Transparency and financial control of aged care providers

Richard Cumpston

(Dr Richard Cumpston is a director of Australian Projections Pty Ltd. As an actuary, he has provided reports on the financial condition of general insurers, as required by the Australian Prudential Regulatory Authority. He can be contacted on richard.cumpston@gmail.com, or 0433 170 276.)

Summary

This submission has been written in response to the Department of Health's Febuary 2019 discussion paper "Managing prudential risks in residential aged care".

Complex structures, and uncontrolled reporting procedures, can

- greatly increase the risks of provider failures, with assets held by related parties but not available to repay accommodation payments
- make it impossible to judge the overall profitability of aged care, so that the government may increase subsidies even when true profitability is high
- make it impossible to provide meaningful information to prospective residents.

Since the start of the guarantee scheme in 2006, there have been 11 or 12 for-profit provider failures leading to claims on the scheme, and no not-for-profit failures leading to claims. Failure of a large provider could involve about 7000 residents, and $1000 million in deposits.

To meet EY's proposed 20% equity requirement, providers might need extra capital of about $11 billion at 30/6/18 (based on untrustworthy balance sheet data as at 30/6/17). These estimates assume that intangible assets, and loans to related parties, have zero value as prudential capital.

Restricting the holders of deposits to the owners of residential care facilities could help keep failure rates very low. Requiring providers to operate through entities whose major purpose is the provision of aged care in Australia would reduce the extra capital needed.

About 12% of providers fail to comply with refunding responsibilities each year. Any instances of non-compliance should be publicly reported, and used as a quality of care indicator.

There can be protracted delays before the guarantee scheme is triggered, causing severe distress to residents and their families seeking deposit repayments. Changes are needed to provide repayments earlier than formal insolvency. Processes are needed to ensure continuing care to residents in failing providers.

Unwinding complex existing structures will incur legal and stamp duty costs. Where the structures have been previously reported to the Department, there may be an argument for the Department to meet some of the costs.

1. Introduction

1.1 Present lack of prudential regulation and transparency

There is no effective prudential regulation system in place for aged care providers. Providers can adopt any financial structures, and can report using any accounting conventions. There is no capital adequacy requirement. No financial information is available to prospective residents allowing useful comparisons between providers. No meaningful information is available on profitability.

1.2 Unacceptable consequences of complex structures

Example A1.1 of the discussion paper (Department of Health 2019) involves two trustee companies, two unit trusts, a related party service company, a related party unit trust, and a family unit trust. Other complex examples are in the discussion paper, and in Ward (2018).

"There is limited transparency and disclosure of financial practices of providers who have trusts in their structure or those who operate their services through trusts. These structures are opaque in terms of what assets they hold, who the beneficiaries are and for what purposes the funds are used." (Department of Health 2019 36)

Complex structures, with or without trusts, can greatly increase the risks of provider failures, with assets held by related parties but not available to repay accommodation payments. Complex structures also make it impossible to judge the overall profitability of aged care, so that the government may increase subsidies even when true profitability is high.

1.3 EY report on accommodation payments

"*The Department of Health engaged EY to provide an independent study of the legislative, business and operational framework for Refundable Accommodation Payments."* (EY 2017 1)

The Department's objectives were described in an EY stakeholder consultation pack as

- the protection of residents
- the protection of the Government, both reputationally when an approved provider is non-compliant; and to reduce the reliance and use of the scheme
- to limit the compliance burden on approved providers (EY 2017 37).

EY recommended the introduction of transparent reporting on provider corporate structures and inter-party transactions (EY 2017 13).

They recommended the introduction of a capital adequacy metric, such as 20% equity on the balance sheet, noting that

"This is equivalent to what is required by financiers before lending against real property." (EY 2017 18)

EY recommended that intangible assets be largely excluded from eligible capital:

"Define quality of capital to include tangible assets such as land and buildings, and intangible assets which are able to be valued, such as bed licences." (EY 2017 18)

EY rated all these recommendations as likely to have major impact, and being of high priority. Like StewartBrown (see below), EY were concerned about inadequate data:

"The primary finding of our Desktop Review was that the data that the Department is given is inadequate for it to assess whether or not Approved Providers comply with the Prudential Standards" (EY 2017 5)

EY's proposals were based on a desktop review, followed by consultation with the Department and 27 industry stakeholders. They made no quantitative estimates of the effects of their proposals. This paper provides some very approximate estimates of the extra capital and profits needed, based on the untrustworthy balance sheet data submitted as at 30/6/17.

1.4 Unpublished report by StewartBrown

"StewartBrown were engaged by the Department of Health to undertake a peer review of the Department's data collection and reporting activities with a view to enhancing current processes and future report content" (StewartBrown 2017 1).

A partly redacted version of the report was obtained under an FOI request. The main reason for redacting part of the report appeared to be that

"Disclosure would prejudice the Department's ability to assess the financial stability and viability of providers." (Department of Health 2018c)

I submit that the Department has very little ability to assess the financial stability of providers, or to control their behaviour.

StewartBrown recommended dropping the residential care balance sheet data

"Due to the high rates of non-disclosure and/or lack of item allocation the Residential Balance Sheet in the ACFR does not provide any reliable information for the Department and should be dropped." (StewartBrown 2017 1)

This is a surprising recommendation, given that the residential balance sheets have provided the asset and liability totals in each of ACFA's five reports of the funding and financing of the aged care sector - see for example ACFA 2017b 113-114. Confidentialised general purpose financial report data for each provider, including residential segment data, were published by the Department from 2006-07 to 2014-15 (see 3.1). Both overall and residential balance sheets are likely to be important in any capital adequacy requirement.

