Royal Commission into Aged Care Quality and Safety

REVISED FUNDING, FINANCING AND PRUDENTIAL REGULATION HEARING PROPOSITIONS – 13 SEPTEMBER 2020

This hearing will inquire into the financing and sustainability of future improvements to the aged care system, the appropriate funding model or models to support the delivery of aged care services, and the prudential regulation of aged care providers.

The hearing will also inquire into:

- whether there is a need to establish a specific financing mechanism to support government (and private) contributions to the aged care system, and if so, how this could be achieved
- whether sustainable high quality care is best secured by funding from consolidated revenue or such other models as social insurance as adapted in other jurisdictions
- whether and how individuals should contribute to the cost of receiving aged care services, including whether distinctions should be drawn between the contributions made for different kinds of aged care services (for example, domestic assistance, personal and clinical care, ordinary living expenses, and accommodation)
- whether the current system for determining the amounts of government subsidies paid to aged care providers is suitable for its purpose
- whether the funding available to providers under the current aged care system is sufficient to support the provision of high quality aged care
- whether, how, and by whom should the price of government subsidies and private fees for aged care services be determined, including in markets where there is not effective competition between providers
- whether the prudential regulation regime that applies to aged care providers is adequate to ensure the sustainability and stability of the aged care system, and if not, what changes if any should be made to improve the prudential regulation of aged care services.

The Royal Commission's terms of reference require the Royal Commissioners to inquire into:[1]

> d. what the Australian Government, aged care industry, Australian families and the wider community can do to strengthen the system of aged care services to ensure that the services provided are of high quality and safe;
>
> …
>
> f. how best to deliver aged care services in a sustainable way, including through innovative models of care, increased use of technology, and investment in the aged care workforce and capital infrastructure;

This document sets out a series of propositions and supporting context relating to the topics of funding, co-contributions and means testing, as well as prudential regulation. The propositions have been developed by Counsel Assisting and staff of the Office of the Royal Commission to test at the Funding, Financing and Prudential Regulation Hearing. The propositions do not necessarily reflect the views of the Royal Commissioners.

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[1] Royal Commission into Aged Care Quality and Safety, Letters Patent 6 December 2018 (d) and (f), https://agedcare.royalcommission.gov.au/publications/letters-patent-6-december-2018.

This hearing will not test specific propositions relating to future financing of the aged care system. Rather, it will build on *Consultation Paper 2 – Financing Aged Care* to examine central questions around whether there is a need to establish a specific financing mechanism to support government (and private) contributions to the aged care system, and if so, how this could be achieved; and whether sustainable high quality care is best secured by funding from consolidated revenue or such other models as social insurance as adapted in other jurisdictions.[2]

This hearing will also not test specific propositions on the topic of capital financing of residential aged care. Views on this topic will be sought through a separate process.

Funding, co-contribution and means testing propositions

The general guiding principles used in developing the funding, co-contribution and means testing propositions set out below are: simplicity; efficiency; effectiveness; accountability and transparency; equity; consistency; and adequacy, as well as sound economic theory and practice. The intention behind the propositions, together with related proposals for reform of program arrangements, is that:

- Each person in need of aged care will receive a timely assessment of their needs, and be supported to obtain and participate in the assessment.
- Each person who is assessed as needing support and care will receive a timely assignment of the right to funding that meets the costs of those needs.
- The levels of funding made available to providers must be sufficient to meet the actual costs of providing high quality support and care. Prices for aged care services should be determined independently of government and based on a robust understanding of the costs associated with care. In order to ensure that the funding continues to meet the actual costs into the future, there should also be regular re-calibration of the prices paid for care, based on a review of recent care costs, again conducted independently of government.
- In addition to direct care costs, providers will be funded for the indirect costs of providing high quality aged care.
- Each provider will be accountable to the system manager for their expenditure of funding through an acquittal process that includes regular reporting of payroll information. This should ensure that funding provided for the purpose of support and care is spent on the required support and care.
- Care will, in general, be delivered or otherwise co-ordinated by a particular approved provider, who will receive the funding in return for those services. Where there is no coordinating provider, feedback loops will be established to ensure that any changes in care needs are appropriately identified, assessed and funded.
- Providers will be incentivised to excel in the provision of high quality care and to invest in enablement, innovate, and to achieve efficiencies and productivity improvements over the long term. The ability of providers to achieve a profit margin from the public funding and private contributions they receive will depend on this. To the extent that providers achieve this, this will tend to put downward pressure on future funding through the independent cost review and price-setting process.
- People living in residential aged care should pay for their accommodation and daily living costs. These arrangements should be subject to a safety net that is consistent with the design of the general social welfare system, as well as possible regulatory controls, from price controls to transparency in the prices charged. This is justified because people in residential aged care have limited or no choice about paying the charges imposed by their provider, and

[2] Consultation Paper 2 – Financing aged care is available online at: https://agedcare.royalcommission.gov.au/sites/default/files/2020-06/consultation_paper_2_-_financing_aged_care_0.pdf.

the services they represent are stapled (supplied in combination with) public funded aged care for which those people have an age-related need.

Management of aged care funding and pricing

Proposition FF 1: Aged care pricing authority

The Australian Government should establish and appropriately resource an independent Aged Care Pricing Authority to ensure that prices for aged care services are determined independently on the basis of benchmarking and cost data, and set at a level intended to meet the cost of delivering those services, less any co-contributions.

In submissions on future aged care program redesign Senior Counsel Assisting proposed that funding should be set by an independent authority on the basis of standardised costs ascertained on regular intervals.[3]

The Australian Government should establish an independent statutory authority responsible for managing aged care funding arrangements and aged care pricing (the Aged Care Pricing Authority). The functions of the Aged Care Pricing Authority should include:

a. Providing advice to the system manager on funding arrangements for aged care services.
b. Developing, designing and maintaining funding models for aged care services, including funding classification and case mix schemes, as well as any associated data standards to support their implementation and operation.
c. On an annual basis, determining and publishing a schedule of benchmarked prices (determined by reference to cost data) that the Australian Government will pay for high quality aged care services, including in regional, rural and remote areas, and for Aboriginal and Torres Strait Islander aged care services. These prices should account for variations in the cost of delivering services in different contexts, and for any co-contributions.
d. Undertaking (or commissioning) regular costing studies and collecting data on the cost of delivering high quality aged care to inform updates to aged care funding arrangements and annual price determinations.

The funding, co-contribution and means testing propositions set out below should be read in conjunction with this proposition.

Proposition FF 2: Funding for indirect costs

The Aged Care Pricing Authority should ensure that prices are set at a level that enables providers to meet both the direct and indirect costs associated with delivering high quality aged care services.

The direct input costs associated with the delivery of high quality aged care services include things such as the costs of adequate numbers of well-qualified, trained and supervised staff, and the costs of care co-ordination. A range of indirect costs must also be met in providing high quality care. These include things such as administration, corporate overheads, ongoing training and education, and regulatory compliance. The Royal Commissioners are also likely to make recommendations to improve management and governance, workplace safety, and support the transition to a new aged care system. Prices need to be set so that providers can meet the full range of these direct and indirect costs.

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[3] Counsel Assisting the Royal Commission, *Submissions on future aged care program redesign,* 4 March 2020, RCD.012.0062.0001 at 0003, available online https://agedcare.royalcommission.gov.au/sites/default/files/2020-06/submissions-by-counsel-assisting-4-march-2020.pdf.

Providers should be required to acquit these amounts in accordance with Proposition FF 12: Payment in arrears and acquittal.

Proposition FF 3: Economic regulation of the aged care sector

The Aged Care Pricing Authority should be responsible for determining what, if any, regulation is applied to private prices for aged care services.

Prices should only be deregulated where the market for aged care services is workably competitive based on defined objective measures of market depth. Any regulation of prices that providers can charge to people receiving aged care for ordinary costs of living, rent, and additional services should be a function of the Aged Care Pricing Authority.

Proposition FF 4: Funding arrangements in 'thin markets'

The Australian Government should utilise funding mechanisms to encourage the entry of providers in places where there is not a workably competitive market and to help ensure access to aged care services.

A system manager should be responsible for determining where there are insufficient services to meet need, despite prices reflecting actual costs, in accordance with defined objective measures of market depth.

