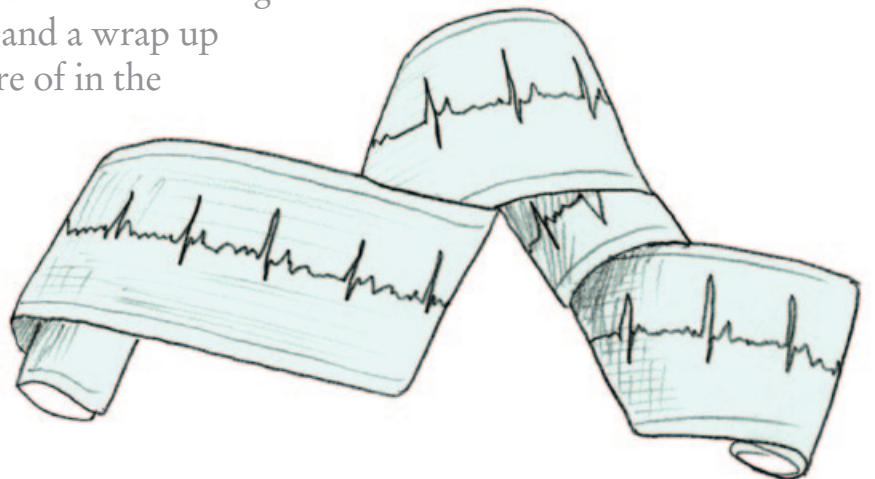


Regular research papers and articles providing sector specific insights and issues analysis – Aged Care sector.

March edition 2011 – Aged Care

Industry Intelligence Unit

Welcome to our sixth Aged Care sector IIU publication. Much has happened in the industry since our last aged care edition. In this issue we examine The Productivity Commission Report, including a look at possible accounting and reporting considerations arising from its recommendations. We also take a look at the findings of last year's survey of retirement villages, which was undertaken by Grant Thornton in collaboration with the Retirement Villages Association. Looking further afield we include a summary of New Zealand's Aged Residential Care Service Review and a wrap up of issues for financiers to be aware of in the next 12 months.



The Productivity Commission Report

On 21 January 2011, the Productivity Commission delivered its long awaited draft report on its comprehensive review of aged care in Australia: Caring for Older Australians. The Commission has made good use of over 500 public submissions to the review as well as their own industry examinations.

The Commission has recognised that the sector requires a complete overhaul, rather than simply fine tuning, if Australia is to have a sustainable aged care system in the future. Recommended initiatives included relaxation on price limits on services and accommodation, including restrictions on accommodation bonds in ordinary high care facilities. Supply restrictions would also be phased out over time and the current managed bed policy would be abolished after five years.

Funding for the investment in improved services would be facilitated through a “user pays” system and public subsidies that would be more closely aligned to the cost of delivering care and accommodation. Existing discrete residential and community care services would be replaced with a single, integrated system of care provision and users of those services would have more choice around the setting in which they receive care (in a quasi “voucher” style model) and their preferred provider.

The report put forward a number of innovative strategies, including a Government managed Equity Release scheme which would enable consumers to make accommodation payments and

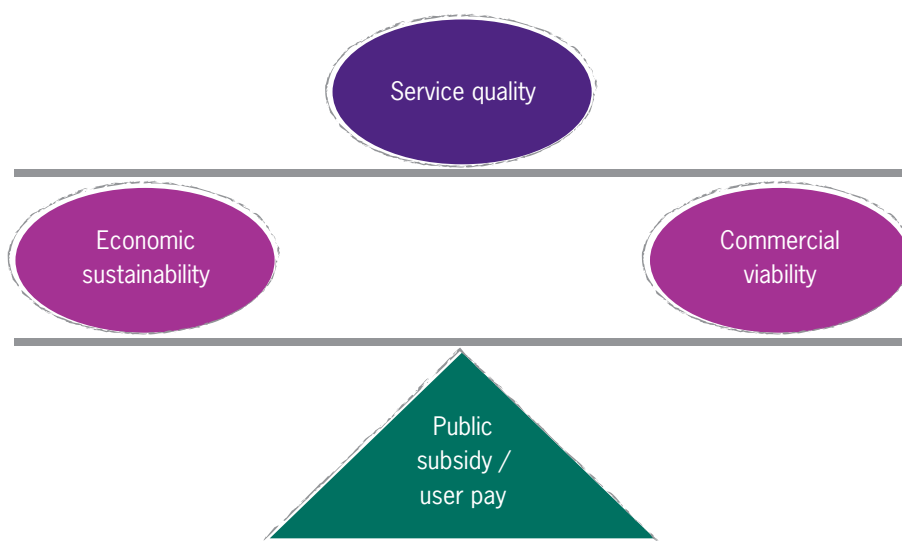
care co-payments without having to sell their homes. An alternative in the form of a new Australian Pensioner Bond scheme would provide pension protection by allowing older Australians to invest the surplus proceeds from the sale of their primary residence. Age pensioners could draw on their bond to fund living expenses and aged care costs.

