APPENDIX 1 - LASA analysis of the review of aged care legislation which provides for the regulation and protection of Refundable Accommodation Payments in Residential Aged Care

Proposal	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
A. Introduce transparent reporting on Approved Provider corporate structures and inter-party transactions	**A1.** Require Approved Providers to report their corporate structures including identity of ultimate shareholders and any significant changes to their ownership	High	This is going to be problematic from the point of view of many private providers. A compromise position maybe to disclose ultimate ownership. Corporate structure may be able to be limited to the type of entity (company, trust, partnership etc). Even in the not-for-profit (NFP) space there can be some complexities in relation to Property Trusts in some of the faith based institutions. Changes to ownership might be covered anyway in cases where the purchaser has to gain accreditation.
	A2. Allow Approved Providers to report on a single entity or consolidated group basis	High	From a prudential point of view this might be counter-productive to collecting good data about the financial position of the consolidated entity. The consolidated basis provides the best information as a single entity may rely on support from the overall group.
	A3. Where an Approved Provider or Approved Provider group wishes to transfer assets outside the group: ▸ The loan to value ratio of the asset to the liabilities should not exceed 80% of the value of the underlying asset ▸ The use must be secured by appropriate security, such as a mortgage (ranking below bank secured debt)	High	This should be tested against the caveats a banker would apply for reasonableness.

	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
B. Redefine the Liquidity Standard	**B1.** Set a liquidity threshold as a defined percentage of Accommodation Payment money held by the Approved Provider Group, such as the higher of 10%, where an Approved Provider is a single site, single facility operation with a smaller Accommodation Payment pool and low resident turnover, a higher threshold	High	This could be an issue from time to time in the business cycle of an approved provider. It may curb investment by smaller operators and in regional and remote areas, particularly regional and remote areas where the first round of RADs may be used to pay off construction debt. This may be more a matter of providing guidance on liquidity rather than setting firm thresholds. If anything along these lines was introduced, there would need to be a phase in period and caveats to manage the burden on operations.
	B2. Phase in the threshold over a 5-10 year period. For example, require 5% within 5 years; 7.5% within 7.5 years and 10% within 10 years	Extreme	This will absolutely be necessary. There may need to be some compromise on the phase in ratios – the Government needs some data in relation to how many providers are in each bracket now and what they will need to do to move to the required thresholds. This could affect the listed entities as their cash to bond ratios are very low.

Ernst and Young (EY) Recommendation	EY Priority	LASA observations
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	Extreme	• A Member says: "*We need to be careful how we define liquidity. Our liquidity always includes "undrawn bank funding" i.e. the component of our bank overdraft and/or line of credit not drawn down that could be used for refunding Bonds or RADs as required"*. Noting the above comment, a change along these lines may be workable as it is the way that most funds would be held now. But the unencumbered cash cold be an issue as most security arrangements with banks etc. have security over all the assets of an entity.

	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
C. Introduce Capital adequacy requirement	**C1.** Introduce a capital adequacy metric, such as, 20% equity on the balance sheet[1]	High	From a for-profit point of view this will be the ratio of share capital or owners' equity as a proportion of the defined assets of the company. For NFPs this will be the members' funds as a proportion of the defined assets. From a NFP point of view the only way to inject capital to increase the ratio will be to increase retained earnings. From a FP point of view there will be some issues around the organisational/group structures. Reference to APS 110 which is APRAs prudential standard on Capital Adequacy is relevant. If a capital adequacy measure is introduced, given some of the bank covenants in play, construction will stall and places will not be built. This may be overkill if there is also more clarity and a minimum standard for liquidity.

[1] This is equivalent to what is required by financiers when lending against real property. Where a borrower is more highly geared, a financier will require them to take out insurance to secure the balance of the value of the property.