In those circumstances, the following interventions could be deployed:

a. The Aged Care Pricing Authority may make a determination that enables any provider operating within a 'thin market' to be paid a loading in order to attract additional providers.
b. In the event the approach outlined in (a) is unsuccessful, the system manager may commission one or more preferred providers, or providers of last resort, with coverage obligations in the area. Commissioned providers could be funded through a combination of block and activity-based funding, sufficient for the delivery of required services for that 'thin market'.

Funding models to be adopted for aged care services

Proposition FF 5: Aged care services to be funded through a combination of block and activity based funding

A combination of block funding to meet fixed costs and activity based funding to meet variable costs should be used to fund aged care services where:

a. necessary to ensure that there will be an adequate supply of services in all areas, or

b. services required are high-volume, relatively uniform and there is little need to differentiate the services provided to meet people's needs.

This funding model could be applied to services such as social supports, assistive technology and home modifications, and respite care. The model would be similar to the current funding model for the Commonwealth Home Support Programme.

The provision of block funding for fixed costs is intended to ensure access to aged care services when and where required. By providing guaranteed funding for fixed costs, older people can be more confident in the availability of services because it offers providers security and flexibility. Procurement processes associated with this type of funding model would need to ensure appropriate area coverage obligations within defined geographical areas, including a requirement that providers service the entire area.

At the same time, the use of activity based funding for variable costs enables service delivery to ramp up or down in response to demand. It will also help to ensure that the funding model contains appropriate accountability mechanisms and incentives for providers.

Proposition FF 6: Aged care services to be funded through individualised bundles

Individualised bundles of funding should be used to fund aged care services where:

a. there are more predictable and ongoing service needs and demands, such as nursing and personal care

b. there is a workably competitive market supplying those services and people can elect to receive services from one or more providers for their assessed needs

c. it may be difficult to classify people into groups that have similar characteristics and similar costs associated with providing aged care services.

Under an individualised approach to funding, people would receive an entitlement to support and care based on their assessed need across a range of domains. This funding model could be applied to care at home, including some of the services currently delivered through the current Home Care Packages Program.

In general, individualised funding allows for greater choice and control for people receiving care. People can make choices about different services they receive, when they receive them, and the providers that deliver them. However, these funding models rely on workably competitive markets because they involve a personalised budget which the person can use to access the services they need. Consequently, an individualised funding approach is likely to be appropriate to support the delivery of aged care services that are more predictable and ongoing, in contrast to the more intermittent services discussed above.

Individualised funding models that involve personalised bundles of services are well suited to aged care services that will need to account for the differing needs of different recipients. An example of this might be the provision of nursing and personal care services, where variations in factors such as mobility and cognition will affect the nature and level of support required. Similarly, the costs involved with providing aged care services may vary significantly based on the setting the service is provided in. For example, the costs of providing aged care services in the home may vary due to differences in the nature of peoples' homes due to factors such as size, layout, or the presence or absence of an informal carer.

In addition, individualised funding is likely to be appropriate in circumstances where, due to the nature of the service being provided, or the location it is being provided in, it may be difficult to meaningfully classify recipients into groups and for those groups to have similar costs. This is a requirement of casemix adjusted activity based funding models (discussed below).

Proposition FF 7: Aged care services to be funded through casemix adjusted activity based funding arrangements

Casemix adjusted activity based funding arrangements should be used to fund aged care services where:

a. a single provider will be responsible for delivering services to the person, and

b. people can be classified into groups that have similar characteristics and similar costs associated with providing aged care services.

Casemix adjusted activity based funding arrangements have been increasingly used in Australian public hospitals since the 1980s[4], and could be applied to care at a residential aged care home.

Casemix adjusted activity based funding models are appropriate where a single provider will be responsible for providing or coordinating all aged care services. Under these circumstances, consumer choice is limited to a selecting a single provider, as there is no scope for funding to be split between providers for different aged care services. Casemix adjusted activity based funding is also likely to be appropriate in circumstances where people can be classified into groups based on similar characteristics, and where the costs of providing services to each group is similar. This allows the level of funding provided to reflect differences in the complexity, level of need, and funding required to different groups receiving similar types of services.

The 2019 Resource Utilisation and Classification Study developed a new casemix adjusted activity based funding model for residential aged care, the Australian National Aged Care Classification (AN-ACC). Under this model, providers would receive:[5]

a. a base tariff payable daily to meet the costs of care delivered equally to all residents (such as clinical supervision and training, facility clinical management and shared care activities such as night supervision and resident observation during social activities and meal times), with the level of the base tariff varying by remoteness, and facility size and type
b. an individualised care payment based on each resident's casemix classification to meet the costs associated with the care of residents with different needs, and
c. an adjustment tariff payable during the first 28 days of care to meet the costs of settling residents into new arrangements.

Specific funding considerations

Proposition FF 8: Maximum funding amounts for care at home

The Australian Government should ensure that the maximum funding amount available for people receiving care at home is the same as the maximum amount available for care in residential aged care

In submissions on program redesign, Senior Counsel Assisting the Royal Commission proposed that funding for care at home should be demand-driven based on assessed need and not rationed. The intent behind this proposal was to enable a greater number of older people to remain in their home, which is overwhelmingly their preference.[6]

Currently, the maximum amount available under the Aged Care Funding Instrument is $223.14 per day (excluding supplements).[7] Applying the principle in this proposition using the current funding levels would result in a maximum annual amount available for care at home of $81,446.10, a 57% increase on the current level of funding available through a Level 4 Home Care Package. In

[4] See generally, Stephen Duckett, *Casemix development and implementation in Australia,* published in J. Kimberly, G. De Pouvourville and T. d'Aunno (Ed) The Globalization of Managerial Innovation in Health Care, Cambridge University Press, March 2007.
[5] McNamee J, Snoek M, Kobel C, Loggie C, Rankin R and Eagar K (2019) A funding model for the residential aged care sector. The Resource Utilisation and Classification Study: Report 5. Australian Health Services Research Institute, University of Wollongong. ISBN: 978-1-74128-299-3.
[6] Counsel Assisting the Royal Commission, *Submissions on future aged care program redesign,* 4 March 2020, RCD.012.0062.0001 at 0003-4, available online https://agedcare.royalcommission.gov.au/sites/default/files/2020-06/submissions-by-counsel-assisting-4-march-2020.pdf.
[7] Department of Health, *Aged Care Subsidies and Supplements: New Rates of Daily Payments from 1 September 2020*, Australian Government, 2020, https://www.health.gov.au/sites/default/files/documents/2020/08/schedule-of-subsidies-and-supplements-for-aged-care-schedule-from-1-september-2020.pdf, viewed 3 September 2020.

practice, the actual level of funding provided would be based on the person's assessed level of need. The Aged Care Pricing Authority would adjust the maximum funding amount for circumstances where the costs of providing care at home are higher, such as in regional, rural and remote areas.

Where people wish to be cared for at home and their funding is approaching the maximum level, because unit costs of care are generally higher in home care than in residential care, an older person would need to consider moving into residential aged care or supplementing the funding available for care at home out of their own pockets and access to informal care. In cases where the person can no longer safely and appropriately continue to receive subsidised care at home, the assessment team, the provider and any care finder appointed for the person might have to assist the person to decide whether the person should start receiving residential care. Ultimately the provider may have to decide whether it is willing to continue to provide services to the person at home, in light of its duty to ensure the person receives high quality care.

Proposition FF 9: Residential aged care supplements

The Australian Government should continue the following residential aged care funding supplements, until such time as the Aged Care Pricing Authority reviews and determines the actual costs associated with them:

a. enteral feeding supplement

b. oxygen supplement, and

c. veterans' supplement.

The Australian National Aged Care Classification factors in costs associated with a range of existing supplements, including for specialist homeless services, facilities in regional, rural and remote areas, as well as for facilities catering for Indigenous Australians. It does not account for the cost of the enteral feeding, oxygen, and veterans' supplements.[8] If the Australian National Aged Care Classification is implemented in residential aged care, the continuation of these supplements until they can be considered by the Independent Aged Care Pricing Authority will ensure that providers are not financially penalised after transition.