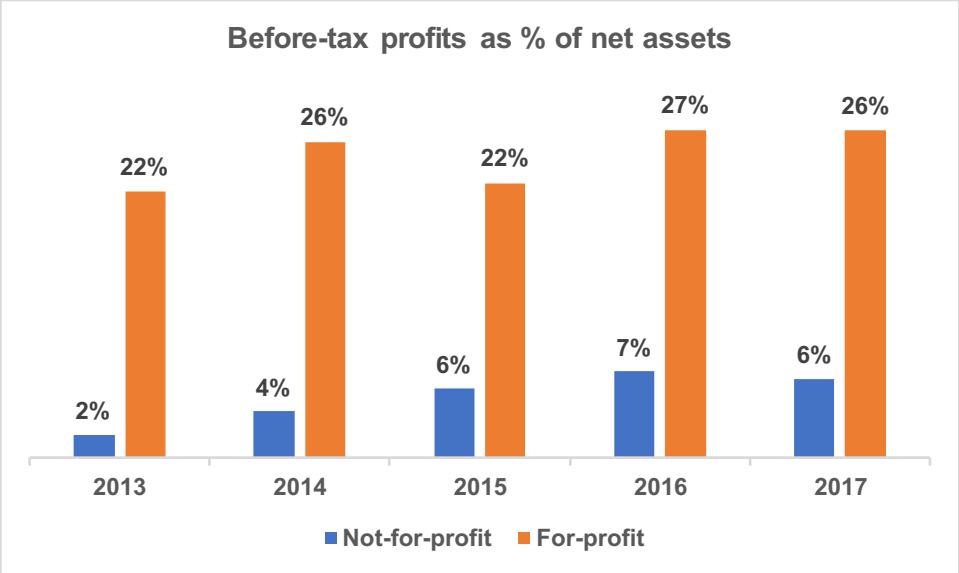
2. Data on aged care providers

2.1 Numbers of providers in each size band at 30/6/17

Places	Providers Not-for-profit	Providers For-profit	Providers Government	Providers Total	Places Total
100 or less	285	150	77	512	30229
101-200	113	94	12	219	30746
201-500	51	35	5	91	27425
501-1000	37	10	1	48	35403
1001-2000	12	5	1	18	26017
2001-5000	5	5		10	32090
5001 or more	1	2		3	18779
Total	**504**	**301**	**96**	**901**	**200689**

The above totals are from data supplied by the Australian Institute of Health and Welfare (2018a). "Places" are those approved by the Department of Health for operational use by residential aged care providers. At 30/6/17 there were 184,077 residents (AIHW 2018b), an occupancy rate of 91.7%. 57% of providers are in the lowest size band. For-profit providers are over-represented in the two highest size bands.

2.2 Before-tax profits as a % of net assets for aged care providers



12-13 before-tax profits are from ACFA (2014 51), 13-14 from ACFA (2015 117), 14-15 data from ACFA (2016 96), 15-16 from ACFA (2017b 96) and 16-17 from ACFA (2018c 95). 11-12 data on debt and assets are from ACFA (2013 38), 12-13 from ACFA (2014 52), 13-14 from ACFA (2015 131), 14-15 data from ACFA (2016 115), 15-16 from ACFA (2017b 114) and 16-17 from ACFA (2018c 118).

Not-for profit providers averaged 5% pa before-tax return on net assets in the five years to 30/6/17, and for-profit providers averaged 24%. The returns for for-profit providers have been much higher than the 13% average after-tax returns for authorised deposit taking institutions, general insurers and life insurers in the ten years to 30/6/17 (APRA 2017 26, 28 & 30).

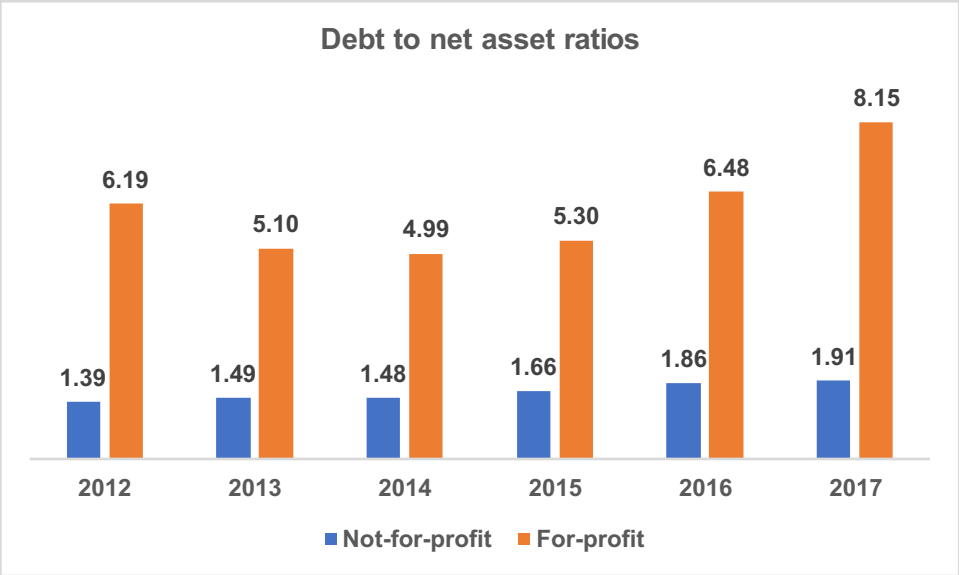
Commenting on the higher returns of for-profits, the Aged Care Guild said

"..a greater number of Guild member facilities provide extra/additional services and most of their facilities are located in major cities or large regional centres which can therefore attract a higher accommodation payment…"

"…the FP sector also contributes taxes to various levels of government in addition to income tax including payroll taxes, stamp duties, council rates and fringe benefits tax. The NFP sector is exempt from paying most of these taxes, either in part or in full." (Aged Care Guild 2018 6)

Note that the Guild and ACFA quote returns on total assets, rather than returns on net assets. APRA uses the latter when looking at the profitability of financial institutions.

