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PARLIAMENT of AUSTRALIA

Senate Economics References Committee

Financial and Tax Practices of For-Profit Aged Care Providers

Submission *(June 2018)*

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1. EXECUTIVE SUMMARY

Senate Economics References Committee Inquiry

On 10 May 2018 the Australian Senate referred an Inquiry titled "the financial and tax practices of for-profit aged care providers" to the Economics References Committee, with a report due by **14 August 2018**.

In particular, the Inquiry is to cover:

a) the use of any tax avoidance or aggressive tax minimisation strategies;
b) the associated impacts on the quality of service delivery, the sustainability of the sector, or value for money for government;
c) the adequacy of accountability and probity mechanisms for the expenditure of taxpayer money;
d) whether current practices meet public expectations; and
e) any other related matters.

Inquiry Terms of Reference

We note that the terms of reference include the definition "aged care providers", and whilst residential aged care is the largest from both a capital, funding and staffing perspective, aged care providers can include the following segments:

- Residential Care (RACF)
- Home Care Packages (HCP)
- Commonwealth Home Support Programme (CHSP)

Several aged care providers supply services in 2 or 3 of the above segments, and this needs to be taken into account when considering the overall sector financial performance, quality of service delivery, viability, taxation consequences and comparative analysis.

Increasingly, Senior Housing (also referred to as Independent Living or Retirement Living) is part of aged care and like residential care, requires a significant capital base. Several retirement living providers, such as Lendlease, Aveo and Stockland, are also listed entities and aged care is provided as part of their offering to residents of their villages.

Therefore, due to the multi-faceted nature of aged care service delivery it is somewhat ambiguous as to what constitutes an aged care provider for the purposes of this Inquiry.

Submission

This submission is specifically in relation to Terms of Reference points a), b) and c) above, with particular emphasis on the sustainability of the sector, funding envelope required from Government, the adequacy of accountability and the required probity practices.

Certain references to the taxation measurement practices will be made in some instances where appropriate.

Our firm has not reviewed the respective quality of service delivery and related clinical practices of specific providers and, accordingly, this submission will remain silent in that regard.

For clarity, we have prepared this Submission in a format whereby the Executive Summary can be read stand-alone, with the following Sections providing more specific detail and analysis if required.

Rationale for Submission

Over recent years there has been considerable media attention given to the quality of care provided in residential aged care facilities. Much of this focus has been on whether sufficient expenditure has been allocated to direct care staffing to enable high care standards to be maintained.

StewartBrown does not make any assessment on the minimum registered nurse or other direct care staffing ratios required in residential aged care facilities to provide the appropriate quality of care, as this is for the regulators/providers/advocates/residents/staff to examine, negotiate, consider and determine on an informative and rational basis. Our focus of attention is on the financial viability of the aged care sector and whether the current funding model can support the existing and proposed direct care staffing cost deemed necessary.

From a funding perspective, StewartBrown has significant financial data that should be considered in any overall analysis. Our detailed sector financial analysis included in our quarterly *Aged Care Financial Performance Survey* (ACFPS) reports, indicates that the overall sustainability of the residential aged care sector is very vulnerable in many instances under the current funding and regulatory climate.

It should be noted that our quarterly residential and home care sector reports, which includes actual performance results, trend analysis and related commentary, is prepared by StewartBrown as public documents which are available on our website. The analysis and commentary are compiled from various sources, including the actual consolidated results from the survey participants as well as from our extensive professional involvement in the aged care sector (refer below).

StewartBrown is not an advocate for any stakeholder in the sector and has no agenda other to ensure that all government policy and public commentary is factually based and objective.

StewartBrown

For background purposes, StewartBrown is a Chartered Accounting firm located in Chatswood, Sydney with an Adelaide branch office. The firm currently consists of 7 Partners and over 70 employees providing services including Audit, Consulting, Business Services, Taxation and Financial Planning. StewartBrown provides these professional services nationally to a range of clients, however, we have a speciality expertise in aged care and community services, social services, independent schools, children's services and disability services.

With respect to aged care and community services, StewartBrown have more than 35 professional staff actively providing significant professional services to the sector nationally including:-

- Audit and assurance
- Preparation of general purpose financial statements
- Annual Prudential Compliance audits
- Community Acquittals
- Governance reviews (including Board and Executive)
- Finance systems and process reviews
- Financial modelling and forecast assignments
- Secondments
- Conference presentations and sector workshops
- Briefings to Department of Health and the Aged Care Financing Authority
- Aged Care Financial Performance Survey *(2017: 188 providers comprising 957 residential facilities; 502 community programmes incorporating 21,009 HCP packages)*

Aged Care Financial Performance Survey (ACFPS)

StewartBrown undertakes the largest financial performance benchmarking survey covering the aged and community care sector in Australia. This survey includes detailed operational, equity and staffing data on a quarterly basis for residential aged care facilities and home care packages.

Our *Aged Care Financial Performance Survey* (ACFPS) commenced in 1995 and has grown exponentially due to the requirement for Boards and executive management to be able to compare their operations to that of other facilities and programmes within the sector.

Over the years, the format of the results of our survey has become more granular in content and has become an integral part of the budgeting, forecasting and review processes within many participant organisations.

Subscribers to our ACFPS include some of the largest providers nationally, including independent stand-alone providers, faith-based and community providers, culturally specific providers, as well as government bodies, including the Department of Health (DOH), Aged Care Financing Authority (ACFA), aged services sector peak bodies, consumer bodies and other service providers.

Our ACFPS surveys quarterly financial and non-financial data for residential (by facility) and home care (by program) at a granular level. In addition, the survey obtains specific segment information and key balance sheet information at organisation (approved provider) level every six months.

Our involvement in the aged care sector over many years has provided us with a unique and comprehensive knowledge of the financial performance of providers and of the financial performance and viability of the aged care sector.

Sector Overview

At 30 June 2017 there were 902 operational residential aged care providers operating 200,689 aged care residential places. The Not-For-Profit (NFP) sector accounted for 55.9% of these places, the For-Profit (FP) sector 39.7% and the State, Territory and Local governments accounted for the remaining 4.4% of places.

All approved providers of Australian Government-Funded aged care services must comply with the responsibilities specified in the *Aged Care Act 1997* and the associated *Principles*. These responsibilities encompass quality of care, user rights and accountability amongst other matters. Each aged care home must deliver care and services required to meet the care needs of the resident as required by the regulatory framework.

Many of the residents in residential aged care are “supported” financially with respect to the cost of their accommodation by government providing accommodation supplements to aged care providers. Of the 234,931 people that received residential aged care during the 2015-16 financial year, around 109,000 were supported residents.

At June 2016, 46.8% of residents were supported. Furthermore, in respect of supported residents during the 2015/2016 year, a total of 59.6% of FP facilities exceeded a 40% supported ratio, compared to 75.6% of the NFP facilities and 78.1% of government operated facilities. While the NFP and government facilities do cater for a larger proportion of supported residents, which is part of their mission, the FP sector clearly makes a significant contribution to providing care for those residents who do not have the financial means to pay for their own accommodation.