The report also calls for the creation of a new agency to assume many of the regulatory roles currently undertaken by the Department of Health and Ageing. Called the Australian Aged Care Regulation Commission (AACRC), it would also take on responsibility for complaints handling and the Aged Care Standards and Accreditation Agency.

The implications

Adoption of these recommendations will go a long way to ensuring that older Australians are able to access the care they need in their preferred setting. The recommended reforms unquestionably open the door for a more viable aged care sector, fuelled by innovation and responsiveness, and tempered by increased competition. Greater levels of consumer contribution will be the driver of greater choice whilst fostering a more sustainable and equitable industry.

Grant Thornton estimates that more than \$21 billion of investment will be required in residential aged care infrastructure over the coming decade. This includes the re-development of



dated facilities as well as sector expansion to accommodate an ageing population. The Commission's recommendations address the major impediment to sector growth – access to capital – and provide for the establishment of suitable pricing mechanisms for accommodation payments for those unwilling or unable to commit a lump sum upon entry.

The proposed changes will not be good for everyone. The report suggests that a more responsive and innovative market will test the management skills of some providers and not all are expected to survive. Those operators that have been solely focused on accessing high care bonds and the deregulation of pricing may not be ready for the competitive pressures that will accompany these changes.

Nevertheless, the recommended changes are inevitable – consumers will make a greater contribution towards the cost of the same services they've been paying for their whole lives, and they will be subsidised for direct aged care services. Future generations of older Australians will not have to accept sub-optimal aged care services and accommodation because the Government will not let them invest in their own wellbeing.

Where to from here?

The Commission has invited responses to the draft report by 21 March 2011.

While there has been some negative sentiment expressed toward specific areas of the report, the Commission's recommendations will help to secure improved accessibility, choice and aged care service quality.

This article is an excerpt from a lengthier Grant Thornton publication, "Productivity Report: Caring for Older Australians – Issues for Consideration". To access a copy of the full detailed publication in its entirety, [click here](#).

by **Cam Ansell**

National Industry Leader – Aged Care
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The Grant Thornton / Retirement Villages Association Survey

Between June and December 2010, Grant Thornton and the Retirement Villages Association (RVA) analysed feedback from the operators of over 320 retirement villages accommodating in excess of 30,000 residents throughout the country. Operators and residents were asked to articulate their views on emerging priorities for consumers and to provide comprehensive data regarding the accommodation and services being delivered to meet those priorities.

This study comes at a crucial time of transformation within the industry. Whilst Australia's ageing population will demand a substantially greater investment in seniors' accommodation, historically low penetration rates understate the potential of just how successfully this industry could grow.

Our research explores not only the current state of the market, but contrasts the changing expectations of future generations of consumers. In doing so, investors, operators and residents can help to unlock the true opportunity of a sector that will become one of the most influential for Australia's construction, health and service markets.



Summary of findings

- Residents are entering retirement living older than expected. They are staying for shorter periods of time and are increasingly demanding assistance with their care needs. Their range of life interests and discerning characters demand more privacy, space and breadth of services and activities.
- Reputation and affordability of villages remain the two highest ranking resident priorities.
- Over 70% of operators surveyed considered that the provision of on-site care services was a critical priority for the majority of residents. The overregulation of aged care services was considered to be the major hurdle in meeting this priority.
- The "Loan License" contracting model remains the most widely used in Australian retirement villages.
- Villages with residential aged care services have older residents who have a shorter length of stay than villages without nursing homes or hostels.
- Operators acknowledged a significant flow-on effect from the slump in the property markets. Three quarters believed the sector was now recovering and that sales were improving.
- There is a low level of understanding of the advantages of retirement living among baby boomers.
- The reforms currently anticipated in the aged care sector are likely to have a dramatic impact on retirement living in Australia.

These findings are a brief preview of the full survey findings report, which is available on the Grant Thornton website by [clicking here](#).

