Statutory Supervisors Monitoring Report

18 March 2009

Retirement Commission
Whiriwhiria!

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The Retirement Commissioner has a role under the Retirement Villages Act 2003 to monitor the effect of the Act. In 2008 I developed a five year monitoring programme. The first stage of that programme was to look at the roles and function under the Act of Statutory Supervisors. David Crichton and Lynda Smart of HFK Ltd Chartered Accountants (then Crichton Horne and Associates) were appointed to undertake this project. They have reported to me and I am issuing my report as a basis for my discussions with the sector, DBH, MED and the Minister. Some draft options are given.

This paper is divided into five sections relating to the specific functions and key issues which have been identified. These are:

- Distribution of villages between Statutory Supervisors
- Fee Charging
- Trust Account Maintenance/Stakeholder facility
- Financial monitoring
- Level of involvement with residents.

The findings are based on interviews and examination of documents with eight of the nine active statutory supervisors, and with interviews with relevant people in the retirement village sector.

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1. Distribution of villages amongst Statutory Supervisors

Key findings:

- There are nine active statutory supervisors. They are from either a Trustee background or a Chartered Accountancy background. These nine supervisors supervise 286 villages, the majority by the Trustee companies.
- There is a concentration of village supervision, with one company supervising 55% of villages.
- In terms of future growth in the sector, it seems likely to come from existing supervisors rather than new entrants. Concentration is likely to become more significant over time.
- A number of villages are still not registered.
- Concern by supervisors about the level of supervision required by some of these unregistered villages and whether the full costs would be recoverable.
- Benefits were experienced when supervising several villages owned by the same operator where there were attributes of experience and good governance, good financial reporting systems, good communication with village management and operator, and a strong financial position from an established group.
- These attributes possibly less likely to be found in smaller stand alone operators, thus requiring more assistance to comply with the Act.

Issues:

- Potential for independence issues where supervisor works for a core group of villages with one parent operator.
- Most supervisors were reluctant to act for those villages which are not yet registered and are considered likely to have high compliance costs.
- There is a minimum number of villages required to make supervisory business generate sufficient funds and to warrant undertaking professional development, networking etc in this area of specialization.
- Concern about the ability of the sector to grow, either through new supervisors, or concentration of villages with existing supervisors.

Options:

- A process is undertaken to help marginal villages which are unregistered to get statutory supervision services in order to fulfill the registration requirements. Options include appointing a default supervisor from a pool of subsidised supervisors, or having a subsidisation scheme which supervisors could take up an appointment under.
- **Best Practice issues**
  - Need minimum number of villages to generate sufficient funds to undertake training and work effectively as supervisor.
  - Independence of Statutory Supervisor: The NZICA has issued its own Code of Ethics regarding independence in Assurance Engagements. This is an issue of concern where a Supervisor has a number of villages but they stem from the one parent operator and provide a large portion of the firm's total fees. A good practice guideline could be developed requiring the Statutory Supervisor to demonstrate some acceptable level of independence over their income stream.
- **Statutory issues**
  - Look at the barriers to entry for any new firm to register as Statutory Supervisors.

2. Fee Charging

Key Findings:

- Typically fees are made up of an initial acceptance fee, for setting up the village (in the range $3,000-$6,000), and an annual fixed fee (a range of $1,750-$$12,000 but averaging $4000-$8000). An additional charge is made for any settlements (ranging $100-$250 per settlement).
- One supervisor has an annual fee for the appointment with all undertakings being charged on a time cost basis (AGM attendance, review of documents etc.).
- Charging was sufficient for a small profit margin, with no evidence of super-profits being made.
- There is a recognized charges anomaly between small and large villages; the level of charges that can be borne by a small village is limited due to the number of residents. The level of work is generally the same – review a set of annual financial statements, review six monthly accounts and quarterly directors' certificates, and attendance at AGM.
- Those villages with better processes for dealing with residents' issues, were familiar with financial reporting requirements under Securities Act, have transitioned into compliance with the Retirement Village Act more easily are less work than those villages who are new to register.