2.3 Debt to net asset ratios for aged care providers



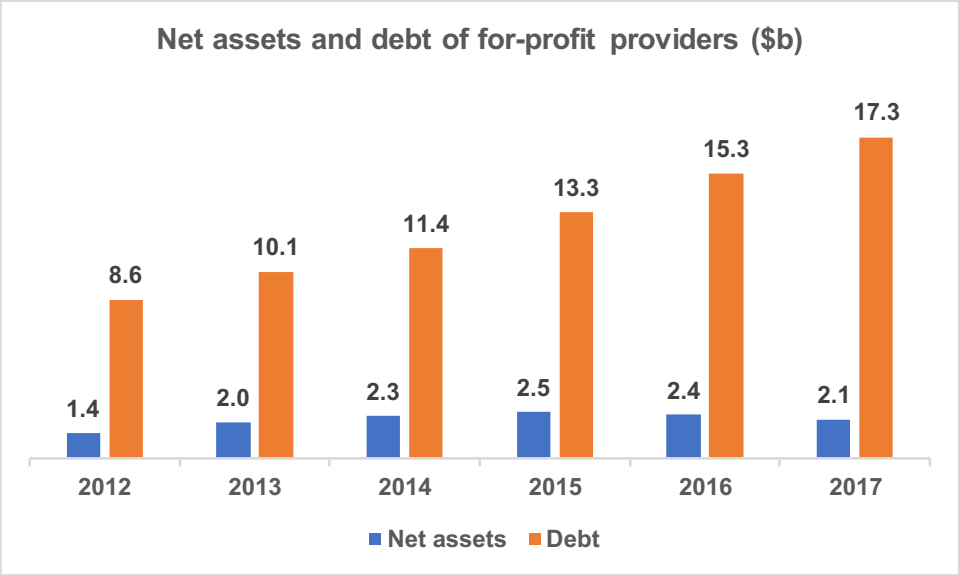
For-profit providers had a debt to net asset ratio of 8.15 at 30/6/17. This is much higher than the 0,21 average debt to net asset ratio of Australian non-financial companies from 2000 to 2015 (Kenney, La Cava and Rodgers 2016 15).

2.4 Estimated profit withdrawals by aged care providers at 30/6/17

Statistic	Not-for-profit $m	For-profit $m
Profit 5 years to 30/6/17	1844	2755
Net assets 30/6/12	6781	1384
Net assets 30/6/17	8259	2125
Increase in net assets	1478	741
Profit withdrawals	**366**	**2014**

For-profit provides made before-tax profits of about $2755 million in the five years to 30/6/17, but their net assets only increased by about $741 million. This suggests that for-profit providers withdrew about $2 billion in dividends or capital in the 5 years to 30/6/17.

2.5 Net assets and debt of for-profit providers



For-profit providers have been reducing their net assets since 30/6/15, while their debts have continued to grow.

2.6 Intangible assets and loans to related parties

Type of assets	Not-for-profit $b	For-profit $b
Bed licences	1.0	1.9
Other intangibles	0.1	2.5
Related party loans	0.2	4.4
Intangibles & related loans	1.3	8.8
Net assets	8.3	2.1

Intangible assets and loans to related parties are from ACFA 2018c 119. Intangible assets for for-profit providers increased by 52% in 2016-17, and their loans to related parties by 29%.

EY recommended that intangible assets, other than bed licences, be excluded from eligible capital in a capital adequacy requirement. The 2018-19 budget included funding for an impact analysis of allocating residential aged care places to consumers instead of providers. If this proposal were adopted, bed licenses might cease to have commercial value.

APRA excludes intangible assets and loans to related parties when measuring the capital adequacy of banks and insurers. If similar exclusions had applied for aged care providers at 30/6/17, for-profit providers would have had eligible net assets of -$6.7 billion, compared with $2.1 billion of reported net assets. Not-for-profit providers would have had $7.0 billion of eligible net assets, compared with $8.3 billion of reported net assets.

2.7 Expenses per aged care resident in 16-17

Expense per resident	Not-for-profit $000s	For-profit $000s	Government $000s	Total $000s
Wages	59.1	61.9	87.6	61.4
Management fees	2.6	3.0	1.3	2.7
Care	2.9	2.7	4.8	2.9
Accommodation	5.5	9.2	4.7	6.9
Hotel	6.6	5.7	7.3	6.3
Administration	3.6	2.6	3.3	3.2
Depreciation & amortisation	5.7	3.5	6.8	4.9
Interest	0.5	1.6	0.2	0.9
Other	1.6	1.8	4.5	1.8
Total	**88.1**	**92.0**	**120.4**	**91.0**

Table 11.2 of ACFA's "Sixth report on the funding and financing of the aged care sector" (ACFA 2018a) showed the expenses of residential care providers in 16-17, subdivided by type. This table, further subdivided by sector (not-for-profit, for-profit, government), was supplied on 9/11/18 (ACFA 2018d). These expenses were divided by resident numbers at 30/6/17 (104,541 not-for-profit, 71,552 for-profit and 7,984 government).

