ACSA
Aged & Community Services Australia

DEPARTMENT OF HEALTH

REVIEW OF REFUNDABLE ACCOMMODATION PAYMENTS

Submission

March 2019

ABOUT ACSA

Aged & Community Services Australia (ACSA) is the leading aged care peak body supporting more than 700 church, charitable and community based, not for profit organisations. Not for profit organisations provide care and accommodation services to about one million older Australians.[1]

ACSA represents, leads and supports its members to achieve excellence in providing quality affordable housing and community and residential care services for older Australians.

Aged care providers make a significant $17.6 billion economic contribution to Australia, representing 1.1 per cent of GDP by producing outputs, employing people and through buying goods and services. The direct economic component is akin to the contribution made by the residential building, construction and sheep, grains, beef and dairy cattle industries.[2]

ACSA members are important to the community and the people they serve and are passionate about the quality and value of the services they provide, irrespective of their size, service mix or location.

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[1] Australian Government, Department of Health, 2016-17 Report on the Operation of the *Aged Care Act 1997*, November 2017.

[2] Deloitte Access Economics, Australia's aged care sector: economic contribution and future directions, Aged Care Guild, June 2016, page 24.

REVIEW OF REFUNDABLE ACCOMMODATION PAYMENTS

BACKGROUND

The Department of Health (the Department) released a discussion paper *Managing Prudential Risk in Residential Aged Care* (the Paper) to engage with the aged care sector and the broader community and elicit views on the issue of managing prudential risk in residential aged care. The Paper outlines the growth of the national pool of refundable accommodation payments, currently around $25 billion, up from $15 billion in 2014 and states 'it is essential that these resident monies are prudently invested and that providers are able to refund these payments when residents leave care[3]'.

The Paper identifies there is currently a framework to manage prudential requirements under the Aged Care Act 1997, noting this framework has been in place for some time. Two reviews are listed as having occurred in relation to prudential matters, one commissioned by the Department and conducted by Ernst and Young[4] (EY) and the other by David Tune[5]. Both reports recommended that the prudential framework be strengthened. Separately, we note the Aged Care Funding Authority (ACFA) attended a report[6] in 2016 examining the Accommodation Payment Guarantee Scheme (the Scheme).

The Government's 2018-19 Budget measure - *Better Quality Care – Managing Prudential Risk in Residential Care* - also supports strengthening the prudential framework.

Suggested areas for strengthening prudential arrangements include:

- Improved and more detailed reporting to the Department of corporate structures, to improve transparency and understanding of related party transactions;
- Introduction of specific liquidity requirements, 10 per cent being the suggested threshold;
- Introduction of a specific capital adequacy requirement, the suggestion being assets exceeding liabilities by an amount exceeding 20 per cent of total assets;
- Enhanced requirements for information and disclosure to the Department where 'significant' events occur - such as change in corporate ownership and/or structure;
- Enhanced financial governance and financial risk management requirements;
- Improved disclosures to residents/families of management of lump sum accommodation payments, including refunds;
- Limiting or phasing out discretionary trusts;
- Providing greater regulatory powers to the Department in relation to prudential matters; and
  Introduction of a requirement for providers to comply with Tier 1 financial reporting requirements.

[3] Managing Prudential Risk in Residential Aged Care Discussion Paper, Australian Government Department of Health, 2019

[4] Review of Aged Care legislation which provides for the regulation and protection of Refundable Accommodation Payments in Residential Aged Care, Department of Health, May 2017

[5] Legislated Review of Aged Care 2017, Department of Health, Tune D., 2017

[6] The Protection of Residential Aged Care Lump Sum Accommodation Payments, Aged Care Financing Authority

As indicated above, the Department commissioned EY to undertake an independent study of the legislative, business and operational framework of refundable accommodation payments in residential aged care (the Report). The stated aims were to develop a framework:

- For approved providers to demonstrate they are adequately capitalised, have sufficient liquidity and good governance;
- That will encourage approved providers to invest accommodation payments monies wisely; and
- That minimises cost and administrative burden for the Department and approved providers.

