REPORT OF AN INQUIRY

INTO ASPECTS OF THE AFFAIRS OF

METROPOLITAN LIFECARE GROUP LIMITED

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Alphabetical listing of persons referred to frequently in the report

Bolton, Mrs C.M.	Non-executive director Metropolitan Lifecare Group Limited ("MLGL"), formerly General Manager
Brewer, Miss A.J.	Barrister & solicitor, Senior Associate, Simpson Grierson Law, Auckland
Cook, Mr C.J.	Executive Deputy Chairman, MLGL, formerly Managing Director
Fitzsimmons, Mr P.W.	Acting Chairman, MLGL, Managing Director FAI Metlife
Gilbert, Mr K.I.	Chartered accountant, partner Wylie McDonald
Irvine, Mr R.M.	Barrister & solicitor, partner Simpson Grierson Law, non-executive director MLGL, company director
James, Mr R.C.	Chartered accountant, partner Arthur Andersen
LeGrice, Dr H.	Non executive director MLGL, Eye surgeon, company director
McCarthy, Ms J.L.	Chartered accountant, former Chief Financial Officer, MLGL
Nelson, Mr R.B.	Barrister & solicitor, partner Simpson Grierson Law
Peterson, Mr C.A.	Sharebroker, Principal, Clavell Equities (Organising Broker) and Clavell Capital Limited (Lead Manager)
Russell, (the late) Sir Spencer	Former chairman and chief executive of National Bank of New Zealand Limited, former Governor Reserve Bank of New Zealand, chartered accountant, chairman MLGL from March 1994 until his death in July 1995
Trow, Prof D.G.	Member, Board of New Zealand Stock Exchange, member Listing Subcommittee, NZSE, Professor of Accountancy, Victoria University of Wellington
Wolf, Dr F.M.	Non-executive director MLGL, senior executive officer of FAI Metlife's parent company

Glossary of terms used in the report

AA	Arthur Andersen, chartered accountants, auditors to MLGL
Beechworth	Beechworth Hospital & Residential Home Limited, member of MLGL group of companies, owner of healthcare facility at Albany
the Code	Code of Proper Practice for Directors issued by the New Zealand Institute of Directors
Discount on acquisition	Amount by which fair value of net assets obtained in an acquisition exceeds the fair value of the consideration given for the purchase
E & Y	Ernst & Young, chartered accountants
FAI Metlife	FAI Metropolitan Life Assurance Company of N.Z. Limited
FRS-7	Financial Reporting Standard No 7, "Extraordinary Items and Prior Period Adjustments" issued by the NZSA in May 1994
Goodwill on acquisition	Amount by which the fair value of net assets obtained in an acquisition is exceeded by the fair value of the consideration given for the purchase
IOD	New Zealand Institute of Directors
Listing Requirements	New Zealand Stock Exchange Listing Requirements issued by the NZSE in July 1989.
Listing Rules	New Zealand Stock Exchange Listing Rules which came into effect on 1 September 1994
Merger accounting	Form of accounting for the combination of two or more entities where no party can be identified as an "acquirer". Referred to in the accounting standards as the "pooling of interests method".
MLGL or "the Company"	Metropolitan Lifecare Group Limited
MLRV	Metropolitan Life Retirement Villages (Lifecare) Limited
NZSA	New Zealand Society of Accountants

NZSE	New Zealand Stock Exchange
Organising Broker	The broker who has undertaken the responsibilities of that position in respect of a Listing procedure, prospectus or similar matter. Clavell Equities was the Organising Broker for the MLGL public share offering in June 1994
"Purchase method"	Form of accounting for the combination or two or more entities where one party can be identified as an acquirer
SBSA	State Bank of South Australia
SBSA Villages	Retirement villages formerly owned by SBSA, purchased by MLRV in August - October 1993, acquired by MLGL with effect from 31 December 1993
SGBW	Simpson Grierson Butler White, now Simpson Grierson Law, barristers & solicitors
SSAP-8	Statement of Standard Accounting Practice, "Accounting for Business Combinations", issued by New Zealand Society of Accountants
Tantara	Tantara Holdings Limited, member of MLGL group of companies, owner of facilities at Browns Bay
VFF	Village Facilities Fees. Lump sum fees charged to incoming residents of retirement villages for use of communal facilities. Generally paid on the basis that if resident leaves village after a fixed period, say four years, none of the amount is refundable. If the resident leaves before the specified period the resident is entitled to a pro rata refund of the VFF based on the unexpired portion of residency
WMD	Wylie McDonald, chartered accountants, accounting advisers to MLGL

REPORT OF AN INQUIRY INTO ASPECTS OF THE AFFAIRS OF METROPOLITAN LIFECARE GROUP LIMITED

1 BACKGROUND

1.1 In June 1995 the Commission decided to undertake an inquiry into aspects of the affairs of Metropolitan Lifecare Group Limited ("MLGL" or "the Company") covering the period from mid 1993 to mid 1995. The terms of reference of the inquiry are set out in Appendix A.

1.2 The quorum of Members dealing with the matter comprised:

Mr A.N. Frankham (Chairman of the inquiry)
Mr J.M. Robson
Mr F.R.S. Clouston

1.3 The Commission retained Mr P.D. McKenzie, barrister of Wellington, as counsel to assist the Commission for the purposes of the inquiry.

2 PROCEDURE OF THE INQUIRY

2.1 The Commission summoned the relevant books and papers of all the principal parties to the inquiry. The Commission assembled a selection of documents, exceeding 800 pages, which constituted the documents of the inquiry for the purposes of the hearing of evidence.

2.2 The Commission made privacy and confidentiality orders under section 19(5) of the Securities Act 1978 ("the Act"). A copy of the orders is attached at Appendix B.

2.3 Hearings for the purposes of the inquiry were held over 6 days from 30 October 1995 to 20 December 1995. At these hearings evidence was received from 19 witnesses. A list of those appearing before the Commission is set out in Appendix C. A list of counsel representing various parties is set out in Appendix D.

2.4 A Consultative Draft report was released to the affected parties for comment on 16 February 1996. All comments received, and final oral submissions, were considered at a meeting of the Commission on 27 March 1996.

2.5 Most evidence was received on oath or affirmation, although, with the consent of counsel, unsworn written evidence was received from three witnesses.

Sir Spencer Russell

2.6 The Company's chairman at the time of the Company's June 1994 share offer, Sir Spencer Russell, died in July 1995.

2.7 The duties of the chairman of a public company are onerous and much is expected of such a person. In the normal course Sir Spencer would have been an important witness in our inquiry.

2.8 In our report we have felt it necessary to make some observations about the role Sir Spencer appeared to play in the affairs of the Company. We also make a number of comments more generally about the conduct of the Company's activities during Sir Spencer's time as chairman. Readers of our report should bear in mind that Sir Spencer has not been able to respond to either our specific or more general comments.

General

2.9 We wish to record our overall appreciation to the Company and the other parties to the inquiry, and to counsel, who have been helpful and co-operative in their approach to all aspects of the Commission's inquiry. This has facilitated the efficient completion of our work.

2.10 When referring to persons in our report we use the customary honorific the first time a person's name is mentioned. Subsequently we use the surname only. No disrespect is intended by this practice.

2.11 Although we have addressed all aspects of our terms of reference during the course of our inquiry, we restrict our comments in this report to those matters where we consider public comment is desirable.

3 BRIEF HISTORY OF METROPOLITAN LIFECARE GROUP LIMITED

3.1 MLGL is a listed issuer with its registered office in Auckland. Its main areas of activity are the operation of retirement villages, nursing homes and private hospitals throughout New Zealand.