Accommodation expenses include wages and superannuation for trades persons doing maintenance and repairing work, electricians, technicians, plumbers, gardeners, painters, drivers. Also included are property repairs, maintenance and replacements, rent, property rates and taxes. Accommodation expenses per resident were 67% higher for for-profit, probably reflecting higher use of rented property

Depreciation and amortisation per resident were 39% lower for for-profit, again probably reflecting higher use of rented property.

3. Estimates for capital adequacy proposals

3.1 General purpose financial record data

General purpose financial record (GPFR) data for each aged care provider from 2006-07 to 2014-15, together with some financial data for their residential care segments, are available from Department of Health (2016). Similar data for 15-16 and 16-17 were recently obtained from the Department (2018c) under the Freedom of Information Act. The Department de-identified the data by expressing all the figures as dollars per average number of residents in the year, with the provider's size only being identified as lying within one of 9 broad bands.

The highest size band is 501+ residents, which accounted for 56% of all residents at 30/6/17. The number of residents for each provider in the 501+ band for 16-17 was assumed to be 1373, chosen so as to balance with the known total number of residents. Lower numbers of residents for this band were assumed for earlier years, again chosen so as to balance with total resident numbers.

The data are in the form of a single record per provider for each year. These "unit record" data are particularly helpful in estimating the effects of proposed capital requirements, which may depend strongly on the individual circumstances of each provider. The de-identification process, and the partial omission of GPFR data for 16-17, greatly reduce the reliability of the estimates that can be made from the data.

3.2 Providers with assets less than liabilities at 30/6/17

Region	Number providers	Providers with asset deficits	Percent providers asset deficits	Asset deficits $m
City	508	61	12%	328
City & Regional	33	3	9%	34
Regional	351	6	2%	10
Total	**892**	**70**	**8%**	**372**

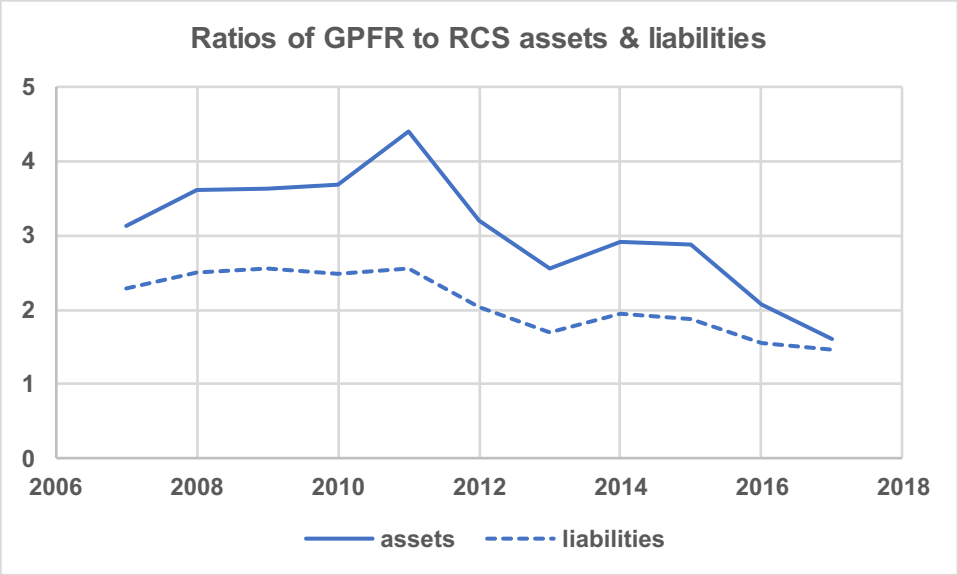
Throughout the period for which GPFR data are available, between 6% and 9% of providers have had asset deficits (ie their assets have been shown as less than their liabilities). At 30/6/17 there were an estimated 70 such providers, with asset deficits adding to about $372m. These 30/6/17 numbers are approximate, as GPFR data were supplied for only 797 providers, compared with the 892 for which RCS data were supplied. Estimates of GPFR data were made by adjusting the supplied GPFR data for each band by the ratios of the RCS to GPFR provider numbers for the band,

One possible reason for a provider being allowed to operate with an asset deficit is that the provider is serving a remote community, But 61 of the 70 were shown as “City”, suggesting that remoteness was not the reason for their continued operation. Of the 70, about 61 appeared to have also had an asset deficit at 30/6/16. Providers thus appear to be able to operate for several years with asset deficits.

It is not clear how these 70 providers were able to continue operating. Were they not-for-profit or government, with the Department of Health willing to accept a guarantee from a parent organisation? Was the Department aware of significant undervaluation resulting from the use of historic asset values? Did the Department consider that some of these providers were providing services that would not otherwise be available to their communities?

To supervise any form of capital adequacy requirement, the Department will need financial data prepared on a market value basis. External parties, such as potential residents and investors, also need market value data (see 6.2).

3.3 **Increasing specialisation in aged care**



One way to look at the extent to which age care providers are specialising in aged care is to look at the ratio of total assets to RCS assets. This ratio rose to a peak of 4.40 at 30/6/11, and has since declined to about 1.72. The ratio of total liabilities to RCS liabilities similarly rose to a peak of 2.55 at 30/6/11, and has since declined to about 1.46. Both these measures suggest that aged care providers are specialising more in aged care. This trend is helpful, as it reduces the capital needed for the industry to meet a capital adequacy requirement.

3.4 Assumptions made in estimating extra capital needed at 30/6/18

The extra capital needed at 30/6/17 was estimated from the unit records at 30/6/17, using total assets and total liabilities. Extra capital was calculated for each provider as the amount (if any) needed to meet the proposed equity requirement, plus a 50% margin. APRA-regulated institutions normally choose to have margins of at least this amount (see 4.5).