Importantly, the location of facilities differ based on the ownership type of the provider as shown by the following table:

Table 1 - Proportion of places by ownership and remoteness at 30 June 2017

Remoteness Classification	Not-For-Profit	For-Profit	Government	Total
Major cities	64.3%	82.6%	22.4%	69.7%
Inner regional	25.4%	13.6%	47.6%	21.7%
Outer regional	9.4%	3.8%	27.0%	7.9%
Remote	0.8%	0.0%	2.1%	0.5%
Very remote	0.2%	0.0%	0.8%	0.2%

The FP facilities are concentrated in the major cities of Australia with a small proportion in the inner and outer regional areas. The NFPs also have a large concentration of facilities in the major cities but have a greater proportion of facilities in the regional and remote areas as part of their mission. Government operated facilities are largely based in those regional and remote areas with a smaller representation in the major cities.

Capital Investment of the Sector

Residential aged care requires a significant amount of capital investment, the majority of which is contributed by the FP and NFP sectors. The government does provide some capital funding but this is generally targeted at regional and remote areas and for capital projects that focus on the care requirements of special needs groups.

In the 2016-17 ACAR, there was a total of 22 capital grants totalling $64 million and of that only $6.4 million was allocated to providers in metropolitan areas. The remainder went to regional and remote providers.

In contrast, during the 2015-16 financial year there was an estimated $4.5 billion of capital spending on residential aged care projects, principally funded by FP and NFP providers, and it is essential that this capital expenditure programme continue over the next decade to meet the expected new aged care accommodation required to house the additional 83,500 places needed over that period. Furthermore, providers need to refurbish their current ageing building stock, much of which is over 20 years old.

This is a significant investment by the FP and NFP sectors and this investment will only be made if the sector is financially sustainable. While refundable accommodation deposits provide some financing for these capital projects, it is essential that providers make a sufficient return on capital investment to encourage the level of investment that will be required to meet the future demand. This will only be possible if the facilities generate a sufficient level of operating profit.

For-Profit and Not-For-Profit Distinction

The Terms of Reference for the Inquiry specifically refer to for-profit aged care providers, however, any analysis of the sector should include reference to the not-for-profit providers as well. As noted above, all providers operate under the *Aged Care Act 1997* and the related legislative and regulatory environment.

Government subsidy funding, consumer access, choice of providers and eligibility to receive aged care services make no distinction between for-profit, not-for-profit or government owned providers.

Apart from certain taxation differentials, the operating, staffing and financial performance of all providers is performed under the same funding model.

Accordingly, as both the FP and NFP providers operate in the same funding, geographic and regulatory environment, the importance of a financially viable and dynamic aged care sector, including both FP and NFP providers, cannot be underestimated.

Tax Justice Network Report

We understand that the report prepared by The Tax Justice Network - Australia (TJN-Aus) and commissioned by Australian Nursing & Midwifery Federation titled "*Tax Avoidance by For-Profit Aged Care Companies: Profit Shifting on Public Funds*" (Report) was one of the drivers initiating the Inquiry.

Accordingly, we make the following comments on certain aspects raised in the TJN-Aus Report:

Taxation

The analysis provided in the TJN-Aus Report in relation to *Table 2* (Total Revenue/Taxable Income/Tax Payable) is inconclusive. It is generally understood that company tax is payable on taxable income not on revenue (gross income) and, therefore, assuming the quoted figures in *Table 2* are accurate, the combined tax payable ($154 million) as a percentage of taxable income ($517.2 million) represents an average income tax rate of 29.8%. We suggest that such an average taxation rate is above the majority of listed or for-profit entities in all other industry sectors in Australia.

The reference to "% Taxable" in *Table 2* (being the tax payable as a percentage of total income) is extraneous, and misleading. The Report has not provided an adequate explanation as to the relevance of such a ratio. Taxable income is separate from revenue, and tax payable is based on taxable income, not on revenue. In our opinion the Report would have more merit if it provided justification on the appropriateness of this ratio and then provide a comparison with other ASX listed entities from other industry sectors.

The linkage between revenue (total income) and tax payable is frequently referred to in the Report and especially in relation to the separate sections on the six entities examined, however, no evidence is presented as to how this is related to tax avoidance or mismanagement. Not surprisingly, the revenue/tax percentage differed significantly between the entities in any case.

For-Profit Ownership Growth

On page 5 of the Report there is the statement "….however there has been rapid growth in the size and spread of for-profit companies". We see no evidence for this claim based on our analysis of providers in the aged care sector. For example, we reviewed the detailed service (provider) listings that the Department of Health issues each year which is based on actual operating beds by facility and includes full details of the approved provider and their legal status.

In summary, the following actual statistics are as follows:

- Comparison by Providers (organisations) showed the FP percentage dropping from 37.0% in 2013 to 33.4% in 2017
- Comparison by Facilities owned showed the FP percentage increasing from 30.4% in 2013 to 32.9% in 2017
- Comparison by Places (beds) the showed the FP percentage increasing from 36.2% in 2013 to 39.7% in 2017

There is no evidence of rapid growth by the FP sector, and the actual ownership relationship between the FP and NFP organisations remains healthy in our opinion, especially since they often service different geographic and demographic regions.

Size of Providers

The Report claims again on page 5 that "Bupa, Opal, Regis and Estia are the largest aged care providers nationally". This statement would be correct if it included specific reference to "for-profit providers nationally". However, it should be noted that the Uniting Church has 69 facilities in NSW alone, and the combined total of Uniting Church operated facilities nationally are significantly larger than any other provider including the six entities examined in the Report.

Similarly, the respective consolidated Catholic entities, Baptist, Anglican and Masonic organisations (amongst other faith-based organisations) would each be of a size larger or equal to any of the six entities included in the Report.

We are unclear as to the intention of making such a comment in the Report other than raising concerns as to the influence of the FP sector, which we would suggest is unfounded.

Public Information

The commentary in the Report that the entities (sic) "…provide very little information on their operations and financial performance" (see page 6) which was followed, in our opinion, by the erroneous and unsupported statement "…..and may be using accounting methods to avoid tax", would appear to be designed to somehow cast doubt on the ethics of the entities mentioned.

We would question the accuracy of the above assertions as included in the Report.

Tax Avoidance

The Report strongly suggests that the six FP entities examined seemingly have legal structures designed to avoid company taxation. We noted that there was no actual evidence provided to support this contention other than commentary on the respective ownership structures and ratio analysis between revenue and tax payable, which, as we have stated earlier can be challenged as being not relevant to the issue.

The Report's use of the terminology "using accounting methods to avoid tax" (or similar) is, in our opinion, misleading. The statutory and legal structures of entities dictate the appropriate accounting treatment, not the reverse.

In any case, taxable income is not determined by accounting standards or the treatment thereof, it is determined by reference to the relevant *Income Tax Assessment Act.*

Financial Analysis

An underlying theme of the Report appears to be in relation to FP entities making large profits gained substantially from recurrent government subsidy funding. The Report was silent regarding analysing the profitability or even making comparison to other industry sectors.