3.2 Significant events in the Company's recent history include:

a For a period of at least 10 years FAI Metropolitan Life Assurance Company of NZ Limited ("FAI Metlife") and Mr C.J. Cook were equal joint owners of MLGL (then known as Metropolitan Life Retirement Villages Limited), which operated retirement village and related hospital/nursing home facilities at Masterton and Pakuranga;

b In August - October 1993, but effective from 1 July 1993, Metropolitan Life Retirement Villages (Lifecare) Limited ("MLRV"), a company also owned equally by FAI Metlife and Cook, purchased four retirement villages from the State Bank of South Australia ("SBSA");

c By two contracts dated 31 May 1994, which appear to have formalised pre-existing but unrecorded agreements reached between the parties, effective from 31 December 1993, MLGL:

i acquired, from MLRV's shareholders, all the shares of MLRV in exchange for shares in MLGL, and thus obtained control of the four retirement villages formerly owned by SBSA;

ii acquired from interests associated with Cook (plus some minority shareholders) all the shares in two companies ("Beechworth" and "Tantara") which owned and operated health care/retirement

facilities at Albany and Browns Bay respectively, in exchange for shares in MLGL;

d On 1 June 1994 MLGL's then $1 ordinary shares were split into 10¢ units and a bonus issue of 1:9 was made to the pre-float shareholders;

e MLGL issued a prospectus on 3 June 1994, offering 5,300,000 new 10¢ shares for subscription, and 9,700,000 existing shares for sale (split equally between FAI Metlife and Cook) at a price of 85¢ per 10¢ share. The offer was fully subscribed. A summary of the various share issues and sales is included in Appendix E.

The prospectus included forecast profits of $4.954 million after tax for the year ended 31 December 1994, and $5.452 million for the year ended 31 December 1995;

f MLGL was listed on the New Zealand Stock Exchange ("NZSE") on 3 July 1994.

3.3 Subsequent to the public listing of the Company:

a On 30 September 1994 MLGL announced an unaudited profit after tax of $1.549 million for the half-year to 30 June 1994;

b On 17 January 1995 the Company announced that its year end profit result was expected to be around 50% of that forecast in the June 1994 prospectus;

c On 15 March 1995 MLGL announced a preliminary full year unaudited after tax profit figure of $2.177 million;

d On 13 September 1995 MLGL announced an unaudited profit after tax for the half-year to 30 June 1995 of $320,000. The directors indicated they expected a pre-tax profit for the full year to 31 December 1995 of less than $3 million;

e On 11 December 1995 MLGL announced a forecast group profit for the year ended 31 December 1995 of approximately $1.4 million before tax and the unbudgeted costs of the Commission's inquiry;

f On 14 March 1996 MLGL announced an after tax net surplus for the year ended 31 December 1995 of $531,000.

g On 15 March 1996 it was announced that Sovereign Assurance Holdings Limited, a New Zealand based life insurance company, had reached agreement with FAI Insurances Limited to acquire all the shares of FAI Metlife.

3.4 From the original offer price of 85¢ per 10¢ MLGL share in June 1994 the traded price of MLGL shares fell steadily to about 32/33¢ per share in July 1995, and have since fluctuated above that level, to be around 43¢ per share in April 1996.

4 THE FORMATION AND FLOTATION OF THE GROUP

The acquisition of retirement villages from State Bank of South Australia

4.1 The records of the Company indicate that as early as November 1992 the then directors of MLGL had given approval for an indicative bid to be made for SBSA's retirement village assets which were at that time being offered for sale.

4.2 At a meeting of MLGL's then directors on 14 April 1993 it was agreed to offer $5.0 million to purchase the SBSA villages, with the offer to be made through a new joint venture company (MLRV) with identical ownership to that of MLGL.

4.3 From the evidence we accept that, at the time of their acquisition in late 1993, FAI Metlife and Cook had genuine reasons for keeping the SBSA assets separate from those of the existing MLGL villages.

4.4 We see nothing untoward in the acquisition of the SBSA villages being made by MLRV even though initial negotiations were undertaken by MLGL. Both companies were jointly owned by FAI Metlife and Cook and any arrangements for sharing the costs of the acquisition were between those two parties.

The decision to float the Metropolitan Lifecare Group

4.5 Shortly after the acquisition by MLRV of the SBSA villages an "in principle" decision was made by FAI Metlife and Cook to investigate the possibility of a public float of an MLGL group.

4.6 We are satisfied on the evidence that the initiative for the float came from FAI Metlife, which wished to realise some of their investment in the Company and

which also saw other benefits for the future growth of the Company.

4.7 We accept that Cook did not intend to sell down his interests in MLGL upon the acquisition of the SBSA companies, but that he and fellow executive director Mrs C. M. Bolton had been persuaded of the merits of a public float by late October 1993 by, in particular, Dr F.M. Wolf, a senior executive of FAI Metlife's Australian parent company.

4.8 It appears that neither Bolton nor Cook sought or received any advice in November 1993 from independent legal or accounting advisors on the merits of proceeding with the float at that time. All the efforts of the advisory team seemed to have been directed at what needed to be done to devise a legal and accounting structure and to prepare the financial statements and forecasts which would be needed for the prospectus.

Management of the float process

4.9 To progress the float process a "Task Force" was established in November 1993. We were told its purpose was to co-ordinate the activities necessary to comply with all pre-float requirements. The Task Force included representatives of the Company's auditors, Arthur Andersen ("AA"), accounting advisers, Wylie McDonald ("WMD"), legal advisers, Simpson Grierson Butler White (now Simpson Grierson Law) ("SGBW"), FAI Metlife and MLGL. Mr C.A. Peterson of Clavell Equities (sharebrokers) and Clavell Capital Limited (merchant bankers), undertook a coordinating and facilitating role in relation to the work of the Task Force.

4.10 In late January 1994, a Board Due Diligence Subcommittee, chaired by director-designate Mr J.M. Irvine, barrister and solicitor, partner of SGBW, company director and including Wolf, Cook and Mr B. Mitchell (an executive director of FAI

Metlife) was established. Peterson's evidence was that its purpose was to make enquiries, on behalf of the Board, whether the Company was ready to float and to ensure that all of the obligations of the board had been properly discharged. Contemporaneously a Due Diligence Committee, with Peterson as convenor, and comprising a similar membership to the Task Force, was formed to assist the Subcommittee.

4.11 The Task Force formulated policy on numerous accounting and other matters relating to the formation of the group for consideration by the promoters, FAI Metlife and Cook and the board of MLGL. The Due Diligence Committee worked on the preparation of the prospectus, and aspects of the float process, for consideration by the Board Due Diligence Subcommittee and adoption by the full Board of MLGL.

4.12 The Board Due Diligence Committee reported to the full board of MLGL at a meeting on 14 March 1994. At that meeting Russell, former commercial and central banker and a chartered accountant, Dr H. LeGrice, eye surgeon and director of several unlisted companies, and Irvine were appointed to the board of directors of MLGL. Russell was elected Chairman of the Company.

4.13 As part of the process of finalisation of the prospectus there was a verification procedure, led by Miss A. Brewer, barrister and solicitor and senior associate of SGBW, and involving Bolton for the whole time and Cook for part of the time, together with Peterson and Mr K. DeSuza, MLGL's company secretary.

4.14 The formal board decisions relating to the acquisitions of MLRV, Beechworth and Tantara, related share issues, and approval of the prospectus, were made at a meeting of directors on 9 May 1994 in which all directors participated.

4.15 The evidence which was put before us indicated that the processes of due

diligence and verification were thorough and well documented. However in our view there were some weaknesses in the way in which the Board was involved in the process:

a The financial statements included in the prospectus, which dealt with some complex accounting issues, were checked by Mr K.I. Gilbert, chartered accountant of Wylie McDonald and his staff (who had been responsible for their preparation) and proofread by Peterson. None of the independent directors were involved in either the verification process or the checking of the financial statements;

b while the Board Due Diligence Subcommittee was chaired by a senior practising lawyer with extensive experience in the commercial world, and included individuals with a wide range of skills and experience, the subcommittee did not include a director experienced in dealing with current accounting issues and also with public company experience. The float in this case involved consideration of a number of accounting issues of some complexity.

The acquisitions of Beechworth Hospital & Residential Home Limited ("Beechworth") and Tantara Holdings Limited ("Tantara")

4.16 The acquisition of Beechworth and Tantara from Cook and some minority interests was a significant step in the formation of the MLGL group as floated to the public.

4.17 The consideration for the acquisition was 801,071 $1 ordinary shares in MLGL, calculated to be 19% of the capital of MLGL following the acquisitions of MLRV,

Beechworth and Tantara but before the float. However, the form of the transaction was an initial payment of $1,273,703 cash to the vendors which was immediately used by them to subscribe for the agreed number of MLGL shares. This manner of effecting the transaction resulted in some apparent contradictions in the prospectus. For example, on page 61 the consideration for the acquisition is described as being "cash". However, on page 55 it is stated that subsequent to balance date the vendors paid an equivalent amount for the issue of 801,071 shares in MLGL. At this point the investor is invited to draw the conclusion that the transaction was in the nature of a shares for shares exchange.

