|---|---|
| Network assets | 10 to 65 years |
| Plant and equipment | 5 to 10 years |

**d) Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

**e) Financial assets**

Financial assets are recognised and derecognised on trade date where purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned. They are initially measured at fair value plus transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into one of four categories; financial assets at fair value through profit or loss, held to maturity investments, available for sale financial assets or loans and receivables. At balance date the Division had the following classes of financial assets:

Financial assets at fair value through profit or loss

Other financial assets relate to outstanding derivatives at year end. All derivative assets are measured at fair value through profit or loss, except for derivatives that are designated and effective cash flow hedges. Effective cash flow hedges are measured at fair value with the movement on these assets are recorded directly in the hedging reserve in the Statement of Changes in Equity. Refer to (i) for the accounting policy on derivative financial instruments.

Loans and receivables

Cash and cash equivalents and trade and other receivables are recorded at amortised cost using the effective interest rate method, less impairment.

**f) Financial liabilities**

Financial liabilities are recognised when the entity became party to the contractual provisions of the instrument.

The Division derecognises financial liabilities when and only when the Division's obligations are discharged, cancelled or expire.

Financial liabilities are classified as either financial liabilities at fair value through profit or loss or other financial liabilities.

Financial liabilities at fair value through profit or loss

Other financial liabilities relate to outstanding derivatives at year end. All derivative liabilities are measured at fair value through profit or loss, except for derivatives that are designated and effective cash flow hedges. Effective cash flow hedges are measures at fair value with the movement on these liabilities are recorded directly in the hedging reserve in the Statement of Changes in Equity. Refer to (i) for the accounting policy on derivative financial instruments.

Other financial liabilities

Trade and other payables are borrowings are financial instruments that are initially measured at fair value, net of transaction costs. They are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective interest basis.

**g) Term debt**

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing. Subsequent to initial recognition, loans and borrowings are carried at amortised cost. Borrowing costs are recognised as an expense when incurred, except to the extent that they are capitalised in accordance with (d) above.

All interest bearing loans and borrowings are measured at amortised cost using the effective interest rate method which allocates the cost through the expected life of the borrowing. Amortised cost is calculated taking account of issue costs, and any discounts or premiums on draw down.

After initial recognition for those interest-bearing loans and borrowings where fair value hedge accounting is applied, the loan balance is adjusted for the change in the hedge risk only. The Division's policy is to hedge the interest/foreign currency risk associated with term debt with financial instruments on matched terms.

Borrowings are classified as current liabilities (either advances and deposits or current portion of term debt) unless the Division has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

**h) Trade and other payables**

Trade payables and other accounts payable are recognised when the Division becomes obliged to make future payments resulting from the purchase of goods and services. Subsequent to initial recognition, trade payables and other accounts payable are recorded at amortised cost. Given the nature of these liabilities amortised cost equals their notional principal.

**i) Derivative financial instruments**

Financial derivatives are initially recognised in the Balance Sheet at fair value on the date a derivative contract is entered into and are subsequently measured at their fair value on each balance sheet date, though the method of recognising the resulting gains and losses is dependent on whether hedge accounting is applied. When derivative contracts are entered into, the Division designates them as either;

- Hedges of the fair value of recognised assets or liabilities (fair value hedge); or
- Hedges of forecast transactions or firm commitments (cash flow hedge) which hedge exposures to variability in cash flows; or
- Other derivative financial instruments not meeting hedge accounting criteria.

The fair values of financial derivatives are determined by reference to the market quoted rates input into valuation models for interest and currency swaps, forwards and options. Changes in fair value of derivatives are recognised:

- For fair value hedges which are highly effective, the movements are recorded in the Income Statement alongside any changes in the fair value of the hedged items;
- For cash flow hedges that are determined to be highly effective to the extent the hedges are effective, the movements are recognised in equity with the ineffective portion recognised in the Income Statement; and for those that are ineffective the movements are recognised in the Income Statement;
- All other movements in the fair value of derivative financial instruments are recorded in the Income Statement.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are deferred in equity. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss in the "other gains and losses" line in the income statement. Amounts deferred in equity are recycled in profit or loss in the periods when the hedged item is recognised in profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

Hedge accounting is discontinued prospectively when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, if the forecast transaction is still expected to occur, any cumulative gain or loss on the hedging instrument is recognised in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the Income Statement for the period.

Fair value hedges

Hedge accounting is discontinued when the hedge instrument expires or is sold, terminated or no longer qualifies for hedge accounting. The adjustments to the carrying amount of the hedge item arising from the hedged risk is amortised to the Income Statement from that date.

**j) Employee entitlements**

Provision is made for benefits accruing to employees in respect of wages and salaries, annual leave, long service leave and sick leave when it is probable that settlement will be required and they are capable of being measured reliably.

Provisions made in respect of employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits which are not expected to be settled within 12 months are measured as the present value of the estimated future cash outflows to be made by the Division in respect of services provided by employees up to reporting date.

Defined superannuation plans
For Defined Contribution Superannuation Plans, the Division recognises and expenses the obligation during the period they arise.

There are a small number of employees that are part of a state Defined Benefit Superannuation plan. The Division has no legal or constructive obligation to pay future benefits, the Crown guarantees these benefits, as a result the plans are accounted for as a defined contribution plan.

**k) Impairment**

Intangible assets that have indefinite useful lives are not subject to amortisation and are assessed for impairment at each reporting date. If the estimated recoverable amount of an asset is less than its carrying amount, the asset is written down to its estimated recoverable amount and an impairment loss is recognised in the Income Statement.

A cash generating unit is the lowest division of assets for which there are separately identified cash flows.

At each reporting date, the Division reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Division estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in the Income Statement immediately, unless the relevant asset is carried at fair value, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in the Income Statement immediately, unless the relevant asset is carried at fair value, in which case the reversal of the impairment loss is treated as a revaluation increase.

**l) Contributed capital**

Contributed capital represents the funds provided by Powerco Limited to the Powerco gas division.

**m) Dividend distribution**

Dividend distribution to the Powerco's shareholders is recognised as a liability in the Division's financial statements in the period in which the shareholders right to receive payment has been established.

**n) Leases**

Operating lease payments, where the lessors effectively retain substantially all the risks and rewards of ownership of the leased items, are included in the determination of profit before taxation in equal instalments over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

**o) Revenue recognition**

Revenue is recognised at the fair value of sales of goods and services, net of GST, rebates, discounts and capital contributions.

Revenue from the rendering of services is recognised in the accounting period in which the services are rendered based upon usage or volume throughput during that period.

**p) Taxation**

The amount recognised for current tax is based on the net profit for the period as adjusted for non-assessable and non-deductible items. It is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred income tax is provided, using the comprehensive balance sheet liability method, on all temporary differences at the balance sheet date between the tax base of the assets and liabilities and their carrying amounts in the financial statements.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax to be utilised.

