

# CHAPTER SIX

STUDENT LOAN SCHEME FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

## 6.0 Financial statements for the year ended 30 June 2006

The financial statements for the Student Loan Scheme comprise schedules of revenue, expenditure, assets and details of cash flow items relating to student loans. The Ministry of Social Development (MSD) and Inland Revenue (IRD) administer student loans on an agency basis within policy parameters set by the Ministry of Education (MOE) on behalf of the Crown.

The financial information represents extracts from the financial statements of Crown activities carried out by the entities administering student loans to provide an overview of the Student Loan Scheme.

The schedule of assets shows a total asset value as at 30 June 2006 of \$5,569.2 million (\$6,464.5 million at June 2005). The reduction of \$895.3 million is a result of a change in the accounting policy for student loans, reflecting the interest-free policy. The adoption of fair value accounting on initial recognition of loans and subsequent impairment (net release of opening bad debt provision) resulted in a one-off write-down of \$1,414.7 million. This is in line with New Zealand International Financial Reporting Standards (NZ IFRS).

## 6.1 Schedule of revenue and expenditure for the year ended 30 June 2006

**Table 14** Schedule of revenue and expenditure for the year ended 30 June 2006

<b>Actual</b>		<b>Actual</b>	<b>Main</b>	<b>Supp.</b>
<b>2005</b>	<b>Notes</b>	<b>2006</b>	<b>estimates</b>	<b>estimates</b>
<b>\$million</b>		<b>\$million</b>	<b>2006</b>	<b>2006</b>
			<b>\$million</b>	<b>\$million</b>
<b>Revenue</b>				
498.4	Interest and penalty income – IRD/MSD	0.0	547.1	294.1
0.0	Interest unwind – MSD	43.3	0.0	0.0
0.0	Interest unwind – IRD	314.8	0.0	0.0
7.5	Administration fees – MSD	8.0	7.9	7.9
<b>505.9</b>	<b>Total revenue</b>	<b>366.1</b>	<b>555.0</b>	<b>302.0</b>
<b>Expenditure</b>				
213.3	Interest write-offs – IRD/MSD	0.0	0.0	0.0
13.2	Deceased and bankruptcy write-offs – IRD	0.0	0.0	0.0
0.0	Initial fair value write-down and subsequent impairment	1	1,414.7	1,479.4
0.0	Fair value write-down on new borrowings	328.4	0.0	299.0
0.0	Other impairment	12.8	0.0	18.1
19.5	Increase/(decrease) in provision for doubtful debt – MSD	0.0	0.0	0.0
189.4	Interest, small balance, deceased write-offs and bankruptcy	0.0	260.0	0.0
0.0	Change in provision for doubtful debt	0.0	79.2	0.0
<b>435.4</b>	<b>Total expenditure</b>	<b>1,755.9</b>	<b>339.2</b>	<b>1,796.5</b>
<b>70.5</b>	<b>Net surplus</b>	<b>(1,389.8)</b>	<b>215.8</b>	<b>(1,494.5)</b>

Notes:

1. The accompanying accounting policies and notes on pages 48-51 form part of these financial statements.
2. Budget figures represent the combined total for the applicable agencies.
3. For a full understanding of the Crown's financial position and the results of its operations for the year, reference should be made to the consolidated audited Financial Statements of the Government for the year ended 30 June 2006.
4. Details of the Consolidated Movements Schedule for the year ended June 2006 are shown in Note 1.
5. Initial fair value write-down and subsequent impairment is disclosed net of release of opening bad debt provision.

Source: Inland Revenue

## 6.2 Schedule of assets as at 30 June 2006

**Table 15** Schedule of assets as at June 2006

<b>Actual</b>		<b>Actual</b>	<b>Main</b>	<b>Supp.</b>
<b>2005</b>	<b>Notes</b>	<b>2006</b>	<b>estimates</b>	<b>estimates</b>
<b>\$million</b>		<b>\$million</b>	<b>2006</b>	<b>2006</b>
			<b>\$million</b>	<b>\$million</b>
<b>Current assets</b>				
1,412.4	Student loan advances	960.5	1,519.4	889.0
(206.4)	Doubtful debt provision (short term)	0.0	(186.0)	0.0
<b>1,206.0</b>	<b>Total current assets</b>	<b>960.5</b>	<b>1,333.4</b>	<b>889.0</b>
<b>Non-current assets</b>				
6,086.7	Student loan advances	4,608.7	6,668.1	4,467.6
(828.2)	Doubtful debt provision (long term)	0.0	(797.1)	0.0
<b>5,258.5</b>	<b>Total non-current assets</b>	<b>4,608.7</b>	<b>5,871.0</b>	<b>4,467.6</b>
<b>6,464.5</b>	<b>Total assets</b>	<b>5,569.2</b>	<b>7,204.4</b>	<b>5,356.6</b>