Any additional supplements required relating to care, and the amount attached to them, should be determined by the Aged Care Pricing Authority having regard to the evidence about costs that cannot be reflected through the Australian National Aged Care Classification. It is acknowledged that under the Australian National Aged Care Classification, specialised homeless residential aged care homes receive a higher base care tariff.[9]

Proposition FF 10: Immediate funding measures to improve the quality of residential aged care homes

Pending the implementation of a new casemix adjusted activity based funding model for residential aged care homes, the Australian Government should make additional funding available tied to an increase in staffing levels.

[8] McNamee J, Snoek M, Kobel C, Loggie C, Rankin R and Eagar K (2019) A funding model for the residential aged care sector. The Resource Utilisation and Classification Study: Report 5. Australian Health Services Research Institute, University of Wollongong. ISBN: 978-1-74128-299-3.

[9] McNamee J, Snoek M, Kobel C, Loggie C, Rankin R and Eagar K (2019) A funding model for the residential aged care sector. The Resource Utilisation and Classification Study: Report 5. Australian Health Services Research Institute, University of Wollongong. ISBN: 978-1-74128-299-3.

Developing the necessary systems and processes required to implement a new casemix adjusted activity based funding model and managing the transition process will likely require several years. At the same time, there is evidence that an increasing number of providers are under financial pressure, and that one of the ways that pressure is being managed is through reductions in care staffing. This will necessarily affect the quality of residential aged care services.

In submissions on the future of the aged care workforce, Senior Counsel Assisting the Royal Commission recommended that a minimum ratio of care staff to residents be introduced and that the ratio should be set at a level necessary to provide high quality care. Implementing this type of recommendation may also have significant lead times given the need to train additional aged care workers.[10]

In order to address providers' financial pressures, begin the process of increasing staffing levels, and improve the quality of residential aged care, the Australian Government should make additional funding tied to an increase in staffing levels available immediately. This could paid to providers who achieve particular staffing level based on increased national average staffing times. Once a new casemix adjusted activity based funding model is implemented, it could be reflected in the National Weighted Activity Unit price for classes of residents. Providers should be required to acquit these amounts in accordance with Proposition FF 12: Payment in arrears and acquittal.

Assessment and acquittal

Proposition FF 11: Principles for the assessment of need

The Australian Government should ensure that there is universal, assisted access to timely assessment (and re-assessment) of needs for support and care. The assessment process should not only directly identify the required supports and care, but it should also identify, or (in combination with pricing information) readily permit identification, of the amounts of funding required to meet the actual needs of the person.

The Australian Government should ensure that the following principles apply to assessment for all aged care funding mechanisms:

a. for care at a residential aged care home:
    i. the level of funding for an individual should be determined independently of the approved provider and, wherever possible before services are provided (services may be offered on an interim basis where necessary), or
    ii. the level of funding for an individual should be determined based on an assessment conducted by the provider and subject to independent review
b. for aged care services provided in other settings, the level of funding for an individual should be determined independently of the approved provider and, wherever possible before services are provided (services may be offered on an interim basis where necessary)
c. reassessment should occur when there is evidence of significantly increased needs, or the possibility of significantly increased needs
d. requests for reassessment of need can be made by a person receiving care, their care finder, or their approved provider (with sufficient oversight)
e. where reassessment determines that a person is entitled to a higher level of funding, and the approved provider can demonstrate that they have been providing the higher level of care then it should be eligible for back-payment to the date that the reassessment was requested
f. in order to promote an enablement approach in care at a residential aged care home, a resident should not be required to be reassessed if their condition improves under the care of a

[10] Counsel Assisting the Royal Commission, *Submissions on the future of the aged care workforce,* 4 March 2020, RCD.0012.0061.0001 at 0034.

provider. The exception to this rule is where the improvement is due to a specific investment from another funding stream.

Proposition FF 12: Payment in arrears and acquittal

The Australian Government should introduce processes for ensuring that funding provided to meet the costs of providing high quality care is spent on providing such care.

The funding arrangements should provide a clear line of sight between the source of funding and the expenditure on care. The Australian Government should require approved providers of aged care services to acquit overall expenditure on care or care staffing hours on a quarterly basis to ensure funding provided for care is spent on care. Where possible, acquittal of expenditure should occur through the same data collection used to inform the setting of prices for aged care services set out in Proposition FF 1.

The Australian Government should ensure that providers of aged care services are paid in arrears for care subsidies. Acknowledging the implications of such a change, there should be a transition period to mitigate the impact on provider cash flow, with the system manager monitoring the period to identify emerging issues.

In addition, people receiving care should have access to simple, standard form reports on the value of the care actually provided. The Australian Government should require providers of all aged care services to submit quarterly reports in a standardised format to people receiving their services detailing what was delivered and what it cost.

Co-contributions and means testing

[These propositions were amended on 13 September 2020. Deleted text is represented by a ~~strike through~~. New text is represented in *italics*, with the exception of Proposition 20 which is a new alternative proposition.]

Proposition FF 13: Fees for social supports

Individuals receiving social supports should be required to make nominal co-payments for the services that they receive.

Nominal co-payments provide an incentive to people receiving care to ensure that the use of the services that they receive is judicious. The level of the co-payment should not be so high, however, as to discourage necessary use.

The level of the nominal co-payments should be determined by the Aged Care Pricing Authority. It could be set at $5 per service, or 5-10% of the cost of the service. These co-payments should not be subject to a means test and hardship arrangements should be available for people who cannot afford the co-payment. The level of co-payment contemplated here is in line with those currently operating in the Commonwealth Home Support Programme.

The Aged Care Pricing Authority should take these payments into account in determining the Government price for these services. This will encourage providers to collect these co-payments and increase the resources available for care.

Proposition FF 14: Fees for assistive technology and home modifications

Individuals receiving assistive technology and home modifications should be required to make nominal co-payments for the services that they receive.

The co-payments for assistive technology and home modifications should be determined by the Aged Care Pricing Authority, on a similar basis to Proposition FF 13 (that is, $5 per service, or 5-

10% of the cost of the service). These co-payments should not be subject to a means test. Hardship arrangements should be available for people who cannot afford the co-payment. The Aged Care Pricing Authority should take these payments into account in determining the government price for these services.

Proposition FF 15: Fees for respite care

Individuals receiving respite care should be required to contribute to the costs of the services that they receive associated with ordinary costs of living and additional services. They should not be required to contribute to the costs of the accommodation and care services that they receive.

The Australian Government benefits from the delivery of respite care, through the reduction in long-term cost of care. It is proposed, therefore, not to provide a disincentive to the uptake of these services through co-payments or means tests. Accommodation costs, although normally a personal responsibility, should be met by the Government in this case as the older person will need to continue to meet the accommodation costs of their usual place of living while they are receiving respite. This is in line with the arrangements that currently operate in residential respite care.

The amount that individuals pay for ordinary costs of living associated with respite should be determined by the Aged Care Pricing Authority and should not be means tested. The Aged Care Pricing Authority should also determine whether additional services associated with respite care should be subject to price regulation. Hardship arrangements should be available for people who cannot afford the co-payment.

Proposition FF 16: Fees for care at home

Individuals receiving care at home should not be required to contribute to the costs of any care services that they receive. They should, however, be required to make nominal co-payments for any domestic assistance services that they receive.

The co-payments for care at home should be determined by the Aged Care Pricing Authority, on a similar basis to Proposition FF 13 (that is, $5 per service, or 5-10% of the cost of the service). These co-payments should not be subject to a means test. Hardship arrangements should be available for people who cannot afford the co-payment. The Aged Care Pricing Authority should take these payments into account in determining the government price for these services.