We suggest that when assessing the financial performance of aged care providers, an appropriate measure is the Return on Assets employed (ROA). Using this relevant ratio, the ROA for year-end 2016 was approximately 1.7%, and this declined to approximately 1.2% for FY17 and we expect it to be around 0.5% for FY18. This is hardly a viable return for aged care provider organisations.

Sector Operating Performance - Six Months ended December 2017

Although the current participation in the StewartBrown ACFPS survey is by a large majority from the not-for-profit (NFP) sector, it does not preclude referring to the survey results when reviewing the comparable financial performance of the for-profit (FP) sector, which is the subject of the Inquiry.

Our December 2017 quarterly surveys comprised the largest participation to date, covering residential aged care, home care packages and organisations and was based on the following data sets:-

- Detailed operating and equity results to December 2017 half year
- 171 provider organisations participated
- 126 provider organisation level financial metrics included
- 915 residential facilities included *(35 facilities excluded)*
- 401 Home Care programs *(21,400 packages)*

The profile of the residential aged care participant facilities based on geographic spread is as follows:

Table 2: Profile of participant residential facilities in the December 2017 Survey

Number of Residential Facilities	Major City	Inner Regional	Outer Regional/Remote	Total
Survey (December 2017)				
Facilities included	600	224	91	915
Facilities excluded	21	6	8	35
Total Survey facilities	**621**	**230**	**99**	**950**
DOH Service Listing (A)	1,647	642	383	2,672
State/local government	33	113	94	240
Service Listing less state/local government (B)	**1,614**	**529**	**289**	**2,432**
Coverage - % of (A)	*37.7%*	*35.8%*	*25.8%*	*34.2%*
Coverage - % of (B)	*38.5%*	*43.5%*	*34.3%*	*37.6%*

Summary of December 2017 Survey Results

The financial performance for the six months ended 31 December 2017 has seen a dramatic reduction in the overall operating performance in each aged care segment. This was anticipated due to funding changes and a freeze on ACFI in real terms (no increase for inflation).

A summary of our observations and the operating results is included below:

Sector Observations

- Legislative and policy uncertainty is influencing provider "behaviour" and strategies
- Slowdown of capital equity infusion continues due to declining financial performance
- New developments are integrating segments (residential/assisted living/home care/ILU's)
- Many older "hostel" style facilities need to be significantly refurbished
- Sector still struggling with deregulation of HCP (pricing/staffing/systems/technology)
- *My Aged Care* portal still has some deficiencies in navigation and reliability
- Increased community education around accommodation pricing and funding is critical
- Funding and revenue streams are a major concern to providers
- Increased issues around staffing and related costs

Organisation Level

- Net assets remained neutral when compared to FY17
- Cash + financial assets = 51.0% of total debt *(external and resident debt)*
- Operating revenue increased by 3.67%
- Employee expenses increased by 6.81%
- Earnings Before Tax (surplus) decreased by 59.9%
- Earnings Before Tax return on assets employed (ROA) was marginal at 0.5% pa
- Net operating loss sustained *(after eliminating revaluations and non-recurrent revenues)*
- Operating result (*) return on assets employed (ROA) was negative (0.1% pa)

  * *Operating result excludes non-recurrent revenues (revaluations/gains on sale/donations)*

Residential Care

- Average ACFI per bed day (pbd) for survey participants was neutral ($171.84 pbd)
- Occupancy levels for survey participants remained neutral (94.4% average occupancy)
- Total care hours per resident per day increased to 3.06 hours per resident per day (FY17 2.91 hours)

- Direct care costs increased by 2.96% ($134.58 pbd)
- Earnings Before Tax (EBT) average for residential facilities reduced by $1,618 per bed per annum (pbpa) to $1,617 pbpa (from $3,236 pbpa)
- EBITDA average for residential facilities reduced by $1,326 pbpa to $7,071 pbpa
- 21.3% of residential facilities recorded a negative EBITDA (16.1% for FY17*) (representing a cash loss)*
- 41.3% of residential facilities recorded a negative EBT (33.9% for FY17)

Home Care Packages

- Revenue per client day (pcd) average for survey participants reduced by 5.03% ($3.70 pcd)
- EBT (surplus) average per client day for survey participants reduced by $2.13 pcd to $3.24 pcd
- Revenue utilisation (average unspent funds) has deteriorated by 4.7%
- Unspent funds average per client has increased by $1,157 per client (to $5,412 per client)
- Staff hours per client per week has remained neutral (average 7.14 hours per week)

StewartBrown Aged Care Reports

StewartBrown issues detailed financial reports and analysis involving the aged care sector as follow:-

- Residential and Home Care sector reports (quarterly)
- Provider Organisation report (bi-annual)
- Listed Provider Analysis report (bi-annual)
- Corporate Administration report (annual)

Copies of these reports are located at http://www.stewartbrown.com.au/

Residential Aged Care Financial Metrics

Residential aged care is a significant proportion of the overall government aged care funding envelope and is characterised by having a very high staffing cost (61.3% of total revenue and 84.2% of government subsidies) and a substantial capital cost for land, buildings and equipment.

The operating result for a residential aged care facility is comprised as follows:-

Care Result

- ACFI Result *(ACFI plus supplements less direct care expenditure - clinical/care/allied staffing and medical)*
- Everyday Living Result *(Basic Daily Fee plus optional services less Hotel/Utilities/Maintenance expenditure)*
- Administration Result *(administration and support services - not separately funded)*

Accommodation Result

- Revenue: Daily Accommodation Payments (resident); Accommodation Subsidy (government)
- Expenses: Depreciation - building/equipment; Refurbishment costs; Other building related expenditure

Under the current funding guidelines, there are no additional revenue streams that providers can utilise.

Financial Viability and Sustainability of the Sector

The overarching message of our December 2017 survey results is the deterioration of financial performance in each of the respective segments which is potentially placing a number of aged care organisations in a financially vulnerable position.

Residential aged care has shown a marked downturn in operating results due to a combination of the COPE indexation freeze, amendments to the ACFI scoring matrix, ACFI downgrades and increased costs. In fact, average ACFI income has remained neutral at $171.85 per bed day compared to $171.13 at December 2016 and $171.84 at June 2017.

The impact of the regulatory changes and cost pressures (particularly staff costs), has resulted in the alarming statistic that 41.3% of residential facilities reported an operating loss for the six months to December 2017, and even more disconcerting is that 21.3% of facilities had negative EBITDA (indicating a cash loss from operations).

Average Earnings Before Tax (EBT) for the period ending December 2017 for residential care was $1,617 per bed per annum, which equates to an unsustainable amount of $4.43 per bed day.

Of further note is that the direct care staffing hours per resident per day increased from 2.91 hours to 3.06 hours, with no additional revenue to compensate for these increased staffing hours combined with rate increases from pre-existing enterprise agreements.

The financial effect of introducing a legislated (mandated) direct care staffing hours to 4.3 hours (up from 3.06 hours) per resident per day would increase the care staffing costs by an overall average of $53.09 per bed per day (including employee on-costs), equating to $19,379 per bed per annum. Without an equal increase in revenue this cost increase would result in over 85% of participating facilities in the survey operating at an EBT loss.