Deferred income tax assets and liabilities are measured at tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at balance sheet date.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow the manner in which the Division expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the division intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax is recognised as an expense or income in the Income Statement, except when it relates to items credited or debited directly to equity, in which case the deferred tax or current tax is also recognised directly in equity, or where it arises from the initial accounting for a business combination, in which case it is taken into account in the determination of goodwill or excess.

**q) Inter-division account**

The inter-division account represents the balance due to other Divisions within Powerco Limited. The balance is the result of inter-divisional transactions since the Division was established.

**Changes in Accounting Policies**

There have been no changes in accounting policies during the year.

**Standards, Amendments and Interpretations issued but not yet effective**

At the date of authorisation of the financial report, a number of Standards and Interpretations were in issue but not yet effective.

Initial application of the following Standards will not affect any of the amounts recognised in the financial report, but will change the disclosures presently made in relation to the Division's financial report:

| Standard | Effective for annual reporting periods beginning on or after | Expected to be initially applied in the financial year ending |
|---|---|---|
| NZ IAS-1 'Presentation of Financial Statements' – Revised Standard | 1 January 2009 | 30 June 2010 |
| NZ IFRS-8 'Operating Segments' | 1 January 2009 | 30 June 2010 |

Initial application of the following Standards and Interpretations is not expected to have any material impact to the financial statements of the Division :

| Standard/Interpretation | Effective for annual reporting periods beginning on or after | Expected to be initially applied in the financial year ending |
|---|---|---|
| NZ IAS-23 'Borrowing Costs' – revised standard | 1 January 2009 | 30 June 2010 |
| NZ IFRS-3 'Business Combinations' - Revised Standard | 1 July 2009 | 30 June 2010 |
| NZIAS-27 'Consolidated and Separate Financial Statements' – Revised Standard | 1 July 2009 | 30 June 2010 |
| NZIAS-32 'Financial Instruments: Presentation' and NZIAS-1 'Presentation of Financial Statements' – Puttable Financial Instruments and Obligations Arising on Liquidation – Revised Amendments. | 1 January 2009 | 30 June 2010 |
| Improvements to New Zealand Equivalents to International Financial Reporting Standards 2008 | Various* | 30 June 2010 |

Other standards/interpretations which are not included above are not relevant to the Division.

* The effective date and transitional provisions vary by Standard. Most of the improvements are effective for annual periods beginning on or after 1 January 2009, with earlier adoption permitted, and they are to be applied retrospectively.

**Notes to and Forming Part of the Financial Statements**
For the year ended 30 June 2008

POWERCO

GAS DIVISION

## 1 REVENUE AND EXPENDITURE

| | Year to 30 June 2008 NZ$000 | Year to 30 June 2007 NZ$000 |
|---|---|---|
| **Operating Revenue** | | |
| Line charge revenue | 50,565 | 54,563 |
| Interest revenue | - | - |
| | 50,565 | 54,563 |
| **EXPENDITURE** | | |
| **Operating expenses** | | |
| Repairs and maintenance costs | 5,780 | 8,158 |
| **Administration expenses** | | |
| Human resource costs | 171 | 160 |
| Bad debts | - | 57 |
| Corporate & administration | 7,326 | 6,547 |
| Marketing & advertising | 228 | 205 |
| Consulting & legal expenses | 824 | 615 |
| | 8,549 | 7,584 |
| **Other expenses** | | |
| Depreciation on network assets | 9,714 | 9,804 |
| Depreciation on plant and equipment | 883 | 1,086 |
| Amortisation of intangibles | 279 | 453 |
| | 10,876 | 11,343 |
| **Finance costs** | | |
| Interest expense | 21,547 | 19,660 |
| **Other losses/(gains)** | | |
| Change in fair value of assets and liabilities classified as held for trading | 3,040 | (5,350) |
| **Total expenditure** | 49,792 | 41,395 |

## 2 TAXATION

| | Year to 30 June 2008 NZ$000 | Year to 30 June 2007 NZ$000 |
|---|---|---|
| **Income tax recognised in the Income Statement** | | |
| Tax expense / (benefit) comprises: | | |
| Current tax expense / (benefit) | (5,340) | (5,495) |
| Deferred tax on temporary differences | 6,901 | 7,307 |
| Effect of changes in tax rates and laws | (766) | (2,885) |
| | 795 | (1,073) |
| **The total charge for the period can be reconciled to the accounting profit as follows:** | | |
| Operating surplus before taxation | 773 | 13,168 |
| Prima facie taxation @ 33% | 255 | 4,346 |
| Tax effect of expenses/(revenue) that are not deductible in determining taxable profit | 1,306 | (2,534) |
| Effect of changes in tax rates | (766) | (2,885) |
| Taxation expense / (benefit) | 795 | (1,073) |

The tax rate used in the above reconciliation is the corporate tax rate of 33% payable by New Zealand corporate entities on taxable profits under New Zealand tax law. The corporate tax rate in New Zealand is to change from 33% to 30% with effect from 1 April 2008. This revised rate has not impacted the current tax payable for the current year but next year the current tax will be calculated on the corporate tax rate of 30%. However, the impact of the change in tax rate has been taken into account in the measurement of deferred taxes at the end of the reporting period.

All temporary differences have been recorded in the financial statements.

**Income Tax - Resolution of IRD Tax Dispute Risk:**

There is currently an Inland Revenue Department ("IRD") investigation into Powerco's allocation of the purchase price between non- depreciable and the tangible depreciable assets of the Central Power ("CP") and former Powerco amalgamation in 2000. The IRD was also challenging the AGL NZ Energy Limited ("AGL") acquisition in 2001 and the United Networks Limited ("UNL") acquisition in 2002. The IRD queried Powerco's use of the market value of assets as the basis for calculating depreciation and the goodwill allocated to the transactions.

The IRD issued two Notices of Proposed Adjustment which proposed disallowing depreciation calculated using the market value of the former Powerco and CP assets acquired by what is now Powerco Limited through the CP amalgamation. The Notices of Proposed Adjustment related to the 2002 income tax year onwards (the 2001 income tax year is statute barred).

Since November 2007 Powerco and its advisors have been in discussions with the IRD which has resulted in Powerco reaching an agreement with the IRD on both the CP and former Powerco networks and the AGL/UNL acquisitions. This agreement has now been formalised by way of a written "Agreed Settlement" between Powerco Limited and the IRD.

This agreement reflects an amount attributed to goodwill of $50 million (with a commensurate reduction in tax depreciable assets) for the CP and former Powerco networks as at 1 September 2000. The written down value of this goodwill amount as at 30 June 2008 was $24.478 million, of which $2.275 million relates to the gas division. Subject to the outcome of discussions with the IRD on the tax treatment of customer contributions there will be no immediate cash tax payment, no use of money interest and no shortfall penalties. The impact of the amount attributed to the tax depreciable assets being reduced by $50 million is a reduction of future tax depreciation entitlements. The IRD has advised that it will not be pursing an adjustment in respect of the UNL and AGL acquisitions. This agreement with the IRD has been recognised in the financial statements as at 30 June 2008 and an amount of $8.483 million ($2.372 million relates to the gas division) has been debited to the Profit & Loss Statement tax expense account to adjust for the tax effect of the embedded goodwill amount in the tax depreciable assets.