Proposition FF 17: Fees for residential aged care

People receiving residential aged care should:

a. Not be required to contribute to the cost of the care services that they receive.

b. Be required to contribute to the costs of the services that they receive associated with ordinary costs of living, with the price regulation arrangements for these services to be determined by the Aged Care Pricing Authority (see Proposition FF 18).

c. Be required to meet the costs of the services that they receive associated with additional services, with the price regulation arrangements for these services to be determined by the Aged Care Pricing Authority.

d. Be required to meet the accommodation costs of the services that they receive, with price regulation arrangements for these services to be determined by the Aged Care Pricing Authority. Where a resident cannot meet these costs themselves, they should be assisted with these costs ~~through the usual Commonwealth Rent Assistance arrangements (see Proposition FF 19)~~ *subject to means testing.*

~~One alternative to above arrangements would be that co-contributions for the cost of care that people receive could be retained, with increased or removed lifetime caps. In the 2017 *Legislated Review of Aged Care*, David Tune AO PSM recommended that government abolish the annual and lifetime caps on means-tested care fees in residential care.[11] Such an arrangement, Mr Tune argued, would ensure that wealthier consumers would continue to contribute towards their care costs while they remain in receipt of services, proportionate with their financial capacity.[12]~~

Proposition FF 18: Fees for residential aged care – ordinary costs of living

The amount that people should be required to contribute to the services that they receive associated with ordinary costs of living should be determined by the Aged Care Pricing Authority. ~~In the first instance it should be set at 60% of the single basic age pension.~~ *Pensioners should have their contribution capped at 85% of their pension entitlement, and the Commonwealth should pay a subsidy to make up any gap.*

These costs are a personal expense normally met by individuals (for food, cleaning, laundry, utilities, etc). However, given the stapling of these costs to the Government subsidy for care (that is, they are supplied in combination with) it is important that the prices for these services be regulated. This is especially true in residential aged care where there can be a degree of provider capture after a resident has moved into an aged care home due to the difficulties in moving.

The Aged Care Pricing Authority would be responsible for regulating prices in this context. It may do so through setting a price on an agreed set of services associated with the ordinary costs of living. The price should reflect any additional costs of these services in residential aged care when compared with the community.

These arrangements would not preclude providers from offering additional or higher quality daily living goods and services (above an already high minimum) through additional service charges.

Hardship arrangements should be available for people who cannot afford the co-payment.

~~Proposition FF 19: Government assistance for accommodation costs~~

~~**People receiving residential aged care should be eligible for Commonwealth Rent Assistance on the same basis as people living in the community. They should be required to pay 25% of the basic age pension plus any Commonwealth Rent Assistance that they receive for their accommodation. If the Aged Care Pricing Authority determines that the reasonable cost of accommodation is higher than this amount then an additional accommodation supplement should be payable to the aged care provider for the difference.**~~

~~Residents who are not eligible for Commonwealth Rent Assistance should be required to pay an amount equal to:~~

- ~~25% of the basic age pension~~
- ~~PLUS the maximum rate of Commonwealth Rent Assistance~~
- ~~PLUS a means tested fee of 50% of all income above the maximum income for a part pensioner in receipt of the maximum rate of Commonwealth Rent Assistance, up to the level of the additional accommodation supplement determined by the Pricing Authority.~~

~~Accommodation costs are a personal expense normally met by individuals. However, the cost of accommodation in residential aged care is considerably higher than in the community – in part because of the health infrastructure built into the facilities. This additional cost can be conceptualised as a health cost to be borne by the Government.~~

[11] D Tune, Legislated Review of Aged Care, 2017, p 86.
[12] D Tune, Legislated Review of Aged Care, 2017, p 85.

~~The proposed means test extends the pension means test beyond the maximum income for a part pensioner in receipt of the maximum rate of Commonwealth Rent Assistance, rather than stacking the aged care means test on top of the pension means test, which currently occurs.~~

Proposition 20: Alternative means testing arrangements

Proposition FF20: In the alternative to proposition FF17(a) the content of the means testing arrangements for accommodation charges and daily care fees in residential care should be recalibrated to achieve progressively greater contributions from people who have greater levels of assets and income without imposing hardship, or arbitrary outcomes on people in certain asset or income brackets.

Under the current means testing arrangements, a person's income and assets[13] may affect the amount they are liable to pay for accommodation, and for care.

Another way of putting this is that the government will pay both a full accommodation supplement and a full care subsidy for a resident whose assessable assets and income are below certain levels, and that resident will not be required to make any contribution. For people whose assessable assets or income are above those levels, the amounts the government will pay for accommodation and care are reduced by the 'means test reduction amount'. The means test reduction amount is the sum of 'income test reduction amount' and the 'assets test reduction amount'.

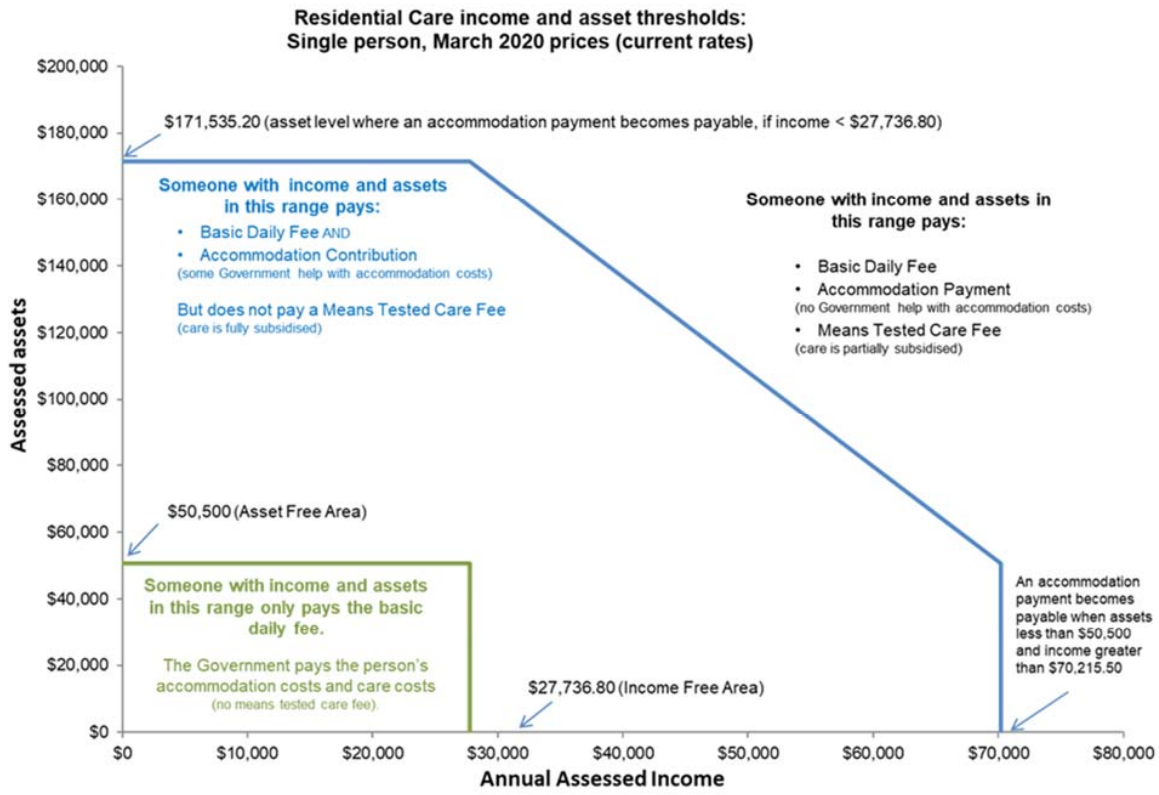
The means test reduction amount first reduces the level of the accommodation supplement payable by the Government and then reduces the level of care subsidy payable by the Government. On the basis of the current settings:

- Fully Supported Residents have income below $27,840.80 p.a. and assessable assets below $50,500. They do not need to contribute to their accommodation costs or their care costs. About a quarter of all residents are in this category. These are the residents whose income and assets place them in the Green Box in Figure 1.
- Non-Supported Residents have income above $70,203.12 p.a. or assessable assets above $171,535.20, or an equivalent combination of income and assets. They have to pay for full cost of their accommodation and contribute to their care costs. About half of all residents are in this category. These are the residents whose income and assets place them above and to the right of the Blue line in Figure 1.
- Other Residents are required to pay for some of their accommodation costs. These residents are not required to contribute to their care costs. About a quarter of all residents are in this category. These are the residents whose income and assets place them between the green and blue lines in Figure 1.

Figure 1: Operation of the Aged Care Income and Assets Tests

[as at March 2020 – to be updated to July 2020: $27,736.80 should now be $27,840.80 and the $70,215,50 should be $70,203.12]

[13] Private income for aged care purposes is defined in the same was as income for age pension purposes. However, the aged care income test applies to total income (private plus pension income), while the pension means test applies to private income.
Assets for aged care purposes are largely defined in the same was as assets for age pension purposes. There are a number of important differences. The first $171,535 in value of the principal residence (if it is not occupied by a protected person) is counted as an asset for aged care purposes. For pension purposes, the value of the principal residence (if it is not occupied by a protected person) is not counted as an asset for pension purposes for the first two years that a person is in residential aged care and its entire is value is counted as an asset after the first two years. The definitions of "protected persons" are also different for pension and aged care purposes. Finally, any Refundable Accommodation deposit paid by a resident is not considered to be an asset for pension purposes but is considered to be an asset for aged care purposes.