Occupancy levels in residential care facilities remained steady at 94.4% average occupancy, however, should there be facility closures due to financial stress it would heavily impact the vulnerable aged requiring high care accommodation.

The anticipated equity and private investment into residential aged care has slowed, predominantly due to legislative and policy uncertainty, and more directly due to the low financial returns. The average EBT return on assets employed (ROA) was a mere 0.5% and after excluding non-recurrent revenue streams such as revaluations and fair value gains on property and investments, the ROA represented a negative return of (minus) 0.1%

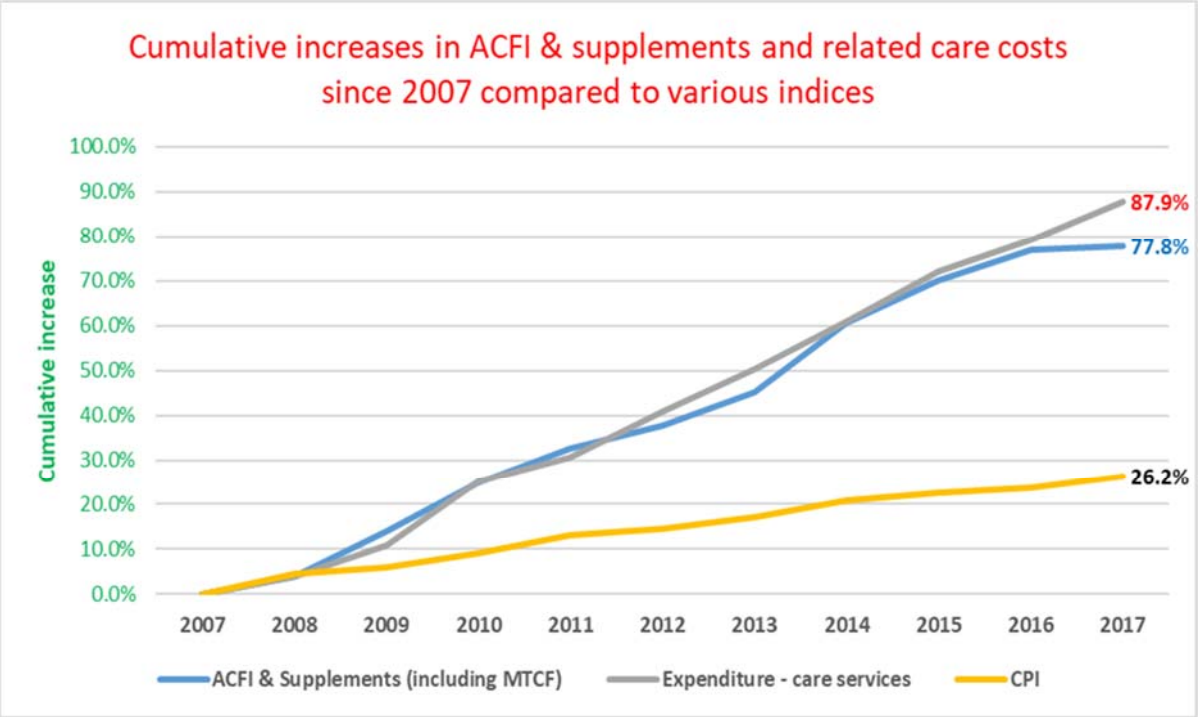
Home care did not escape the performance downturn with a revenue decline of 5.03% underpinning an overall reduction in profitability of 39.7%. Staffing hours per client per day were maintained at existing levels, however, increased pay rates was a major contributing factor to the downturn in results.

Since June 2016 the number of approved providers in home care has increased nationally by 307 (61.5% increase), however, the number of funding packages has only increased by 2.77% since deregulation in February 2017 (from 72,272 packages to 74,205 packages).

The financial viability of outer regional, rural and remote aged care providers is reaching a pivotal point. Some 56% of residential facilities in these geographic locations are operating at a loss, with 33% now operating at a cash deficiency. There are few opportunities for existing providers to merge or sell their facilities to larger providers, meaning that remedial funding will be essential in our opinion.

ACFI residential care subsidies are now increasing at a lower rate than the costs of providing direct care (refer below graph) and this will create further financial tension and risk the need to actually reduce staffing hours in an attempt to remain financially viable.

Table 3: Graph showing cumulative increases in ACFI and direct care expenditure



	2007 $ pbd	2017 $pbd	Cumulative Increase
ACFI & Supplements (including Means-tested care fee)	$96.66	$171.84	**77.8%**
Expenditure - Direct Care services	$71.63	$134.58	**87.9%**

Accommodation pricing for residential care (Refundable Accommodation Deposits and Daily Accommodation Payments) have not translated into a major equity pipeline for providers. This is due to the number of supported residents (over 45% nationally) and consumer reluctance to pay high accommodation prices commensurate with the average housing prices.

At December 2017, the average surplus from accommodation revenue and accommodation costs (by majority being depreciation and refurbishment) equated to $3,387 per bed per annum. Assuming a new residential bed costs around $280,000 to build and the depreciated bed value is currently around $175,000, the return on investment is not sustainable being less than 1.95% pa.

However, in our view the above surplus of $3,387 is overstated because the typical depreciation charge for buildings is spread over a 40 year effective life with little to nil refurbishment factored in. If buildings were depreciated over a more realistic 25 year effective life, then the return per bed per day would result in a deficit rather than a surplus.

In conclusion, with the home care national prioritisation queue (consumers assessed for funding but not yet allocated full funding) swelling by 15,698 since June 2017 to now being over 104,600, coupled with the estimated 83,500 new residential beds being required over the next 10 years to meet the ageing population demands, the sector requires significant investment.

For this investment to occur the sector must be financially sustainable and, in our opinion, urgent action is required to allow providers to access alternative revenue streams and have less reliance on government funding.

Recommendations in Relation to Improving Financial Sustainability

We recommend that a *minimum* COPE (indexation) increase of 3.00% be approved effective from 1 July 2018 which would improve ACFI revenue by an average of around $5.15 per bed day ($1,880 per bed per annum). This would also uplift the ACFI base for the July 2019 COPE indexation.

Targeted regional and remote subsidies need to be implemented as a priority.