In addition to this agreement Powerco has two small outstanding issues to resolve with the IRD, being the depreciation claimed on the zone substations and the tax treatment of customer contributions in the 2002 to 2005 income tax years.

| | | |
|---|---|---|
| **Income tax recognised directly in equity** | | |
| Deferred tax - revaluation of financial instruments treated as cash flow hedges | (319) | 486 |

**Notes to and Forming Part of the Financial Statements**
For the year ended 30 June 2008

POWERCO

GAS DIVISION

| Deferred tax - temporary differences | Property, plant & equipment NZ$000 | Cash flow hedges NZ$000 | TOTAL NZ$000 |
|---|---|---|---|
| **Balance 30 June 2006** | 26,837 | - | 26,837 |
| Charged / (credited) to the Income Statement | 5,266 | 2,041 | 7,307 |
| Charged to equity | - | 486 | 486 |
| Change in tax rate | (2,885) | - | (2,885) |
| **Balance 30 June 2007** | 29,218 | 2,527 | 31,745 |
| Charged / (credited) to the Income Statement | 7,941 | (1,040) | 6,901 |
| Charged to equity | - | (319) | (319) |
| Change in tax rate | (660) | (106) | (766) |
| **Balance 30 June 2008** | 36,499 | 1,062 | 37,561 |

## 3 BORROWINGS

| | | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
|---|---|---|---|
| Non-current liabilities at amortised cost | | | |
| Subordinated bonds | | 20,796 | 20,446 |
| Guaranteed bonds | | 88,332 | 86,916 |
| US dollar private placement notes | | 48,920 | 44,981 |
| Commercial bank debt | | 42,980 | 34,689 |
| Commercial paper facility | | 32,311 | - |
| Working capital advance facility | (note 5) | 5,677 | - |
| | | 239,016 | 187,032 |
| Current liabilities at amortised cost | | | |
| Bank overdraft | (note 5) | 9 | 321 |
| Commercial paper facility | | - | 32,521 |
| Commercial bank debt | | - | 5,799 |
| Working capital advance facility | (note 5) | - | 4,162 |
| | | 9 | 42,803 |

| (a) Subordinated bonds | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
|---|---|---|
| Subordinated bonds | 21,540 | 21,680 |
| Adjustment for the fair value of the interest rate risk | (465) | (815) |
| | 21,075 | 20,865 |
| Deferred funding costs | (279) | (419) |
| **Carrying value of subordinated bonds** | 20,796 | 20,446 |

$100 million of subordinated bonds were issued on 15 April 2005 and are unsecured, subordinated debt obligations of Powerco Limited. They have a tenure of 5 years and have an interest rate of 7.64% p.a. fixed until expiry on 15 April 2010. $21.540 million (2007: $21.680 million) of subordinated bonds have been allocated to Powerco's gas division.

| (b) Guaranteed bonds | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
|---|---|---|
| 7 year guaranteed bonds | 21,538 | 21,679 |
| Adjustment for the fair value of the interest rate risk | (1,063) | (1,722) |
| 9 year guaranteed bonds | 21,538 | 21,679 |
| Adjustment for the fair value of the interest rate risk | (1,063) | (1,722) |
| 11 year guaranteed bonds | 10,769 | 10,839 |
| Adjustment for the fair value of the interest rate risk | (532) | (861) |
| 7 year guaranteed bonds | 28,003 | 28,183 |
| 12 year guaranteed bonds | 10,770 | 10,839 |
| | 89,960 | 88,914 |
| Deferred funding costs | (1,628) | (1,998) |
| **Carrying value of guaranteed bonds** | 88,332 | 86,916 |

$250 million of Guaranteed Bonds were issued on 29 March 2004 as unsecured debt obligations of Powerco Limited, of which $53.845 million has been allocated to the Powerco gas division (2007: $54.197 million). The scheduled payments by Powerco Limited of interest and principal are guaranteed on an unsecured basis by US-based XL Capital Assurance Inc, a specialist financial guaranty organisation. The bonds expire on 29 March 2011 (7 year bonds), 29 March 2013 (9 year bonds) and 29 June 2015 (11 year bonds). The interest rates on the bonds are fixed until maturity.

| | |
|---|---|
| 7 year guaranteed bonds | 6.22% |
| 9 year guaranteed bonds | 6.39% |
| 11 year guaranteed bonds | 6.53% |

On 28 September 2005 a $180 million issue of guaranteed bonds took place, as secured unsubordinated obligations of Powerco Limited, of which $38.773 million has been allocated to the Powerco gas division (2007: $39.022 million). The scheduled payments of interest and principal payable by Powerco Limited were again guaranteed on an unsecured basis by XL Capital Assurance. The bonds expire on 28 September 2012 (7 year bonds) and 28 September 2017 (12 year bonds). The interest rates on the bonds are fixed until maturity.

| | |
|---|---|
| 7 year guaranteed bonds | 6.59% |
| 12 year guaranteed bonds | 6.74% |

Under the trust documents constituting the guaranteed bonds, Powerco Limited has covenanted to ensure that, if XLCA defaults on its obligations under the Financial Guaranty, Powerco Limited will procure a sufficient number of its subsidiaries to guarantee its obligations under the guaranteed bonds by signing a subsidiary guarantee so that at all times the total tangible assets of Powerco Limited and all guaranteeing subsidiaries exceeds 85% of the total tangible assets of the Powerco Group. As at 30 June 2008, no Subsidiary Guarantee had been executed.

The guaranteed bonds are secured against the network assets of Powerco Limited through the Security Trust Deed.