The Report states that the existing funding regime needs to be improved to ensure:

- That residents/consumers are protected from losing their refundable accommodation payments to insolvent approved providers;
- That approved providers and their investors have policy clarity; and
- That the Department operates an equitable, well-regulated and transparent Scheme.

The Report identified three current key areas of deficit:

1. **Data deficit** – in relation to the data that is provided to the Department, making it difficult to assess whether approved providers comply with Prudential Standards;

2. **Deficiencies in the Liquidity Standard** – with gaps identified in how the Department is able to assess and measure whether approved providers have sufficient funds available to repay accommodation payments; and

3. **Deficiencies in the Disclosure Standard** – gaps in legislation and the Department's powers have a compounding effect on how the Department is able to obtain information and assess approved provider compliance with the Disclosure Standard and the Prudential Requirements overall.

PRUDENTIAL RELATED STANDARDS

The legislative instruments for prudential management are the:

- Aged Care (Accommodation Payment Security) Act 2006 – the legislative authority for the Accommodation Payment Guarantee Scheme;
- Fees and Payments Principles 2014 (No 2) – which address the Prudential Standards (Liquidity, Records, Governance & Disclosure); and
- Division 52N of the Aged Care Act 1997 – which defines the permitted uses of refundable accommodation monies.

COMMENTARY

ACSA supports a prudential scheme that is transparent to residents, their significant others and the Department. Transparency should include visibility of where Refundable Accommodation Deposit (RAD) monies are kept and how the money is being used. Such a system should provide surety that approved providers are managing the capital funding appropriately and are always in a position to refund RAD monies in a timely manner.

Default events in the sector over the life of the Scheme, which was introduced in 2006[7], amount to approximately $43 million out of a total 'bond' pool that is now approximately $25 billion, equating to a lifetime default rate of just 0.2 per cent.

Any changes to the Scheme need to be proportionate to the actual level of risk to care recipients and their families/significant others.

Currently, the Scheme refunds any gap in the repayment of RADs where there has been a default. While Government has always had the ability to impose a levy on the industry to meet these costs, to date it has never done so. This will change from July this year, when the Government will impose a mandatary levy on all approved providers where refund costs to residents exceed $3 million in a financial year due to default events[8];

There may be merit in an approach that has additional requirements, determined on an actuarial basis, for some providers that represent a higher risk - for example, highly leveraged providers. We suggest a higher level of requirements and reporting is placed on providers deemed at greater risk of default events.

In his paper *Protecting residents against the financial failure of aged care providers* Dr Richard Crumpston[3] describes an estimated failure rate for not for profit providers being 0.016 per cent versus 0.045 per cent failure rate estimated for Australian Prudential Regulation Authority (APRA) regulated institutions from 2004 to 2017 (p15). He also describes for profit providers having higher failure rates (p18).

Data shows us that for profit providers (since 30 June 2015) have been reducing their net assets, while their debts have continued to grow[9] and that cash and financial assets (as a percentage of debt and separately as a percentage of refundable loans) are very low at 4.6 per cent and 5.7[10] per cent respectively.

ACSA strongly opposes any change that increases the likelihood of not for profit approved providers carrying an increased risk of a significant levy burden should highly leveraged (thinly capitalised) for profit providers default on their ability to refund accommodation payment monies, particularly where it places their own financial position at risk.

Additionally, ACSA is concerned about unintended consequences from the recommendations on certain sections of the market (for example small, stand alone, Regional, Rural and Remote (RRR); Culturally and Linguistically Diverse (CALD), Aboriginal and Torres Strait Islander (ATSI) or specialist service providers) and recommends transition provisions/considerations be put in place for these types of service providers.