Notes:

1. The accompanying accounting policies and notes on pages 48-51 form part of these financial statements.
2. Budget figures represent the combined total for the applicable agencies.
3. For a full understanding of the Crown's financial position and the results of its operations for the year, reference should be made to the consolidated audited Financial Statements of the Government for the year ended 30 June 2006.
4. Details of the Consolidated Movements Schedule for the year ended June 2006 are shown in Note 1.

Source: Inland Revenue

## 6.3 Schedule of cash flows for the year ended 30 June 2006

**Table 16** Schedule of cash flows for the year ended 30 June 2006

<b>Actual</b>		<b>Notes</b>	<b>Actual</b>	<b>Main</b>	<b>Supp.</b>
<b>2005</b>			<b>2006</b>	<b>estimates</b>	<b>estimates</b>
<b>\$million</b>			<b>\$million</b>	<b>2006</b>	<b>2006</b>
				<b>\$million</b>	<b>\$million</b>
<b>Cash flows – operating activities</b>					
<i>Cash was provided from:</i>					
258.8	Interest repayments received	1	179.9	252.8	260.2
<b>258.8</b>	<b>Net cash inflow (outflow) from operating activities</b>		<b>179.9</b>	<b>252.8</b>	<b>260.2</b>
<b>Cash flows – investing activities</b>					
<i>Cash was provided from:</i>					
313.1	Capital repayments received	1	371.1	396.9	314.4
<i>Cash was disbursed for:</i>					
(969.2)	Amount borrowed in current year	1	(1,045.5)	(1,192.1)	(1,213.0)
<b>(656.1)</b>	<b>Net cash inflow (outflow) from investing activities</b>		<b>(674.4)</b>	<b>(795.2)</b>	<b>(898.6)</b>
<b>(397.3)</b>	<b>Net student loan cash inflow (outflow)</b>		<b>(494.5)</b>	<b>(542.4)</b>	<b>(638.4)</b>

Notes:

- 1 The accompanying accounting policies and notes on pages 48-51 form part of these financial statements.
- 2 Budget figures represent the combined total for the applicable agencies.
- 3 For a full understanding of the Crown's financial position and the results of its operations for the year, reference should be made to the consolidated audited Financial Statements of the Government for the year ended 30 June 2006.
- 4 Details of the Consolidated Movements Schedule for the year ended June 2006 are shown in Note 1.

Source: Inland Revenue

## 6.4 Statement of accounting policies

### For the year ended 30 June 2006

#### **Reporting entity**

The scheme is a Crown activity which forms part of the consolidated Financial Statements of the Government. The scheme has dimensions of revenue, expenditure, assets and cash flows within the overall Financial Statements of the Government.

#### **Statutory authority**

The Student Loan Scheme is administered jointly by the Ministry of Education, the Inland Revenue Department and the Ministry of Social Development, under the Student Loan Scheme Act 1992, the Credit Contracts and Consumer Finance Act 2003 and the Education Act 1989.

#### **Budget figures**

The budget figures are those presented in the Budget Night Estimates (Main Estimates) and those amended by the Supplementary Estimates (Supp. Estimates) and any transfer made by Order in Council under section 26A of the Public Finance Amendment Act 2004. The budget figures provided are extracted from the details of the Estimates of Appropriation for Inland Revenue and the Ministry of Social Development, as applicable. The totals shown are the combined totals for the applicable agencies.

#### **Advances**

Advances are financial instruments. The accounting policy for advances has changed during the year. These are now initially recognised at fair value and subsequently reported at amortised cost. Forecast repayments for the following year are used to calculate the current portion of advances.

The 2005 figures are recorded at the amounts expected to be ultimately collected in cash.