	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
	C2. Define quality of capital to include tangible assets such as land and buildings; and intangible assets which are able to be valued, such as, bed licences	High	This makes sense should the capital adequacy ratio be adopted. • A Member says: *"We need to be careful about including intangible assets such as bed licenses particularly with the looming deregulation and in light of the fairly recent issues with intangible asset "valuations" highlighted by the ABC Childcare case".* • Note the Department of Health said (Prudential Advisory Group papers, Nov 2017): "Implement, but only allow certain intangible assets to be included at a discounted rate". This appears somewhat consistent with the above comment.
D. Improve the Disclosure Standard to provide better transparency of Approved Providers' businesses and how they are using Accommodation Payments	**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*"	High	Currently it is a 28-day notification period of "a change of circumstances that materially affects the approved provider's suitability to be a provider of aged care". This introducing a continuous disclosure and there will need to be some clarity about what type of events will require a notification. Currently these are defined under S8.3 which is very broad and somewhat subjective.

Ernst and Young (EY) Recommendation	EY Priority	LASA observations
D2. Require the prior consent of the Department to be given to material changes in the legal ownership or control of an Approved Provider	High	This would be required as it stands as part of the approval of key personnel – but again there will need to be clarity on “material changes”. For example, boards of NFPs and CEOs as well as for-profits change and evolve on a regular basis – getting prior consent for these changes is not practical. If it means the on the sale or transfer of an approved provider entity, then that may be tenable – similar to ACCC rules – but there will need to be minimum approval times in any regulation.
D3. Require Approved Providers to adopt an industry standard such as APS330 or Direct2APRA (D2A) reporting. Approved Providers would be obligated to disclose the following to the Department: ▸ changes in corporate structure ▸ significant related party transactions, which are required to be reported in the GPFR ▸ cash flow in accordance with the Accounting Standards to show the financial position of the Approved Provider ▸ compliance with the liquidity standard (including any period of non-compliance and how it was rectified) ▸ compliance with the capital adequacy metric (including any period of non-compliance and how it was rectified)	High	With the exception of the first and last dot points, the other matters currently have to be reported to the department via GPFR, ACFR or APCS. Adoption of APS330 would require capital adequacy ratios and possibly minimum liquidity amounts quarterly. This would not be necessary if a capital adequacy ratio is adopted – a preferred option. All other information is currently disclosed.

	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
E. Retain requirement for an Independent Auditor to sign-off the APCS	**E1.** Reinstate / Do not remove the requirement for an independent auditor to sign-off the APCS	High	This is likely to be reasonable.
F. Enhance Governance Standard – Introduce: Part 1 Corporate Governance	**F1.** Develop the Governance Standard to adopt generally accepted corporate governance principles (such as those adopted by ASIC, APRA, ASX and the ACNC). This includes (leveraging ASX corporate governance principles 3rd ed.): ▸ lay foundations for the management and oversight of the organisation ▸ to act ethically and responsibility ▸ safe guard reporting ▸ prepare a code of conduct for “key personnel” to improve industry practices to operate in accordance with recipients of care’s best interests Impose an obligation for Approved Providers to produce a corporate governance statement which describes the extent to which they have complied with the code of practice and principles	Moderate	This might be reasonable on some level, but given the wide variety of corporate structures involved in the sector, this could be difficult to enforce or there may be issues with clarity. The ACNC framework is very broad and does cater for a variety of structures and may be the best guide for a framework. A code of conduct, etc could be incorporated into a governance standard. Funding could be provided by the Government to Peaks to develop appropriate templates for the sector to adopt.

	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
G. Enhance Governance Standard – Part 2: Introduce a Financial Risk Management Framework	**G1.** Incorporate a financial risk management standard into the Governance Standard.	Moderate	This is a reasonable suggestion.

	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
H. Enhance the disclosure to recipients of care and their families on how Accommodation Payment funds will be treated, including for the Permitted Uses and on a winding-up of an Approved Provider	**H1.** Require Approved Providers to disclose to recipients of care and their families how Accommodation Payment money will be held, when it will be refunded and how recipients of care rank on a winding up of an Approved Provider	Moderate	S 15d of Fees and Payment Principles 2014 Number 2 would cover this as far as refunding arrangements. Ranking upon winding up is problematic as families would rank as unsecured creditors. This could just be confusing for people and the main thing they need to know is that the Bonds are guaranteed by the Government. How the money would be held is also problematic as this can change on a daily basis and is counter-intuitive to the permitted use rules and how accommodation funds can be used. This implies that all deposits are 'held' in some liquid form which is not the case. This could be modified to disclose in what form minimum liquidity amount is held.