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For the year ended 30 June 2008

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**c) US dollar private placement**

| | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
|---|---|---|
| 11 year US dollar private placement notes | 20,284 | 20,413 |
| 12 year US dollar placement notes | 19,558 | 19,776 |
| 13 year US dollar private placement notes | 23,543 | 23,604 |
| Adjustment for fair value of the interest rate risk | (14,099) | (18,381) |
| Deferred funding costs | (366) | (431) |
| **Carrying value of the US dollar private placement** | 48,920 | 44,981 |

$294.266 million of US dollar private placement notes were issued on 25 November 2003 to private US investors by Powerco Limited, of which $63.385 million has been allocated to the Powerco gas division (2007: $63.793 million). The coupon payments are semi-annual and the note issue expires 25 November 2014 (11 year), 25 November 2015 (12 year), and 25 November 2016 (13 year). The notes are secured against the network assets of Powerco Ltd through the Security Trust Deed.
The interest rates on the notes are fixed until maturity.

| | |
|---|---|
| 11 year US dollar private placement notes | 5.47% |
| 12 year US dollar private placement notes | 5.57% |
| 13 year US dollar private placement notes | 5.67% |

**d) Commercial paper facility**

Powerco Limited has established a commercial paper facility to enable Powerco Limited to borrow money from the capital market. The programme is supported by a cash advance facility of $200 million with a syndicate of banks made up of the Commonwealth Bank of Australia, Westpac Banking Corporation and ANZ National Bank. This facility expires in August 2009. The facility has the benefit of the Security Trust Deed dated 10 March 2005 as a Senior Secured Debtor Facility, and as such the principal is secured against the network assets of Powerco Limited. At 30 June 2008 a sum of $45,000,000, which includes an interest portion of $1,004,133 of 90 day bills at a weighted average interest rate of 9.15%, with varying maturity dates, had been drawn down under the commercial paper programme (2007: $150,000,000 was drawn down under the commercial paper programme which included an interest portion of $3,017,076 at a weighted average interest rate of 8.15%). An amount of $105,000,000 has been drawn on the standby facility at 30 June 2008, at a weighted average rate of 8.91% (2007:9.17%). As at year end the carrying value approximates the fair value.

At year end the amount of the commercial paper facility allocated to the Powerco gas division was $32.311 million (2007: $32.521 million).

**e) Commercial bank debt**

A $160 million Term Loan Facility agreed and drawn in August 2004, expiring August 2009, which was used to refinance the remaining tranche of the Asset Purchase Facility used to fund the acquisition by Powerco Limited of United Networks Limited (UNL) assets. The Term Loan Facility is jointly provided through Commonwealth Bank of Australia, Westpac Banking Corporation and ANZ National Bank, each with an equal share. The interest rate on the $160 million Term Loan Facility is currently 9.43%. The Term Loan Facility has the benefit of the Security Trust Deed, for the purposes of which it is designated as a Senior Secured Debt Facility and thus secured against the network assets of Powerco Limited. As at 30 June 2008 a sum of $160 million had been drawn (2006: $160 million with an interest rate of 8.71%).

During the period Powerco increased the revolving cash advances tranche of the existing $230 million Standby Cash Advances Facility from NZ$30 million to NZ$60 million. The purpose of this facility is the short-term funding of development capital expenditure, and the facility will be drawn down and repaid as funding is required. This additional amount of the facility is jointly provided by Westpac Banking Corporation, ANZ National Bank and Commonwealth Bank of Australia and is due to expire on 3 August 2009. As at 30 June 2008 NZ$45 million was drawn on the facility at a weighted average interest rate of was 9.06% (2007: NZ$30 million drawn at a rate of 8.59%).

At year end the amount of the term liabilities allocated to the gas division was $42.980 million (2007: $34.689 million). There was no current liability balance at year end (2007: $5.799 million).

As at the reporting date the carrying value approximates the fair value as interest rates are reset each quarter.

| | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
|---|---|---|
| Comprises: | | |
| Current liabilities | - | 5,799 |
| Term liabilities | 42,980 | 34,689 |
| **Total commercial bank debt** | 42,980 | 40,488 |

**f) Covenants**

Powerco Limited has covenanted with all counterparties to ensure certain financial criteria are met throughout the term of the debt agreements. There have been no covenant breaches to date.

**g) Financial assets and liabilities**

The following tables detail the fair value of financial liabilities

| | 30 June 2008 | | 30 June 2007 | |
|---|---|---|---|---|
| | Carrying Amount NZ$000 | Fair Value NZ$000 | Carrying Amount NZ$000 | Fair Value NZ$000 |
| Financial assets: | | | | |
| Interest rate swaps | 4,503 | 4,503 | 8,634 | 8,634 |
| | 4,503 | 4,503 | 8,634 | 8,634 |
| Financial liabilities: | | | | |
| Subordinated bonds | 20,796 | 20,796 | 20,446 | 20,446 |
| Guaranteed bonds | 88,332 | 83,051 | 86,916 | 84,160 |
| US dollar private placement notes | 48,920 | 48,920 | 44,981 | 44,981 |
| Commercial paper facilitites | 32,311 | 32,311 | 32,521 | 32,521 |
| Commerical bank debt | 42,980 | 42,980 | 40,488 | 40,488 |
| US cross currency interest rate swap | 14,124 | 14,124 | 18,407 | 18,407 |
| Interest rate swaps | 4,066 | 4,066 | 6,078 | 6,078 |
| | 251,529 | 246,248 | 249,837 | 247,081 |

The fair value of financial assets and financial liabilities are determined as follows:
- For floating rate debt carrying value approximates fair value due to continuing interest rate reset.
- For fixed rate debt opposing floating rate derivative instruments matching tenor and term are used in offset position to calculate fair values. The movements in these derivatives approximate movements in market values.
- The fair value of financial derivatives and fixed rate debt are determined by reference to the market quoted rates input into valuation methods.

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**4 DERIVATIVE FINANCIAL INSTRUMENTS**

a) The Division enters into New Zealand dollar floating to fixed interest rate swap agreements to reduce the impact of changes in floating interest rates on its borrowings and thus reduce variability in cash flows. Fixed to floating instruments are entered into in order to hedge the changes in fair value of fixed rate New Zealand dollar debt. The Division also utilises cross currency interest swaps to hedge against the variations in interest costs and fair value of the US dollar private placement debt.

Derivative instruments are initially recognised at fair value on the contract date and subsequently measured at their fair value on each balance sheet. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Division designates certain derivatives as either (i) hedges of highly probable forecast transactions (cash flow hedges), or (ii) hedges of the fair value of recognised assets or liabilities or a firm commitment (fair value hedges).

The Division documents, at the inception of the hedge transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and hedging strategy. The Division also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(i) Cash flow hedges
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the Income Statement. Amounts accumulated in equity are transferred to the Income Statement in the same period in which the hedged item affects the Income Statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the Income Statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss reported in equity is immediately transferred to the Income Statement.

(ii) Fair value hedges
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement, together with any changes in the fair value of the hedged risk.

(iii) Derivatives that do not qualify for hedge accounting
Certain derivative instruments are undertaken as hedges of economic exposures but do not qualify for hedge accounting. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the Income Statement.

The fair value of financial derivatives and fixed rate debt are determined by reference to the market quoted rates input into valuation models.

All derivative instruments are carried on Balance Sheet at their fair values. Movements in the hedging reserve are shown in the Statement of Changes in Equity.