4.18 The evidence is that the terms on which the two companies were integrated into the group were the result of commercial negotiations between Cook and Wolf, with no involvement by the independent directors in the negotiation process. It appears final agreement on the terms of the transaction were reached in late February 1994. The necessary formal board resolutions giving effect to the acquisitions were made at the meeting of MLGL directors on 9 May 1994.

The Ernst & Young opinion

4.19 As part of the process of obtaining the NZSE's approval for the listing of MLGL, the NZSE's Listing Subcommittee (see section 8 of the Report), on 19 April 1994, drew Clavell Equities' attention to the applicability of Listing Requirement 9.1.2(a) to the acquisitions of Beechworth and Tantara, those acquisitions being significant transactions with related parties of the issuer. The effect of the Requirement was that, without a waiver from the NZSE, MLGL would have been obliged to obtain an Appraisal Report and submit the transaction to a general meeting of the Company for approval.

4.20 In order to avoid the uncertainty of having to submit the transaction to a post-float vote of the shareholders of MLGL the directors of MLGL, on 26 April 1994, sought a waiver from the NZSE from the requirements of Requirement 9.1.2(a). In support of the waiver application the directors of MLGL sought an opinion from Ernst & Young, chartered accountants ("E & Y"), on the fairness and reasonableness of the arrangements agreed between Cook and Wolf, both as to the parties involved and as to MLGL's future public shareholders.

4.21 E & Y's conclusion in relation to MLGL's shareholders as at 31 December 1993, as set out in a letter of 26 April 1994 to the directors of MLGL, was that, based primarily on the projected share of future earnings, but also taking account of the net tangible assets being brought into the group by Beechworth and Tantara, they considered *" the transaction to be fair and reasonable to [those] shareholders."*

4.22 With respect to the future (post-float) public shareholders E & Y's conclusion, based on a view that *"In the event the actual results differ from projected results to the extent that the 19% allocation would not have been appropriate, the only parties to be affected would be FAI and Cook interests..."* was *" ... that the transaction in respect of the allocation of 19% of the share capital in MLGL to Cook interests, [was] fair and reasonable to the public shareholders of MLGL ...".*

4.23 In effect E & Y had considered that, because the transaction had occurred before the public float, and details were disclosed in the prospectus, the actual allocation of the share capital of MLGL between Cook and the FAI Metlife interests to allow for the acquisitions of Beechworth and Tantara was irrelevant to the future public shareholders of MLGL.

4.24 In reaching their view of the transaction in relation to FAI Metlife and Cook, E & Y had relied on information and projections provided to them by MLGL and its

advisors and had not undertaken independent valuations of the Beechworth and Tantara companies as investments in their own right.

The views of the directors on the transaction

4.25 Irvine, Cook and Wolf indicated in their evidence that they considered that the consideration Cook and his associates received for Beechworth and Tantara was irrelevant to the future public shareholders because the transaction occurred before the public float and the prospective public shareholders were in a position to assess the investment being offered by the Company and the promoters on the basis of the information contained in the prospectus and could then decide to either subscribe or not subscribe to the offering.

Disclosures in the prospectus

4.26 The prospectus included a statement on page 24 that *"In summary, the independent Directors are satisfied that the transfer prices* [our emphasis] *are fair and reasonable to the public shareholders in MLGL following the completion of this offer."* (This statement referred to both the acquisitions of MLRV and Beechworth and Tantara.)

4.27 Subsequently, on page 25, the prospectus, referring just to the Beechworth and Tantara transaction, said that the transaction had been reviewed independently by E & Y who had concluded " *... that the transaction in respect of the allocation of 19% of the share capital in MLGL to Cook interests, [was] fair and reasonable to the public shareholders of MLGL ...*". Mr D.S. Kingston, chartered accountant, partner of E & Y, confirmed in evidence that this wording had been reviewed and, after amendment by MLGL, approved by E & Y.

Our comments

4.28 Concerning the procedures followed by the directors of MLGL, and the disclosures in the prospectus relating to, the acquisitions of Beechworth and Tantara:

a We think investors would have concluded, from the wording of the prospectus, that the independent directors had obtained independent valuations of the companies being acquired before expressing the view they did as recorded in paragraph 4.26;

b We believe the prospectus should have included:

i a statement that the independent directors had not obtained an independent valuation of Beechworth and Tantara as businesses;

ii the views of the independent directors of MLGL that the transfer prices for Beechworth and Tantara were not considered to be relevant to the future public shareholders of MLGL;

iii statements (by the directors) that E & Y, in reaching the views attributed to it:

- had not undertaken an independent valuation of Beechworth and Tantara;

- had based their view of the reasonableness of the transactions as between FAI Metlife and Cook on information and projections provided to them by MLGL and its advisers of the forecast income and asset contributions

from Beechworth, Tantara and the balance of the MLGL group;

- had based their assessment of the fairness and reasonableness of the acquisitions of Beechworth and Tantara to the future public shareholders on their view that only FAI Metlife and Cook would be affected if actual results differed from the projected results on which the division of equity between the two parties had been negotiated, so the number of shares allocated to Cook was irrelevant to the Company's prospective future public shareholders;

iv An unequivocal statement that the arrangements with Cook and his associates were for the allocation of 19% of the expanded capital of MLGL in exchange for their shares in Beechworth and Tantara.

4.29 In our view such disclosures would have put prospective investors in MLGL on notice that they should look closely at the acquisitions on the basis of the information disclosed in the prospectus about them. As it is, we think that investors were given a degree of assurance by the wording of the prospectus, because of the expressed views of the directors and the reported views of E & Y concerning the fairness and reasonableness of the transfer prices to the future public shareholders, that the value of the businesses acquired had been subject to external scrutiny, which was not the case.

4.30 With respect to E & Y we note that the firm did what was asked of them by the directors of MLGL. They expressed a view of the reasonableness of certain transactions as between FAI Metlife and Cook and in respect of the future public shareholders on the basis of information provided to them by the Company.

They were not preparing an Appraisal Report as that term was used in the Listing Requirements of the NZSE. However as we have noted there were important caveats to the conclusions in their report to the directors of MLGL which were not reproduced in the prospectus. In that respect, while it was the directors of MLGL who were ultimately responsible for the contents of the prospectus, we think E & Y should have required that these caveats be set out in the prospectus before giving their approval to the relevant wording appearing in the prospectus.

4.31 In summary we think that the statements in the prospectus of the independent directors' conclusions in relation to, and their reference to E & Y's opinion of, the fairness and reasonableness of the acquisitions of Beechworth and Tantara were confusing by failing to refer to the matters set out in paragraph 4.28 above.

Accounting for the acquisitions

4.32 The shares of MLGL issued to Cook and associated parties in exchange for their shares in Beechworth and Tantara were valued for accounting purposes at $1.59 per share, giving a total value of consideration of $1,273,703.

4.33 The acquisitions of Beechworth and Tantara were "purchases" for the purposes of applicable accounting standards. Guidance is given in paragraph 4.27 of SSAP-8, Accounting for Business Combinations as to how to determine the "cost" of consideration given for a purchase. When securities are issued as consideration for a purchase, which was effectively the case here, the cost is to be measured, where possible, by an assessment of the fair value of the securities issued. We received expert evidence on this question in relation to the consideration given for the acquisition of Beechworth and Tantara.

4.34 We agree with the expert evidence (from Mr J.C. Hagen, chartered accountant, Executive Chairman of Deloitte Touche Tohmatsu, who was retained for the purposes of our inquiry by the Company) that the preferred basis for measuring the consideration given for Beechworth and Tantara was use of a value per MLGL share of $4.59 (being the average book value per MLGL share after the combination with MLRV and the 31 December 1993 revaluation of its assets) rather than $1.59 (which was the average book value of MLGL shares before that merger and asset revaluation), although a value of $2.78 per share (based on the net tangible assets of Beechworth and Tantara) was also justifiable.