Issues:

- Those villages yet to comply with the Act are likely to be smaller villages and would generate insufficient fee income for the work required to become fully compliant. Statutory Supervisors have some reservations about accepting these villages for costs reasons and risk reputation for their firm of association with non-compliant or failing village.
- A competent operator and manager are a significant factor in making a supervisor's job easier.
- There are fours sets of professional fees required for compliance with the Act; accountants' fees, auditors' fees, valuers' fees and Statutory Supervisor fees. Cost is acting as a barrier to some smaller villages. There is a definite need for their roles but cost efficiency needs to be looked at.

Options:

- **Best Practice issues**
    - Include in any best practice guide a section on costs which provide some transparency around costs and the range of charges.
- **Statutory issues**
    - Address the issue of cost as a barrier to compliance and the ability to appoint a Statutory Supervisor.

3. Trust Account Maintenance/Stakeholder facility

Key Findings:

- The requirements under sections 29 and 42 of the Act for maintaining a stakeholder facility, which is independently held and in an interest bearing account, were met.
- One Statutory Supervisor has contracted the stakeholder role to solicitors.
- Administration of trust accounts was satisfactory. There were good internal control processes in the management of their trust account with good separation of duties, regular reconciliations and documentation to support any transfers or payments

Issues:

- Clarification is needed of the ability of the Statutory Supervisor to contract out the stakeholder role to another party. This has a potential conflict of interest between the solicitor's obligations as solicitors to the village owner and their obligations to the Statutory Supervisor. This was the situation prior to the introduction of the RV Act where the village owner's solicitor provided the trust account facility.
- One supervisor did not follow the correct procedure for holding the funds under the name of the incoming resident during the fifteen day cooling off period, instead holding them under the name of the outgoing resident.

Options:

- **Best practice issues**
  - The Statutory Supervisor checks the calculation of funds to be distributed against the deductions allowed under the occupation licence agreement. Many supervisors were also getting written acceptance of the payment sum as calculated by the operator before making final distribution of funds.
  - Ensure that the correct procedure is followed i.e. funds are to be held in the trust account in the name of the incoming resident until expiry of the cooling off period. At that point the funds plus interest can then be transferred into the outgoing residents account.
- **Statutory issues**
  - Level of audit and review depended on whether the supervisor was a Trustee or Chartered Accountant firm. Chartered accountancy firms do not generally have their trust accounts externally audited but have a practice review undertaken by the Institute of CA once every three years. Trustee companies are requires to have their trust account audited on an annual basis as part of their statutory obligations under other Acts. Further guidance is needed on the stakeholder role, in particular whether the stakeholder account should be independently audited on an annual basis.

4. Financial monitoring

Key findings:

- All but one of the supervisors reviewed used the standard TCA deed of supervision. It lists the requirements of the quarterly reports operators must provide to the supervisor, in addition to the six monthly accounts, annual financial statements and annual budgets.
- There were some distinct variations in the level of analysis of these different reporting formats undertaken by Statutory Supervisors.
- There appears to be undue reliance on the work of auditor in the preparation of annual financial statements by some supervisors. Although all advised they did review and analyse financial statements, only three supervisors had any evidence on file of reviewing and analyzing the annual financial statements.
- A broad interpretation has been applied to regulation 47(3) (b) as to what level of inadequacy would materially prejudice the interests of residents.

Issues:

- Supervisors in their analysis of the financial statements were not taking advantage of the information contained in a management letter from the auditor that is issued at the time of the audit.
- Interpretation varied amongst Statutory Supervisors as to what level of financial inadequacy would materially prejudice the interest of the retirement village residents, some comfortable with a certain level of financial inadequacy.
- One issue that has been identified through the financial monitoring process is that of operators providing guarantees in relation to borrowing or undertaking additional without the Statutory Supervisor's approval.
- Statutory Supervisors don't have the power to prevent a shareholder mortgaging their shares in the operator company, or using those shares as a personal guarantee arrangement.
- Where the operator is not a separate legal entity, such as a sole trader or partnership entity, the Statutory Supervisor is limited in their ability to assess the financial vulnerability of the owner in respect of their other business activities or borrowings.
- Some Statutory Supervisors only accepted appointments from operators they felt were financially strong and had good governance.
- Some supervisors were placing reliance on the strong equity at the parent level in their financial monitoring role i.e. where a retirement village had some financial difficulties but was part of a financially sound parent company. However most villages operate as a separate legal entity and are therefore unable to rely on strength of parent for their continuing viability.
- Certificate required from Statutory Supervisors under section 13 creates an issue for those members of the NZICA as it becomes an assurance engagement. This statement should come from the village's auditor rather than the Statutory Supervisor.
- Provision of financial statement to residents at AGM of village, are often 'made available' and a summary presented. A small sample of these was analysed and unable to be reconciled to the financial statements.
- Issue of Statutory Supervisor's report not being given to village residents and no alternative report obvious.