The total extra capital needed was assumed to grow by 13% from 30/6/17 to 30/6/18, as this was the actual liability growth rate from 30/6/12 to 30/6/17.

3.5 Extra capital and profits needed at 30/6/18 under different proposals

Proposal	Maximum liability as % of eligible assets	Intangible assets eligible?	Extra capital needed $b	Extra profits needed $b
1	0.9	Yes	2.4	0.4
2	0.8	Yes	6.0	1.0
3	0.7	Yes	12.9	2.1
4	0.9	No	6.7	1.1
5	**0.8**	**No**	**10.8**	**1.8**
6	0.7	No	18.3	3.0

Proposal 5 is broadly similar to EY's proposed 20% equity on the balance sheet, after excluding all intangible assets from eligible capital.

Authorised deposit-taking institutions, general insurers and life insurers have averaged after-tax profits of about 13% a year over the last 10 years (APRA 2017 27, 29 & 31). The above estimates of extra profits needed were made assuming after-tax profits of 13%, together with a company tax rate of 30% for for-profit providers. Under proposal 5, extra capital of $11 billion would need about $2 billion of extra before-tax profits a year.

3.6 Exclusion of intangible assets may not be desirable

EY suggested that eligible capital for a capital adequacy test should exclude most intangible assets. This is similar to APRA's policy of excluding all intangible assets (see 4.6).

Providers who have grown rapidly by acquisitions in recent years may have intangible assets greater than their net assets. Excluding intangible assets from eligible capital would create immediate difficulties, and a transition period of up to 5 years might be needed. But intangible assets are an accepted consequence of company purchases, which may often help efficiency and innovation.

3.7 Potential sources of extra capital

Some of the potential sources of extra capital are

- Recognition of past capital appreciation by using market values rather than historic
- Retention of after-tax profits, rather than withdrawal
- Splitting aged care and other operations
- Raising extra capital.

4. Australian Prudential Regulatory Authority

4.1 Functions of APRA

"APRA is an independent statutory authority that supervises institutions across banking, insurance and superannuation, and is accountable to the Australian Parliament.

APRA was established by the Australian Government on 1 July 1998 following the recommendations of the Wallis inquiry into the Australian financial system. Prudential regulation is concerned with maintaining the safety and soundness of financial institutions, such that the community can have confidence that they will meet their financial commitments under all reasonable circumstances.

APRA oversees

- *authorised-deposit taking institutions (such as banks, building societies and credit unions)*
- *general insurers*
- *life insurers*
- *friendly societies*
- *private health insurers*
- *reinsurance companies, and*
- *superannuation funds (other than self-managed funds).*

Under the legislation that APRA administers, APRA is tasked with protecting the interests of depositors, policyholders and superannuation fund members." (APRA 2018a).

4.2 Zero value for intangible assets

Under APRA's Prudential Standard GPS 112 (APRA 2013b), general insurers must exclude from eligible capital

- goodwill and other intangible assets arising from an acquisition, net of adjustments to profit to profit or loss reflecting any changes arising from impairment of goodwill
- other intangible assets as defined by Australian Accounting Standards, including costs associated with debt raisings and issuing capital instruments, capitalised information technology software costs and other capitalised expenses.

5. Failure rates

5.1 Provider failure rates calendar years 2006 to 2017

Sector	Not-for-profit	For-profit
Average number of providers that held bonds	533	322
Assumed number of provider failures	0	12
Estimated failure rate per year	0.00%	0.31%

Numbers of providers that held bonds in 12-13, 13-14, 14-15 and 15-16 are in ACFA (2014 126), ACFA (2015 159), ACFA (2016 159) and ACFA (2017b 142). Total numbers of providers in each sector from 2006 to 2017 are from AIHW (2018a). The proportions of providers in each sector holding bonds prior to 12-13 were assumed to be as in 12-13, and the proportions in 16-17 assumed to be as in 15-16. Assumed numbers of provider failures leading to guarantee claims are the 10 shown in ACFA (2017a 57-58), plus one advised by ACFA (2018a), plus one recent event that may lead to guarantee claims.

The 0.31% failure rate for for-profit providers was estimated as the assumed number of failures, divided by the average number of providers holding bonds, and divided by 12.

5.2 Reserve Bank of Australia failure analyses

Kenney, La Cava & Rodgers (2016) analysed data on 23,000 Australian companies from 2000 to 2015. Data for listed companies included all domestically domiciled non-financial companies listed on the Australian Stock Exchange, covering more than 2400 companies. Data on unlisted companies were from Dun & Bradstreet, based on annual data for more than 20,000 companies. There were 532 failures, an annual failure rate of 0.6%. Companies that failed had a mean debt-to-assets ratio of 0.24, while non-failures had a ratio of 0.172.

5.3 Industry and macroeconomic effects on failure rates

Kenney, La Cava and Rodgers (2016 22) found that failure rates varied between industries. For example, they found that health care and social assistance had a failure rate of about 0.36% a year, compared with 0.6% for all industries. They also found that macroeconomic effects matter:

"The observed pattern in the time dummies suggests they represent macroeconomic conditions. For instance, they typically spike during slowdowns, as demonstrated during the 2001 and 2008-09 periods. There is also evidence of a spike around 2012 and 2013, suggesting the decline in commodity prices and the fall in mining investment were associated with a relatively high rate of company failure."