Several of the Tune Review recommendations should be implemented as soon as practicable (1 July 2018 or 1 January 2019) including:-

- ✓ Recommendation 14 - effective deregulation of Basic Daily Fee for residential care
- ✓ Recommendation 16 - compulsory consumer contributions for CHSP
- ✓ Recommendation 12 - compulsory to charge the basic (care) fee for home care packages
- ✓ Recommendation 11 - comparability of home care prices on My Aged Care site
- ✓ Recommendation 7 - Level 5 home care package funding to be introduced
- ✓ Recommendation 3 - ACAR for bed licences to be removed within 2 years, leading to deregulation of residential aged care

Accountability and Probity

In our opinion, the current requirements for accountability and reporting of relevant financial and non-financial information is appropriate and adequate, and currently includes:

- The *Aged Care Act 1997* requires that the residential aged care providers prepare audited General Purpose Financial Reports (GPFR) in accordance with all accounting standards
- The *User Rights Principles 2014* state that the respective GPFR must be made available to all intending or current residents of residential aged care facilities
- The *Fees and Payments Principles 2014 (no. 2)* include four (4) standards that must be adhered by approved provider organisations, namely:-
  - Liquidity Standard
  - Records Standard
  - Governance Standard
  - Disclosure Standard

  Paragraph 57(1)(a) to (f) of the *Principles* detail the extent of financial information that must be provided
- Effective from 31 October 2017, the Department of Health mandated that all providers must also submit the *Aged Care Financial Report* (ACFR) in addition to their audited GPFR. The ACFR must include the following specific information:
  - Statements of Income & Expenditure, Financial Position, Cash Flows and Notes *(Approved Provider level)*
  - Statement of Income & Expenditure and Financial Position *(Residential care segment)*
  - Annual Prudential Compliance Statement *(accompanied by a separate external Audit Opinion)*
  - Detailed supporting schedules in relation to Annual Prudential Compliance Statement
  - Survey of Aged Care Homes
  - Home Care Financial Report
  - Short Term Restorative Care Financial Report

In the sphere of financial reporting, it is essential to note that the Department of Health mandates financial reporting for the residential aged care providers who receive Government subsidies.

In addition, from a statutory reporting perspective, all approved providers have additional reporting requirements.

- With respect to FP entities, if they satisfy the definition of being a "Large Proprietary Company" or are a "Public Company" (which cover the majority of aged care providers), then they are required to lodge their GPFR with ASIC and these are a public document.
- Conversely, all NFP entities must lodge their GPFR with the *Australian Charities and Not-for-profits Commission* (ACNC) and these reports are readily available from the ACNC website.

As there are two existing reporting regimes (ASIC and ACNC) we would not support the proposal requiring the lodgement of audited annual financial statements with ASIC for "any company that receives Commonwealth funds over $10 million in any financial year" as recommended in the TJN-Aus Report. This recommendation is also ambiguous in that it makes no differentiation as to the type of Commonwealth funding (e.g. residential aged care, home care, disability etc).

2. ORGANISATION ANALYSIS

For reference purposes we set out below extracts from our December 2017 ACFPS survey including the financial performance and balance sheet of aged care providers at an organisational level rather than at individual segment level.

Operating Results for six months ended 31 December 2017

	Survey December 2017 *(6 months)*	Survey June 2017 *(12 months)*	Listed Entities December 2017 *(6 months)*	ACFA June 2016 *(Residential)*
Number of organisations	*126*	*126*	*3*	*949*
Number of facilities	*758*	*748*	*169*	*2,669*
Number of residential beds	*52,392*	*50,943*	*16,365*	*195,825*
Number of home care clients (packages)	*18,475*	*18,075*	*320*	*n/a*
Income & Expenditure	**$'000**	**$'000**	**$'000**	**$'000**
Revenue				
Operating revenue	3,508,988	6,769,396	746,799	16,570,000
Other revenue	91,650	213,716	239	
Other income	72,872	171,876	4,600	602,000
Total revenue	3,673,510	7,154,988	751,638	17,172,000
Expenses				
Employee expenses	2,442,851	4,574,147	502,769	10,855,600
Depreciation and amortisation	243,446	441,840	32,443	772,200
Finance expenses	23,010	58,262	9,677	149,800
Other expenses	905,380	1,787,637	124,052	4,331,500
Total expenses	3,614,687	6,861,886	668,941	16,109,100
Surplus (EBT)	**58,823**	**293,102**	**82,697**	**1,062,900**
Operating Surplus (Deficit)	**(14,049)**	**121,226**	**78,097**	**460,900**
Ratios				
EBT return on assets (ROA)	*0.5%*	*1.3%*	*3.5%*	*2.6%*
Operating surplus return on assets (ROA)	*-0.1%*	*0.6%*	*3.3%*	*1.1%*
Operating surplus % of operating revenue	*-0.4%*	*1.8%*	*10.5%*	*2.8%*
Employee expenses % of operating revenue	*69.6%*	*67.6%*	*67.3%*	*65.5%*
Depreciation as % of property assets	*3.2%*	*3.0%*	*2.6%*	*3.3%*

Balance Sheet Summary as at 31 December 2017

	Survey December 2017	Survey June 2017	Listed Entities December 2017	ACFA June 2016 *(Residential)*
Number of organisations	*126*	*126*	*3*	*949*
Number of facilities	*758*	*748*	*169*	*2,669*
Number of residential beds	*52,392*	*50,943*	*16,365*	*195,825*
Number of home care clients (packages)	*18,475*	*18,075*	*320*	*n/a*
Balance Sheet	**$'000**	**$'000**	**$'000**	**$'000**
Assets				
Cash and financial assets	6,933,548	5,850,326	125,244	5,611,000
Operating assets	442,257	573,063	60,006	8,055,000
Property assets	15,426,477	14,726,150	2,536,851	23,629,000
Intangible assets	882,114	827,481	1,977,613	3,400,000
Total assets	23,684,396	21,977,020	4,699,714	40,695,000
Liabilities				
Refundable loans	12,764,428	11,635,972	2,195,213	21,872,000
Borrowings	835,044	780,456	507,467	3,756,000
Other liabilities	1,930,306	1,509,345	523,124	4,122,000
Total liabilities	15,529,778	13,925,773	3,225,804	29,750,000
Net Assets	**8,154,618**	**8,051,247**	**1,473,910**	**10,945,000**
Net Tangible Assets	**7,272,504**	**7,223,766**	**(503,703)**	**7,545,000**
Ratios				
Net assets proportion % total assets	*34.4%*	*36.6%*	*31.4%*	*26.9%*
Property assets proportion % total assets	*65.1%*	*67.0%*	*54.0%*	*58.1%*
Cash + financial assets % refundable loans	*54.3%*	*50.3%*	*5.7%*	*25.7%*
Cash + financial assets % debt	*51.0%*	*47.1%*	*4.6%*	*21.9%*

Return on Assets (ROA)

This ratio relates to the operating surplus (recurrent surplus) as a measure of the total assets employed.

The ROA ratio is used to assess what levels of real return providers are achieving in relation to the assets employed (irrespective of the debt/equity/notional debt). The only variable is whether assets have been revalued or held at historical cost.

As residential aged care has a high capital requirement and consequently a large equity investment, the ROA ratio provides an indication of the returns in relation to the capital intensity and, accordingly, are an important indicator of the overall financial returns required to maintain ongoing viability.

3. RESIDENTIAL AGED CARE ANALYSIS

Analysis of Operating Losses by Facility

The effect of further deterioration of facility financial performance due to the combination of the COPE freeze, amendments to the ACFI scoring matrix, ACFI downgrades and increased costs, has resulted in many facilities moving into a more financially vulnerable position.