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[7] Aged Care (Accommodation Payment Security) Act 2006, Commonwealth Government of Australia

[8] Managing Prudential Risk in Residential Aged Care Discussion Paper, Australian Government Department of Health, 2019, p11

[9] Protecting residents against the financial failure of aged care providers, Crumpston R., Australian Projections Pty Ltd, September 2018, p8

[10] Aged Care Financial Performance Survey, December 2017 Summary Results Analysis, StewartBrown 2018

Whilst the proposed measures may reduce the already very low risk of failure of not for profit providers, we are concerned they will raise the capital requirements of providers and increase the profits needed to service capital, while doing little for aged care residents[11].

ACSA is unclear as to whether independent modelling of the EY recommendations has occurred, but believes such modelling should occur and include:

- The impact on industry of the Paper's recommendations;

- Analysis of the impost on industry of the proposed capital adequacy requirement. Crumpston[12] reports as much as $11 billion of extra capital may be required;

- Clarity about the transition period that would be required by industry to the proposed changes; and

- Insight as to what information is available from liquidators of failed providers that may assist in understanding whether the proposed recommendations would have made a material difference to the outcomes for those providers and their residents.

ACSA has some concerns that the recommendations as they currently stand risk:

- The not for profit sector carrying a greater risk and burden through levy imposition from default events by highly leveraged (thinly capitalised) for profit entities - noting that from July this year, the Government will impose a mandatary levy on all approved providers where refund costs to residents exceed $3 million in a financial year due to default events[13];

- Reducing growth, stymieing capital development works and hindering investment in the sector;

- Some providers exiting the sector due to increased financial pressures on their operations resulting from changed liquidity and capital requirements;

- Negative impacts on a range of providers, including RRR, smaller providers, CALD and special interest group providers, disproportionate to the risk;

- Liquidity and/or capital adequacy metrics that will be a significant requirement for some providers to meet, creating a higher risk of default/financial hardship, or impacting on the way some providers operate;

- Counterproductive outcomes for providers, for example restricting the charging of new accommodation payments where a provider breaches capital or liquidity thresholds, including when they may be attempting to return to compliance in relation to thresholds; and

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[11] Protecting residents against the financial failure of aged care providers, Crumpston R., Australian Projections Pty Ltd, September 2018, p1

[12] Protecting residents against the financial failure of aged care providers, Crumpston R., Australian Projections Pty Ltd, September 2018, p20

[13] Managing Prudential Risk in Residential Aged Care Discussion Paper, Australian Government Department of Health, 2019, p11

- Limiting or phasing out of trusts may result in disruption to the sector, could discourage new entrants or may trigger unwanted tax consequences.

RECOMMENDATIONS

Issue: Insufficient transparency in reporting
Options A1, A2 and A3

Option A1: Require approved providers to report their corporate structures, including identity of ultimate (beneficial) shareholders and any significant changes to their ownership or control.

Stated rationale: Currently there is no requirement for providers to inform the Department when there are changes to their corporate structure, ultimate shareholders, ownership or control. Because of this gap, the Department does not always have a clear understanding of a provider's structure.

ACSA recommends:

- The Department considers a level of disclosure requirement that provides an appropriate level of transparency and visibility into an approved provider's corporate structures and ownership (including changes to these), but that minimises unintended consequences such as:
    - Unnecessary regulatory compliance burden, particularly on those providers with simple or stable corporate structures and ownership; or
    - Hindering investment into the sector.
- Consultation occurs, and agreement is reached, with the sector on what constitutes a 'significant change' that would need to be reported on. This discussion could be facilitated by reference to Australian Accounting Standards i.e. AASB 128.
- An approach that takes into consideration the complexities that can be present in the corporate structures of some not for profit church-based institutions.

Option A2: Allow approved providers to report on a single entity or consolidated Approved Provider Group (APG) basis.

Stated rationale: Aged care organisations vary in organisational type, size, location etc and there is considerable variety in their corporate structures. A consequence of complex structures, including those with related entities, is complexity in reporting and inconsistency in the way providers report financial information. EY states the intent of its recommendation is for residents and the Department 'to see where the money is at all times and to what use it is going to be put[14]'.

