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**3 September 2020**

Louise Amundsen / Rodger Prince  
Co-Solicitors Assisting in the Royal Commission  
Royal Commission into Aged Care Quality and Safety  
Level 5, 101 Pirie Street  
Adelaide SA 5000

Dear Ms Amundsen and Mr Prince

**Department of Health comments on background materials / expert reports commissioned by the Royal Commission in relation to the funding, financing and prudential regulation hearing**

1 We refer to:

- (a) the letter from the Royal Commission dated 18 August 2020, in which the Royal Commission sought the Commonwealth's views regarding the analysis and conclusions contained in the following documents prepared by the Royal Commission for the purpose of the funding, financing and prudential regulation hearing (the **FFP Hearing**) (which are referred to as 'the **Background Materials**':
  - (i) A paper titled 'Expenditure Constraints and Major Budget Measures'; and
  - (ii) A spreadsheet titled 'Aged Care Expenditure'; and
- (b) the following eight research reports commissioned by the Royal Commission in preparation for the FFP Hearing (referred to as 'the **Expert Reports**':
  - (i) *'The profitability of aged care'* by Frontier Economics;
  - (ii) *'The report on the profitability and viability of the Australian aged care industry'* by BDO;
  - (iii) *'Technical mapping between ACFI and AN-ACC'* by the University of Wollongong;
  - (iv) *'Financial analysis relating to aged care providers for assessment of prudential risk'* by BDO;
  - (v) *'Aged care reform: projecting future impacts'* by Deloitte Access Economics (the **Deloitte Report**);
  - (vi) *'The cost of residential aged care'* by the University of Queensland;
  - (vii) *'Price regulation approaches for aged care'* by Flavio Menezes; and



(viii) 'Required return for aged care service providers' by Frontier Economics.

- 2 The Department of Health (**Department**) is grateful to the Royal Commission for the opportunity to consider and provide comments on the Documents and the Reports.
- 3 This letter provides:
  - (a) the Department's comments on the analysis and conclusions contained in the Background Materials;
  - (b) the Department's high-level comments on the Expert Reports generally; and
  - (c) the Department's more detailed comments on the Deloitte Report.

### The Background Materials

- 4 The Department notes that it has previously addressed issues raised in the Background Materials in its response to Notice to Produce Documents and Give Information or a Statement in Writing number NTG-0755 dated 10 July 2020 (**Response**).<sup>1</sup>
- 5 The Department agrees in principle with the following conclusions in the Background Materials:
  - (a) Funding for aged care is an important lever in improving quality outcomes but other changes, including addressing the role of providers in lifting quality standards, are important to improving quality.
  - (b) The Aged Care Funding Instrument (**ACFI**) is no longer an appropriate mechanism for determining the funding that providers need to meet the care of individual residents and the Australian National Aged Care Classification (**AN-ACC**) provides solutions to the concerns identified with the ACFI.
  - (c) Wage Cost Index 9 is not an appropriate indexation and, as noted in the Response, would change under the AN-ACC.
- 6 The Department makes the following additional comments in relation to the Background Materials:
  - (a) Various selected comparison points (e.g. growth pre and post-1984) would reflect very different results if altered. For example, significant growth was seen post-2008.
  - (b) The use of ACFI as an indicator of frailty needs to be treated with caution as it does not directly measure frailty but in part reflects growth in provider claiming behaviour and changes in claiming patterns.
  - (c) While the Department is presently of the view that there are no major spends missing from the Background Material, significant upwards Estimates Variations which reflected increases to budgeted expenditure may not be contemplated. For example, in relation to page 13 of the Expenditure Constraints and Major Budget Measures paper (under the sections headed '2015-16 MYEFO – revision to ACFI' and '2016-17 Budget – further revision to ACFI'), the Department notes:

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<sup>1</sup> CTH.1000.0004.9191.