Table 4: Analysis of facilities making EBT and EBITDA losses

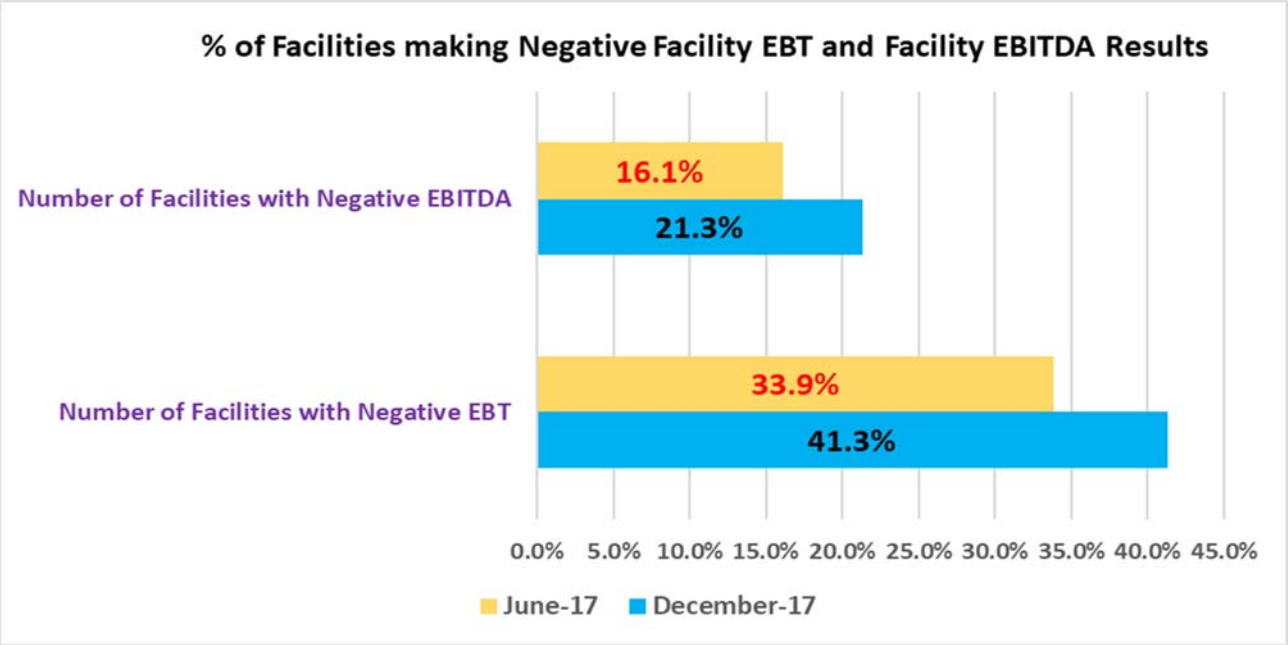


Table 5: Analysis of facilities making EBT losses (by remoteness)

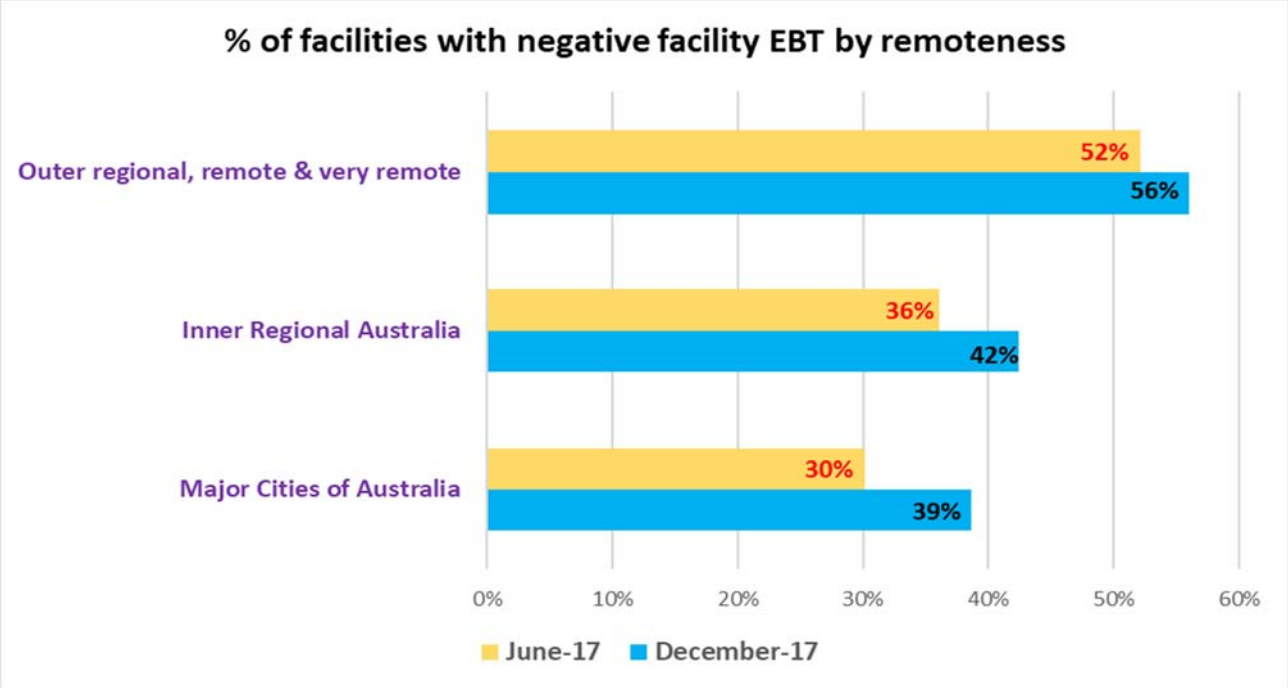
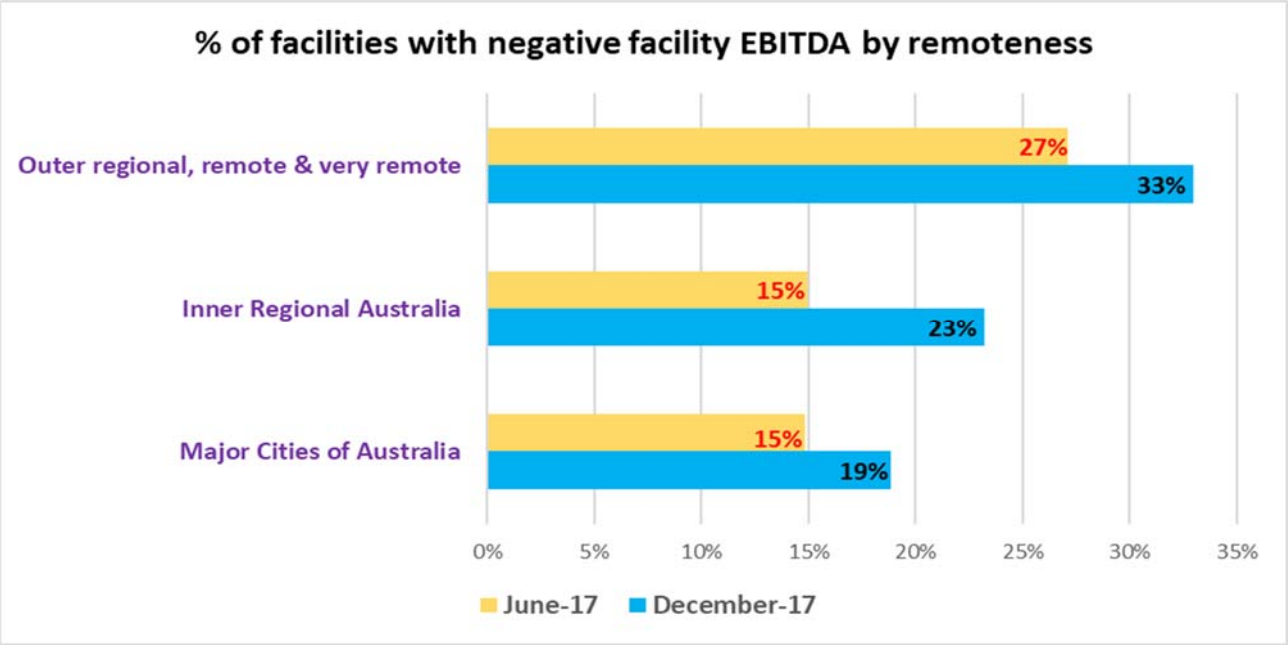