4.35 Use of a value of $4.59 per share to value the consideration would have resulted in:

a the disclosure in the financial statements of an amount of "goodwill on acquisition" of $1.4 million, rather than the "discount on acquisition" of $953,000 which was disclosed;

b the disclosure of the amount of "consideration" for the acquisitions of Beechworth and Tantara as being $3.7 million rather than $1,274,000;

c a reduction in the Company's forecast profit of $141,000 per year (because of the need to write off the goodwill on acquisition over ".. *the period during which the benefit is expected to accrue to the investor ....*" which is "... *unlikely to exceed 10 years...*"(para 4.60, SSAP-8)).

Had $2.78 per share been used there would have been an equivalent but correspondingly reduced effect.

4.36 Peterson, in his evidence, told us that disclosure of this information in the prospectus may have resulted in the offer price of MLGL's shares being lowered

by "*... a few cents ...*" per share.

4.37 We believe that the description of the terms of the acquisitions of Beechworth and Tantara would have been more accurate if it had recorded the cost of the acquisitions using $4.59 or $2.78 per MLGL share rather than $1.59, although we acknowledge that both Hagen and the accounting expert retained by the Commission (Mr D.V. Christiansen, chartered accountant, National Chairman, KPMG) did not consider the impact of these differences material in the accounting sense.

4.38 In our view the use of the $1.59 value appeared to arise from a calculation error by WMD which was not detected by AA in the process of their audit.

The forecast financial information included in the prospectus

4.39 It is a matter of public record that the Company's financial results have fallen well short of the results forecast in the June 1993 prospectus. For this reason we considered the manner in which the forecasts had been compiled and reviewed.

4.40 For the purpose of the Commission's proceedings Hagen reviewed the forecasts included in the prospectus and the procedures followed in their preparation and concluded that, in his opinion, "*the assumptions noted in the prospectus were appropriately incorporated into the forecasts and given the circumstances and expectations held at the time the prospectus was issued, the forecasts were properly compiled on the footing of the assumptions and taken overall were not unreasonable*".

4.41 In our view the directors of MLGL approached the preparation of the forecast financial information in the 3 June 1994 prospectus in a conscientious manner.

The process of review of the assumptions underlying the forecasts undertaken by the auditors appeared thorough.

4.42 We saw no evidence that the forecast results had been deliberately exaggerated to produce favourable outcomes. It appeared to us from the evidence that the directors and advisers closely involved with the preparation of the forecasts genuinely believed that the forecast results could and would be achieved.

4.43 Notwithstanding our view, we were concerned that the directors, particularly those joining the Board of MLGL for the first time at its meeting on 14 March 1994, may have obtained undue comfort from some personal comments made by the audit engagement partner, Mr R.C. James to the meeting of the Board Due Diligence Subcommittee which immediately preceded the Board meeting, and which were reiterated in the minutes of the Board meeting itself.

4.44 James was recorded in the minutes of the Board Due Diligence Subcommittee as saying, in response to an enquiry from Mr R.B. Nelson, barrister and solicitor, partner of SGBW "*... that in his view the forecasts were, to an extent, conservative. Mr James advised he personally believed that the Group could do better than the forecasts, but not to a significant extent.*"

4.45 James told us that he had made a personal comment based on discussions he had had with senior MLGL executives, in particular Cook, about MLGL's plans and prospects. James said that it was " *... perhaps unfortunate ...*" that he had expressed his personal view, although it had " *... seemed innocuous ...*" to him at the time. He acknowledged that "*... it certainly wouldn't be for [him] to be judging the forecasts in lieu of those who were duly responsible.*"

4.46 Irvine and LeGrice have assured the Commission that the reported remark by James was only a relatively minor part of a much fuller and detailed briefing they

received, that its influence on them would have been insignificant, and that it in no way discouraged them from undertaking necessary enquiries of their own.

4.47 Nonetheless we think that James was unwise in the circumstances to have expressed a personal view on the attainability of the forecasts to the extent that his views were based on what he had been told by Cook about the Company's future plans and involved factors not incorporated in the formal forecasts.

The financial statements included in the prospectus

4.48 In the course of our inquiry we reviewed aspects of the manner in which the Company dealt with some of the many accounting policy issues faced in the course of preparing the financial statements that were included in the prospectus.

4.49 The issues we reviewed included the reporting of an Abnormal Profit of $3.55 million in the results of MLGL for the year ended 31 December 1993 which was the result of what was described in the financial statements as a change in accounting policy for dealing with the Company's income from the amortisation of Lifecare and Village Facilities Fees ("VFF") lump sum payments.

4.50 Whereas it was MLGL's accounting policy to recognise the income from these payments over the period (generally four years) during which MLGL would be obliged to make pro rata refunds to residents who vacated a village unit, the SBSA companies had generally spread the income benefits over a much longer period, around 8 years, based on the average expected time that residents would occupy their units.

4.51 The accumulated effect of the SBSA's accounting policies, by the time the

villages were acquired by MLRV, were "liability" balances of some $3.89 million in "unearned" Lifecare and VFF accounts.

4.52 In the course of preparing the financial statements of MLRV for the period ended 31 December 1993 the old SBSA accounting policies were changed to match those being followed by MLGL. This meant the write-off of the "unearned" Lifecare and VFF balances, which released $3.89 million to income. This write-off was treated by MLRV, and then by MLGL, in their respective 31 December 1993 consolidated financial statements as an "abnormal profit".

4.53 We questioned whether this accounting treatment was appropriate. We received evidence on this issue from the directors, the accounting advisers, the auditors, and from experts retained by the Company (Hagen) and the Commission (Christiansen).

4.54 We noted that expert opinion was divided as to the appropriate accounting treatment for this set of circumstances. Hagen's view was that the circumstances represented a change in accounting estimate rather than a change in accounting policy, and that the Company's treatment was appropriate. Christiansen, on the other hand, considered that this was a change in accounting policy and that there should have been no abnormal profit included in the Company's 1993 results, but instead an appropriate adjustment should have been made to MLGL's opening (i.e. 1 January 1993) reserves position.

4.55 We recognise that the accounting standards may leave room for reasonably held alternative views on the issue. We also acknowledge that the abnormal profit was disclosed in the prospectus so that readers of the prospectus should have been able to ascertain the source of the bulk of MLGL's reported profit for the year ended 31 December 1993.

4.56 However, in our view, the profit benefit arising from the accounting policy change (or change in estimate) had nothing to do with the activities of MLGL in the reporting year, but instead reflected an adjustment by MLGL to what had been a different approach to the recording of village income from two significant sources by the SBSA village owning companies when they had been under the control of different owners.

4.57 To clarify the position for the future we believe it is appropriate to review applicable accounting standards. For this purpose we are referring our report to the New Zealand Society of Accountants ("NZSA") in relation to the present provisions of financial reporting standard FRS-7 Extraordinary Items and Fundamental Errors which currently require that all "revenues" (including income benefits arising from changes in accounting policies), be included in the financial results of the period in which they are first recognised.

4.58 We are aware that SSAP-8 is currently under review by the NZSA. We think it would be desirable that any new Financial Reporting Standard (if it is not to defer in this matter to FRS-7) should include a stipulation that an acquirer or combining entity (in the case of merger accounting) is not able to materially enhance its reported revenue as a result of adjustments to accounting policies covering balances built up in prior periods when an acquiree or other combining entity was under separate control.

Our overview of the 3 June 1994 prospectus, including the financial statements

4.59 In the course of our review of the 3 June 1994 prospectus, including the financial statements incorporated therein, we have identified certain deficiencies. These are described above.

4.60 We have also given careful consideration to how these deficiencies would have affected a prospective investor in the securities of MLGL when considering whether or not to invest in the securities of the Company in June 1994.

4.61 In our view, on balance, the deficiencies in respect of the Company's financial statements were not of sufficient materiality to affect the overall truth and fairness of the statements to the degree that we consider they did not present a true and fair view of the Company's results for the year ended 31 December 1993 and of its financial position at that date.

4.62 In our view some information relating to other matters covered in the prospectus was presented in a confusing manner and some explanations and disclosures could have been more helpfully presented. However the presentational shortcomings in the prospectus did not, in our view, on balance, render the 3 June 1994 prospectus false or misleading in any material particular.

5 CORPORATE GOVERNANCE ISSUES

5.1 Our comments on corporate governance issues are made against the background of the obligations of company directors as outlined in the relevant sections of the 1955 and 1993 Companies Acts, as well as the guidance provided by the Code of Proper Practice for Directors ("the Code") issued by the New Zealand Institute of Directors ("IOD").