The Division holds the following financial instruments:

| | Notional Principal | | Fair Value | |
|---|---|---|---|---|
| | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
| **Fair Value Hedges** | | | | |
| 1 - Interest Rate Swaps | 98,000 | 98,000 | (3,134) | (5,134) |
| 2 - US Cross Currency Swaps | 82,394 | 82,394 | (14,124) | (18,407) |
| **Cashflow Hedges** | | | | |
| 3 - Interest Rate Swaps | 84,000 | 74,200 | 1,201 | 2,226 |
| **Derivatives not in hedge relationship** | | | | |
| 4 - Interest Rate Swaps | 16,800 | 16,800 | 437 | 767 |
| 5 - Interest Rate Swaps | 95,200 | 144,200 | 816 | 1,994 |
| 6 - Interest Rate Swaps | 161,000 | 133,000 | 1,556 | 2,823 |
| 7 - Interest Rate Swaps | 22,400 | 22,400 | (538) | (943) |
| 8 - Interest Rate Swaps | 22,400 | 22,400 | 439 | 823 |
| 9 - Interest Rate Swaps | 60,200 | - | (340) | - |
| | 642,394 | 593,394 | (13,687) | (15,851) |

1 Interest rate swaps
The Division receives New Zealand fixed interest rates and pays New Zealand dollar floating interest rates. These qualify for hedge accounting as fair value hedges and are entered into on terms matched to the underlying obligation.

2 US cross currency interest rate swaps
The Division receives US dollar fixed interest and pays New Zealand dollar floating interest. The hedge is both a fair value hedge and hedges the movements in currency that would affect interest payments and final repayment at maturity, these were entered into at terms to match the underlying obligation.

3 Interest rate swaps
The Division receives New Zealand dollar floating interest rates and pays New Zealand dollar fixed interest. The hedge is to fix the variable floating obligations efficiently as per the hedge policy and the treasury policy and is on matched terms. These are cash flow hedges.

4. Interest rate swaps
The division receives New Zealand dollar floating interest rate and pays New Zealand dollar fixed interest. The hedge is to fix the variable floating obligation efficiently as per the hedge policy and the treasury policy and is on matched terms but not hedge accounted.

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5 Interest rate swap
To swap back fixed New Zealand dollar debt converted to floating back to fixed debt. The swap is used to match the interest rate profile in accordance with the Board strategy and is on matched terms. Hedge accounting is not applied to these swaps.

6 Interest rate swap
To convert New Zealand dollar floating debt from number 2 above to New Zealand dollar fixed debt. The swap is used to modify the debt profile in accordance with the Board strategy and is on matched terms. Hedge accounting is not applied to these swaps.

7 Interest rate swaps
To unwind floating to fixed swaps which existed when the hedging policy was changed. These are to offset previous interest rate swaps and match the terms of those including termination date and rolls. Hedge accounting is not applied to these swaps.

8 Interest rate swaps
Historical floating to fixed swaps which are offset by 7 above on matched term and roll basis. Hedge accounting is not applied to these swaps.

9 Interest Rate Swaps
To unwind portions of cash flow hedges. These hedges offset portions of swaps shown in 3, 4 and 5 above and are not hedge accounted.

All cash flow hedges above are on matched terms. The Division's policy is to refloat any fixed rate debt, thus giving a totally floating portfolio, then re-hedge as per the parameters in the treasury policy. This has had the effect that some fixed rate hedges are applied against floating rate hedges. In line with NZ IAS-39 these are not able to be designated as hedges for accounting purposes and thus movements in the mark to market value of these is passed through to the Income Statement although they are implemented on matched terms.

The Group's New Zealand dollar and foreign currency fixed rate debt is converted to floating New Zealand dollar debt through the use of derivatives, with these exactly matching the term and nominal value of the debt. At the point of issue the nominal value of the bonds was equivalent to the fair value, and the fair value of the derivative was zero. The marking to market of the derivatives outlines movements in interest rates or currency rates.

Powerco bonds are able to be traded on the NZDX and an active secondary market exists. This valuation method assumes a constant credit rating.

**The fair value of financial instruments is disclosed in the financial statements as follows:**

| | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
|---|---|---|
| **Other current financial assets** | | |
| Interest rate swap | 608 | - |
| | 608 | - |
| **Other non-current financial assets** | | |
| Interest rate swap | 3,895 | 8,634 |
| | 3,895 | 8,634 |
| **Other non-current financial liabilities** | | |
| US cross currency interest rate swap | 14,124 | 18,407 |
| Interest rate swap | 4,066 | 6,078 |
| | 18,190 | 24,485 |
| **Net fair value of assets / (liabilities)** | (13,687) | (15,851) |

**b) Currency swaps**

Under currency swap contracts, the division agrees to exchange specified principal and interest foreign currency amounts at an agreed future date at a specified exchange rate (fixed for floating). Such contracts enable the division to mitigate the risk of adverse movements in foreign exchange rates.
The following table details the currency swaps outstanding as at reporting date.

| Outstanding contracts as at 30 June 2008 | Average interest rate | Average exchange rate | Contract Value NZ$000 | Fair Value NZ$000 |
|---|---|---|---|---|
| Over five years | BKBM + 88 basis points | 0.5947 | 82,394 | (14,124) |

| Outstanding contracts as at 30 June 2007 | Average interest rate | Average exchange rate | Contract Value NZ$000 | Fair Value NZ$000 |
|---|---|---|---|---|
| Over five years | BKBM + 88 basis points | 0.5947 | 82,394 | (18,407) |

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**Interest rate swap contracts**

Under interest rate swap contracts, the Division agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the Division to mitigate the risk of changing interest rates on debt held. The fair value of interest rate swaps is determined by discounting the future cash flows using the yield curve at reporting date. The average interest rate is based on the outstanding balances at the end of the financial year. The interest rate swaps settle on a quarterly basis with the Division settling the difference between fixed and floating interest rates on a net basis.
The following tables details the notional principal amounts and remaining terms of interest rate swap contracts outstanding as at reporting date:

| | 30 June 2008 | | | 30 June 2007 | | |
|---|---|---|---|---|---|---|
| | Average contracted fixed interest rate | Notional principal amount | Fair value | Average contracted fixed interest rate | Notional principal amount | Fair value |
| | | NZ$000 | NZ$000 | | NZ$000 | NZ$000 |
| **Cash flow swaps** | | | | | | |
| Less than 1 year | 7.32% | 5,600 | 46 | 6.48% | 4,200 | 30 |
| 1 to 2 years | - | - | - | - | - | - |
| 2 to 5 years | 7.05% | 11,200 | 138 | 7.32% | 5,600 | 82 |
| 5 years + | 6.77% | 67,200 | 1,017 | 6.78% | 64,400 | 2,114 |
| **Total cash flow interest rate swaps** | | 84,000 | 1,201 | | 74,200 | 2,226 |
| **Fair value swaps** | | | | | | |
| Less than 1 year | - | - | - | - | - | - |
| 1 to 2 years | 7.64% | 28,000 | (466) | - | - | - |
| 2 to 5 years | 6.31% | 56,000 | (1,976) | 6.93% | 56,000 | (2,271) |
| 5 years + | 6.53% | 14,000 | (692) | 6.44% | 42,000 | (2,863) |
| **Total fair value interest rate swaps** | | 98,000 | (3,134) | | 98,000 | (5,134) |