Table 6: Analysis of facilities making EBITDA losses (by remoteness)



Brief commentary

- The total percentage of facilities making an EBITDA loss has increased by a further 5.2%, from 16.1% to 21.3% of the total participation number (915 facilities). In addition to this a further 21 facilities who made both an EBT and EBITDA loss were excluded due to being outside the acceptable range
- The total percentage of facilities making an EBT loss has increased by a further 7.5%, from 33.9% to 41.3% of the total participation number
- Tables 2 and 3 above, graph the number of facilities making an EBT and EBITDA loss as a percentage of total number of facilities in their respective geographic location (remoteness).
    - In relation to outer regional/remote/very remote facilities, 56% of facilities in this geographic area have made an EBT loss (33% have made an EBITDA loss)
    - For inner regional located facilities 42% made an EBT loss and 23% made an EBITDA loss
    - Similarly, of the facilities located in major cities, some 39% of these made an EBT loss and 19% made an EBITDA loss

Direct Care Staffing Metrics

Direct Care staffing metrics include care staff costs and care staff hours. The ability to efficiently and appropriately align staffing levels to funding and facility design, while meeting the care needs of residents, leads to improvements in the facility's financial performance.

A summary of the direct care staff hours by category per resident per day for the Survey *Average* and Survey *First 25%* is included in the below table.

Table 7: Care staffing metrics for survey Average and survey First 25%

	Average			First 25%		
	Dec 17	**June 17**		**Dec 17**	**June 17**	
Care staff costs as % of total care expenses	58.61%	58.51%	↑	57.72%	57.26%	↑
Costs by type - $ pbd						
Care management	7.98	7.46	↑	8.27	7.08	↑
Registered nurses	21.18	20.52	↑	17.37	16.34	↑
Enrolled & licensed nurses	9.39	12.60	↓	6.41	9.42	↓
Other unlicensed nurses & personal care staff	78.90	74.54	↑	70.20	65.99	↑
Allied health & lifestyle	7.16	5.95	↑	6.66	5.45	↑
Agency staff	3.59	3.16	↑	2.23	1.84	↑
Total care labour costs	**128.20**	**124.22**	↑	**111.14**	**106.12**	↑
Hours by type - hours worked per resident per day						
Care management	0.12	0.12	-	0.10	0.11	↓
Registered nurses	0.38	0.37	↑	0.32	0.29	↑
Enrolled & licensed nurses	0.29	0.26	↑	0.24	0.19	↑
Other unlicensed nurses & personal care staff	2.11	2.05	↑	1.92	1.84	↑
Allied health & lifestyle	0.15	0.12	↑	0.13	0.11	↑
Imputed agency care hours implied	0.01	n/a		0.02	n/a	
Total Care Hours	**3.06**	**2.91**	↑	**2.73**	**2.53**	↑

Brief commentary

- The category allocations are consistent with the Nurses and Midwifery Board of Australia and, accordingly, AIN and TAFE qualified staff have been included with the "Other unlicensed nurses & personal care staff" classification
- Total labour costs have increased for both the survey *Average* and *First 25%* since June 2017, by 3.2% and 4.7% respectively
- Total care hours have increased for both the survey *Average* and for the *First 25%* by 5.3% and 7.7% respectively, and are now at 3.06 hours and 2.73 hours worked per resident per day respectively
- Initial feedback from providers in relation to an explanation for increase in care hours is that it may be partially due to the impact of influenza and gastro outbreaks

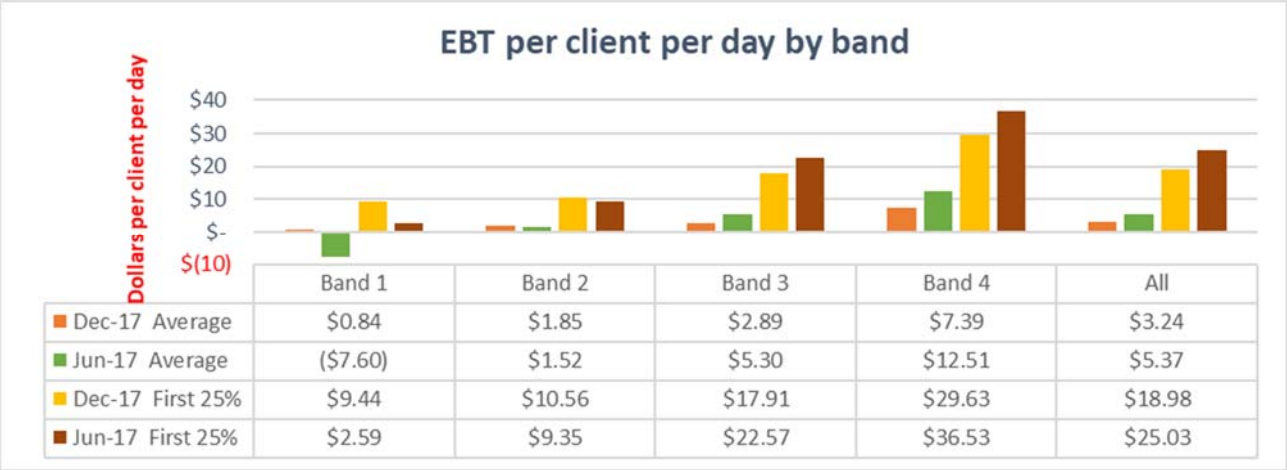
4. HOME CARE ANALYSIS

Results Overview

The December 2017 quarter showed a decline in the net result with the Survey's *Average* Earnings Before Tax (EBT) at $3.24 per client per day (pcd) compared to $5.37 pcd as at June 2017. The Survey *First 25%* also had a reduction in surplus by $6.05 pcd to $18.98 pcd.

For both the Survey *Average* and *First 25%* the profitability declines were in Bands 3 and 4, whilst Bands 1 and 2 had slight increases.