Adequacy of the Company's management resources

5.2 It is apparent from the evidence that the Due Diligence Subcommittee of the Board of MLGL was conscious of the importance of securing adequate management resources, and of not relying unduly on the skills of Cook and Bolton. As events transpired, and certainly as they were evident at the time of the hearing before the Commission, the Board of MLGL misjudged the skills and experience of the executive team, including the executive directors, relative to their roles in a public company structure.

5.3 The Company's current Acting Chairman, Mr P.W. Fitzsimmons (also managing director of FAI Metlife) acknowledged in evidence that the Company fell short of its 1994 forecast results because the management team "... *was not equal to the task of achieving the [planned] efficiencies and the development plan ...*" for a number of diverse reasons, including *"... unanticipated ..."* staff turnover, difficulties of integrating the SBSA villages, diversion of management time as a result of the float process, difficulties in completing prospectus registrations, unfavourable effects of health reforms, and a change in the original development plan which put emphasis on a new village at Paraparaumu rather than on "in-fill" developments at existing villages.

5.4 Cook and the other directors of MLGL now appreciate that the skills required to run a successful public company are different from those required to run a successful group of private companies. We believe this fact should have been apparent to the directors of MLGL, and to Cook, at the time of the float.

Management information systems

5.5 In the course of our inquiry we saw the information which was provided to the directors of MLGL at their regular meetings. We agree with the comments of the directors, made to the Commission with the benefit of hindsight, that the information provided to directors was extensive but in many respects unhelpful to them in their task of monitoring and directing the management of the business.

5.6 It is apparent that the problems inherent in integrating the SBSA village accounting reports into the MLGL group reports, together with inadequate technical and managerial resources being available to cope with the integration, affected the company over many months of the 1994 financial year. Partly as a result of these problems financial reports to the Board were not only inadequate but also not timely.

5.7 It was the responsibility of the Board to ensure that reporting systems were in place to provide adequate and timely information to the board. In our view the directors of MLGL failed in their duty to have such reporting systems in place.

5.8 In our view the root of this problem lay in the decision of the promoters, FAI Metlife and Cook, to proceed with a public float before the Company's reporting procedures had been properly established, but also reflected the lack of

familiarity of Cook with managing a publicly listed company and the failure of the Company to appoint appropriate staff to key positions and to put in place management information systems which would have alerted management and the Board to the nature and extent of the Company's evolving profit situation.

5.9 The evidence is that concerted action at board level to rectify the Company's management and reporting problems did not occur until after the December 1994 meeting of the Board, by which time "the horse had bolted" in respect of the 1994 year. In our view the reasons for the Board's failure to act earlier probably included a misplaced confidence in Cook's management ability, Russell's illness (which we were told affected him from around September 1994 onwards), and the extent of the Board's prior experience with management of a public company.

5.10 We observed that the auditors, in an internal Audit Planning Memorandum prepared for the 1994 year end audit, had commented adversely on several aspects of the management of the Company, including the failure of accounting staff to keep up to date accounting records and to produce more timely reports, and the ability of the managing director to override management controls.

5.11 We were surprised that these concerns had not been communicated to the chairman of the Company or to the Audit Committee. This situation seemed to reflect both:

a a lack of appreciation on the part of the Audit Committee that it should meet with the auditors, without management present, to ascertain any concerns the auditors may have about management issues; and

b the presumption on the part of the auditors that the directors understood all the deficiencies they had themselves identified.

The Audit Committee

5.12 MLGL's Audit Committee was established by the directors of MLGL at their meeting on 14 March 1994. It was chaired by Irvine and included Fitzsimmons and LeGrice. The Committee did not include either Russell or Wolf, the only directors of MLGL who had accounting training or experience.

5.13 The Committee did not comply with the guidelines in the Code in that there were no written terms of reference.

5.14 The Audit Committee had little involvement in accounting policy issues. This was probably inevitable given the composition of the committee.

Composition of the Board of directors

5.15 We believe it is desirable that both the chairperson and the chief executive officer of a listed issuer should have had prior experience in the governance of that type of company. It is particularly important that at least one of them does have the requisite experience. Listed issuers have a range of accountabilities which impose special obligations on their directors and management.

5.16 In the case of MLGL the chairman, Russell, while a well known and respected commercial and central banker, did not have direct experience with the management, direction or "culture" of a listed issuer. Given that neither Cook nor Bolton were familiar with the obligations of a listed issuer we believe it was all the more important that the chairman of the Company should have had a full appreciation of the reporting and other external accountabilities of such a company.

5.17 Additionally, MLGL's directors were faced with several important accounting issues in the course of preparation of the financial statements which formed part of the June 1994 prospectus, and in the preparation of subsequent financial statements.

5.18 The evidence is that, while the accounting policies were formally approved by the directors of MLGL, it was WMD and AA who effectively determined accounting policies at that time.

5.19 The MLGL board appeared to us to lack a person trained and experienced in dealing with current accounting issues and also experienced in public company matters. We acknowledge Russell was a chartered accountant but his technical accounting experience was not sufficiently current for him to fill the role we think was necessary at this stage in the affairs of the Company. In addition Wolf, while he had an academic qualification in economics and accounting, told us in evidence that he did not claim to be an expert in accounting matters.

5.20 In view of the nature of the issues to be considered by the Board of the Company, and acknowledging that directors were free to seek advice from external advisers, we believe the Board should have been adequately equipped to analyse the advice it received and to determine the appropriate course to be followed.

6 COMMUNICATIONS WITH SHAREHOLDERS AND THE STOCK EXCHANGE FROM THE TIME OF LISTING

6.1 As a listed issuer MLGL has various obligations under the Listing Requirements (1989) and more recently the Listing Rules (1994) of the NZSE, and under company law more generally, to communicate information about its affairs to its shareholders and to the sharemarket.

6.2 In the course of our inquiry we identified a number of issues for comment relating to the Company's disclosures to its shareholders and the Stock Exchange.

Half-yearly Directors' statement to 30 June 1994

Basis for the original statement

6.3 The half-year directors' statement, first made to the Stock Exchange on 30 September 1994, reported the half-year result to 30 June 1994 and included references to "... *profit being ahead of budget* ..." and to the Company's forecast profit "... *being in line with that contained in the float prospectus*".

6.4 In our view there was not a proper basis for the directors to make the statement on 30 September 1994 that the "forecast profit" for the full year was "in line" with that contained in the float prospectus. Contrary to the implication of the wording, no new formal forecast had been prepared at that date on which the directors could have based the statement. The directors were relying on the original prospectus profit forecast which they still believed, despite the absence of a formal review, would be achieved.

6.5 There is no record in the minutes of the directors' meeting of 9 September 1994

that the directors had come to any view on the attainment of the budget profit forecast. While directors did consider an analysis of the Company's profit performance to 30 June 1994 and various revised village development plans, they did not have a profit reforecast. It appears that any confidence the directors may have had that the prospectus forecast profits would be met may simply have been an echo of the views expressed by the executive directors that the full year's forecast results could be achieved.

Changes in the Directors' Statement as distributed to shareholders

6.6 When the Directors' Statement was subsequently distributed to shareholders in late October 1994 the references to "... *profit being ahead of budget ...*" and to the Company's forecast profit "... *being in line with that contained in the float prospectus*" had been omitted.

6.7 We were told that the directors did not see these changes as being of any significance. However in our view a statement by directors concerning forecast profit being in line with the prospectus forecast was not one to be taken lightly, and we do not agree that the omission, from the later statement, of the reference to forecast profit was only a minor matter.

6.8 We observe that since the second statement was still dated 30 September 1994 there was nothing to alert any investor who had seen the Company's original statement that the text had been amended.

6.9 Although there are inconsistencies in the evidence, we are satisfied that the initiative for the changes to the Directors' Statement came from James and that the amendments were made despite some concern being expressed by Peterson about changing a statement already released to the market. The view

promoted by James was that, if it was not necessary to make a comment on attainment of the forecasts, then it was better not to make such a statement.

6.10 James' concern arose because of some uncertainty on his part that the Company would reach its forecast profit by year end. James was aware that the first half-year profit had arisen almost entirely from a change in accounting policy applied to the sale of units acquired vacant from SBSA, which prompted the quite reasonable concern on his part (since there were no further such units to sell) that there could be a profit shortfall by year end.