Issues for aged care and retirement village financiers to be aware of in the next 12 months

Productivity Commission draft report *Caring for Older Australians*

Although still a draft (which has invited feedback and submissions by 21 March 2011), it is expected to have some significant impact for financiers. These may include:

- Impact on banks' security by the removal of allocated places to a user pays system and public subsidies
- Establishing the cost of accommodation supply will be more complicated than analysis of original construction costs
- Cost of construction is not defined in the report to include the cost of land
- The move away from accommodation bonds to accommodation charges may necessitate lends which are based on cash flow rather than loans against assets.

Cash is king

Cash is the lifeblood of any business. Bankers, investors and professional advisors are now focusing on the often ignored sustainable and residual cash flow generated by businesses rather than simply placing emphasis on the "value to loan" position. The current lends are taking into account the borrower's ability to cover not only the interest payable but the serviceability of the debt.

Location

There is continuing demand from bankers and investors for well located, quality properties with low ongoing service fees. It is unlikely that banks will fund building many more retirement villages on the outskirts of towns and cities, but would consider funding appropriate facilities close to existing services, community facilities and transport.

Valuations

Residual land values have started to move up in certain locations, however, bankers are very cautious of valuations given the issues they faced during the GFC and the downturn which followed. Bankers will still be required to be "conservatively optimistic" when extending facilities based on new entrants or greenfield developments.

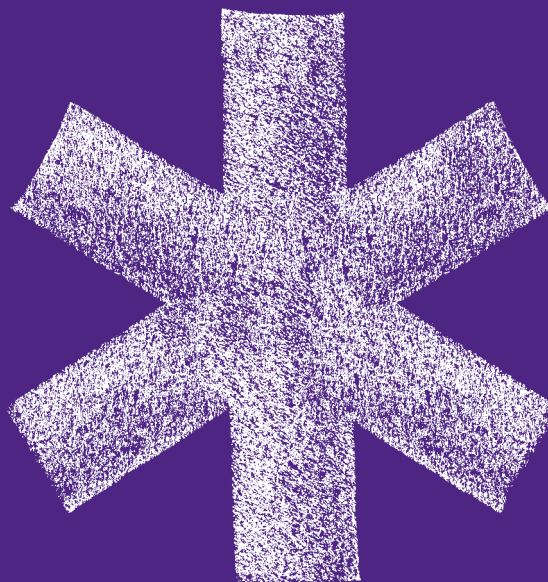
Management / Operators / Providers

This is still the most important aspect for banks to consider. It is unlikely that new entrants to the industry with little experience would be supported in the current environment. Incumbent operators and providers will need to:

- improve the choice and quality of accommodation that can be offered to aged care recipients which will result in increasing access to capital funding
- improve the quality of services that can be offered to aged care recipients by ensuring that recurrent funding is reflective of the real cost of care
- plan for the construction and renovation of services in response to consumer demand
- direct key resources - often wasted on unreasonable regulatory compliance requirements - back to care provision.

with Trevor Pogroske

Director - Recovery & Reorganisation
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Accounting and reporting considerations arising from the Productivity Commission recommendations

Whilst the Productivity Commission didn't specifically address the reporting and accounting requirements of operators in the aged care sector, it would be fair to say that the recommendations which have been proposed would have a significant effect on the regulation of financial information as well as the accounting concepts to deal with the new transactions proposed. Currently, the regulation and reporting for aged care operators is principally set out by the Aged Care Act 1997 and User Principals, in conjunction with the Department of Health and Ageing (DOHA). In summary the requirements for financial reporting are as follows:

- Requirement for audited general purpose financial statements four months after year end.
- Audited Prudential Statement four months after year end. These statements deal with liquidity, disclosure to non-residents and maintenance of records.

The proposed transfer of responsibilities from DOHA to the Australian Aged Care Regulation Commission (AACRC) will no doubt change the reporting requirements set out above. In particular, the burden of producing general purpose financial statements regardless of the definition under the Australian Accounting requirements or type of entity structure must be reviewed. In addition the Prudential Statement, which was implemented as part of the regulation to monitor the guarantee

of accommodation bonds, could be replaced, due to the recommended change in the nature of accommodation bonds.