**Forward foreign currency exchange contracts**

The division has entered into a cross currency swaps to hedge the exchange rate and interest rate risk arising from the US private placement notes.

| | Average Exchange Rate | | Foreign Currency | | Contract Value | | Fair Value | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | 2007 | 2008 (DR)/CR US$000 | 2007 (DR)/CR US$000 | 2008 (DR)/CR NZ$000 | 2007 (DR)/CR NZ$000 | 2008 (DR)/CR NZ$000 | 2007 (DR)/CR NZ$000 |
| 5 years + | 0.5947 | 0.5947 | 58,281 | 58,281 | 98,000 | 98,000 | (3.134) | (5,134) |
| | 0.5947 | 0.5947 | 58,281 | 58,281 | 98,000 | 98,000 | (3,134) | (5,134) |

**Hedge movements recognised in the Income Statement**

| | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
|---|---|---|
| (Loss)/gain arising on derivative in a designated fair value hedge relationship. | (6,139) | 19,522 |
| (Gain)/loss arising on an adjustment for hedge items in a designated fair value hedge relationship. | 6,139 | (19,522) |
| **Net effect on profit for the period** | - | - |

No items have been reclassified as measured at cost or amortised cost during the period.

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**(f) Financial Instruments**

**Capital Risk Management**

The Division manages its levels of debt and equity to ensure an efficient capital structure while maintaining certain internal financial ratios. Powerco's Treasury Policy specifies a long term target for total debt divided by total capital, this is managed both by reviewing debt levels and altering distributions which influences the balance of equity. Total capital includes non-current and current asset of the division which is equivalent to the equity and liabilities of the division (refer to the balance sheet).

The Division also complies with financial covenants agreed with lenders as part of financing agreements. These include a capital structure covenant comparing debt to debt equity, and also minimum net worth covenant as calculated by adding equity plus subordinated debt. As at 30 June 2008 all external convenants had been complied with.

**Risk Management**

The Division engages in business in Australia and New Zealand and has currency expenses relating to the Australian dollar and US dollar. In the normal course of events the Division is exposed to loss through

(1) Market risk
(2) Credit risk
(3) Liquidity risk.

The Division's risk programme recognises the unpredictability of financial markets and seeks to minimise the potential adverse effects of market movements. The Division uses derivative financial instruments for this purpose, but does not engage in holding instruments for trading or speculation.

Management of this risk is performed in accordance with the policies approved by the Board of Directors. These cover both detailed policies and specific areas such as foreign exchange risk, interest rate risk, credit risk and liquidity risk as well as the use of derivatives and appropriateness of counter parties.

**(1) Market risk**

(i) Foreign exchange exposures

The Division has foreign exchange exposures arising from US dollar denominated debt. This exposes the Division to potential gains and losses arising from currency movements. The Division's policy relating to US dollar denominated debt is to minimise the exchange rate exposure by use of matching hedges taken out at the time the loans were drawn down.

(ii) Interest rate exposures

Interest rate risk is the risk that interest rates will change, increasing or decreasing the cost of borrowing or lending. The Division's short-term borrowings are on a floating daily interest rate. Non-current debt is funded by the fixed coupon bonds and Powerco's commercial paper program based on 90 day Bank Bills.

Powerco has entered into interest rate swap agreements to reduce the impact of the changes in interest rates on its borrowings. As at 30 June 2008, Powerco Limited had interest rate swap agreements with registered banks. The weighted average of the interest rate swap agreements (excluding the reverse swap agreements) produce an interest rate of 6.77%p.a. Powerco's Treasury Policy specifies parameters regarding the levels of interest rate hedging which are monitored by the board on a monthly basis.

**(2) Credit risk**

Financial instruments with the potential to subject the Division's credit risk principally consist of bank balances and accounts receivable. There are no significant concentrations of credit risk. These accounts are subject to a Board Prudential Supervision Policy which is used to manage the exposure to credit risk. As part of this policy, limits on exposures have been set and are monitored on a regular basis. Cash deposits are only made with registered banks. The maximum credit risk is the carrying value.

**(3) Liquidity risk**

Liquidity risk is the risk that the Division may be unable to meet its financial obligations as they fall due. This risk is managed by maintaining sufficient cash and deposits together with access to committed credit facilities. The division adheres to a Treasury Policy, approved by the Board of Directors, which specifies certain levels of liquidity thatmust be maintained for short term requirements and further stipulations regarding the timing of refinancing of upcoming debt maturities. Liquidity levels are forecast and monitored on a continuous basis.

**(g) Foreign currency sensitivity analysis**

Powerco's foreign currency borrowings are 100% hedged against movements in the NZD/USD exchange rate. Any movements in the value or borrowings or the interest payable due to a movement in the exchange rate is offset by an equal and opposite movement in the value and cash flows applicable to the hedge. As such the sensitivity calculation shows no movement in either the P&L or equity in relation to these borrowings.

**(h) Interest rate sensitivity analysis**

The following table details the Division's sensitivity to a 100BP increase and decrease in the New Zealand interest rates, with all other variables held constant as at the reporting date. 100bp is Powerco's and the industry accepted sensitivity rate used when analysing volatility through interest rate movements, and represents management's assessment of the possible change in interest rates. This analysis includes cashflows on floating rate debt and interest rate derivatives as well as movements in the interest rate swap curve.

| | 30 June 2008 NZ$000 | 30 June 2007 NZ$000 |
|---|---|---|
| Net profit before tax +100BP | 3,328 | 5,279 |
| Net profit before tax -100BP | (3,555) | (5,657) |
| Total Equity +100BP | 2,443 | 2,989 |
| Total Equity -100BP | (2,653) | (3,241) |

**5 CASH & WORKING CAPITAL ADVANCES FACILITY**

Powerco Limited operates a wholesale capital advance facility with the Commonwealth Bank of Australia for up to $30 million. As at 30 June 2008, the full $30 million was drawn down on the facility (2007: funds drawn of $30.0 million). The facility is based on a revolving credit arrangement and as such does not have set repayment dates. The facility expires on 22 March 2011. The facility has the benefit of the Security Trust Deed, as a Senior Secured Debt Facility. This facility had interest rates ranging from 8.15% to 8.50 %. The amount allocated to the gas division at year end $5.677 million (2007: 4.162 million).

At year end the amount of bank overdraft allocated to the gas division was $0.009 million (2007: $0.321 million). The overdraft interest rate on this facility at that date was10.5% (2007:10.0%).

There is no right of set-off between any of the facilities.

**6 PROVISIONS**

This provision relates to employee entitlements such as accrued wages, bonuses, holiday pay and long service leave. The provision is affected by a number of estimates including the expected employment period of employees and the timing of employees utilising the benefits. The majority of the provision is expected to be realised within the next two years.