5.4 Using company data to model the effects of intangible assets

Depending on the extent of company data publicly available, it may be possible to examine the effects of debt-to-asset ratios if intangible assets are included or excluded from assets. This would help decide whether intangible assets should be excluded from eligible capital in any capital adequacy requirement for aged care providers. Any prudential regulation should be evidence-based.

6. Low-cost suggestions to help protect aged care residents

6.1 Making the Department of Health responsible for prompt repayment of all deposits

"…in the event that a consumer has difficulty in recovering a lump sum accommodation deposit, they have rights to undertake legal proceedings against the provider to recover those funds … The options available … may include bringing an action against the provider under contract law…Where the provider is a corporation ... the consumer could issue a statutory demand to the provider … Exercising this kind of recourse may impose a cost on the consumer in terms of legal advice and fees." (ACFA 2017a 43)

If a provider is determined to delay a refund, the consumer will often not be able to afford a court battle. A resident may need the refund urgently, to help move to a resident care facility better moving their needs.

"There may be a considerable interval during which the resident, estate or government seek retrieval of the funds before a formal insolvency event … ACFA recognises that in some cases there may be protracted delay in the refund of an accommodation payment" (ACFA 2017a 59)

"The legally prescribed conditions for the triggering of the refund scheme were not adequate to address a case where a rogue operator resisted declaration of insolvency. This resulted in a situation where residents and their families were in a stressful state of uncertainty for several months until one of them, independently of the Department, brought on a successful insolvency action through the courts." (Council on the Ageing ACT 2017 10)

Of the 965 providers submitting Annual Prudential Compliance Statements for 2015-16, 111 reported instances of non-compliance with refunding responsibilities (Department of Health 2017 91). This high non-compliance rate suggests that a system is needed to help residents obtain overdue refunds, well before the guarantee scheme is formally triggered. This would involve the Department paying all refunds overdue for more than a short period, and seeking repayments and penalties from the providers. This would help the Department monitor the performance of providers, and take prompt corrective action. It would also help identify legislative gaps. For example, where a deposit has been paid by persons other than the resident, can this be refunded directly to the payers when the resident dies?

To allow the Department to ensure that all deposits are promptly repaid, providers should be required to notify the Department immediately of any deposit payments, notices of departure, departures, probate or letters of administration, and deposit repayments.

6.2 Requiring providers to submit financial accounts in standard format

"General purpose financial reports are prepared as per accounting standards and there can be various interpretations of those standards by each provider" (StewartBrown 2017 p10).

A standard format would allow better analysis and control. Note that the Australian Taxation Office requires self-managed superannuation funds to report in standard format.

One important variation between providers is the use of historic values for land and buildings, rather than fair market values. This can make comparisons between providers misleading, as well as create problems with interpreting summary data published by the Department. There may be generally accepted market values for residential care. For example, an EBIDTA yield of 12% to 15%, plus the amount of any accommodation bonds held, is a current market value yardstick. The better the location and facilities, the lower the yield multiple that may apply (Bailey 2018). All providers should be required to report market values.

6.3 Requiring providers to supply copies of their aged care accounts on request

Under section 58 of the Fees and Payments Principles 2014, providers are required to supply the most recent audited accounts of their aged care component on request from a prospective care recipient. A request on 9/2/18 to the 8 largest for-profit providers (excluding the 3 listed providers) showed that only one was willing to provide these audited accounts for research purposes. One provider was only willing to supply its accounts to a person already approved for residential care. Section 58 should be amended to require supply in response to any request. This would allow individuals to compare potential sources of residential care, well before they or a relative are approved for residential care.

6.4 Making available summaries of provider general purpose financial reports

Under section 86.3 of the Aged Care Act 1997, the Secretary of the Department of Health has the discretion to disclose information relating to a provider if it is necessary in the public interest to do so. This discretion has apparently been used since 2003 to publish electronic lists of aged care services, showing their locations, providers, approved places and Commonwealth subsidies. Publication of general purpose financial report summaries, together with residential care segment data, would allow comparative analyses, a better-informed market and better advice to individuals seeking care. Note that detailed financial statistics for each general insurer have been publicly available since 1975 - for example, APRA 2018b.

6.5 Restricting the holding of resident deposits to the owners of residential care facilities

"One of the business models attracting interest and market activity is the separation of aged care operations from the property holding operations. Depending on how the models are

structured, and the subsequent transactions that occur, this may give rise to an actual or perceived heightened level of risk…" (ACFA 2017a 34)

For-profit providers have had far higher failure rates than not-for-profits. The data in 2.7 show that for-profit providers are making more use of rented facilities than not-for-profit. This suggests that direct ownership of residential care facilities may be important in reducing failures leading to guarantee claims.

We know from Ward (2018) that some large for-profit providers have complex ownership structures, where ownership of facilities is separated from provision of care. It would be straightforward (but tedious) to research the ownership of facilities for both for-profit and not-for-profit providers, to see if significant differences exist.

"Obstacles have been raised by multiple financiers and investors with regard to OpCo and PropCo structures, with increased risks of moving assets away from liabilities." (EY 2017 40)

"The Guild supports increased prudential supervision of the industry, which will increase the Commonwealth's understanding of risk (e.g. freehold vs leasehold)" (Aged Care Guild 2017 13)

Even if it is not feasible to immediately insist on direct ownership of existing facilities, it should be feasible to require all providers to clearly inform prospective residents about the ownership of the facility, and whether their accommodation bond will be held by the owner. This information should be on MyAgedCare, and on service lists published by the Department.

