StewartBrown

Integrity + Quality + Clarity

Australian Government

Department of Health

Managing Prudential Risk in Residential Aged Care

Submission *(March 2019)*

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1. Executive Summary

1.1 Managing Prudential Risk in Residential Aged Care

In February 2019, The Australian Department of Health (the Department) released the discussion paper "*Managing Prudential Risk in Residential Aged Care"* in consultation with the residential aged care sector and the broader community on the issue of managing prudential risk in residential aged care.

The existing framework in place under the *Aged Care Act 1997* (*the Act*) supports this objective however two recent reviews have recommended that the prudential framework be strengthened (*Ernst and Young* and the *Tune Review*).

The Department has invited submissions from all interested stakeholders to gather the sector's views on the options for better managing prudential risk in residential aged care.

1.2 StewartBrown Chartered Accountants

StewartBrown is a Chartered Accounting firm located in Chatswood, Sydney with an Adelaide branch office. The firm currently consists of 6 Partners and over 70 employees providing services including Audit, Consulting, Business Services, Taxation and Financial Planning. StewartBrown provides these professional services nationally to a range of clients, however, we have a speciality expertise in aged care and community services, social services, independent schools, children's services and disability services.

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

- Audit and assurance
- Preparation of General Purpose Financial Reports
- Annual Prudential Compliance Statement audits
- Community Acquittals
- Governance reviews (including Board and Executive)
- Finance systems and process reviews
- Financial modelling and forecast assignments
- Secondments
- Conference presentations and sector workshops
- Briefings to Department of Health and the Aged Care Financing Authority
- Aged Care Financial Performance Survey *(2018: 192 providers comprising 974 residential facilities; 512 community programmes incorporating 24,952 HCP packages)*

1.3 Background

Prudential Risk

As noted in the Department discussion paper, residential providers currently hold in excess of $25 billion of refundable accommodation payments (RADs and Accommodation Bonds) and there has been a significant increase since the July 2014 when the new accommodation payments structure was introduced. The amount of RADs held are projected to increase to $36 billion by 2025.

In 2016 at the request of the Minister for Health, Aged Care and Sport the Aged Care Financing Authority (ACFA) prepared a report *"The Protection of Residential Aged Care Lump Sum Accommodation Payments"* to examine the existing Accommodation Payment Guarantee Scheme (Bond Guarantee Scheme) and any potential alternatives.

This report considered a range of alternate options and concluded, in principle, that the continuation of the existing Bond Guarantee Scheme is a viable option, and the Scheme's beneficiaries should contribute to the cost of the guarantee.

In May 2018 after consideration of the Tune Review, the Government announced as part of the Federal Budget the "Better Quality of Care - managing prudential risk in residential care" a strengthening of standards in relation to RADs by:

- introducing a compulsory retrospective levy on residential aged care service providers where defaults exceed $3 million in any fiscal year;
- developing stronger prudential standards applied to accommodation payments held by residential service providers; and
- raising the Government's prudential regulatory capability to better protect the growing pool of accommodation payments

The review made two key recommendations for the strengthening of the protection of accommodation payments:

- A strengthening of the Prudential Standards and their oversight including consideration of the findings and recommendations of the EY review
- Mandating the recoupment of the Bond Guarantee Scheme costs

Accommodation Payment Guarantee Scheme 2006

The legislative authority for the Bond Guarantee Scheme is the *Aged Care (Accommodation Payment Security) Act 2006*. Since its inception the Bond Guarantee Scheme has been triggered 11 times, paying approximately 260 RAD refunds amounting to $41.7 million (plus accrued interest of $1.8 million).

The reforms to the Bond Guarantee Scheme are to improve certainty to providers and consumers as to how the levy will operate. In summary, the compulsory retrospective levy is being legislated to be enacted where the default cost exceeds $3 million in any fiscal year.

Whilst such a levy has existed for a number of years, the proposed legislation is to make it enforceable effective from 1 July 2019, with the calculation period for defaults commencing from July 2018.

Our understanding of the proposed legislation is that should there be a default of greater than $3 million in any one fiscal year, the levy will be calculated on the basis of the respective Approved Providers RAD balance as a percentage of the total RAD balance. Should there be a significant default, it is likely that the levy will be administered over a number of years.