For people with income and assessable assets in the latter two categories, the amount of the government's contribution toward care subsidy and accommodation supplement for the person will reduce by the sum of:

a. an income test reduction amount of 50%, i.e. 50 cents for every dollar in excess of the maximum taxable income[14] for a full pensioner ($27,840.80 for a single person); and

b. an assets test reduction amount of:

   i. 17.5% of assets between the asset free threshold ($50,500) and the 'first asset threshold' ($171,535.20)

   ii. plus 1.0% of assets between the first asset threshold and the 'second asset threshold' ($413,605.60)

   iii. plus 2.0% of assets above the second asset threshold.

The operation of these thresholds and rates are inequitable and arbitrary in three ways.

First, the way in which the current settings in the assets test work is insufficiently progressive. The rate at which the value of additional assets above the value of $50,500 impacts on entitlements is very great (17.5%) and impacts disproportionately on disposable income toward the bottom end of the wealth spectrum. By comparison, in the context of the age pension, the asset test reduction rate is a flat 7.8%, ie 7.8 cents for every dollar over a threshold of $482,500 for a single non-homeowner, or about $268,000 for a single home-owner.

[14] The pension consists of four components – the basic pension, the variable component of the pension supplement, the fixed component of the pension supplement and the energy supplement. The latter two are not taxable income and are ignored by the aged care income test.

Secondly, the current settings have an adverse impact on people who have assets assessed in the assets test[15] of a value between $171,535 and about $500,000, by comparison with people whose assets are above that level. Some illustrative examples of these effects are given below.

Thirdly, they have markedly different impacts on effective marginal tax rates and therefore on disposable income, for people in different asset and income brackets. Again, some illustrative examples of these effects are given below.

The green bordered box in **Figure 1** represents Fully Supported Residents.

The interior of the blue line (excluding the green bordered box) represents residents who are making some contribution towards their accommodation but who are not required to contribute a means tested care fee. The impact of the current settings on a single person who owns a home of even low value and who has very little income outside the age pension may be eliminate their disposable income altogether, or to compel them to sell the home to pay the contributions. For example, take a single pensioner who owns a home of say $150,000 value, has no income outside the pension, and who does not lodge an accommodation bond/RAD. The person will be liable to pay a basic daily fee of $19,019 per annum out of pension income of $24,552 per annum. In addition, they will be liable to pay an accommodation contribution of $17,412 pa, quickly exhausting all their remaining pension income and forcing them to sell and consume the proceeds of their home to pay the accommodation contribution.

On the exterior side of the blue line, particularly for people whose assets are not greatly in excess of the first asset threshold, the impacts can be even more extreme. If the value of the person's home is at or above $171,535, the government will make no contribution to the person's accommodation. For people whose homes are not of a value greatly in excess of $171,535, again the impact on disposable income is very severe. For example, for a single pensioner who owns a house of any value at or above $171,535 and has no other assets, the pensioner will be required out of pension income of $24,552 per annum to pay the basic daily fee of $19,019 per annum and will almost certainly be asked by their provider to pay a daily accommodation payment at least as high as the full accommodation supplement payable by the government for some residents of $21,181 pa. This will result in disposable income of negative $15,648 per annum. If the pensioner has any additional assets, they will face uncapped accommodation charges and their financial position will be even worse.

Section 52J-5 provides a measure of protection from the person having to provide a refundable accommodation deposit which would leave then with assets below a certain threshold known as the 'minimum permissible asset value', which is 2.25 the basic age pension per annum (currently about $50,500). But this provides no protection against having to pay a DAP which might leave the person with negative disposable income.

Although people quite low on the spectrum of wealth may face hardships of this kind, at the upper end of the spectrum people are well insulated from having to pay large contributions. No matter how valuable a person's home, or their interest in the home, may be, no more than $171,535 of the value of the home can ever be included in the assets test. Further, the residential aged care means test is subject to daily, annual and lifetime caps.

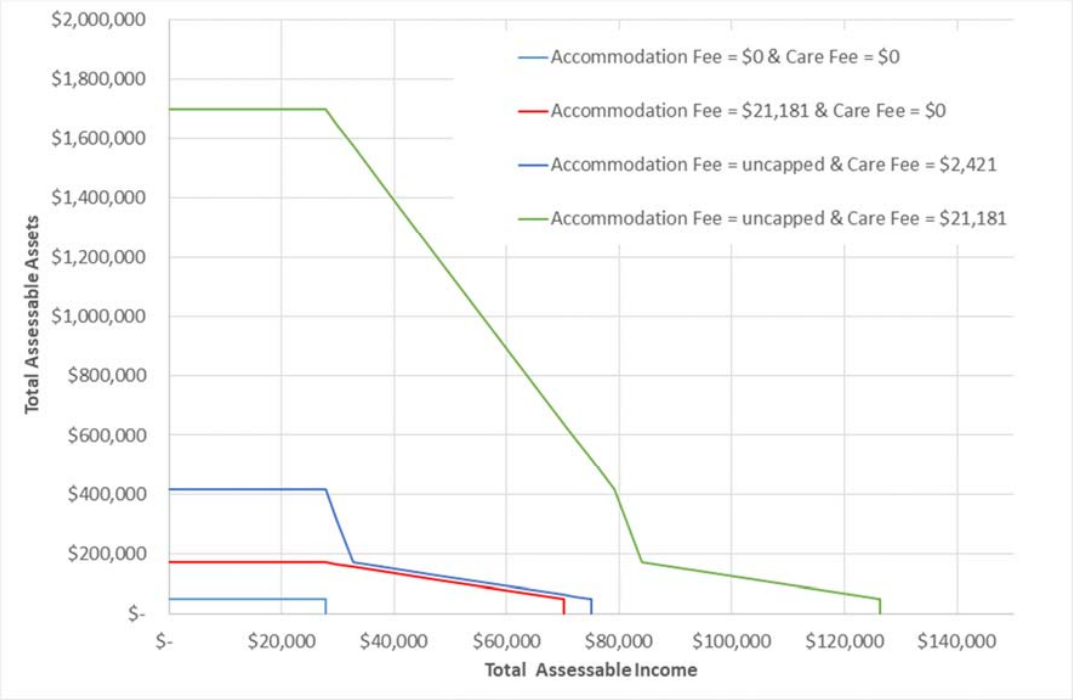
- The means tested fee on any day cannot be greater than the sum of the maximum value of the accommodation supplement and the amount of care subsidy that would be otherwise payable for the resident. The most that this can be for any resident is $281.33 per day.
- The means tested fee in any year cannot be greater than $28,087.
- The means tested fee in a lifetime cannot be greater than $67,410.

These caps are fixed, irrespective of a person's wealth.

[15] If a person owns a home, only the first $171,535 of its value is included in the assets test, and then only if a protected person is not living in the home.

Figure 2: A larger scale version of the assets/income graph appears below, showing the operation of the means test beyond the two thresholds depicted in Figure 1, above. The two thresholds are now depicted by the blue and red lined boxes closest to the origin of the graph, the second asset threshold is depicted in light blue, and a random contribution fee level has been selected to illustrate the effects of the means test beyond the second asset threshold, depicted in green.

Figure 2: Operation of the Aged Care Income and Assets Tests



A person in the area beyond the red line faces uncapped accommodation charges and must also make some contributions to care costs (as well as the basic daily fee). The means test reduction rate is much lower from the red line outward, meaning that there are disproportionate impacts on people closer to the red line than further out. For example, a person on the blue line is facing uncapped accommodation charges and is contributing $2,421 p.a. toward care (as well as paying the $19,019 p.a. daily care fee), even though they may have no assessable income and only about $400,000 in assessable assets. The person on the green line, who might have assessable assets of four times the value of the first person, pays about $19,000 more per annum in overall contributions. Further, the second person is, like everyone else, protected by a lifetime cap set at the same amount ($67,410).