6.6 Requiring providers to operate through entities whose major purpose is the provision of aged care in Australia

70% of the 966 providers with unit records at 30/6/15 had total assets less than 1.5 times their residential care assets (see 3.2). All of these could probably be described as having residential aged care as their main business. The remaining 285 had total assets of $28 billion, compared with residential care assets of about $7 billion. Particularly for these 285, losses in their other businesses could be a significant threat to their viability as residential aged care providers.

The Commonwealth provided 71% of the total residential service income of aged care providers in 15-16 (ACFA 2017b 97). The Commonwealth also provides means-test exclusions for aged care deposits, and guarantees the refund of deposits. Given these high levels of Commonwealth assistance, it may be reasonable to require that aged care be provided through entities whose major purpose is aged care. This would help in their supervision, and make comparative analyses more meaningful.

6.7 Requiring arrangements similar to those acceptable to financiers

In preparing its 2017 report to the Department of Health, EY consulted with 27 industry participants, including 4 financiers:

"One of the participating financiers explained that the bank has basic arrangements in place with certain rules, similar to Permitted Uses, where they generally don't allow movement of money outside the disclosed group structure.

One of the participating financiers agreed that improved transparency and reviews of incoming shareholders, share transactions and movement of money related to approved providers is required.

Multiple participants required clarity of how to identify the reporting entity "group". There were mixed views about what should be excluded from the group if the intent is to have sight of the financial viability of the group overall." (EY 2017 40)

"The financier's view was that the Department of Health should be taking action to ensure that approved providers can be sold as going concerns prior to administration commencing". (EY 2017 42)

Banks and other financiers lend on a secured basis, ranking ahead of the unsecured interest-free deposits made by residents. On behalf of residents, the Department should be insisting on structural and reporting arrangements at least as stringent as those required by financiers.

6.8 Requiring the controlling entity of a group to be responsible for all of them

Some groups have separate Department of Health approvals for many separate residential care services, under different provider names. The adequacy of assets of the group should be assessed as a whole, with the controlling entity ultimately responsible for all deposit refunds.

6.9 Process to ensure continuing care to residents in failing providers

At 30/6/17, there were 13 providers with 2000 or more places (see 2.1). Larger groups tend to have higher debt-to-asset ratios and more complex structures, and may thus have higher failure rates. Assuming a 1% failure rate for these 13 providers suggests a large failure about every seven years. There needs to be a process to ensure continuing care for the residents if a group with say 5000 residents collapses.

An industry consortium, formed by Mission Australia, the Benevolent Society, the Brotherhood of St Laurence and Social Ventures Australia, took over 570 ABC Learning Centres after the company went into receivership in November 2008 (Wikipedia 19/6/18). A similar industry consortium may be needed to provide continuing care when a large provider collapses. The liquidators of providers that have triggered the guarantee scheme should be able to advise about any structural issues that hampered continuing care.

7. Conclusions

The Department of Health has begun a four-year process to better protect payments made by aged care residents. The capital adequacy requirement proposed by EY may need about $11 billion of extra capital, and about $2 billion a year to provide reasonable profits on the extra capital. A transition period of up to five years may be needed, taking the reform process to over a decade.

No failures of not-for-profit providers leading to guarantee scheme claims have occurred since the scheme began in 2006. The failure rates of or-profit providers have been about half those of non-financial Australian companies. Controlling the structures of aged care providers could help ensure failure rates remain very low.

Low-cost measures to protect aged care residents could include making the Department of Health responsible for prompt repayment of all deposits. Ready availability of provider financial statements in standard form could help consumers choose providers. Steps are needed to ensure that continuing care is provided to residents of failed providers.

The Department's work on better protection for aged care residents could be helped by

- Better disclosure of the Department's data, operations and plans
- Advice from APRA on appropriate company structures for prudential regulation
- Analysis of data on company failures to estimate the effects of debt-to-asset ratios and intangible assets.
- Analysis of data on late deposit repayments to look for relationships with provider financial stress, and measures to relieve resident hardship
- Analysis of complaints data on late payments
- Analysis of reports by liquidators of failed providers
- Consultation with a wide range of consumer and industry representatives.

Acknowledgements

I am grateful for the help given to me by Anna Howe, Marijan Jukic, Ian Appleby and Jenni Joenpera of AIHW, Georgina McGrath of the ACFA Secretariat, Derek Dittrich of ACSA, Pamela Graudenz of the ACT Retirement Village Residents Association, Paul Feldman of Council on the Ageing ACT, Richard Rosewarne of Applied Age Care Solutions, Helen Rowell, Peter Kohlhagen and Nigel Boik of APRA, Guy Thorburn and Stuart Mules of the Australian Government Actuary's Office, Nigel Murray and Andrew Coll of the Department of Health, Stephen King of the Productivity Commission, Aaron Bruhn of the ANU Research School of Finance, Actuarial Studies and Applied Statistics, Hugh Sarjeant of Australian Projections, David Heath of Cumpston Sarjeant, Jason Ward of the University of Tasmania, Bruce Bailey and Joseph Zhang of Pride Living, Cecile Lefort of the RBA and David Sinclair of StewartBrown. The opinions expressed are however my own.