Prudential Standards

The Prudential Standards as set out in the *Fees and Payments Principles 2014 (No 2)* (the *Principles*) outline the regulatory requirements of providers in respect of their prudential management of refundable accommodation deposits, accommodation bonds and entry contributions (collectively known as accommodation deposits).

The *Aged Care Act 1997* requires that all Approved Providers must comply with the Prudential Standards as set out in the *Fees and Payments Principles 2014 (No.2)*.

There are four Prudential Standards being:

- Liquidity Standard
- Records Standard
- Governance Standard; and
- Disclosure Standard

One of the requirements contained in the Disclosure Standard is the disclosure each year of certain information to the Department. The Approved Provider must submit to the Secretary a statement in the form specified disclosing matters relating to the compliance with the Prudential Standards during the year and disclose instances or periods of non-compliance with those Standards (included with the Annual Prudential Compliance Statement).

Permitted Uses

Division 52N of the *Aged Care Act 1997* defines permitted uses. The use of refundable accommodation deposits (RADs) is regulated by *Part 6* of the *Principles.*

An Approved Provider is permitted to use RADs for the following:

a) Capital expenditure for residential or flexible aged care purposes
b) Invest in certain financial products
c) To make a loan (with certain conditions to be satisfied)
d) To refund or repay debt accrued for the purposes of refunding accommodation deposits
e) To repay debt accrued for the purposes of capital expenditure as referred to in (a) above
f) To repay debt accrued before 1 October 2011 (the application date for the current permitted use rules) if the debt is accrued for the purposes of providing aged care to care recipients

Annual Prudential Compliance Statement

Approved Providers that hold refundable accommodation deposits are required by 52N-1 of the *Aged Care Act 1997* to comply with the Prudential Standards. The Disclosure Standard requires to complete and submit the Annual Prudential Compliance Statement (APCS) to the secretary of the Department within four months of the end of their financial year.

The APCS acts to demonstrate the compliance with the four Prudential Standards. The APCS must be audited by an independent external auditor.

The APCS contains questions about the number and value of the accommodation deposits held, whether refunds were paid on time, and whether they complied with Prudential Standards. Approved Providers are also required to provide information to support their compliance with permitted uses for accommodation deposits.

Financial Reporting Requirements

Division 2 of the *Accountability Principles 2014* requires Approved Providers to submit to Department the following:

- Aged Care Financial Report (ACFR) *(which includes the Annual Prudential Compliance Statement)*
- General Purpose Financial Report

Corporate Governance

Governance refers to the systems that are in place to "govern" or control an organisation. Each organisation must consider how this is best achieved for their organisation which can depend on for example, the size and complexity of the organisation as a whole.

Those charged with governance - such as the Board of Directors, Responsible Entities, Management Committee or similar (Directors) are the primary stakeholders influencing corporate governance of the organisation and have the ultimate responsibility and accountability of ensuring strategic goals are met, financial sustainability is maintained, as well as to comply with obligations as set by the regulatory environment in which the organisation operates.

For Approved Providers, with regards to financial reporting and prudential compliance, the Directors must ensure compliance with the following (depending on the type of organisation):

- *Corporations Act 2001* (for listed companies, and for-profit companies)
- *Australian Charities and Not-for-Profits Commission Act 2012* (for registered not-for-profit entities)
- *Income Tax Assessment Act 1997*
- *Aged Care Act 1997*
- *Fees and Payments Principles 2014 (No 2)*
- *Accountability Principles 2014*

The Directors must ensure appropriate mechanisms have been implemented to ensure compliance with the above regulatory environment in addition to a significant number of other legislative and statutory obligations. This includes the responsibilities relevant to managing prudential risk within the organisation and ensuring compliance with the current Standards as set out in the respective *Principles.*

With particular reference to the Governance Standard, the Directors must ensure that the organisation only uses RADs for permitted uses and that RADs are refunded to residents or their estates within the specified timeframe. The Governance Standard also sets out the minimum governance system that should be adopted by an Approved Provider including those in relation to reporting and delegation. An important component is the requirement to enable a robust risk management environment.