The impacts of the aged care means test on effective marginal tax rate (depicted in **Figure 3** below) and disposable income (**Figure 4**) are also problematic and justify reform.

a. The effective marginal tax rate of part-pensioners is very high because of the combination of the pension taper rate (of 50 cents for every $1 of private income above $4628.00 per annum, combined with the aged care taper rate of 50 cents for every $1 of total income above $27,840.80 per annum.

   - A pensioner with private income of $20,000 and no assets is entitled to a pension of $16,865.80. Out of their total income of $36,865.80 they are required to pay income tax of $768.07 and the Medicare levy of $710.54. They also have to pay their aged care basic care fee of $19,019.26 and a means tested contribution to their accommodation of $3,843, leaving them with annual disposable income to meet all their other costs after fees and taxes of $13,245. If their private income increases by $100 then their fees and taxes increase by $90.80.

- Pensioners with private income between $23,000 and $45,000 per annum, face an effective marginal tax rate if 99.5%. That is, for every $100 that their income increases, their taxes and fees increase by $99.50.

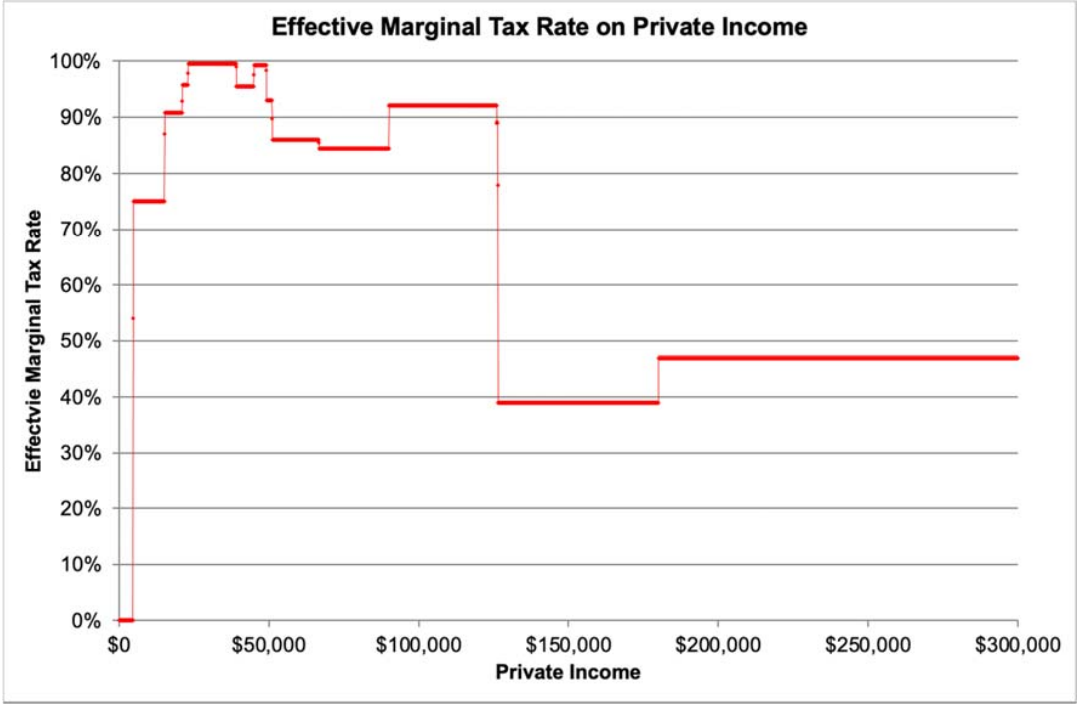
b. The effective marginal tax rate of self-funded retirees with incomes just above the pension income cut off are also high because of the combination of the aged care taper rate of 50 cents for every $1 of total income above $27,840.80 per annum and their marginal tax rate and the effect of the withdrawal of the low and middle income tax offset.

- A self-funded retiree with private income of $55,000 and no assets is not entitled to a pension. Out of their income they are required to pay income tax of $8167 and the Medicare levy of $1,100. They also have to pay their aged care basic care fee of $19,019.26 and a means tested contribution to their accommodation of $13,579.60, leaving them with annual disposable income to meet all their other costs after fees and taxes of $13,134.14. If their private income increases by $100 then their fees and taxes increase by $86.00.
- Self-funded retirees with private incomes between $96,000 and $126,000 face an effective marginal tax rate of 92%.

c. The effective marginal tax rate of self-funded retirees with incomes above $126,377.94 per annum are much lower because the annual cap on means tested fees, which means that all residents with incomes above this level pay the same means tested care fee of $28,087.41.

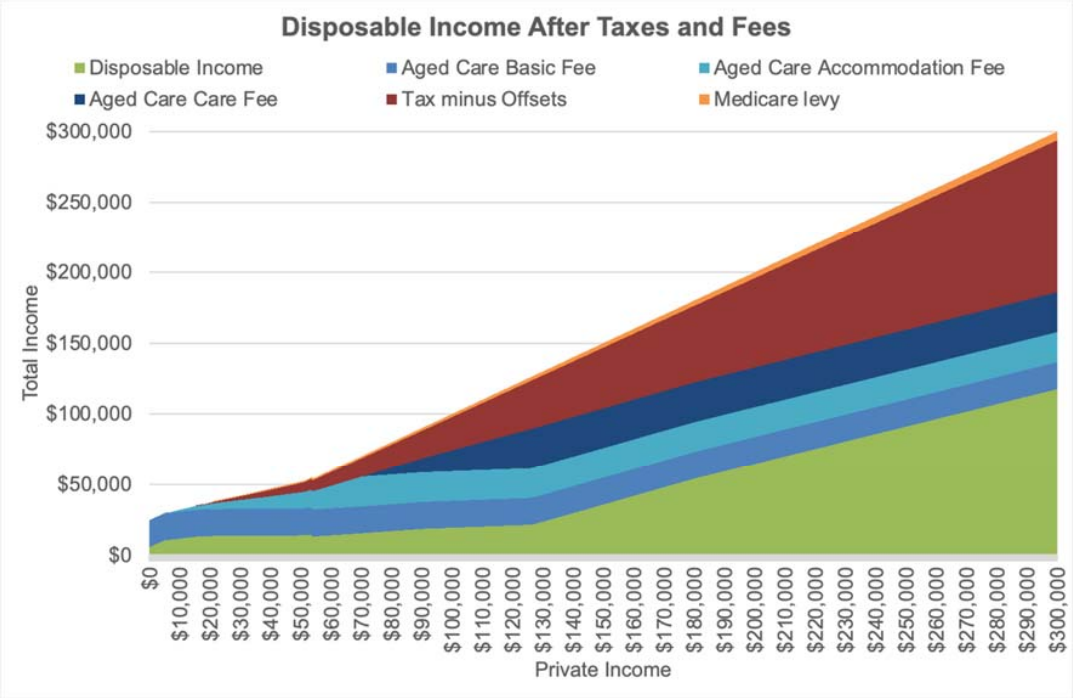
- For example, the effective marginal tax rate for self-funded retirees with total incomes between $126,500 and $180,000 is 39% - which is less than half that faced by pensioners and self-funded retirees with less income.

Figure 3: Operation of the Aged Care Income test on EMTR



The following figure illustrates the disproportionate effects on people whose income is under about $130,000 p.a. compared with people whose income is greater than this (assuming no assets).

Figure 4: Operation of the Aged Care Income Test on Disposable Income



We submit that the settings should be adjusted to commence means testing reduction at a higher level, and for the reduction rate to be more gradual, and to be more consistent in its effects in requiring contributions to both accommodation and care charges, so as to avoid the sorts of arbitrary impacts mentioned above.

Prudential regulation propositions

The aged care system needs strengthened aged care prudential oversight and financial management arrangements that are consistent with best practice prudential regulation in other sectors. The precise content of reporting and prudential obligations to be imposed on providers should not be static, but should vary with changes in accounting standards, innovations in financial management and prudential oversight, and other relevant developments and circumstances. These propositions outline the elements of the prudential regulatory framework, guiding principles for its refinement over time, certain statutory duties directly binding on providers, enhanced regulatory powers, and measures to improve regulatory capability.

The body responsible for prudential regulation and financial risk analysis in the future (the **prudential regulatory body**) should be charged with developing and implementing a robust financial reporting and liquidity and capital adequacy framework that has the dual objectives of providing oversight of:

- the security of refundable accommodation deposits, and
- the financial sustainability of providers, which is crucial to their ability to provide ongoing and high quality care to older people.

