

Aged Care Royal Commission

Report on Profitability

and Viability

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A report released by the Royal Commission into Aged Care Quality and Safety has highlighted:

- A lack of transparency relating to financial performance;
- A weak relationship between financial metrics and the quality of care provided; and
- The need for more comprehensive and consistent data on financial performance.

For more information please contact us to discuss how the report may impact your business

----- The Report -----

On 9 September 2020, the Royal Commission into Aged Care Quality and Safety released a report on the Profitability and Viability of the Australian Aged Care Industry ("**Report**"). The Report, prepared by BDO, utilises unpublished data held by the Commonwealth Department of Health to consider the profitability and viability of providers.

Key aspects of the report that are considered in further detail below are the financial viability of aged care businesses, the relationship between financial metrics and quality of care, business models currently utilised in the sector and perceived issues with lack of transparency and useful data.

The Report may have various implications for the direction of public policy in the aged care sector. Accordingly, we also consider the recommendations set out throughout the Report.

----- Business Models -----

An area receiving significant consideration in the Report, is the business models utilised in the aged care sector. In particular, the use of complex group company structures. Both positive and negative aspects of the capacity for companies to utilise these structures were considered.

The current national financial framework of aged care accommodates sophisticated investors who use complex structures in order to maximise returns. By maximising the capacity for profits this theoretically reduces the requirement or quantum of funding by the Commonwealth. However, the Report notes that group structures decrease transparency and increase the risks of having to pursue defaulting RAD loans and they make it difficult to understand return levels.

This issue of transparency gained attention in the Report, with various references to the need for increased transparency in the aged care sector. This is considered in greater detail below.

----- Lack of Transparency -----

According to the Report, there is significant difficulty in understanding various aspects of financial performance of providers including the return on investment in the aged care sector.

The reasons for this lack of transparency include the use of group company structures and the use of related parties to generate returns. The Report emphasises that increased transparency would allow for more informed decision-making regarding policies and investment decisions.

Accordingly, the Report recommends improving transparency within group structures including with regard to returns or losses made by approved provider's related parties, the relationships between these parties and the terms of transactions with related parties. To improve transparency, it recommends that financial reporting at the consolidated group level may be required.

----- Relationship Between Income and Quality of Care -----

BDO note that they were tasked by the Royal Commission with investigating the link between providers' finances and care indicators. The Report found only a "weak" statistical relationship between the financial metrics of an aged care provider and care indicators. The Report also noted that an issue with the current funding framework is that it allows for group company structures that weaken the relationship between the drivers of returns and the quality of aged care services provided by the provider.

This finding is significant for a number of reasons, including that this suggests that the Royal Commission is continuing to look closely at the relationship between ownership and quality of care. This provides a strong indicator that the Royal Commission is highly likely to recommend significant reforms in the financial framework that underpins the aged care sector and associated issues like permissible ownership structures and reporting requirements. Just how willing the Royal Commission is likely to be to recommend regulating sensitive issues like returns will be revealed in its final report, which is currently due to be provided on 26 February 2021.

----- Increased Data Requirements -----

Related to the perceived lack of transparency in the sector, the Report recommends that the Commonwealth collect more data on the financial activities of companies in the aged care sector.

According to the Report, there is a lack of useful, consistent data and of particular note, a lack of reporting requirements for home care services at the approved provider level.

Given the focus throughout the Royal Commission on the lack of available data to assist decision making in the aged care sector, a recommendation for consistent data collection is likely to be adopted by the Royal Commission.

----- Profitability and Viability of Aged Care Businesses -----

The Report gives significant consideration to the profitability and viability of businesses in the aged care sector. According to the Report, the introduction of Consumer-Directed Care in February 2017 has led to a major decline in profits, with the profit margin decreasing from 10.7% in FY2017 to 3.7% in FY2019. **Significantly, the Report found that the 10 largest aged care providers operated at a loss in FY2018 and FY2019.**

The Report has the following findings with respect to the number of companies that are either not profitable or are not or may not be viable in the sector in FY2018.

Company	Not Profitable	Not Viable	May not be Viable
Approved Providers	13.3%	8.3%	39%
Residential Aged Care Providers	12.1%	10%	39%
Home Care Providers	29.5%	Unknown	Unknown

----- Recommendations and Potential Consequences for the Sector -----

According to the Report, greater transparency is required regarding returns and losses, profitability and viability, financial support received by operators, expenses and other non-aged care related activities that would benefit policy making and decisions related to investment. However, the Report also advises caution in the implementation of any new policies in this area as new policies could have significant implications on the return on investment for investors and the viability of the sector as an investment asset class. In particular, the Report notes that the use of company structures is "perfectly reasonable".

The findings of the Report are likely to play a significant role in shaping public policy development.

The Report also highlights the Royal Commission's focus on the relationship between income and the quality of care provided and the need for the Commonwealth to harness further data to assist its policy decision making – these issues and recommendations for data collection and transparency are likely to feature prominently in the recommendations of the Royal Commission.