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## 7 PROPERTY, PLANT AND EQUIPMENT

| | Network assets NZ$000 | Plant and equipment NZ$000 | Work in progress NZ$000 | TOTAL NZ$000 |
|---|---|---|---|---|
| **Gross carrying value** | | | | |
| Balance at 30 June 2006 | 417,080 | - | 999 | 418,079 |
| Acquisition of plant & equipment assets from inter-division | - | 9,287 | - | 9,287 |
| Transfers | 5,460 | - | (5,460) | - |
| Additions | 1,219 | 200 | 6,610 | 8,029 |
| Disposals | - | - | - | - |
| Balance at 30 June 2007 | 423,759 | 9,487 | 2,149 | 435,395 |
| Transfers | 10,339 | - | (10,339) | - |
| Additions | - | 1,025 | 10,729 | 11,754 |
| Disposals | - | - | - | - |
| Balance at 30 June 2008 | 434,098 | 10,512 | 2,539 | 447,149 |
| **Accumulated depreciation** | | | | |
| Balance at 30 June 2006 | 42,333 | - | - | 42,333 |
| Acquisition of plant & equipment assets from inter-division | - | 3,067 | - | 3,067 |
| Disposals | - | - | - | - |
| Depreciation expense | 9,804 | 1,086 | - | 10,890 |
| Balance at 30 June 2007 | 52,137 | 4,153 | - | 56,290 |
| Disposals | - | - | - | - |
| Depreciation expense | 9,714 | 883 | - | 10,597 |
| Balance at 30 June 2008 | 61,851 | 5,036 | - | 66,887 |
| **Net book value 30 June 2007** | 371,622 | 5,334 | 2,149 | 379,105 |
| **Net book value 30 June 2008** | 372,247 | 5,476 | 2,539 | 380,262 |

## 8 OTHER INTANGIBLES

| | Software NZ$000 | TOTAL NZ$000 |
|---|---|---|
| **Gross carrying value** | | |
| Balance at 30 June 2006 | - | - |
| Acquisition of plant & equipment assets from inter-division | 990 | 990 |
| Additions | 251 | 251 |
| Disposals | - | - |
| Balance at 30 June 2007 | 1,241 | 1,241 |
| Additions | - | - |
| Disposals | - | - |
| Balance at 30 June 2008 | 1,241 | 1,241 |
| **Accumulated amortisation** | | |
| Balance at 30 June 2006 | - | - |
| Acquisition of plant & equipment assets from inter-division | 317 | 317 |
| Disposals | - | - |
| Amortisation expense | 453 | 453 |
| Balance at 30 June 2007 | 770 | 770 |
| Disposals | - | - |
| Amortisation expense | 279 | 279 |
| Balance at 30 June 2008 | 1,049 | 1,049 |
| **Net book value 30 June 2007** | 471 | 471 |
| **Net book value 30 June 2008** | 192 | 192 |

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## 9 CONTINGENT LIABILITIES AND COMMITMENTS

As Powerco is an integrated business, this disclosure relates to the business as a whole.

**Contracts**
Powerco Limited has a contract with Tenix Alliance New Zealand Limited (Tenix), who provide electricity and gas field services. There is a condition in the contract that states that a payment is made to Tenix for performing better than budgeted and a payment is made to Powerco if performance does not meet budget. The amount of the payment is determined by a predetermined calculation in the contract on an annual basis. At this time, any payment for future periods to or from Powerco cannot be quantified.

**Fonterra**
Fonterra has raised an issue with Powerco about their charges for the 2008/2009 year. The total amount in dispute is approximately $1.7 million. No legal proceedings have been issued and the companies continue to explore the issue.

| **Commitments** | **30 June 2008 NZ$000** | **30 June 2007 NZ$000** |
|---|---|---|
| Commitments for future capital expenditure resulting from contracts entered into: | | |
| Not longer than 1 year | 6,549 | 6,625 |
| Longer than 1 year and not longer than 5 years | 9,131 | 13,682 |
| Longer than 5 years | - | |
| | 15,680 | 20,307 |

## 10 RELATED PARTY TRANSACTIONS

**Trading Transactions**

For the year ended 30 June 2008, the Powerco gas division was charged management service fees of $0.398 million (2007: $0.342 million) from BBI Networks (New Zealand) Limited. The payment terms are: "payment is required when an invoice is provided from BBINNZ and the amount is set in recognition of the following services being provided: executive strategic management, corporate development and asset management operational advice and direction, corporate financial advice, strategic treasury management advice, corporate revenue and risk management advice and other corporate policy formulation and advice".

The Powerco gas division has inter-company accounts with the other divisions of Powerco Limited. The inter-company accounts are unsecured and no interest has been charged in the current period.

No expense has been recognised during the period in respect of bad or doubtful debts.

A notional charge for the cost of insurance has been made from the corporate division to the gas division of $894,554 (2007: $784,991).

In 2007 Powerco gas division acquired $6.893 million of non network assets from one of the other divisions of Powerco Limited of which $0.673 million was made up of intangible assets. Of the assets acquired $2.322 million was funded by equity and $4.571 million by debt.

| **Compensation of key management personnel** | **Year ended 30 June 2008 NZ$000** | **Year ended 30 June 2007 NZ$000** |
|---|---|---|
| The remuneration of directors and other members of key management during the year were as follows: | | |
| Short-term benefits | 477 | 355 |
| Post employment benefits | 3 | 5 |
| | 480 | 360 |

The remuneration of directors and key executives is determined by the remuneration committee having regard to the performance of individuals and market trends.

## 11 SUBSEQUENT EVENTS

In August 2008, BBI announced that it was undertaking a formal price discovery process on a number of its assets; this included seeking a 50% co-investor in Powerco. After a competitive bidding process, Queensland Investment Corporation (QIC) has agreed to acquire a 50% interest in Powerco New Zealand. The agreement was signed on the 3 November 2008. Completion is expected to occur in late February 2009 following receipt of various consents and a new Board of directors will be formed at the same time.

Powerco and Vector Limited had their application for a judicial review of the Commerce Commission and Government's decision to impose control over both companies' gas distribution businesses was declined in December 2007. Costs have been awarded against Powerco and Vector, Powerco's share of costs has not been quantified and is not expected to exceed $1 million. Powerco's appeal of this decision was not allowed.

The Commerce Commission issued a final Authorisation controlling the gas distribution services of Powerco and Vector on 31 October 2008. This decision requires Powerco to reduce its average charges by 11.1% from 1 January 2009 and increase them by no more han CPI per annum, until 30 June 2012.

Powerco Limited declared a dividend in November of $15.02 million. Under the current allocation, the gas divisions portion is $2.40 million.

Deloitte

**POWERCO LIMITED – GAS DIVISION**

**GAS (INFORMATION DISCLOSURE) REGULATIONS 1997**

**Certification by Auditor in Relation to Financial Statements**

We have examined the attached financial statements prepared by Powerco Limited – Gas Division dated 27 November 2008 for the purposes of regulation 6 of the Gas (Information Disclosure) Regulations 1997.