Key prudential regulation and financial risk oversight functions of the prudential regulatory body should be:

- the collection of financial information, primarily from providers, and analysis of that information
- agile use of effective information gathering powers, akin to those conferred on the Commissioner of Taxation[16]
- monitoring information received under providers' statutory continuous disclosure obligations
- continuous monitoring of the ongoing financial sustainability and performance of providers
- oversight of financial and commercial arrangements that have the potential to affect continuity of care
- sharing of information with other parts of the aged care institutional framework, including the quality and safety regulatory function and complaints handling function,
- the use of prudential and financial information to inform the evaluation of the risk profiles of approved providers
- selective interventions where required to manage financial risk in the system and safeguard the interests of care recipients.

The development and implementation of a prudential regulation framework for the aged care sector will be critical during the period of reform and transition to the new aged care system. That is because the period of reform and transition is likely to be a period in which some providers will be unable to attain and maintain the required standards of care and should be assisted to an orderly exit from the sector and a sale of assets to better-performing providers. Financial risk monitoring and analysis will be a source of important intelligence for the quality and safety regulatory function to be performed most effectively, efficiently and most responsively to risk. It will also be an important source of intelligence to inform the most appropriate performance of system management functions relating to the orderly exit of poor-performing providers and the maintenance of continuity of care and service coverage for older people.

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[16] See *Taxation Administration Act 1953* (Cth) Schedule 1, sections 353-10 and 353-15. The predecessor powers conferred on the Commissioner under sections 263 and 264 of the *Income Tax Assessment Act 1936* (Cth) have been interpreted broadly: e.g. in *Industrial Equity Ltd v Deputy Federal Commissioner of Taxation* (1996) 170 CLR 649, a majority of the High Court upheld the dismissal of a judicial review application against a random audit. The powers proposed for the prudential regulatory body would permit it to conduct random audits of compliance by providers with their prudential regulatory requirements.

Active monitoring and management of financial risk

Access to the right financial and corporate information and the ability to analyse that information is critical to good prudential regulation. The proposition that follows will ensure that the prudential regulatory body has the tailored and regular information that it needs to exercise financial risk oversight functions in relation to the sector.

Under the Accounting Standards, General Purpose Financial Reporting requirements differ between Tier 1 entities (such as private sector trading entities) and Tier 2 entities (such as privately held entities and many not for profits). Some of the exemptions currently available to Tier 2 entities are relevant for analysis of the financial viability and sustainability of entities in the aged care sector. These include disclosure obligations in respect of operating segments, related party disclosures and joint arrangements.

Many aged care providers currently operate under the reduced disclosure requirements available under Tier 2, or are excluded entirely from Tier 1 and Tier 2 reporting requirements. Various recent reviews of the prudential arrangements for aged care have suggested that the lack of visibility under these reduced reporting arrangements increases the risks for prudential oversight of the sector and have argued for more of the entities operating in the aged care sector to be brought within the ambit of Tier 1-type reporting.[17]

The Australian Accounting Standards Board is working to clarify the current Reporting Framework, which includes revising the disclosures required for Tier 2 reports. Even the strengthened reporting requirements introduced through this reform process will not fully satisfy the strengthened prudential oversight required for aged care. In addition, there are aged care providers that are not captured by the General Purpose Financial Reporting requirements.

The proposition below is designed to support Special Purpose Financial Reporting for aged care providers, including requirements for segment reporting, reporting on capital transactions and a continuous disclosure regime for aged care providers, to support effective prudential oversight of the sector.

Proposition PR 1: More stringent regular financial reporting requirements

The prudential regulatory body should be empowered under statute to require aged care providers to submit regular financial reports. The frequency and form of the reports should be prescribed by the prudential regulatory body.

Without limiting the powers of the prudential regulatory body to determine the manner and form of the regulator financial reporting regime, the body may decide:

a. to require aged care providers, or certain classes of aged care providers, to submit special purpose financial reports;

b. to specify the required content of special purpose financial reports;

c. to specify the regularity of reporting for all providers, or for particular classes of providers;

d. to publish the financial reports received from providers.

The required content of the financial reports should be specified by the prudential regulatory body to achieve the following purposes:

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[17] For example Department of Health, *Managing Prudential Risk in Residential Aged Care: Discussion Paper*, *2019*, pp 3, 41; Ernst & Young, *Review of Aged Care legislation which provides for the regulation and protection of Refundable Accommodation Payments in Residential Aged Care*, May 2017, also argued for strengthening of the Disclosure Standard to require disclosure of corporate structure and related party transactions (p 35) and to provide better transparency of Approved Providers' businesses and how they are using Accommodation Payments (p 14).

- improve transparency of approved providers' businesses and how they are using accommodation payments;
- improve understanding of the financial sustainability of approved providers and assist the regulator to identify and monitor providers who are potentially at risk of financial failure or non-permitted use of accommodation payment balances.

Guided by these purposes, the prudential regulatory body may, in determining the required content of the special purpose financial reports, be informed by such accounting standards as it deems fit, and may require providers to report on:

- earnings/turnover, total expenses and net profit/loss
- total current and non-current assets
- total current and non-current liabilities
- net cash from operations, financial activities and investing activities
- financial information specific to an operating segment[18] of an entity that involves the provision of aged care
- total net cash
- current ratio
- liquidity ratio
- capital adequacy ratio.

Proposition PR 2: Information gathering powers

The prudential regulatory body should be empowered under statute to require by notice served on any person involved in the provision of aged care services:

a. to provide information specified in the notice to the prudential regulatory body that the body requires for the purpose of administration or operation of the [Aged Care Act and any future replacement legislation]

b. to attend and give evidence before the prudential regulatory body, or an individual authorised by the body, for the purpose of the administration or operation of the [Aged Care Act and any future replacement legislation]

c. to produce to the prudential regulatory body, any documents in the person's custody or under the person's control, for the purpose of the administration or operation of the [Aged Care Act and any future replacement legislation]

The prudential regulatory body should be empowered to require the information or evidence to be given orally or in writing, and on oath or affirmation. For that purpose the body or authorised individual should be empowered to administer oaths and affirmations.

Further, for the purposes of the [Aged Care Act and any future replacement legislation] the prudential regulatory body or an individual authorised by the body should be empowered under statute and entitled:

a. at all reasonable times to enter and remain on any land, premises or place

b. to full and free access at all reasonable times to any documents, goods or other property

c. to inspect, examine, make copies of, or take extracts from, any documents.

[18] As defined in AASB 8 Operating Segments.

An individual authorised by the prudential regulatory body for the purposes of this section should not be entitled to enter or remain on any land, premises or place if, after having been requested by the occupier to produce proof of his or her authority, the individual does not produce an authority signed on behalf of the body stating that the individual is authorised to exercise powers under the above provisions.

Proposition PR 3: Continuous disclosure requirements in relation to prudential reporting

Aged care providers should be required under statute to comply with continuous disclosure requirements,[19] by which:

a. if an aged care provider becomes aware of material information that[20] affects the provider's ability to pay its debts as and when they become due and payable; or

b. if an aged care provider becomes aware of material information that affects the ability of the provider or any contractor providing services on its behalf to continue to provide aged care that is safe and of high quality to individuals to whom it is currently contracted or otherwise engaged to provide aged care.

the provider must immediately disclose the information to the prudential regulatory body.

A failure to comply with the continuous disclosure obligation should be an offence. It may be the subject of an application by the prudential regulatory body to a court of competent jurisdiction for a civil penalty.

A person involved in a contravention should be subject to accessorial liability. A person involved in the contravention should not be liable if the person proves that they took all steps (if any) that were reasonable in the circumstances to ensure that the provider complied with its continuous disclosure obligations and that after doing so the person believed on reasonable grounds that the provider was complying.

The prudential regulatory body should be empowered to provide guidance as to circumstances in which continuous obligations will be engaged. For example, and without limitation, the prudential regulatory body may provide guidance about the relevance and materiality of changes in key financial metrics such as:

- earnings/turnover
- net profit
- net assets
- net cash from operating activities
- net cash from financing activities
- net cash from investing activities.

[19] Adapted from section 674 of the *Corporations Act 2001* (Cth) and ASX Listing Rule 3.1.