Glossary

ACFA	Aged Care Financing Authority
ACFR	Aged Care Financial Report
ACSA	Aged & Community Services Australia
AIHW	Australian Institute of Health and Welfare
APRA	Australian Prudential Regulatory Authority
EBITDA	Earnings before interest, taxes, depreciation and amortisation
FOI	Freedom of Information Act 1992
GPFR	General Purpose Financial Record
HIH	HIH Insurance Ltd
RAD	Refundable Accommodation Deposit
RBA	Reserve Bank of Australia
RCS	Residential care segment

References

ACFA (2013) "Inaugural report on the funding and financing of the aged care sector", June,

downloaded 21/8/18 from https://agedcare.health.gov.au/sites/g/files/net1426/f/documents/05_2014/attachment_2_acfas_report_to_the_former_government1_0.pdf

ACFA (2014) "Report on the funding and financing of the aged care industry", July, downloaded 24/7/16 from https://agedcare.health.gov.au/2014-report-on-the-funding-and-financing-of-the-aged-care-industry

ACFA (2015) "Third report on the funding and financing of the aged care sector", July, downloaded 24/7/16 from https://agedcare.health.gov.au/aged-care-reform/aged-care-financing-authority/2015-report-on-the-funding-and-financing-of-the-aged-care-industry

ACFA (2016) "Fourth report on the funding and financing of the aged care sector", July, downloaded 24/7/16 from https://agedcare.health.gov.au/2016-report-on-the-funding-and-financing-of-the-aged-care-industry

ACFA (2017a) "The protection of residential aged care lump sum accommodation payments", May 29, downloaded 20/6/18 from https://agedcare.health.gov.au/reform/the-protection-of-residential-aged-care-accommodation-lump-sum-accommodation-payments

ACFA (2017b) "Fifth report on the funding and financing of the aged care sector", July, downloaded 24/7/18 from https://agedcare.health.gov.au/2017-report-on-the-funding-and-financing-of-the-aged-care-industry

ACFA (2018a) email from ACFA Secretariat on trigger events on the accommodation payments guarantee scheme, January 16

ACFA (2018b) downloaded 9/8/18 from https://agedcare.health.gov.au/aged-care-reform/aged-care-financing-authority

ACFA (2018c) ""Sixth report on the funding and financing of the aged care sector", July, downloaded 28/8/18 from https://agedcare.health.gov.au/reform/aged-care-financing-authority/2018-acfa-annual-report-on-funding-and-financing-of-the-aged-care-sector

ACFA (2018d) "Information in relation to aged care funding and financing", email November 9 from FOI@health.gov.au

Aged Care Guild (2016) Submission to the Legislated Age Care Review, downloaded 27/8/17 from https://agedcare.health.gov.au/reform/aged-care-legislated-review/submissions

Aged Care Guild (2018) Submission 17 to the Senate Economics References Committee inquiry into the tax practices of for-profit aged care providers", June, downloaded 13/7/18 fro https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Taxpractices-agedcare

AIHW (2018a "R1718_2706_Cumpston May 3.xlsx", Excel file supplied May 3

AIHW (2018b) "Aged-care-data-snapshot-2017.xlsx", downloaded August 13 from https://www.gen-agedcaredata.gov.au/

APRA (2013a) "Prudential Standard GPS 100 Capital Adequacy" downloaded 20/6/18 from https://www.apra.gov.au/sites/default/files/GPS-110-Capital-Adequacy-January-2013.pdf

APRA (2013b) "Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital" downloaded 20/6/18 from

https://www.apra.gov.au/sites/default/files/GPS-112-Capital-Adequacy-Measurement-of-Capital-January-2013.pdf

APRA (2017) “16/17 Annual Report”, Sydney, October 6

APRA (2018a) downloaded13/7/18 from https://www.apra.gov.au/about-apra

APRA (2018b) “Quarterly general insurance institution-level statistics March 2018” May 24, downloaded 20/6/18 from https://www.apra.gov.au/sites/default/files/0518-QGIPS-March-2018.pdf

Bruce Bailey (2018) personal advice August 13

Council on the Ageing ACT (2016) Submission to the Legislated Aged Care Review, downloaded 23/8/18 from https://agedcare.health.gov.au/reform/aged-care-legislated-review/submissions

Department of Health (2016) “De-Identified Data from the 2014-2015 General Purpose Financial Reports (GPFRs)” https://agedcare.health.gov.au/funding/financial-data-residential-aged-care/de-identified-data-from-the-2014-2015-general-purpose-financial-reports-gpfrs

Department of Health (2017) “2016-17 report on the operation of the Aged Care Act 1997” downloaded 20/6/18 from https://www.gen-agedcaredata.gov.au/Resources/Reports-and-publications/2017/November/2016%E2%80%9317_Report_on_the_Operation_of_the_Aged_Ca

Department of Health (2018) “Notice of Decision Department Reference FOI 756”, August 27

Department of Health (2019) “Managing prudential risk in residential aged care”, discussion paper February downloaded 3/2/19 from https://consultations.health.gov.au/residential-and-flexi-aged-care-division/managing-prudential-risk-in-residential-aged-care/

EY (2017) “Review of aged care legislation which provides for the regulation and protection of refundable accommodation payments in residential aged care”, report to the Department of Health May 26, downloaded 20/6/18 from https://agedcare.health.gov.au/sites/g/files/net1426/f/documents/08_2017/review-legislation-refundable-accommodation-payments-in-residential-aged-care.pdf

Rose Kenney, Gianna La Cava & David Rodgers (2016) “Why do companies fail?”, Reserve Bank of Australia discussion paper RDP 2016-09. Downloaded 9/8/18 from https://www.rba.gov.au/publications/rdp/2016/pdf/rdp2016-09.pdf

StewartBrown (2017) “Peer review of ACFA’s data collection and reporting activities”, report to the Department of Health, June, obtained on 16/2/18 in partially redacted form under FOI 146-1718

Jason Ward (2018) “Tax avoidance by for-profit aged care companies: Profit shifting on public funds”, report to Taxation Justice Network - Australia, downloaded 20/6/18 from http://anmf.org.au/documents/reports/ANMF_Tax_Avoidance_Full_Report.pdf