- (i) these items note the measures taken to reduce the rate of growth in ACFI claiming but do not mention or put this in the context that Government actually increased its estimates of spending to reflect higher growth rates at the same time. The net effect was that the projected growth rate in funding was reduced, not that funding went backwards as could be implied.
  - (ii) the ACFI 2015-16 and 2016-17 changes show a \$1.7 billion saving but have not recorded the upwards Estimates Variation of \$3.8 billion made at the time, which shows an overall spending increase compared to estimates. The net effect was that Government increased its estimated expenditure on residential care, but the measures reduced the estimated rate of growth, still leaving a net increase in overall funding estimates.
- 7 The Department has indicated that, if it would be of assistance to the Royal Commission, it would be willing for its internal modellers and technical experts to participate in a meeting with the authors of the Background Materials to discuss and explore some of the technical aspects of the modelling, including potential concerns with the assumptions and methodology that has been adopted. For example, the Department has concerns with:
- (a) the method used to calculate real expenditure (as it appears to be based not on a price deflator but simply nominal GDP amounts which increase over time to both price and volume);
  - (b) using a geometric average for GDP comparisons;
  - (c) the use of 80 plus population growth to project residential care demand (as that assumption would create places significantly in excess of demand reflected in current residential care occupancy); and
  - (d) apparent lack of allowance for impact of increased life expectancy, productivity improvements or greater shift to higher level home care packages.

All these factors would affect the assumptions and findings in the Background Materials, in some cases potentially significantly. The intent is for that meeting to serve as a forum in which the technical experts can explore and discuss the Background Materials, rather than trying to reduce observations (on very technical matters) to writing.

### The Expert Reports

- 8 The Department notes, as stated in the Expert Reports, that there are limitations of the research and assumptions which form the basis of observations and findings in the Expert Reports. While the Department understands that in considering the Expert Reports the Royal Commission will give due regard to these limitations and assumptions, it is the Department's opinion that the justification for these assumptions and the source data relied on, is not always clear. As a result, and without further information, the Department cannot at this stage confirm whether it agrees or disagrees with the balance of the observations and findings contained in the Expert Reports.
- 9 The Department has also not yet had the benefit of hearing and considering the evidence that will be tendered and explored during the FFP Hearing, which may impact on the conclusions in the Expert Reports, and the position the Department ultimately takes in respect of the Expert Reports.





## The Deloitte Report

### *Categorisation of the funding impact of potential policy reforms*

- 10 As stated above, it is difficult to comment on the conclusions drawn in the Deloitte Report due to the lack of explanation about the underlying assumptions and methodology used to estimate costs of future policy reform. In particular, the range of potential policy reforms listed on pages 23 to 25 of the Deloitte Report, have been considered in the researchers' modelling and categorised as having a high, medium or low funding impact. However, the basis on which the funding impact of specific policy reforms have been categorised and the definition of 'low', 'medium' and 'high' is unclear.
- 11 It is the Department's opinion that the funding impacts of the policy reforms contemplated, require further examination. For example, the Deloitte Report has categorised the funding impact from uncapping supply in home care and extending home care packages as 'medium' and 'low' respectively. Without more information about the basis for this categorisation, the Deloitte Report may be understating the funding impact of these policy reforms.

### *Substitutability of residential and home-based care*

- 12 The Department suggests that further consideration is needed regarding:
- (a) the extent to which residential aged care is substitutable with home-based care, as contemplated in the Deloitte Report; and
  - (b) whether a shift to home-based care for all older Australians based on individual choice would be less expensive, particularly for those with complex care needs.

### *Impact of COVID-19*

- 13 The Deloitte Report acknowledges that it has not attempted to incorporate or account for policy changes that have or may come about as a result of the COVID-19 pandemic. Given the significant impact of COVID-19 on both the aged care sector and the broader Australian economy, further consideration may be needed regarding how ongoing COVID-19 pressures may affect the assumptions and funding impacts of suggested policy reforms. The Department notes in particular, that the future projections contained in the Deloitte Report are likely to be significantly affected by the COVID-19 pandemic.
- 14 Finally, the Department notes that it has previously made submissions relevant to a number of the issues and potential reforms discussed in the Deloitte Report, including on:
- (a) funding models;<sup>2</sup>
  - (b) interfaces with health services;<sup>3</sup> and
  - (c) workforce issues.<sup>4</sup>

<sup>2</sup> Submissions by the Commonwealth in response to Counsel Assisting's Submissions on Adelaide 4, dated 22 April 2020.

<sup>3</sup> Submissions by the Commonwealth in response to Counsel Assisting's Submissions on the Canberra hearing, dated 7 February 2020.

<sup>4</sup> Submissions by the Commonwealth in response to Counsel Assisting's Submissions on Adelaide 3, dated 13 March 2020.



The Department suggests that further consideration of these submissions could provide additional context to the findings and observations contained in the Deloitte Report.

- 15 Please contact us if you have any questions or if we can otherwise be of assistance to the Royal Commission at this time.

Yours faithfully  
**Gilbert + Tobin**

A handwritten signature in blue ink, appearing to read 'Andrew Floro'.

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