#### **Interest**

Interest is calculated on the student loan account balances as at 1 April each year on a daily basis at a rate determined by the government (currently 6.9 percent per annum). Interest is written off where qualifying criteria are met.

#### **Impairment**

An amount is recognised at reporting date if there is objective evidence of impairment as a result of:

- one or more loss events that occurred after the initial recognition of the loan, and
- the loss event (or events) has had a reliably measurable impact on the estimated future cash flows of the collective book of student loans.

For the student loan scheme, this involves a comparison between the amortised cost of the loans to the present value of the estimated future cash flows of the loans discounted at original effective interest rate. The present value of estimated future cash flows excludes future credit losses that have not been incurred.

#### **Amortised cost**

This is the amount at which the financial asset is measured at initial fair value, less repayments plus the cumulative interest unwound using the effective interest rate, less any reductions for impairments or non-collectibles.

#### **Changes in accounting policies**

In November 2005, the government agreed that interest will not be charged on student loans where certain criteria, largely related to being domiciled in New Zealand, are met.

To reflect the value of student loans under this interest-free policy, the accounting policy for reporting loans has also been updated. The accounting policy is to initially recognise student loans at their fair value and to subsequently report them at amortised cost. This accounting policy is to apply from 2005/06 and is consistent with the 'loans and receivables' designation under International Accounting Standard 39 (IAS 39) for financial instruments. The Crown will be adopting the New Zealand equivalent to IAS 39 for all financial instruments from 1 July 2007.

The key changes resulting from the interest-free student loan policy and adopting a new accounting policy are:

- There is a one-off write-down of \$1,414.7 million in 2005/06 of the existing loan book to fair value. See note 1.
- The difference between the fair value of new loans and the amount lent is recognised as an expense in the year the loan is provided.
- The initial fair value write-down will be unwound (ie recognised as income) over the maturity of the loans. The value will be adjusted for any impairment (eg non-repayments caused by death or bankruptcy of the borrowers).

For an analysis of the annual movement in student loans refer to 'Note 1: Consolidated Movements Schedule' on page 49.

#### **Fair value write-down and subsequent impairment**

The following fair value write-downs are a result of the change in accounting policies and subsequent impairment:

Inland Revenue Department	\$1,249.6 million
Ministry of Social Development	\$165.1 million

See note 1 on page 49.

All other policies have been applied on a basis consistent with the previous year.

## 6.5 Notes to the financial schedules for the year ended 30 June 2006

### Note 1:

**Table 17** Consolidated movements schedule for the year ended 30 June 2006

<b>Consolidated Actual</b>		<b>Consolidated Actual</b>	<b>Inland Revenue</b>	<b>Ministry of Social Development</b>
<b>2005 \$million</b>		<b>2006 \$million</b>	<b>2006 \$million</b>	<b>2006 \$million</b>
7,499.1	Nominal loan balance	8,370.0	7,473.0	897.0
(1,034.6)	Adjustment due to initial fair value recognition and impairment	(2,800.8)	(2,495.0)	(305.8)
<b>6,464.5</b>	<b>Total student loans</b>	<b>5,569.2</b>	<b>4,978.0</b>	<b>591.2</b>
<b>5,994.9</b>	<b>Student loans opening balance</b>	<b>6,464.5</b>	<b>5,766.4</b>	<b>698.1</b>
0.0	Loans transferred from MSD to IRD	0.0	966.5	(966.5)
0.0	Fair value write-down on new borrowings transferred	0.0	(320.9)	320.9
969.2	Amount of new borrowings	1,045.5	0.0	1,045.5
7.5	Administration fees on loans	8.0	0.0	8.0
(313.1)	Less capital repayments	(371.1)	(306.5)	(64.6)
<b>663.6</b>		<b>682.4</b>	<b>339.1</b>	<b>343.3</b>
498.4	Interest charged	0.0	0.0	0.0
0.0	Interest unwind	358.1	314.8	43.3
(258.8)	Interest repayments	(179.9)	(179.9)	0.0
(226.5)	Interest, small balance, deceased write-offs and bankruptcy	0.0	0.0	0.0
<b>13.1</b>	<b>Net increase (decrease) in interest receivable</b>	<b>178.2</b>	<b>134.9</b>	<b>43.3</b>
(208.9)	Change in provision for doubtful debt	0.0	0.0	0.0
0.0	Initial fair value write-down and subsequent impairment	(1,414.7)	(1,249.6)	(165.1)
0.0	Fair value write-down on new borrowings	(328.4)	0.0	(328.4)
0.0	Other impairment	(12.8)	(12.8)	0.0
1.8	Other movements	0.0	0.0	0.0
<b>(207.1)</b>	<b>Net increase (decrease) in other movements</b>	<b>(1,755.9)</b>	<b>(1,262.4)</b>	<b>(493.5)</b>
<b>6,464.5</b>	<b>Student loans closing balance</b>	<b>5,569.2</b>	<b>4,978.0</b>	<b>591.2</b>