[14] Managing Prudential Risk in Residential Aged Care Discussion Paper, Australian Government Department of Health, 2019, p17

ACSA recommends:

- Where approved providers have structured themselves into an APG they are to report on a consolidated group basis for prudential and financial regulation reporting purposes. The key issue to be addressed is transparency of reporting - that 'permitted use concerns' are managed, responsibility for individual entity liabilities are addressed within the consolidated provider group, intra-group or related party transactions are captured etc. Transparent reporting by those providers with complex structures is in the interest of the sector, particularly with the move to a mandatory levy approach by Government, scheduled for July 2019.

- That where refundable accommodation monies are transferred outside of an APG, an enhanced disclosure and security regime is in place, as discussed in the Paper[15].

Option A3: Where an approved provider wishes to transfer assets outside the approved provider, the Loan to Value Ratio (LVR) of the assets to the liabilities should not exceed 80 per cent of the value of the underlying assets, and the use must be secured by appropriate security - such as a mortgage (ranking below bank secured debt).

Stated rationale: The EY report identifies a level of risk to the protection of refundable accommodation monies associated with the transfer of assets by a provider to related parties. Without disclosure of such transfers, the Department 'has no view of the function or use of RADs'…similarly it has 'limited or no knowledge of the financial viability of the parties who received those assets'.

ACSA supports the recommendation and additionally recommends:

- Addressing transparency in relation to the transferring of assets outside a provider (or provider group) so that transfers are transparent, adequately secured and clearly reported.

- That further consultation occurs with the sector to determine an appropriate percentage figure for the LVR (recommendation A3 currently suggests it should not exceed 80 per cent).

- Strengthening the conditions/requirements relating to the transfer of assets outside the approved provider, for example:

    - The commercial nature of loans made;

    - Loan repayment conditions being reported on in financial statements;

    - Outlining the use of the transferred assets once outside the approved provider; and

    - Requiring independent valuation of underlying assets when determining the LVR.

[15] Managing Prudential Risk in Residential Aged Care Discussion Paper, Australian Government Department of Health, 2019, p19

Issue: Need to redefine the Liquidity Standard
Options B1, B2 and B3

Option B1: Set a liquidity threshold as a defined percentage of accommodation payment monies held by the APG, such as the higher of 10 per cent*, where an AP is a single site, single facility operation with a smaller accommodation pool and low resident turnover - a higher threshold.

**For example, 10 per cent of RAD monies held by the provider or the amount RADs refunded by the provider in the preceding three months*

Stated rationale: The Liquidity Standard currently puts the onus and risk of determining an appropriate level of liquidity on individual providers.

Currently, under Division 2-Liquidity Standard (Fees and Payments Principles 2014), the Principles already prescribe a requirement to 'implement, maintain and comply with liquidity management strategy'. They do not prescribe set thresholds, but rather refer to 'sufficient liquidity', including what this might mean, and also maintaining minimum levels of liquidity to meet certain purposes. The Principles also discuss the provider's 'liquidity management strategy'.

We note the Paper cites that the majority of providers already have a liquidity level equal to or greater than 10 per cent of their RADs (p24), noting 'only 23 per cent of providers would be impacted' (p26).

What we currently do not have is visibility of the type and makeup of those 23 per cent of providers that would not currently meet the proposed 10 per cent liquidity threshold. As a peak body, we wish to understand the profile of these providers, - for example, how many of these are not for profit operators in RRR locales (thin markets) or small or specialist services?

We propose avoiding the adoption of a fixed liquidity threshold in the first instance, noting that a fixed threshold does not take into consideration an individual provider's size, business mix and complexity.

Therefore, ACSA recommends:

- Independent analysis and modelling be undertaken to understand the impact of this recommendation on industry, particularly understanding those providers that would currently not meet the 10 per cent liquidity threshold.

- Consideration be given to an actuarial type approach when setting minimum liquidity thresholds, utilising a 'probability of sufficiency' to set ratio targets based on the provider's balances over time. This could be applied across the industry, negating the need for an even higher liquidity threshold for 'single site, single facility' operations as specified in recommendation B1.