6.11 We do not believe that any directors apart from Cook and Bolton were aware of the changes between the two statements, and we believe Cook and Bolton acted without authority in changing the text of the statement. In our view this reflected a lack of appreciation by both Cook and Bolton of the obligations of a listed company towards both its shareholders and the Exchange.

6.12 It is doubtful that Russell was aware of the changes to the statements. He was not on the original distribution list for the draft half-yearly financial statements and was, we were informed, overseas at the time the amended statement was issued.

A procedural issue

6.13 The text of the original directors' statement was not considered at a meeting of either the full board or the Audit Committee prior to its release to the NZSE.

6.14 A first and final draft of the report was distributed to directors on the basis that, unless individual directors advised they had any disagreement, the statement would be taken as approved. This was, in our view, unsatisfactory. The document was important. It is unlikely that use of such a procedure would have

afforded the directors adequate opportunity to review and comment on the text of the statement.

Referral

6.15 We are referring the issue set out in paragraphs 6.13 and 6.14 to the Market Surveillance Panel of the NZSE and to the IOD.

The statement to the Stock Exchange of 17 January 1995

6.16 The directors of MLGL issued a statement to the NZSE on 17 January 1995 stating that they anticipated the profit outcome for the year to 31 December 1994 to be around 50% of the level forecast in the June 1994 prospectus. We examined the timeliness of the making of that statement.

6.17 The Company's then Chief Financial Officer, Ms J. McCarthy, at Cook's request, produced a spreadsheet analysis dated 19 October 1994 (but evidently not completed until 29 October) which showed a profit after tax of $2.019 million for MLGL for the full year to 31 December 1994. McCarthy's analysis was reviewed at a MLGL senior management seminar on October 30 and 31 where certain adjustments to that forecast outcome were made. These adjustments increased MLGL's expected year end after-tax profit to $5.015 million.

6.18 Following the October 30/31 meeting Cook asked McCarthy to revise her analysis taking account of the various factors identified during the meeting. However this task had not been completed by late November 1994, at which time Cook asked Gilbert and Peterson to review the Company's expected profit position, using the adjusted McCarthy analysis as a basis.

6.19 Cook convened a meeting on 25 November with Gilbert, Peterson and Bolton to discuss likely year-end profit outcomes. Following this meeting Gilbert reviewed the adjusted McCarthy analysis. He also factored in the Company's actual results to end October 1994 (which were available to him around 1 December).

6.20 Just adjusting for logical errors in the modified analysis had lowered the expected profit to $3.97 million. However when Gilbert had factored in the actual year-to-October results (which were around $2.0 million below budget) this had lowered the expected year-end after-tax profit to $3.46 million.

6.21 Cook was told of Gilbert's analysis around 8/9 December 1994. Cook told us he had immediately informed Russell. The Board was informed of the position at its meeting on 12 December 1994.

6.22 The directors sought advice as to their obligations to the market from Nelson and Peterson. The advice given was that MLGL should inform the market as soon as the directors had reliable information on which to base a profit estimate.

6.23 We were told the directors considered it was necessary to wait until after the end of the financial year both to get an accurate indication of the Company's revenues for the year and to allow for some profit-enhancing options to be explored.

6.24 The actual statement to the Exchange was made after insistence by, in particular, Peterson (in January 1995), that an early statement should be made.

Our comment

6.25 We accept that the Board as a whole was not made aware of the Company's likely profit shortfall until their meeting on 12 December 1994. However on the basis of the evidence presented to us we believe that the directors should have been concerned from at least September 1994 about the Company's profit outcome because they knew, by that time:

i that most of the Company's profit for the first half year had not been achieved in the manner in which it had been forecast; and

ii the construction of new nursing home facilities had not taken place as expected, and running costs of existing facilities were over budget (although management was attending to this); and

iii changes in statutory supervisor and other factors meant delays in having the Company's village prospectuses finalised.

6.26 We believe that the directors should have been aware of these general factors before the meeting of 12 December 1994 and should have taken earlier steps to commission a review of the Company's ability to meet its forecast profit.

6.27 We agree with Hagen that the directors received proper advice in December 1994 about what they should then do to inform the market of the Company's predicament. We also agree with Hagen that they did not act sufficiently promptly on that advice.

6.28 In our view, neither the Board nor Cook seem to have fully appreciated the need for early advice to the market about the Company's changed profit expectations. In our view the directors took insufficient interest in following the matter up with

Cook.

6.29 In our view inadequacies in management and management information systems were the principal cause of both management and the Board being unaware of the state of the Company's financial position from at least late October 1994. The Board must accept responsibility for these inadequacies.

6.30 It seems to us that the directors of MLGL were ready to accept the verbal assurances of management that year end profit would meet budget when this view had not been substantiated by detailed analysis. In our view the directors should have insisted on receiving written reports from management showing how the year end forecast profit would be achieved. On the evidence, to the contrary, they were ready to rely on their knowledge of the Company's general development plans and to accept the executive directors' verbal assurances.

7 OUR OVERALL COMMENT ON THE COMPANY'S READINESS TO FLOAT

7.1 In our view the decision to proceed with the public float so soon after the acquisition of the SBSA villages was an error of judgement by those concerned. By November 1993 MLGL's management team had not had the chance to get to grips with the challenges of integrating the SBSA villages into the MLGL group's systems and "culture". We were surprised that the directors of MLGL and the promoters of the issue did not receive advice to this effect from any of their advisers.

7.2 In our view the Board of MLGL, and the promoters of the issue, FAI Metlife and Cook, should have postponed plans to float the group until they were confident they fully understood the SBSA businesses and had sorted out all management and information system issues, and accounting policy differences, resulting from the acquisition.

7.3 The matters on which we have commented in our report are indicative of a company which became a listed issuer without a proper appreciation of the board or management or information system resources which its obligations as a listed issuer would require.

7.4 We make further comment in the next section of the report on the obligations of Peterson and Clavell Equities, the "Organising Broker".

8 THE ROLE OF THE STOCK EXCHANGE AND ITS MEMBERS

Processing an application for Listing

8.1 When prospectuses are presented to the NZSE for listing they are reviewed by a Listing Sub-committee of the Board of the Exchange, usually working with a legal officer on the Exchange's staff. The Listing Sub-committee for some years has comprised Professor D.G. Trow, Victoria University, Mr J.A. Cimino, SBC Warburg, Auckland, and Mr H.J. Taylor, Hamilton Hindin Greene, sharebrokers, Christchurch.

8.2 Once the Sub-committee has completed its review of a prospectus it makes recommendations to the full Board of the NZSE, which makes the formal decisions on listing and on any waivers sought. This process was followed for the MLGL draft prospectus (where the NZSE's 1989 Listing Requirements were applicable).

8.3 NZSE's counsel informed us that, in reviewing any prospectus, the Sub-committee would have regard to the limitations of the NZSE's role as expressed in paragraph 2 of the Foreword to the Listing Requirements or (since September 1994) the Listing Rules:

> ***Participants' responsibility***
>
> *The Exchange considers that the market works best when buyers and sellers are fully responsible for the quality and consequences of their decisions to buy and sell. Participants should therefore recognise that the market operates on the caveat emptor principle qualified only in the specific respects mentioned below and reflected in the Rules. Accordingly the Rules are not intended to result in merit regulation by the Exchange of issuers availing themselves of market facilities. A regulatory approach based on attempted merit assessment of issuers by the Exchange would offer a spurious assurance to investors.*

The Organising Broker's obligations

8.4 The NZSE grants authority, pursuant to Requirement 4.1.1 (repeated in Rule 7.15.1(b)), to one of its members to act as "Organising Broker" in respect of each prospective public issue of securities on the Exchange. Clavell Equities was granted an Authority to Act as the Organising Broker for the MLGL share issue (although this role was not acknowledged in the prospectus).