Liquidity and Capital Adequacy Management

Part 5, division 2, section 43 of the *Fees and Payments Principles 2014 (No 2)* states *"If an approved provider holds one or more refundable deposit balances, accommodation bond balances or entry contribution balances, the approved provider must maintain sufficient liquidity to ensure that the approved provider can refund, in accordance with the Act and these principles, any of those balances that can be expected to fall due in the following 12 months."*

Approved Providers are required to implement a written Liquidity Management Strategy which satisfies the following:

a) The amount (expressed as an amount of whole dollars) required to ensure that the Approved Provider has sufficient liquidity for the purposes of *section 43*;
b) The factors that the Approved Provider has regard to in determining the minimum level of liquidity;
c) The form in which the Approved Provider will maintain the minimum level of liquidity.

EY have made the recommendation that Approved Providers must maintain a prescribed percentage of liquid assets, for example, 10% of the value of lump sum accommodation payments held.

EY have also recommended Introducing a specific Capital Adequacy requirement so that a provider must maintain a prescribed percentage of net assets, for example, assets must exceed liabilities by an amount exceeding 20% of total assets.

We agree with EY's recommendations (*B1* and *C1*) on minimum liquidity levels and capital adequacy requirements, however before setting any mandated minimum ratios the Department will need to assess the impacts to Approved Providers and the residential aged care sector as a whole.

1.4 Ernst and Young (EY) Review

Included as *Appendix "A"* is a summary of the EY recommendations as included in the *Review of Aged Care legislation which provides for the regulation and protection of Refundable Accommodation Payments in Residential Aged Care* (*EY Review*), and our respective commentary.

As an overarching comment, EY have recommended that Approved Providers should establish a sound risk management framework to support their Liquidity Strategy and Investment Management Strategy and periodically review the effectiveness of the framework.

This includes recommendations that the Disclosure Standard should be amended to include an obligation on Approved Providers to disclose material events or information. *We agree with these recommendations.*

In addition to this, we **recommend** that the Disclosure Standard be amended so that the Approved Provider should disclose the classes of assets which investments were made during the financial year, including the amount invested. This disclosure should be mandatory for all prospective care recipients as well as annually to all existing residents. This could be provided in a simple disclosure statement along with some of the existing mandatory disclosures.

EY have recommended the introduction of minimum liquidity and capital adequacy ratios over a reasonable transition period. Without knowledge as to the potential effect to some Approved Providers that this might have, we can see certain merit in this approach which could have subsidiary benefit in regards to governance at provider level.

We **recommend** that only 50% of accessible funds through an unrestricted bank facility (overdraft or line of credit) be included in the minimum liquidity level calculation, as the use of such a line of credit could be used by the Approved Provider for non-permitted use purposes. If the liquidity facilities are only provided for RAD liquidity purposes (purpose utilisation restricted) then the full 100% should be included in the calculation.

1.5 Governance and Disclosure

Abstract

The EY recommendation around governance (*EY Proposal "F"*) is in our opinion the primary consideration in managing prudential risk. The Governance Standard is the appropriate mechanism to implement further enhancements to the governance requirements.

The Prudential Standards should provide the authority and guidance for managing prudential risk in residential aged care. A key component of the Prudential Standards relates to "governance" and this is where the primary focus should be directed - in ensuring that the Approved Provider has a strong and robust governance structure, including a risk management framework, that is supported by appropriate legislative requirements.

This is an area where many Boards will require guidance in establishing an appropriate risk management framework for their organisation. Any legislative requirement for a robust risk management framework should be accompanied by resources for providers to assist them. This is likely to be in the form of education and guidance materials for those responsible for the governance of the provider organisations.

The enhancement of the General Purpose Financial Report (GPFR) requirements and compliance will provide the best and easiest method for the Department to ensure proper governance. It is our **recommendation** the GPFR should include Declarations that when signed by the Directors and Auditors will have statutory authority.

General Purpose Financial Reports

With the exception of the listed entity Approved Providers (Estia Health/Regis Aged Care/Japara Healthcare) and State, Territory and Local Government Approved Providers, all residential aged care providers can be categorised as Tier 2 reporting entities but have the option to prepare Tier 1 GPFR's.