We certify that, having made all reasonable enquiries, to the best of our knowledge, those financial statements have been prepared in accordance with the requirements of the Gas (Information Disclosure) Regulations 1997.

Deloitte

Deloitte
Hamilton
27 November 2008

This audit report relates to the financial statements of Powerco Limited – Gas Division for the period ended 30 June 2008 that have been published in the *New Zealand Gazette*. The *New Zealand Gazette* is required to publish hard copies of audited financial statements and the related audit report of Powerco Limited – Gas Division for the period ended 30 June 2008, and to include an electronic version of the published *New Zealand Gazette* on the *New Zealand Gazette*'s website.

We have not been engaged to report on the integrity of the financial statements of Powerco Limited – Gas Division that have been published on the *New Zealand Gazette*'s website. We accept no responsibility for any changes that may have occurred to the financial statements since they were initially signed and published.

This audit report refers only to the financial statements named above. If readers of this audit report are concerned with the inherent risks arising from electronic data communication, they should refer to the original signed and published hard copy of the audited financial statements and related audit report dated 27 November 2008 to confirm the information included in the audited financial statements published in the *New Zealand Gazette* or on the *New Zealand Gazette*'s website. Legislation in New Zealand governing the preparation and dissemination of financial information may differ from legislation in other jurisdictions.

POWERCO

GAS DIVISION

**Statement of Financial and Effiency Performance Measures**
**For the year ended 30 June 2008**

**1 DISCLOSURE OF PERFORMANCE MEASURES PURSUANT TO REGULATION 15 AND PART II OF THE FIRST SCHEDULE OF THE GAS (INFORMATION DISCLOSURE) REGULATIONS 1997**

| Financial Performance Measures | Notes | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| ( i ) Accounting Return on Total Assets | (a), (b) | **6.60%** | **7.18%** | **6.43%** | **7.92%** |
| ( ii ) Accounting Return on Equity | | **-0.03%** | **16.98%** | **4.47%** | **5.54%** |
| ( iii ) Accounting Rate of Profit including revaluation | (a), (b) | **4.76%** | **5.49%** | **4.65%** | **5.30%** |
| ( iv ) Accounting Rate of Profit excluding revaluation | (a), (b) | **4.76%** | **5.49%** | **4.65%** | **5.30%** |
| **Efficiency Performance Measures** | | | | | |
| ( v ) Direct Line Cost per Kilometre | | **$981.32** | **$1,408.53** | **$1,248.23** | **$1,299.10** |
| ( vi ) Indirect Line Cost per Gas Customer | | **$82.53** | **$73.35** | **$88.29** | **$93.84** |

Notes:
(a) This calculation excludes current borrowings and other financial assets from working capital because the borrowings and other financial assets do not relate to operational obligations.
(b) EBIT for the purposes of this calculation excludes the hedging loss of $3.040 million as shown in the Income Statement as Other Gains/Losses, and the hedging loss of $1.537 million recognised in the Statement of Changes In Equity. This is because the hedge gain/loss does not meet the definition of revenue in the Gas (Information Disclosure) Regulations 1997.

**2 DISCLOSURE OF PERFORMANCE MEASURES PURSUANT TO REGULATION 17 AND PART III OF THE FIRST SCHEDULE OF THE GAS (INFORMATION DISCLOSURE ) REGULATIONS 1997**

| | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|
| **2.1 Energy delivery efficiency measures** | | | | |
| ( a ) Load Factor | 72.50% | 73.65% | 83.32% | 66.34% |
| ( b ) Un-accounted for Gas Ratio | 2.50% | 2.50% | 2.50% | 2.50% |
| **2.2 Statistics** | | | | |
| ( a ) System Length | 5,890km | 5,792 km | 5,609 km | 5,415 km |
| ( b ) Maximum monthly amount entering the system | 1,057,925 | 1,082,107 | 1,055,459 | 1,242,515 |
| ( c ) Total amount of gas conveyed | 9,204,033 | 9,564,363 | 10,553,384 | 9,891,000 |
| ( d ) Total amount of gas conveyed on behalf of other persons | 9,204,033 | 9,564,363 | 10,553,384 | 9,891,000 |
| ( e ) Total customers | 103,602 | 103,404 | 103,986 | 104,203 |

**3 DISCLOSURE OF PERFORMANCE MEASURES PURSUANT TO REGULATION 18 AND PART IV OF THE FIRST SCHEDULE OF THE GAS (INFORMATION DISCLOSURE ) REGULATIONS 1997**

| | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|
| **3.1 Un-planned interruptions in transmission systems** | 0 | 0 | 0 | 0 |
| **3.2 Un-planned interruptions in distribution systems** | | | | |
| ( a ) Un-planned interruptions other than those directly resulting from un-planned interruptions of a transmission system. | 0.001889 | 0.0146* | 0.0036 | 0.0043 |
| ( b ) Un-planned interruptions directly resulting from un-planned interruptions of a transmission system. | 0 | 0 | 0 | 0 |

**NOTE** * This figure includes the Wellington CBD water inundation outage of August/September 2006. Without that significant event the reported figure would have been 0.0034

**Deloitte**

## POWERCO LIMITED – GAS DIVISION

## GAS (INFORMATION DISCLOSURE) REGULATIONS 1997

### Certification of Performance Measures by Auditor

We have examined the attached information being:

(a) Financial performance measures specified in clause 1 of Part 2 of Schedule 1 of the Gas (Information Disclosure) Regulations 1997; and

(b) Financial components of the efficiency performance measures specified in clause 2 of Part 2 of that schedule,

and having been prepared by Powerco Limited – Gas Division and dated 27 November 2008 for the purposes of regulations 15 and 16 of those regulations.

We certify that, having made all reasonable enquiries, to the best of our knowledge, that information has been prepared in accordance with the requirements of the Gas (Information Disclosure) Regulations 1997.

Deloitte

Deloitte
Hamilton
27 November 2008

This audit report relates to the performance measures of Powerco Limited – Gas Division for the year ended 30 June 2008 that have been published in the *New Zealand Gazette*. The *New Zealand Gazette* is required to publish hard copies of audited performance measures and the related audit report of Powerco Limited – Gas Division for the year ended 30 June 2008, and to include an electronic version of the published *New Zealand Gazette* on the *New Zealand Gazette*'s website.

We have not been engaged to report on the integrity of the performance information of Powerco Limited – Gas Division that have been published on the *New Zealand Gazette*'s website. We accept no responsibility for any changes that may have occurred to the performance information since they were initially signed and published.

This audit report refers only to the performance information named above. If readers of this audit report are concerned with the inherent risks arising from electronic data communication, they should refer to the original signed and published hard copy of the audited performance information and related audit report dated 27 November 2008 to confirm the information included in the audited performance information published in the *New Zealand Gazette* or on the *New Zealand Gazette*'s website. Legislation in New Zealand governing the preparation and dissemination of financial information may differ from legislation in other jurisdictions.

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