8.5 The Subcommittee, in discharging its responsibilities under the Listing Rules or Listing Requirements, would have regard to the Organising Broker's responsibilities in relation to the application. These responsibilities were set out in the footnote to Requirement 4.1.8 (and are repeated in Rule 7.15.3) which state:

> *The Organising Broker is primarily responsible for lodging with the Exchange all the documents required to support the application. Notwithstanding that the Directors are responsible for the accuracy of the information provided to the Exchange and the market in the course of Listing, the Exchange attaches particular importance to the Organising Brokers' role in preparing the Issuer for Listing. That role involves satisfying themselves, on the basis of all available information, that the Issuer is suitable to be Listed. Organising Brokers should pay particular attention to the composition of the board of Directors of the applicant and to whether the necessary range of skills and experience is available. Possible minorities should be represented through the appointment of non-executive independent directors.*
>
> *In particular, therefore, Organising Brokers should satisfy themselves that the Directors:*
>
> *(a) can be expected to prepare and publish all information necessary to create and maintain an informed market in the Issuer's securities;*
>
> *(b) appreciate the nature of the responsibilities they will be undertaking as directors of a Listed Issuer; and that they*
>
> *(c) can be expected to honour their obligations under these*

Requirements as well as generally to shareholders and to creditors.

8.6 Clavell Equities, in a letter dated 21 March 1994 to the NZSE accepting the responsibility as organising broker in relation to the listing of MLGL, recorded that *"... it is satisfied, after making reasonable enquiries that the requirements of the exchange for listing have been or will be met and that it is appropriate for the issuer to be listed."* We sought to establish the level of enquiries which had been undertaken by Clavell Equities.

8.7 Peterson told us that, in discharging their responsibilities, Clavell Equities had carefully assessed the competence and integrity (and, where relevant, independence) of each prospective director of MLGL as well as of the executive staff. Clavell Equities' principals, between them, visited all of the Company's facilities and talked to senior staff at each one. They also said they relied on the experience and knowledge of the Company, its directors, senior management and advisers which they had gained through their involvement with the Task Force and Due Diligence Committee.

8.8 Peterson said he was aware, prior to the Listing, that the financial reporting systems of the former SBSA villages were being integrated with those of MLGL and said that as far as he was concerned the process was being handled by apparently competent staff under external supervision (from WMD). He also said that he had discussed with Cook and Bolton their obligations as directors of a public company.

8.9 By the time of the allotment of the securities Clavell Equities had a report on the MLGL float dated 9 June 1994 prepared by FPG Research Limited. The report had been commissioned by Clavell Capital Limited for MLGL to assist in the marketing of the issue.

8.10 Peterson told us that if the FPG report had been unfavourable to the Company's listing Clavell Equities would have acted on this, if necessary by recommending to the directors not to allot. However to have been of any value for this purpose the report from FPG should have been to hand before the prospectus had been issued. In any event we observe that at that late stage a decision to not allot the securities would have been a major and difficult one.

8.11 We noted that Clavell Capital Limited, the lead manager, was entitled to receive a success fee of $50,000 which was payable on the date of allocation of new shares by the share registry pursuant to the prospectus offer (see our comments later in this section of the report).

8.12 With respect to Clavell Equities' responsibilities for the documents required to support the application for listing, we found from the evidence that the original draft prospectus documentation submitted to the NZSE was well below the standard expected by the Exchange (and below what the Exchange was entitled to expect). Peterson accepted responsibility for the decision to forward the first draft of the prospectus to the NZSE. We were told that the directors of MLGL were unaware at the time that the document was being provided to the NZSE.

Our comment

8.13 We have concluded, and set out earlier in this Report, that in our view:

a MLGL should not have floated when it did. It was not ready;

b the chairman of MLGL, while an experienced banker and a person of public standing, had not had any direct experience in the governance of

a listed issuer. The chief executive officer had no experience with the management of a listed issuer;

c the corporate restructuring preparatory to the float called for consideration of a number of complex accounting issues;

d the board of directors of MLGL did not include a trained person experienced in dealing with current accounting issues and also experienced in public company matters;

e Cook and Bolton seemed to be largely unaware of their responsibilities as directors of a listed public company.

8.14 We think the weaknesses in MLGL's structure that we have identified, and the Company's lack of readiness to float, should have been evident at the time.

Waivers of Listing Rules

8.15 As part of the application for Listing the NZSE was asked to agree to waivers from the obligations of Listing Requirement 9.1.2(a) which required the issue of an Appraisal Report and the approval of the shareholders in general meeting to the pre-float acquisitions of MLRV, Beechworth and Tantara. The Listing Sub-committee supported the waiver requests and they were granted by the full Board of the NZSE.

8.16 We noted that had the 1994 Listing Rules been in effect at June 1994 the corresponding Rule would not have applied to the transaction because of a change in the definition of "Issuer" in the revised Rules.

8.17 In the circumstances we agree with the approach taken by the NZSE. We accept that where, as in this case, transactions with related parties had been undertaken prior to Listing, the appropriate approach was to concentrate on the adequacy of disclosures concerning those transactions so that prospective investors would be able to decide for themselves whether or not they wished to invest in the securities being offered.

Overall comments on the role of the Stock Exchange and its Members

8.18 We have five areas of comment. First, we are satisfied that the Sub-committee, working with its limited resources and having regard to the NZSE's regulatory philosophy, applied itself diligently to its review of the MLGL prospectus. We have no doubt that the prospectus, although still unsatisfactory is some respects, was enhanced as a result of the Subcommittee's work.

8.19 Second, in our view the NZSE has a responsibility to ensure that companies accepted for listing are reasonably ready for that status.

8.20 However, in the case of MLGL, the Subcommittee was confronted with documentation well below standard, which lead to delays in the listing process and culminated in the Managing Director of the NZSE writing to Clavell Equities, after the float had taken place, to express the Exchange's concern at the quality of the original documentation.

8.21 We think the NZSE should have taken its concerns further and enquired of Clavell Equities as to the suitability and readiness of the Company to list. The NZSE has told us that the Subcommittee's satisfactory experience with Clavell Equities, in relation to an earlier float was relevant to their handling of MLGL's application for Listing.

8.22 Third, it is arguable that the existence of a success fee payable to Clavell Capital, whether or not this may be a regular feature in arrangements between a prospective listed company and the organising broker or a related company, put Clavell Equities in a position of conflict of interest when it came to discharging its obligations to the NZSE as Organising Broker.

8.23 We invite the NZSE to review its Rules in relation to success fees or similar incentive arrangements payable to Organising Brokers, or companies associated with them, in the endeavour and to consider whether any issues of principle arise.

8.24 Fourth, Clavell Equities responsibility as "Organising Broker" was not acknowledged in the prospectus. Clavell Capital Limited was described as "Lead Managers", while Forsyth Barr Limited was named as the "Lead Broker" to the issue.

8.25 We believe every prospectus should identify the body given authority by the NZSE to act as "Organising Broker", and should also indicate how the responsibilities of that company or firm relate to those of other parties, such as a "lead broker", also named in the prospectus. We are referring this matter to the NZSE.

8.26 Finally, as a general comment, we think it would be helpful if the NZSE gave more publicity to the way in which it goes about approving applicants for Listing, the responsibilities both it and the Organising Broker assume, the procedures for processing prospectuses and similar documents presented for approval, and the manner in which it deals with requests for waivers.

9 REFERRALS

9.1 In accordance with section 10 of the Act we refer our report to the various bodies set out below.

The Directors of Metropolitan Lifecare Group Limited

9.2 We refer our report to the directors of Metropolitan Lifecare Group Limited for consideration of our comments and observations.

New Zealand Stock Exchange

9.3 We refer our report to the New Zealand Stock Exchange to consider our comments and observations, particularly those in section 8 on the report.

Market Surveillance Panel of the New Zealand Stock Exchange

9.4 We refer our report to the Market Surveillance Panel to consider our comments on the Company's compliance with its obligations to keep its shareholders, and the market more generally, informed of relevant information concerning its activities.

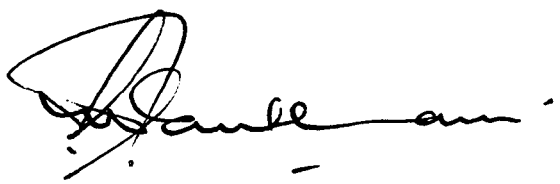
New Zealand Society of Accountants

9.5 We refer our report to the New Zealand Society of Accountants to consider our

comments on current and prospective financial reporting standards.

New Zealand Institute of Directors

9.6 We refer our report to the New Zealand Institute of Directors to consider our comments on various corporate governance issues and the manner in which directors approve releases to the Stock Exchange.