- The adoption of a liquidity guidance approach and materials that describe the characteristics of 'sufficient liquidity', but that do not prescribe across the board, fixed liquidity thresholds for industry. That the definition of 'sufficient liquidity' is negotiated and agreed with industry.

Additionally, consideration needs to be able to be given to factors that may temporarily cause providers to breach liquidity thresholds for legitimate operating reasons (e.g. where a first round of RADs is used to pay down construction debt, or where expanding aged care services) without penalty or onerous reporting requirements.

Option B2: Phase in the liquidity threshold over a 5-10-year period. For example, require 5 per cent within five years, 7.5 per cent within 7.5 years and 10 per cent within 10 years.

Stated rationale: This recommendation seeks to mitigate the impacts of implementing a minimum liquidity threshold. The threshold requirement could be phased in over time

We reiterate our recommendation above - that independent analysis occur before consideration is given to introducing a fixed liquidity threshold. However, were one to be introduced, then ACSA recommends:

- That a staged introduction of a liquidity threshold occurs across a number of years, the timeframe to be developed in consultation with industry through the Department's Prudential Advisory Group.

Option B3: Define the form of liquidity as real liquid or accessible funds being a combination of unpledged/unencumbered cash in the bank, a bank facility (such as an overdraft or line of credit) or money that can otherwise be accessed immediately.

Stated rationale: This recommendation seeks to legislate a definition of liquidity assets. It is stated that the impact on 'most of the sector is likely to be minimal' (p27).

ACSA recommends:

- That the definition of what are and are not appropriate forms of liquid assets is determined in consultation with industry. This could be achieved through the Department's Prudential Advisory Group.

Issue: Introduce a capital adequacy requirement.
Options C1 and C2

Option C1: Introduce a capital adequacy metric, such as 20 per cent equity on the balance sheet.

Stated rationale: Under current legislation there is no requirement for providers to maintain a minimum level of capital adequacy. Requiring providers to maintain a minimum level of capital will further strengthen the financial viability of the residential aged care sector.

Capital adequacy is an important measure of a provider's financial health. However, the setting of a 'hard target' (i.e. percentage of equity) is a rigid approach to a diverse (size, business mix etc) industry, which may create unintended consequences.

A 20 per cent metric may be a significant requirement for some providers to achieve (for example, small, stand alone, CALD or special interest providers), with unintended consequences that impact on the way they operate, and which is disproportionate to the risk being managed.

Additionally, a fixed 20 per cent capital metric may impact on the operational activity of some providers having unintended consequences such as stalling much needed construction activities*[16] or curbing investment activity for some smaller providers (this is noted in the Paper, p27).

ACSA would be concerned if a fixed capital adequacy requirement were to impact on the historical use of lump sum payments to fund re/developments (i.e. if the capital adequacy requirement resulted in a greater proportion of accommodation payment monies being 'quarantined' for the purpose of achieving the fixed adequacy threshold).

ACSA recommends:

- Independent analysis and modelling be undertaken to understand the impact of this EY recommendation on industry, including the potential impact on development activities in the sector before any decision is made regarding introducing a fixed capital adequacy metric.

Option C2: Define the quality of capital to include tangible assets such as land and buildings; and intangible assets which are able to be valued and only in instance where the value is significantly discounted and can only account for a portion of the total value of capital adequacy.

Stated rationale: Currently, there are no rules outlining the quality and composition of a provider's balance sheet and no measures protecting against the risks of thin capitalisation.

The EY report raises the possibility of either excluding intangible assets altogether or alternatively including them but at significantly discounted rates.

ACSA recommends:

- Engagement with industry through the Department's Prudential Advisory Group to define 'quality of assets', including how the 'quality of assets' impact adequacy tests.

- Independent analysis and modelling be undertaken to understand the impact of changing how intangible assets are treated, including whether a transition period may be required for industry - noting the treatment of bed license values will need to be addressed.