Tier 2 reporting entities are required to adopt Australian Accounting Standards AASB 1053: *Application of Tiers of Australian Accounting Standards* and AASB 2010-2: *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirement* in the preparation of their GPFR.

In accordance with the Reduced Disclosure Requirements, Tier 2 entities are not required to apply or fully disclose the following Australian Accounting Standards applicable to aged care providers:

AASB 7 Financial Instruments: Disclosures
AASB 8 Operating Segments
AASB 9 Financial Instruments
AASB 11 Joint Arrangements
AASB 12 Disclosure of Interests in Other Entities
AASB 124 Related Party Disclosures

AASB 8 Operating Segments

Before the introduction of the Aged Care Financial Report and amendment to the Accountability Principles 2014, providers were required to "*treat residential aged care as a reportable segment within the meaning of the Accounting Standard relating to segment reporting that applies to the relevant financial year*".

This requirement resulted in providers including a residential aged care segment disclosure in the audited GPFR, however, with the introduction of the ACFR from 2016/17 financial year which includes the residential aged care segment information, the residential aged care segment can now be excluded from the GPFR.

As many Approved Providers have operating and capital activities beyond those governed by the *Aged Care Act*, for the Department to make a reasonable assessment of the provider's overall financial viability they require full visibility over the other operating segments. To this extent, we **recommend** that the compulsory requirement to adopt *AASB 8 Operating Segments* be implemented.

Other Accounting Standards

In addition to Tier 2 entities not having to comply with *AASB 8 Operating Segments*, these entities also do not have to comply with a number of other Australian Accounting Standards as already noted above.

Where Approved Providers have transactions or activities that would otherwise have to be reported on under these Accounting Standards but for the fact that they are Tier 2 entities, we **recommend** that when the applicable Accounting Standard applies to their entity, then the provider should report in accordance with the Accounting Standard. For example, if an Approved Provider entity had related party transactions then it would need to report these transactions in accordance with *AASB 124 Related Party Disclosures*.

For the *Financial Instruments* standards, we **recommend** that the Approved Provider limit their application to only having to compulsorily disclose where entities have investments in financial instruments other than cash and term deposits or external borrowings other than residents' borrowings.

The application of these Accounting Standards, where applicable, to all Approved Providers will ensure a greater level of disclosure and transparency and a greater level of consistency in those disclosures. Guidance may have to be provided in the format that is preferred by the Department, and consultation with the Accounting bodies in creating a legislative framework would also be encouraged.

The fact that these disclosures will be included in the GPFR also means that they will be subject to audit which will provide further assurance to users of the GPFR including the Department, residents and their families.

The other aspect to having a greater level of disclosure in the GPFR is that the ACFR becomes an instrument for collecting supplementary data for analysis by the Department, rather than being the primary source of data for assessing whether an entity is at risk of financial failure. This role will now be primarily filled by the GPFR as it will provide information on the whole of the entity which will be a better guide as to its future viability and other risk factors.

Directors' Declarations

Currently, the ACFR and APCS does not require a Declaration by those charged with governance (Directors) stating that the information provided is true and correct. A Key Person, being an executive member of management, can lodge and sign the minimalist Declaration that now exists.

We **recommend** that included in the GPFR is a Declaration by the Directors that the entity has complied with Part 5 of the *Fees and Payments Principles 2014 (No.2)*. The Declaration would attest to the information contained in the APCS and in relation to the permitted use of RAD's as well as other matters contained in the APCS.

Such a Declaration would be in addition to the existing Directors Declaration in relation to the financial statements which includes the ability to "pay debts as and when they become due and payable". Similar Declarations are required for other legislation which may affect an Approved Provider such as the NSW *Charitable Fundraising Act 1991* or similar state-based Acts.

Audit Opinions

Currently, the GPFR and the APCS requires an audit opinion whilst the ACFR does not require an audit opinion.

We **recommend** that the Audit Opinion as included in the GPFR be required to include another Assurance Opinion on the Approved Provider's compliance with Part 5 of the *Fees and Payments Principles 2014 (No.2).*

The Audit Opinion would be based on an audit conducted in accordance with the applicable Standards on Assurance Engagements (*ASAE 3100 Compliance Engagements)*, issued by the Auditing and Assurance Standards Board and with the Approved Provider's Compliance with the Prudential Requirements.