The accounting aspects in relation to the recommendations will only become apparent once more details on the transactions effecting the aged care sector are presented, however the following issues may arise:

- **Recognition of revenue** – the proposed exposure draft on revenue recognition and the recommendation set out by the Productivity Commission could see a change in how aged care providers recognise revenue from residents. Under the current standard, revenue is recognised when the risks and rewards of ownership of a product or service are transferred to the customer. Under the proposed model, revenue would be recognised only when the customer obtains control of a transferred product or service. This could have an effect on the manner in which aged care providers have previously recognised revenue in relation to accommodation charges and would mean that these entities could only recognise revenue as the entity satisfies each performance obligation with the resident.
- **Intangibles** - In particular the accounting treatment of bed licences in relation to possible impairment, valuation of bed licences and legal status of the licence could change under the recommendations where

the licence no longer has an economic value or a legal title.

- **Impairment** - Aged care providers would need to assess 'old' assets which may be impaired based on low occupancies due to market decline.
- **Leases** - The Australian Accounting Standards Board has released an Exposure Draft on leases which proposes putting all leases on the statement of financial position. These proposals can be expected to have significant compliance implications for many entities which rely on leasing. The effect of loan agreements and bank covenants may need to be considered as a result of bringing liability on to the statement of financial position.
- **Financial instruments** - The accounting treatment for accommodation bonds and the legal nature thereof would need to be considered following the Productivity Commission recommendations. The substance over form of these agreements would need to be modelled into the accounting treatment in compliance with Australian Accounting principals.

with **Andrew Rigele**
Director – Audit & Assurance
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New Zealand aged residential care service review

In September 2010 Grant Thornton New Zealand published the findings of the most extensive review of residential aged care services in New Zealand ever undertaken, with the highest provider participation rate of any comparable international study.

The review was commissioned by leaders from the residential care sector and New Zealand's District Health Boards (DHBs), to comprehensively assess the cost, capacity and service delivery implications of the increasing number of elderly New Zealanders likely to require aged residential care services. The review was undertaken by Grant Thornton New Zealand and managed by a steering group comprising sector and government representatives. The steering group was assisted by an expert advisory panel of clinicians, academics and representatives of providers and DHBs.

The review identified an urgent need to take steps to plan for the residential care of New Zealand's ageing population. The report warns that by 2026 the over 65 population is expected to increase by 84 per cent, from 512,000 to 944,000 people. During this period the overall population is projected to grow by 20 per cent, from 4.2 million to 5 million. This will mean that by 2026 an additional 12,000 to 20,000 people will require aged residential care. There are currently just 34,000 aged care beds in New Zealand.

Chris Fleming, the Lead CEO for Health of Older People for the DHBs said, "We all see the release of this report as the start of an ongoing collaborative

process to seek solutions. We recognise that a comprehensive and coordinated response to the challenges presented is required rather than a reactionary response which fails to take into account the overall policy direction required".

In other key findings, the report says that by 2026:

- The supply of facilities needs to increase by between 78% and 110% per cent to meet the projected increase in residents and to replace older facilities. Demand for rest home care will begin to increase between 2012 and 2015.
- The current operating profits from stand alone residential care facilities are insufficient to stimulate the required private sector investment.
- The workforce needed to service the aged care sector must increase by between 50% and 75%.

"The key question arising from this review was not if these pressures were going to arise, but when, over what period and to what degree," the review says. Future investment in the residential aged care sector will require a significant lead-in time, the review notes. "As such, clearly articulating the priorities pertaining to costing, demand, supply, workforce and models of care will enable us to move forward off a robust base ensuring the appropriate environment is developed to meet the challenges ahead."

with **Cam Ansell**
National Industry Leader – Aged Care
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The review has identified four scenarios for the delivery of residential aged care services in the future:

- Improving the current approach: Addressing key issues in the current model.
- Enhancing professional services in the community: Developing community-based models to allow for funding for acute hospital and other services to shift to services focused on prevention and quality of life.
- Individualised funding: Empowering individuals to make their own choices to reduce the need for centralised co-ordination.
- Special purpose low income housing for the elderly: Providing joint housing options for older people between their own home and residential care.

To access a full copy of Grant Thornton New Zealand's "Aged Residential Care Service Review", [click here](#).

Industry Intelligence Unit

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The IIU is unique in its objective of providing stakeholders with information, understanding and analysis of the issues faced within specific industries and sub-industries. The IIU also seeks to provide pragmatic, commercial, practical measures and initiatives to improve stakeholder value.

Industry focus

The IIU utilises the industry experience and expertise of Grant Thornton partners and staff across Australia. The IIU is predominantly focused on the following industries and their related sub industries:

- Property
- Retail
- Aged Care
- Automotive
- Hospitality
- Financial Services
- Professional Services

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