Issue: Enhance disclosures to the Department.
Options D1, D2 and D3

Option D1: Amend section 9(1) of the Act to require notification 'as soon as it happens and in no event more than 14 days after it happens'.

[16] The Aged Care Financing Authority in their report *The Protection of Residential Aged Care Lump Sum Accommodation Payments*, indicate that lump sum accommodation payments have served as a form of interest free loans to providers that have financed approximately 50% of assets in the sector (p31). The report also notes that cash and liquid assets retained from lump sum payments also attracts interest which contributes to the cash flow available to cover debt repayments (p33).

Stated rationale: The EY report found that information required by the Department is often delayed, which reduces the ability to be more proactive in regulating provider compliance with prudential requirements.

ACSA recommends:

- That a move to adopting a 'continuous reporting' approach be considered.
- That the Department works with industry through its Prudential Advisory Group to define what type of events would require notification.

Option D2: Require the prior consent of the Department to be given to material changes in legal ownership or control of an approved provider.

Stated rationale: That there is a gap between what applicants must disclose to become an approved provider and what they are required to report under prudential requirements. It is noted that some provider changes, such as changes in ownership or control, may impact on provider suitability.

ACSA supports a reporting approach that provides transparency of ownership and control, or changes in same, to the Department.

ACSA recommends:

- Engagement with the Department's Prudential Advisory Group to determine:
    - What is meant by 'requiring consent for changes in legal ownership' and how this may impact on industry, taking into consideration unintended consequences;
    - What is meant by 'material changes'; and
    - Reporting timeframes required for notification of changes in ownership or control.

Option D3: Enhanced Disclosure Standard - Require approved providers to adopt an industry standard on disclosure such as APS330. Approved providers would be obliged to disclose the following to the Department:

1. Changes in corporate structure;
2. Significant related party transactions, which are required to be reported in the General Purpose Financial Report (GPFR);
3. Cashflow in accordance with the Accounting Standards to show the financial position of the approved provider (currently reported annually);
4. Compliance with the Liquidity Standard (including any period of non-compliance and how it was rectified); and
5. Compliance with the capital adequacy metric (including any period of non-compliance and how it was rectified).

Stated rationale: The EY report identified deficiencies in the Disclosure Standard which impact on the Department's ability to obtain information and to assess provider compliance with prudential requirements.

ACSA notes that apart from points 1 and 5 above, the other matters are reported to the Department through the current reporting formats.

ACSA recommends:

- That the Department works with industry through its Prudential Advisory Group to define which standard is to be adopted for disclosure reporting, including the reporting frequency.

Issue: Independent auditor.
Option E1

Option E1: Retain requirement for an independent auditor to sign off on the Annual Prudential Compliance Statement (APSC).

ACSA notes this proposal was adopted in 2017 and is therefore no longer a consideration.

Issue: Strengthen governance requirements.
Options F1 and G1

Option F1: Develop the Governance Standard - Introduce Part 1 Corporate Governance.

Stated rationale (F1 and G1): Currently the Governance Standard only stipulates that providers receiving RADs must document, implement and maintain a governance system, have an investment management strategy, and keep them both up to date. The Standard's current focus means the Department cannot be assured that a provider has adopted important aspects of contemporary governance and financial management practices.

Division 4 – Governance Standard 49 Requirement for governance system (Fees and Payments Principles 2014) already prescribes requirements for a prudential governance system.

There is a need for a strong governance framework. Industry already has available to it suitable frameworks.

ACSA recommends:

- The Department provides guidelines on what constitutes good governance in relation to prudential matters, including minimum inclusions for a governance framework, but allows approved providers to determine their own governance framework that best suits their business size and complexity.

Option G1: Incorporate a financial risk management standard into the Governance Standard.

Division 4 – Governance Standard 50 Requirement for investment management strategy (Fees and Payments Principles 2014), already prescribes requirements for a written investment management strategy.

There is a need for a strong financial management framework. Industry already has available to it suitable frameworks.