Member, for the Commission

17 April 1996
Securities Commission
12th Floor
Reserve Bank Building
2 The Terrace
WELLINGTON.

TERMS OF REFERENCE FOR AN INQUIRY UNDERTAKEN BY THE SECURITIES COMMISSION IN RESPECT OF METROPOLITAN LIFECARE GROUP LIMITED ("MLGL")

(a) To consider whether the prospectus dated 3 June 1994 issued by MLGL omitted any material information required under the Securities Act 1978 or the Securities Regulations 1983 and whether the prospectus was false or misleading in any material particular;

(b) To consider the procedures observed by the directors of MLGL in relation to:

(i) the formation of the MLGL group of companies prior to the public floatation, including the acquisitions of various assets and businesses;

(ii) the preparation of the prospectus dated 3 June 1994;

(iii) the monitoring of the performance of MLGL;

(iv) the communication of information to the shareholders of MLGL and the New Zealand Stock Exchange about the performance and prospective performance of MLGL;

(c) To consider the procedures observed by the promoters of the securities of MLGL offered for sale in the prospectus of 3 June 1994 in relation to:

(i) the formation of the MLGL group of companies prior to the public floatation, including the acquisitions of various assets and businesses;

(ii) the preparation of the prospectus dated 3 June 1994;

(d) To consider the role of the professional advisers to MLGL, including the auditors, in relation to:

(i) the formation of the MLGL group, including the acquisitions of various assets and businesses;

(ii) the preparation of the prospectus dated 3 June 1994;

(iii) the provision of information to the sharemarket concerning MLGL's performance.

(e) To consider the role of the New Zealand Stock Exchange in applying the Listing Agreement and the provisions of the Listing Rules in relation to the public floatation and offering of shares by MLGL and the other offerors in June 1994;

(f) To consider whether the published financial statements of MLGL for the year ended 31 December 1993, for the half-year ended 30 June 1994, and for the year ended 31 December 1994, fairly reflected the financial position, financial performance and cash flows of MLGL;

(g) To consider whether to report to MLGL, its directors, its shareholders, or to any other appropriate body.

12 September 1995

Securities Commission

12TH FLOOR, RESERVE BANK BUILDING
2 THE TERRACE, WELLINGTON
NEW ZEALAND
TELEPHONE 64-4-472 9830
FACSIMILE 64-4-472 8076
P.O. BOX 1179

Our Ref: 424

APPENDIX B

CONFIDENTIALITY ORDERS

At its meeting on 9 October 1995 the Securities Commission made the following orders under section 19(5) of the Securities Act 1978 in relation to the Commission's inquiry into aspects of the affairs of Metropolitan Lifecare Group Limited, pursuant to its terms of reference of the inquiry:

1. that the proceedings be heard in private

2. prohibiting, with effect from the commencement of the inquiry:

a. the publication or communication of any information or document or evidence which is furnished or given or tendered to, or obtained by, the Commission, in connection with the inquiry, and

b. the giving of evidence involving such information, document, or evidence,

by any person other than the Commission or the person furnishing it or any person authorised to act on their behalf,

these orders being subject to any further order of the Commission.

9 October 1995

(METLIF\CONF.DOC)

APPENDIX C

LIST OF WITNESSES WHO GAVE EVIDENCE TO THE COMMISSION FOR THE PURPOSES OF THE INQUIRY

Directors of Metropolitan Lifecare Group Limited

Mr P.W. Fitzsimmons, O.B.E.	Acting Chairman, also managing director FAI Metropolitan Life Assurance Company of N.Z. Limited
Mr C.J. Cook	Executive Deputy Chairman, formerly Managing director, also director Private Health Care (NZ) Ltd
Mrs C.M. Bolton	Non-executive director, formerly General Manager
Dr F.M. Wolf	Non-executive director, also senior executive, FAI Insurances Limited, Australia
Mr R.M. Irvine	Non-executive director, also partner, Simpson Grierson Law, Auckland, company director
Dr H. LeGrice,O.B.E.*	Non-executive director, also company director

Professional advisers

Mr R.C. James	Chartered accountant, partner, Arthur Andersen, auditors to MLGL
Mr K.I. Gilbert	Chartered accountant, partner Wylie McDonald, accounting advisers to MLGL
Mr R.B. Nelson	Barrister & solicitor, partner Simpson Grierson Law, solicitors to MLGL
Miss A.J. Brewer	Barrister & solicitor, senior associate, Simpson Grierson Law
Mr D.S. Kingston	Chartered accountant, partner Ernst & Young

Mr C.A. Peterson	Principal, Clavell Capital Limited, merchant bankers, lead managers, and partner, Clavell Equities, sharebrokers, Organising Brokers for the June 1994 MLGL share issue
Mr A.J.D. Moore*	Chartered accountant, partner Staples Rodway
Mr S.E. Bauld*	Chartered accountant, partner Price Waterhouse

New Zealand Stock Exchange

Prof D.G. Trow	Member, Board of NZSE, member of Listing Subcommittee, NZSE, chartered accountant, Professor of Accountancy, Victoria University of Wellington
Mr P.E. Leloir	Manager, Legal and Surveillance, NZSE, barrister & solicitor
Mr S. Law	Legal officer, NZSE, barrister & solicitor

Expert Witnesses

Mr J.C. Hagen	Chartered accountant, Executive Chairman, Deloitte Touche Tohmatsu, Chairman, Accounting Standards Review Board, appearing as expert witness for MLGL
Mr D.V. Christiansen	Chartered accountant, National Chairman, KPMG, appearing as expert witness for the Commission

* Did not appear before Commission. With consent of counsel, provided written, unsworn testimony.

APPENDIX D

COUNSEL REPRESENTING PARTIES TO THE INQUIRY

Counsel who made submissions or appeared before us, and the parties they represented, were:

Mr B.P. Keene, barrister of Auckland, for all parties except E & Y and NZSE, and for AA in respect of the presentation of final submissions.

Mr A.F. Grant, Russell McVeagh McKenzie Bartleet & Co, Auckland, for AA, except for the presentation of final submissions.

Mr S.L. Franks, Chapman Tripp Sheffield Young, Wellington, for NZSE.

Messrs T.P. Greville and E.G. Kernohan, Buddle Findlay, Auckland, for E & Y.

[METLIF\COUSEL.LST]

APPENDIX E

FLOAT OF MLGL IN JUNE 1994
OUTLINE OF MOVEMENTS IN SHAREHOLDINGS OF MLGL
FROM PRE - ACQUISITIONS TO POST FLOAT

	Cook	FAI Metlife	Others	Public	TOTAL
Capital at 31/12/93 ($1 shares)	1,000,000	1,000,000	-	-	2,000,000
Acquire MLRV 31/5/94*	707,547	707,547			1,415,094
Purchase Bchwth & Tantara 31/5/94*	641,318	-	159,753	-	801,071
Total $1 shares on issue 31/5/94	2,348,865	1,707,547	159,753		4,216,165
Dist.	55.7%	40.5%	3.8%		
Split into 10¢ shares 1/6/94*	23,488,650	17,075,470	1,597,530		42,161,650
1:9 bonus 1/6/94*	2,609,851	1,897,274	177,503		4,684,628
10¢ shares on issue 3/6/94	26,098,501	18,972,744	1,775,033		46,846,278
New issue				5,300,000	5,300,000
Sell down	(4,850,000)	(4,850,000)	-	9,700,000	-
Final share holdings 3/7/94*	21,248,501	14,122,744	1,775,033	15,000,000	52,146,278
Voting dist.	40.7%	27.1%	3.4%	28.8%	

* Denotes date of share issue, not necessarily date transaction took place.

[METLIF\SHARES.CHT]

APPENDIX F

LIST OF DIRECTORS OF MLGL AT 3 JUNE 1994

Sir Spencer Thomas Russell, chairman (died July 1995)

Peter William Fitzsimmons O.B.E., Deputy Chairman (Acting Chairman from July 1995)

Clifford James Cook, Managing Director (Executive Deputy Chairman since August 1995)

Carole Marion Bolton, General Manager (non-executive director since August 1995)

Ronald MacGregor Irvine, non-executive director

Dr Hylton LeGrice O.B.E., non-executive director

Allan Brooke Mitchell, non-executive director

Frank Michael Wolf, non-executive director

Directors appointed since June 1994

Robert John Opiat, Managing Director from August 1995