	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
I. Limit or phase out discretionary trusts	**I1.** Allow no new discretionary trusts in Approved Provider group structures	High	**LASA opposes this proposal – we question whether there is any real evidence of actual problems regarding discretionary trusts, noting the low rate of call on the guarantee scheme.** This will affect private providers and may have tax implications for them and hence, for the viability of residential aged care operations. • A Member says: *"Operators will have to sell their businesses to themselves or others to get out of the trust arrangements. If he sold there would be transaction costs and taxes of the order of $20m. Trusts are a preferred vehicle in small business to protect assets and allow flexibility to distribute income. The 'no new trusts' provision may reduce new entrants to the industry".*

	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
	I2. Phase out discretionary trust structures in a 5-10 year period	Extreme	LASA opposes this as per above.
J. Where Approved Providers do not comply with the Liquidity and Capital Adequacy requirements either: ▸ ***Restrict their ability to charge new Accommodation Payments; or*** ▸ ***Require them to provide additional security in place until they comply with those thresholds.***	**J1.** If the Approved Provider capital 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[2] ▸ restrict the charging of new Accommodation Payments until the capital metric is achieved. This may also require an amendment to the Sanctions Principles accordingly	High	The proposed approach would not be feasible for NFPs. Sanctions of any type should be a last resort rather than a first response.
K. Compliance education and training	**K1.** The Department create a communication and engagement strategy for engaging with Approved Providers and other stakeholders in the Aged Care industry	Extreme	Agreed Part of that engagement should include funding for education of key personnel including boards, setting up guidelines and templates to assist providers to understand the prudential regulations and any new risk management framework

[2] There is a limit to how much equity can be injected via subordinated debt under tax legislation.

	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
L. Overarching systematic risk management framework	**L1.** To support the revised Prudential Standards, the Department will need to recalibrate its current risk assessment methodology and model to reflect the new compliance requirements. We recommend that the Department adopt a probability and impact rating system (PAIRS) - type model adopting a qualitative and quantitative assessment criteria of Approved Providers. The revised model will reflect the criteria in the Prudential Standards should be risk-based and commensurate with the size and sophistication of the Approved Provider. The framework should focus towards higher risk entities. Considerations of what the model would include are: ▸ Risk management ▸ Financial management metric ▸ Capital management (as redefined in the Prudential Standards) ▸ Liquidity management (as redefined in the Prudential Standards) ▸ Management and corporate governance practices (as redefined in the Prudential Standards)		Agreed
	L2. Introduce an internal risk management strategy document for the Department to assess the inherent risks of Approved Providers' non-compliance which may mean that an Approved Provider is not financially viable or that the Scheme is called on		Agreed
	L3. Introduction of measures to assess threshold requirements		Agreed
	L4. Consideration to be given to determine appropriate segmentation and classification of Approved Providers		Agreed
M.	**M1.** Assess demands and develop target operating model to support the new regulatory framework *To be considered in conjunction with the Stewart Brown review*		Agreed

	Ernst and Young (EY) Recommendation	EY Priority	LASA observations
N.	**N1.** Collect *data* and enhance the analytics capability within PRS to assess and understand risk profile of Approved Providers in light of the revised the Prudential Standards *To be considered in conjunction with the Stewart Brown review*		Agreed
	N2. Enhance number of resources and the use of more sophisticated tools in the PRCS to conduct compliance activities *To be considered in conjunction with the Stewart Brown review*		Agreed
O.	**O1**. Consider developing and socialising a holistic end-to-end business process across the Department, including (i) identifying who is collecting or accessing prudential data about Approved Providers and for what purpose and (ii) escalation pathways. This should ideally be done in collaboration with other teams in the Department that are involved in the compliance pathways To be considered in conjunction with the Stewart Brown review		Agreed