Continuous Disclosure

Currently, if there are breaches of prudential rules they are not disclosed to the Department until the APCS is lodged each year by the due date of 31 October, which can be up to 16 months after the event has occurred.

We **recommend** that a continuous disclosure regime operate whereby Approved Providers will be required to notify the Department of certain breaches within a set timeframe. It is not suggested that this will involve all breaches, rather it be restricted to breaches that may signal that the Approved Provider is under financial stress. These would include:

- Not meeting minimum liquidity levels (mandatory levels if introduced or those as stipulated by the current Liquidity Management Strategy)
- Repayment of Refundable Accommodation Deposits being outside the specified timeframe (possibly within certain thresholds - one late payment may not signify an issue but several late payments over a short period may do so)
- Not meeting the Capital Adequacy ratio

These would provide the Department with early warning signs that an Approved Provider is in financial difficulty and may help to prevent an eventual financial failure.

We **recommend** that the APCS include specific questions in relation to whether the Approved Provider has had any of the above breaches during the fiscal year and accordingly, if they were notified to the Department within the set timeframe.

This would then have further legislative authority due to the Declarations noted above requiring to be signed by the Directors and the Auditors.

APPENDIX "A"

Proposal	**Recommendation**	**Priority**	**StewartBrown Comments**
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 may 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 with NFP's 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 the single entity basis might be counter-productive from collecting sufficient data about the financial position of the consolidated entity. The consolidated basis provides the best information as a single entity may reply 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	These would appear to be reasonable constraints. Ensuring proper security over assets would be worthwhile - may have to mandate a valuation of the assets over which security is held.

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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 for smaller providers 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. EY are suggesting a higher ratio for smaller providers - this may force some providers out of business. EY's own evaluation said that the exit of some providers is a risk. This may be an issue in regional and remote areas where no alternate provider is wishing to enter. This may be more a matter of providing guidance on liquidity rather than setting firm thresholds. If any requirement along these lines was introduced it would need a transition 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. May be some compromise on the phase in ratios - need 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 much as anyone as their cash to bond ratios are very low. For most not-for-profits that were around in the capital grant era, and for those mature organisations this should not be an issue, but if organisations have largely been relying on external debt and have been on a continuous growth strategy it may be an issue.
	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	This is reasonable - it is the way that most funds would be held now. The unencumbered cash could be an issue as most security arrangements with banks etc. are to have security over all the assets of an entity. It needs to be clear that these ratios will be based on the total cash or liquid assets of an organisation and that we are not stepping back into the realm of having cash quarantined as "RAD cash". We recommend that <u>unrestricted</u> bank facilities (overdraft or line of credit) be calculated on the basis of 50% of the limit (rather than the full limit or available borrowings) as the use of such a line of credit could be utilised for a non-Permitted Use purposes.

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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 perspective there will be some issues around the organisational/group structures. Reference to *APS 110* which is APRAs *Prudential Standard on Capital Adequacy* is worth considering. If a capital adequacy measure is introduced, given some of the exiting bank covenants , new construction may stall in the first instance. This recommendation may be modified if there is also more clarity and a minimum standard for liquidity.
	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. However, according to ASIC and the Accounting Standards bed licences can't be valued, and they are likely to lose their value should there be a deregulation of residential places. We recommend that this be restricted to tangible assets - may cause issues for listed entities and some private providers who are more likely to have values attached to bed licences.

[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.

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Proposal	Recommendation	Priority	StewartBrown Comments
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 28 days notification period of "a change of circumstances that materially affects the approved provider's suitability to be a provider of aged care". This is moving toward continuous disclosure and there will need to be some clarity about what type of events will require a notification. Currently defined under S8.3 which is very broad and somewhat subjective.
	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	Would have thought this was required as it stands as part of the approval of key personnel - but again will need clarity around "material changes". For example, Boards of NFPs and CEOs as well as for-profits change and evolve on a regular basis - practicality around getting prior consent for these changes are not tenable. If the recommendation relates to situations such as the sale or transfer of an approved provider entity, then that may be tenable – similar to ACCC rules - but will need to have minimum approval times in any regulations.
	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)	Extreme	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 amount quarterly. Would not be necessary if capital adequacy ratio is not adopted - preferred option. All other information is currently disclosed.