Table 8: Comparison of EBT (operating surplus) December 2017 and June 2017



	Band 1	Band 2	Band 3	Band 4	All
Dec-17 Average	$0.84	$1.85	$2.89	$7.39	$3.24
Jun-17 Average	($7.60)	$1.52	$5.30	$12.51	$5.37
Dec-17 First 25%	$9.44	$10.56	$17.91	$29.63	$18.98
Jun-17 First 25%	$2.59	$9.35	$22.57	$36.53	$25.03

Brief commentary

- Survey *Average* EBT per client per day has declined due to:
  - Revenue reduction of 5.03% since June 2017
  - Total expenditure decrease of 2.4% - however, as this is lower than the decline in revenue the net result is a reduction in EBT
  - Reduction in expenses coming from case management and advisory, and administration and support costs, rather than from direct service and sub-contracted or brokered costs (this increased by 1.9%)
  - Band 4 revenue declining by a greater amount
- The survey *First 25%* has also declined for similar reasons:
  - Revenue reduction of 1.6%
  - Total expenditure has remained roughly the same (only a 0.09% increase compared to June 2017)
  - Dramatic increased service provision and administration cost (9%)
- The decline in revenue may be due to providers reducing their pricing (due to increased competition) with service provision revenue (direct service and brokered) not reducing at the same rate as costs
- The EBT of Band 2 (survey *Average* and *First 25%*), comprised mostly of Level 2 & 3 packages, has increased because the reduction in expenses is greater than the reduction in revenue

5. CHALLENGES

Wages Funding Gap

There is a significant campaign, particularly from the Australian Nursing & Midwifery Federation (ANMF), for a mandated increase in direct care hours provided to residents to 4 hours and 18 minutes per day (i.e. 4.3 hours), up from 3.06 hours, and a further increase in the hourly rate of 15% for direct care staff (nurses and carers).

We are not qualified to make comment in relation to the adequacy of the current or proposed direct care hours provided with respect to quality of care outcomes. However, in this section we analysis and calculate the potential additional cost of increasing direct care hours and, consequently, the government subsidy funding gap, should the increased hours be mandated or required.

The following tables provide details of our methodology and calculations in this respect.

Table 9: Calculation of direct care staff costs as % of government subsidy

	$ (per bed day)	Note
Government subsidy	188.59	*1*
Resident fees	63.22	*2*
Total residential revenue	$ 251.81	
Direct care staff costs (A)	$ 128.20	*3*
Direct care staff costs as % of total revenue	51%	
Direct care staff costs as % of government subsidy (B)	**68%**	

Note
1. Subsidy includes ACFI and supplements + Accommodation supplements
2. Resident fees exclude means-tested care fees (included with ACFI)
3. Direct care wages excludes workers compensation, hotel services, property and administration

Table 10: Calculation of cost of increased staffing hours per resident per day

	$ (per bed day)	Note
Direct care staff costs (A)	128.20	
Workers compensation insurance premium (2.2%)	2.82	
Total direct care staff costs (C)	$ 131.02	
Average staff costs (per resident per hour)	$ 42.82	*4*
Total direct care staff costs (assuming ANMF ratio) (D)	$ 184.12	*5*
Additional staff costs (D - C)	$ 53.09	
Direct care staff cost uplift % *(E)*	***24%***	

Note
4. StewartBrown Aged Care Financial Performance Survey (3.06 hours per resident per day)
5. ANMF media release 5/4/2018 "4 hours and 18 minutes" (4.3 hours per resident per day)

Table 11: Calculation of funding gap

		$ ($'billion)	Note
Residential government subsidy funding (F)	$	12.1	*6*
Staff cost funded by subsidy (F x B) (G)	$	8.2	
Staff cost lift % (E)		24%	
Staff hourly wage adjustment % (H)		15%	*7*
Adjusted staff cost funded by subsidy (G x E x H) (I)	$	11.7	
Funding gap (I - G)	**$**	**3.5**	

Note
6. Productivity Commission - Report on Government Services 2018 (Table 14A.4)
7. Hourly rate uplift (Korn Ferry)

Commentary
Based on the respective assumptions adopted and using data obtained from the StewartBrown ACFPS and available from the Department of Health, we estimate that the additional funding required (the funding gap) to meet the joint aspirations of increased direct care hours per resident per day and increased average hourly wage rate by 15%, will require additional government subsidy or consumer funding of some **$3.5 billion**.

It must be stressed that such a combination of increased care hours and uplift in wage rates will not occur in a single time frame and would have to be implemented progressively over some years. The purpose of this analysis is to clearly demonstrate the financial consequences of the funding gap that needs to be considered in any future considerations.

Residential Aged Care Inventory

Estimate of Additional Places Required

The Aged Care Financing Authority (ACFA) included the following statement in the *"Fifth report on the Funding and Financing of the Aged Care Sector (July 2017)"*

"It is estimated that the residential care sector will need to build an additional 83,500 places over the next decade in order to meet the provision target of 78 operational places per 1,000 people over age 70. This compares with 33,667 new places that came online over the previous decade. The estimated investment requirement of the sector over the next decade is in the order of $35 billion."

Profile of Current Residential Aged Care Facilities

The following tables provide a profile of current residential buildings based on an extract from the ACFPS. The Age (year groupings) is based on the year the facility was first opened.

Table 12: Profile of current residential care facilities by year grouping

Age (years)	Total Number of Facilities	Facilities with Significant Refurbishment	Facilities with no Significant Refurbishment
1-5	28	17	11
6-10	84	13	71
11-15	92	17	75
16-20	106	16	90
20+	602	184	418
Total	**912**	**247**	**665**

Table 13: Profile of current residential care facilities by year grouping (percentage)

Age (years)	Total Number of Facilities	Facilities with Significant Refurbishment	Facilities with no Significant Refurbishment
1-5	3.1%	60.7%	39.3%
6-10	9.2%	15.5%	84.5%
11-15	10.1%	18.5%	81.5%
16-20	11.6%	15.1%	84.9%
20+	66.0%	30.6%	69.4%
Total	**100.0%**	**27.1%**	**72.9%**

Commentary

As noted above, ACFA estimate that an additional $35 billion capital inflow will be required to build the additional residential aged care places required to meet the anticipated ageing population demand.

The above tables illustrate that there will be a requirement for significant capital inflows to refurbish and upgrade the existing residential facilities. It is interesting to note that 66% of facilities first opened 20+ years ago, and of these some 69.4% have not had a major or significant refurbishment.

It is not possible to estimate the full extent of capital required to upgrade the existing facility inventories, however, it would be reasonable to assume that this will greatly exceed the amount required for new constructions.

The bulk of the investment to fund the future capital expenditure required by the aged care sector is expected to be provided by the FP and NFP sectors. While Refundable Accommodation Deposits play a part in financing this investment, a large part is financed through borrowings from financial institutions.

Without sufficient operating profit to cover the interest cost and ultimate repayment of borrowings and an adequate return on investment outlaid by providers, the ongoing investment in the sector may not be justified. Clearly, it is essential for the future of the sector that profit levels are sufficient to encourage future investment in the sector, enable borrowings to be repaid over time and to provide a profit return to the provider whether FP or NFP.