[20] Information is regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decision (Prudential Standard APS 330: Public Disclosure; see also AASB Practice Statement 2 Making Materiality Judgements.

Scrutiny of management arrangements

Proposition PR 4: Requirement to report on outsourcing of care management

Aged care providers should be required under statute to notify the prudential regulatory body of any proposed sub-contracting of the care management before the arrangement takes effect.[21] The prudential regulatory body should have power to make directions in relation to the arrangement if it gives rise to concerns about quality and safety of care.[22]

If an aged care provider appoints a sub-contractor to manage the provision of care on its behalf, the following provisions should apply under statute:

a. before the appointment, the aged care provider must inform the proposed subcontractor of the effect of these proposed provisions
b. the continuous disclosure obligations apply to the subcontractor as if the subcontractor were the aged care provider
c. further, the aged care provider remains bound by the continuous disclosure provisions in relation to the aged care provided by the subcontractor on its behalf.

Clear and enforceable liquidity and capital adequacy requirements

There should be clear and enforceable liquidity requirements to ensure that residential care providers are able to repay refundable accommodation deposits promptly as and when required without jeopardising their financial viability. The prudential regulatory body should be empowered to apply risk adjusted liquidity requirements to providers, pursuant to guiding statutory principles.

In addition, there should be clear and enforceable capital adequacy requirements to help ensure that in the event of insolvency of providers, refundable accommodation deposits are likely to be able to be recoverable without large financial impacts on the Australian Government and the aged care sector through the Aged Care Accommodation Payment Guarantee Scheme and associated industry levies.

Proposition PR 5: Liquidity requirements

The prudential regulatory body should be empowered under statute to impose liquidity requirements on residential aged care providers which hold refundable accommodation deposits, for the purpose of ensuring that such providers are able to repay refundable accommodation deposits promptly as and when required without jeopardising their financial viability.

Without limiting the manner in which the prudential regulatory body may impose liquidity requirements, the body may:

a. require providers to obtain and submit annual certification by an independent auditor that the provider is able to meet its financial liabilities, including refundable accommodation deposits, likely to become due and payable in the next 12 month period;
b. require providers to maintain a particular ratio of liquid assets to financial liabilities, including refundable accommodation deposits, in excess of a specified ratio (liquidity threshold) and to notify the prudential regulatory body with a specified time if at any time that liquidity threshold is infringed.

[21] See recommendation 14 of the Carnell Report into Earle Haven.
[22] See recommendation 15 of the Carnell Report into Earle Haven, which recommended that the Secretary of the Department consider whether the proposed arrangement is in the best interest of care recipients and provide the power to veto the arrangements.

The prudential regulatory body should be empowered to take a varied approach to setting appropriate liquidity thresholds for different providers, based on criteria to be determined by the prudential regulatory body. The prudential regulatory body should determine the liquidity thresholds and criteria on a basis that strikes a balance between the risk of providers defaulting on their obligations and the capital requirements of the providers' operations necessary to the provision of high quality aged care services. For example, the criteria may involve an assessment of:

- the provider's financial risk, balance sheet strength and financial viability
- the nature of provider's services (ie residential care only, or residential care combined with other services)
- the provider's business strategies and direction, including capital requirements and
- the size of their financial liabilities (if any).

If the prudential regulatory body proposes to introduce liquidity thresholds, before the liquidity thresholds take effect, the prudential regulatory body should be empowered to determine a transition pathway for the introduction of the liquidity thresholds. In determining the transition pathway, the prudential regulatory body should ensure that providers with low current liquidity thresholds have adequate time to prepare for the adherence to higher liquidity thresholds without affecting their ability to ensure continuity of aged care services.

Proposition PR 6: Capital adequacy requirements

The prudential regulatory body should be empowered under statute to impose capital adequacy requirements for the purpose of ensuring that providers maintain adequate net assets above the liabilities they owe.

Without limiting the manner in which the prudential regulatory body may impose capital adequacy requirements, the body may:

a. require providers to obtain and submit annual certification by an independent auditor that the provider has adequate capital to ensure the continuity of its aged care services
b. require providers to maintain a particular ratio of net assets to liabilities in excess of a specified ratio (capital adequacy threshold), and to notify the prudential regulatory body within a specified time if at any time that capital adequacy threshold is infringed

The prudential regulatory body should be empowered to take a varied approach to setting appropriate capital adequacy thresholds for different providers, based on criteria to be determined by the prudential regulatory body. The prudential regulatory body should determine the capital adequacy thresholds and criteria on a basis that strikes a balance between the risk of providers having inadequate capital to continue to provide high quality and safe aged care services, and reasonable flexibility and innovation in providers' financing arrangements. For example, the criteria may involve an assessment of:

- the provider's financial risk, balance sheet strength and financial viability
- the nature of provider's services (ie residential care only, or residential care combined with other services)
- the provider's business strategies and direction, including capital requirements and
- the size of their accommodation payment liability (if any).

If the prudential regulatory body proposes to introduce capital adequacy thresholds, before the capital adequacy thresholds take effect, the prudential regulatory body should be empowered to determine a transition pathway for the introduction of the capital adequacy thresholds. In determining the transition pathway, the prudential regulatory body should ensure that providers with low current net capital to liability ratios have adequate time to prepare for the adherence to

higher capital adequacy thresholds without affecting their ability to ensure continuity of aged care services.

Enforcing the prudential requirements

There should be a range of enforcement options and tools to support, encourage and require prudential regulatory compliance. Those tools should include infringement notices and civil penalties. The tools should also include consequences in terms of the prudential risk profile of the provider, with the result that the provider will be subject to increased regulatory scrutiny.

Proposition PR 7: Tools for enforcing the prudential requirements

In the event of breach by a provider of the new prudential requirements, including the financial reporting requirements and the notification requirements that apply in the case of infringements of the liquidity threshold and capital adequacy threshold applicable to the provider, the prudential regulatory body should be empowered under statute to impose one or more of the following outcomes:

a. informal methods, such as increased regulatory scrutiny or additional reporting requirements

b. directions to a provider:[23]

i. not to borrow any amount;
ii. not to accept any payment on account of share capital, except payments in respect of calls that fell due before the direction was given;
iii. not to repay any amount paid on shares;
iv. not to pay a dividend on any shares;
v. not to discharge any policy or other liability;
vi. not to transfer any asset;
vii. not to pay or transfer any amount to any person, or create an obligation (contingent or otherwise) to do so;
viii. not to undertake any financial obligation (contingent or otherwise) on behalf of any other person;
ix. to hold, or otherwise deal in a specified way, with a specified amount of capital;

c. court enforceable undertakings

d. imposition of civil or administrative penalties

e. recommend to the quality and safety regulator the imposition of sanctions to limit the ability of the provider to expand its services, the revocation of accreditation for a facility, or the revocation of approved provider status/license to operate.

The prudential regulatory body should also be empowered to apply to a court of competent jurisdiction for penalties for contravention of provisions that are integral to the integrity of the prudential regulatory regime. Without seeking to limit the scope of offences that could be provided for in legislation, offence provisions should be enacted for:

- failing to comply with prudential reporting obligations and
- failing to comply with applicable liquidity thresholds in a significant and sustained manner.

There should be scope for those offences to be imposed on:

- the provider (as a corporate entity)

[23] These directions are adapted from directions powers conferred on APRA by *Private Health Insurance (Prudential Supervision) Act 2015* (Cth) sections 96 and 97.

- one or more directors of the provider, and
- key personnel involved in the contravention.

Building the capability of the regulator

Proposition PR 8: Building the capability of the regulator

The Australian Government should ensure that its prudential capability in relation to the aged care sector includes the following:

a. an effective program to recruit and retain senior forensic accountants and specialists who have prudential regulatory experience, and sufficient numbers of supporting employees who have either accounting qualifications or other financial skills

b. systems and processes to capture, collate, analyse and share regulatory intelligence from internal and external sources to build a risk profile of aged care providers

c. a system and processes to monitor indicators of risk revealed by providers' financial reporting tailored to the aged care sector and to respond to them in a timely manner

d. an electronic forms and lodgement platform for the use of all large operators, with an optional alternate electronic filing system available for smaller operators

e. appropriate resourcing of the above system and processes, including design expertise, Information Communications Technology requirements, technical support, and recruitment and training of sufficient numbers of appropriately skilled staff.