ACSA recommends:

- The Department provides guidelines on what constitutes sound financial management in relation to prudential matters but allows approved providers to determine their own financial framework that best suits their business size and complexity.

Issue: Enhance disclosures to the resident/family.
Option H1

Option H1: Require approved providers to disclose to recipients of care and their families how accommodation payment monies will be held, when they will be refunded and how recipients of care rank on a winding up of an approved provider.

Stated rationale: That Section 57 of the Disclosure Standard does not include an obligation for providers to disclose to recipients of care and their families how RADs will be used by the provider, when RADs will be refunded, or how residents will rank in the event of financial insolvency.

The EY report indicates that currently, under Section 57 of the Disclosure Standard (Fees and Payments Principles 2014), approved providers are under no obligation to disclose how accommodation payment monies will be held, when they will be refunded or how care recipients rank on a wind up of an approved provider. However:

- Under Sections 57 & 58 Disclosure to care recipients (Fees and Payments Principles 2014), there is already a range of information that must be provided to care recipients in relation to 'permitted uses', including relating to when the care recipient enters the service and separately when they request such information;

- Under Division 52N – Permitted uses (Aged Care Act 1997) there are guidelines as to the use of refundable accommodation monies; and

- Under Division 52P – refunds (Aged Care Act 1997), there are guidelines which prescribe the refunding of refundable deposit balances.

ACSA supports the current disclosure arrangements to residents and their families, as outlined in the bullet points above that relate to the use, protection and refunding of their accommodation payments.

We do not support the component that proposes to outline where they 'rank on winding up'. We believe this may simply add confusion and uncertainty for little gain - what is important is to communicate to residents and their families that their accommodation payment money is guaranteed by Government.

Issue: Limit or phase out discretionary trusts.
Options I1 and I2

Recommendation: Limit or phase out discretionary trusts.

Stated rationale: That the Department needs assurance that providers are financially viable, that they are adequately capitalised and hold sufficient liquid funds to repay RAD monies when due. It is believed that trust structures can be opaque in terms of what assets they hold, who the beneficiaries are, and for what purpose the funds are used.

In the EY report, two options are suggested to retain discretionary trusts:

1. Improve transparency of all trusts and transfers to/from them through additional reporting requirements; and

2. Restrict the level of transfers to all trusts (including discretionary) to mitigate the risk of separation of assets from liabilities.

ACSA notes it would be valuable for industry to understand what type and number of providers would be affected.

ACSA recommends:

- That the Department works with industry through its Prudential Advisory Group to determine the future treatment of trusts, including understanding the implications of changing arrangements related to the use of trusts, including unintended consequences such as unwanted taxation (if trusts were to be phased out).

- Improving transparency of all trusts and transfers to/from them through additional reporting requirements.

Issue: Compliance with new liquidity and capital adequacy requirements.
Option J1

Option J1: If the approved provider's capital or liquidity falls below the liquidity or capital adequacy thresholds, require the approved provider to make up the shortfall - such as by injecting additional capital or by entering into a subordinated loan with shareholders - and restrict the charging of new accommodation payments until the capital metric of liquidity threshold is achieved.

Stated rationale: That providers that do not meet the minimum level of liquidity will have 90 days to rectify their position or be required to make up the shortfall.

The recommendation to restrict the charging of accommodation payments is akin to a sanction-type outcome. This is likely to be counter-productive for approved providers that are attempting to return to compliance and cause additional financial stress by limiting their ability to fund their service. The provider may then need to seek out other forms of debt.

As stated earlier, there may be legitimate operating reasons for providers periodically failing to meet the thresholds and the most likely outcome of withholding new accommodation payments is to delay the return to meeting the liquidity or capital requirements.

ACSA recommends:

- That any requirement to make up shortfalls in liquidity or capital (such as by injecting capital) where thresholds are not met should account for the nature and business mix of the approved provider (small, stand alone, RRR, CALD or special needs group service etc) when considering how long they are given to return to compliance; and

- That any provision to restrict the charging of new accommodation payments should be limited to those approved providers where it can be clearly demonstrated there is wilful disregard to compliance requirements in liquidity and/or capital.