Source: Inland Revenue

## Note 2: Changes in accounting policies

### Student loans

Student loans are recognised initially at fair value<sup>37</sup> plus transaction costs and subsequently measured at amortised cost using the effective interest rate method, less any impairment loss.

The effective interest rate discounts estimated future cash flows through the expected life of the loan to the net carrying amount of the loan, excluding future credit losses. Interest is recognised on the loan evenly in proportion to the amount outstanding over the period to repayment.

Allowances for estimated irrecoverable amounts are recognised when there is objective evidence that the loan is impaired. Impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the loan, and that a 'loss' event (or events) has an impact on the estimated future cash flows of the student loan book that can be reliably measured.

The data for student loans has been integrated from files provided by Inland Revenue, the Ministry of Social Development and the Ministry of Education. It consists of records of all borrowers from the start of student loans in 1992. The data from before 1997 is limited with mainly Inland Revenue information available. The current data is up to 31 March 2003, and contains information on borrowings, repayments, income, educational factors, socioeconomic factors amongst others and has been analysed and incorporated into the valuation model. Data to 31 March 2005 is now in the process of being analysed and will be available to be incorporated in the valuation model in 2006/07. Any revised future cash flows arising from incorporating the updated data that impact the valuation will be recognised as they occur in 2006/07.

Given the lead time required between analysing the raw data and its availability for use in the valuation model, it is expected that there will always be a 15-month lag between the available data set and the valuation reported in the annual accounts.

### Student loans book value

Student loans fair value is the amount for which the loans could be exchanged between knowledgeable, willing parties in an arm's length transaction. On initial recognition of student loans, fair value is determined by projecting forward the repayments required under the scheme, to a willing buyer, and discounting them back at an appropriate discount rate.

Inland Revenue and the Ministry of Social Development have adapted the Ministry of Education's valuation model to be International Accounting Standards compliant and to reflect the recently introduced student loans interest-free, amnesty and voluntary repayments legislation.

As student loans are subsequently measured at amortised cost, the model projects all future cash flows to the Crown associated with the loan and the effective interest rate is calculated at initial recognition. This rate is used to spread the Crown's interest income across the life of the loan and determines the loan's book value at each reporting date. If the timing of future receipts is revised, the book amount at reporting date is adjusted to reflect the revised estimated cash flows at the loan's original effective interest rate. The adjustment is recognised as income or expense in the statement of financial performance.

The model's substantive information has remained consistent with previous years, incorporating educational, demographic, income and loan data. As such, the fair value is sensitive to changes in a number of underlying assumptions, including future income levels, repayment behaviour and macroeconomic factors such as inflation and the discount rate.

The following table illustrates the recent changes to key assumptions:

**Table 18** Recent changes to key assumptions

Assumptions	30 June 2006	30 June 2005
Weighted average effective interest rate	6.63%	N/A
Interest rate applied to loans for overseas borrowers	6.90% (6.70% outyears)	7.00% (6.80% outyears)
Cost of administration as a percentage of the average outstanding loan balance	0.15%	0.20%
Consumer Price Index	3.20%	2.80%
Future salary inflation	3.60%	3.40%

Source: Inland Revenue

<sup>37</sup> Fair value is the amount for which the loans could be exchanged between knowledgeable, willing parties in an arm's length transaction.

### ***Student loans fair value***

Fair value is the amount for which the loan book could be exchanged between knowledgeable, willing parties in an arm's length transaction as at 30 June 2006. The estimated fair value of the student loan debt at 30 June 2006 has been determined to be approximately \$5,538 million (\$5,994 million at 30 June 2005).