- An operator indicated to the Statutory Supervisor an intention not to circulate financial statements as there was something in them they preferred the residents did not see, using only a summary sheet instead.
- Giving a concession to the operator over delays in providing annual statements, should be granted only after careful consideration.
- Annual fee setting process: most increases were noted to be not much higher than the CPI, well scrutinized by residents and Statutory Supervisors. Most owners appear to be subsidizing the operation of the village.

Options:

- **Best Practice issues**
  - Improvement of systems, such as, the use of worksheets/checklists to provide evidence of thorough consideration of the financial position
  - Consider the financial position of each village entity rather than placing reliance on the parent company.
  - Use of a summary statement to residents at the AGM needs to be audited and /or independently verified as correct. Could be an extension of the financial statements which are audited.
  - Request a copy of the management letter from the auditor as part of the financial review process.
  - Guidance is given to Statutory Supervisors as to what financial issues would materially prejudice the interests of residents, e.g. negative equity, negative working capital, and unauthorized guarantees being given. Consideration could also be given to whether any statutory options exist which would clarify which issues require action.

- **Statutory issues**
  - Consider the need for additional protection for residents where the village operator is a sole trader or partnership and the village is therefore exposed to the debt of the individuals. One option is for it to be a requirement that each village is registered as a separate legal entity.
  - The certificate required from Statutory Supervisors under section 13 should come from the village's auditor rather than the Statutory Supervisor.
  - Investigate the issues around the situation of a village being in financial difficulty, such as, the difficulties of finding an alternative operator willing to purchase a village as a going concern, or where a sale would compromise the residents' financial interest.

5. Level of involvement with residents

Key findings:

- Although there was the intention for the supervisor to take on some form of advocacy role for residents, the nature of charging and invoicing acts a barrier.
- Visiting provincial villages (other than for AGM), can be cost prohibitive.
- The disputes process has a number of problems, role and level of involvement of Statutory Supervisor is unclear.
- Cost of dealing with complaints and disputes were an issue for Statutory Supervisors.

Issues:

- Costs of dealing with complaints a concern and issues may not be given due consideration.

Options:

- **Best practice issues**
    - Keeping residents' correspondence on file, with detailed notes of conversations/ meetings concerning the village.
    - Use of residents committees to help sort out issues and act as a filter to the Statutory Supervisor of complaints
    - Standard to number of visits to villages
    - Guidance as to action to be taken by the Statutory Supervisor in a dispute situation.

- **Statutory issues**
    - Explore whether an enhanced advocacy role is better achieved by something like the current tenant/ landlord relationship. There is a need for an easier, more economical process of dispute resolution, e.g. compared with the tenancy services mediation process where the fee is $20.
    - Access to a similar mediation/ dispute process to the tenancy service.
    - Define the reporting requirements in section 42 of the Act concerning the annual report from supervisors to the registrar and residents, and consider including it as part of the disclosure requirements for incoming residents.

6. Other issues:

- What should be the role of Retirement Commissioner/or other body in terms of ongoing monitoring; should there be some form of continuing review programme.
- Whether the Act currently gives the Commissioner, or other body, adequate powers of inspection, in particular, whether the wording of the Securities Act should be mirrored, giving powers to issue orders relating to inspections and the provision of information.
- These issues should be most appropriately addressed in any review of the Retirement Villages Act 2003.