Issue: Assessment of financial viability.
Options AA1, AA2 and AA3

Option AA1: Assessment of financial viability. Create legislative authority to support the assessment of the financial viability of approved providers by:

- Allowing independent reviews by the Commonwealth of a provider's current financial information (audited and unaudited);
- Allowing the Department to require the provision of current financial information where there are concerns of approved provider financial viability - when warranted; and
- Allow the Department to require the provision of relevant supporting information, including current financial reports for the approved provider and/or related entities, where there are concerns relating to an approved provider's financial viability, prudential compliance or permitted use.

Stated rationale: Prudential requirements are predominantly concerned with the provider's ability to repay RADs. It is stated that the Department's authority to undertake action in instances where there are concerns about a provider's ability are limited. This proposal is said to address that gap.

ACSA agrees with this recommendation, including the requirement to report to the Department within a set timeframe (continuous reporting approach).

Option AA2: Require approved providers to inform the Secretary (under S9(1) of the Act) of concerns relating to financial viability.

Stated rationale: The Department's intent with these additional recommendations is said to allow for independent review by the Commonwealth of an approved provider's financial situation where there are warranted concerns in this regard, and additionally that approved providers be required to inform the Commonwealth of concerns regarding their financial situation.

ACSA supports this recommendation. Reporting requirements should not be onerous for approved providers and the onus should be on providers to report to the Department within a set timeframe (continuous reporting approach) as and when they have concerns about their financial viability, and only in relation to predetermined criteria - such as not meeting liquidity requirements or having trouble meeting the legislated timeframe to refund accommodation payment monies.

Option AA3: Support the migration of all providers to Tier 1 financial reporting.

Stated rationale: Currently only listed providers are required to report to Tier 1 standards. Tier 2 reporting applies to not for profit private sector entities. We understand this recommendation is designed to address the Reduced Disclosure Requirements (RDR) of Tier 2 reporting, with a view to the Commonwealth having a clearer view of approved provider financial positions.

Tier 2 reporting comprises the recognition, measurement and presentation requirements of Tier 1 reporting, but with reduced disclosures corresponding to those requirements[17]. Currently, all not for profit private entities have the choice of reporting at Tier 1 or Tier 2 level.

ACSA's understanding is that there are reduced disclosure requirements at Tier 2 level that relate to matters that are likely to be of interest to the Department in the prudential space, including in relation to operating segments, joint arrangements, disclosure of interest in other entities and related party disclosures.

The Paper discusses concerns relating to where a provider chooses to report at Tier2, the RDRs can mean there is a lack of transparency in some areas that impact on aged care providers. The example given is a lack of transparency related to transfer of assets to 'related parties', and this lack of visibility 'increasing the risks' to the Scheme. The risk is said to be an increased risk to all providers of the Scheme's levy being triggered[18].

ACSA does not support all approved providers being required to report at Tier 1, as this would be a regulatory burden carried by all providers, including those with non-complex organisational structures (i.e. those that do not use discretionary trusts or have related party transactions etc).

ACSA proposes an alternate approach, that is:

- Approved providers be required to report at the reporting level (Tier 1* or Tier 2) that is commensurate with their level of organisational complexity and that provides full transparency and visibility across areas that are of interest to the Department's understanding of the use and security of accommodation payment monies.

  **There could be a process whereby approved providers seek exemption to Tier 1 reporting, for instance those providers that do not have related party transactions.*

If the Department determines that all approved providers are to report at Tier 1 then the sector should be given sufficient time to adjust to any change in reporting requirements, with consideration given to transition processes to assist those providers that will require support.

[17] Managing Prudential Risk in Residential Aged Care Discussion Paper, Australian Government Department of Health, 2019, p40

[18] Managing Prudential Risk in Residential Aged Care Discussion Paper, Australian Government Department of Health, 2019, p41