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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	Agreed, this has already been actioned. Currently the APCS is signed by a Key Person rather than the Directors. We recommend that it be a requirement for the Directors to sign the APCS.
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 responsibly ▸ 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	We agree that increased governance is a primary consideration, and the Governance Standard is the appropriate mechanism. Code of Conduct, etc could be incorporated into the Governance Standard.
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.

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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 no 2* would cover this as far as refunding arrangements. Ranking upon winding up is problematic as they would currently rank as unsecured creditors. This may cause confusion for consumers (residents and family) with the main requirement to clearly disclose that RADs are guaranteed by the Government (and the limits around this guarantee). How the deposit funds 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. Suggest this be modified to disclose in what form minimum liquidity amount is held.
I. Limit or phase out discretionary trusts	**I1.** Allow no new discretionary trusts in Approved Provider group structures	High	TBA - This will affect private providers and may have tax implications. It would be beneficial to know how many providers would be affected and in what way. We would imagine that structures such as tax would mainly be used for tax minimisation purposes rather than to strip assets.
	I2. Phase out discretionary trust structures in a 5-10 year period	Extreme	EY evaluate benefits as: • More financially robust Approved Providers • Reduce incidence of those • Approved Providers using corporate structures to move assets away from liabilities • Increased ability to track Accommodation Payment money and Permitted Uses more easily

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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	Will only be an issue if the minimum capital adequacy ratio recommendation is adopted. This should be determined in conjunction with the minimum liquidity amount prescribed. Need to consider the implications for NFPs - what mechanisms do they have to inject additional capital. 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.

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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

APPENDIX "A"

Proposal	**Recommendations**	**Priority**	**StewartBrown Comments**
Overarching systematic risk management framework (continued)	**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. New operating model for PRCS to Administer Prudential Standards	**M1.** Assess demands and develop target operating model to support the new regulatory framework		Agreed
N. Strengthen tools, resources and capability in PRCS to improve compliance function	**N1.** Collect data and enhance the analytics capability within PRCS to assess and understand risk profile of Approved Providers in light of the revised the Prudential Standards		Agreed
	N2. Enhance number of resources and the use of more sophisticated tools in the PRCS to conduct compliance activities		Agreed
O. Enhance the end-to-end processes and collaboration with respect to the compliance of approved Providers	**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		Agreed

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APPENDIX "A"

FURTHER OPTIONS (DEPARTMENT OF HEALTH)

Issue: *Risk/Response*	Recommendations	Priority	StewartBrown Comments
10. Assessment of financial liability	**AA1.** Create legislative authority to support the assessment of the financial viability of Approved Providers: ▸ Allow independent review by the Commonwealth of provider's current financial information (audited and unaudited) ▸ Allow the Department to require the provision of current financial information where there are concerns of provider's financial viability when warranted ▸ Allow the Department to require the provision of relevant supporting information including current financial reports for the provider and/or related entities where there are concerns relating to a provider's financial viability, prudential compliance and/or permitted use		Agreed. We suggest that these recommendations be integrated with enhancing the Governance Standard to ensure more accountability by the Directors. The requirement for Directors to include the Prudential Disclosures in the GPFR and the Auditors Report to be also included will assist in the governance accountability. If a approved provider fails to meet the required capital adequacy or liquidity threshold, the responsibility should be for the organisation to advise the Department in the first instance (and the APCS include a question as to whether such an circumstance occurred). The places the accountability firmly with the Directors who could be held personally liable if there was a deliberate default.
	AA2. Require Approved Providers to inform the Secretary (under Section 9(1) of the Act) of concerns relating to financial viability		Agreed (refer above).
	AA3. Support the migration of all providers to Tier 1 financial reporting		We believe this will be very onerous on a number of providers. We suggest that the Principles be amended to include compulsory adoption of certain Accounting Standards if applicable.