The fair value calculation is sensitive to the underlying assumptions chosen. For example, a 1 percent increase in the discount rate would decrease fair value by approximately \$339 million, whereas a 1 percent decrease in the discount rate would increase fair value by approximately \$391 million.

Through the everyday operations of the Student Loan Scheme the Crown is exposed to the risk that borrowers will default on their obligation to repay their loans or die before their loan is repaid, causing the scheme to incur a loss.

The Student Loan Scheme policy does not require borrowers to provide any collateral or security to support advances made. As the total sum advanced is widely dispersed over a large number of borrowers, the scheme does not have any material individual concentrations of credit risk.

### ***Loan repayments***

For the year ended 30 June 2006, there was a total decline of 3.7 percent, the equivalent of \$20.9 million, in loan repayments. In 2006/07, repayments are expected to be slightly higher than 2005/06 repayments, regardless of the decrease in the interest component of loans.

## **Note 3: Financial instruments**

Such arrangements occur as part of the everyday operations of the scheme through the provision of loan advances.

### ***Credit risk***

For the Student Loan Scheme, credit risk is the risk that borrowers will default on their obligation to repay their loans or die before their loan is repaid, causing the scheme to incur a loss.

The Student Loan Scheme policy does not require borrowers to provide any collateral or security to support advances made. As the total sum advanced is widely dispersed over a large number of borrowers, the Student Loan Scheme does not have any material individual concentrations of credit risk.

The credit risk is reduced by collection of compulsory repayments through the tax system.

### ***Interest rate risk***

Interest rate risk is the risk that the value of financial instruments will fluctuate due to changes in interest rates. Changes could impact on the government's return on loans advanced. The interest rate and the interest write-off provisions attached to student loans are set by the government.

## Audit Opinion

### To the readers of the Student Loan Scheme's financial statements for the year ended 30 June 2006

The Auditor-General is the auditor of the financial statements of the Student Loan Scheme. The Auditor General has appointed me, H C Lim, using the staff and resources of Audit New Zealand, to carry out the audit of the financial statements of the Student Loan Scheme, on his behalf, for the year ended 30 June 2006.

#### *Unqualified opinion*

In our opinion the financial statements of the Student Loan Scheme on pages 44 to 51:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
  - the assets as at 30 June 2006; and
  - the revenue and expenditure, and cashflows for the year ended on that date.

The audit was completed on 3 October 2006, and is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Chief Executives of the Ministry of Education, Inland Revenue Department and Ministry of Social Development, and the Auditor, and explain our independence.

#### *Basis of opinion*

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the Chief Executives in the preparation of the financial statements;
- confirming year-end balances;
- determining whether accounting policies are appropriate to the circumstances of the Student Loan Scheme and consistently applied; and
- determining whether all financial statement disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements.

We evaluated the overall adequacy of the presentation of information in the financial statements. We obtained all the information and explanations we required to support our opinion above.

***Responsibilities of the Chief Executives of the Ministry of Education, Inland Revenue Department and Ministry of Social Development and the Auditor***

The Chief Executives are responsible for preparing financial statements in accordance with generally accepted accounting practice in New Zealand. The financial statements must fairly reflect the financial position of the Student Loan Scheme as at 30 June 2006 and the results of its operations and cash flows for the year ended on that date.

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001.

***Independence***

When carrying out the audit we followed the independence requirements of the Auditor General, which incorporate the independence requirements of the Institute of Chartered Accountants of New Zealand.

Other than the audit, we have no relationship with or interests in the Student Loan Scheme.



**H C Lim**

Audit New Zealand  
On behalf of the Auditor-General  
Wellington, New Zealand

**Matters relating to the electronic presentation of the audited financial statements**

This audit report relates to the financial statements of the Student Loan Scheme for the year ended 30 June 2006 included on the Ministry of Education's web site. The Ministry of Education's Chief Executive is responsible for the maintenance and integrity of the Ministry of Education's web site. We have not been engaged to report on the integrity of the Ministry of Education's web site. We accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

The audit report refers only to the financial statements named above. It does not provide an opinion on any other information which may have been hyperlinked to/from these financial statements. If readers of this report are concerned with the inherent risks arising from electronic data communication they should refer to the published hard copy of the audited financial statements and related audit report dated 3 October 2006 to confirm the information included in the audited financial statements presented on this web site.

Legislation in New Zealand governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.