How will changes to aged care accommodation bonds affect your business?

Deals Point of View - Health

February 2012

In our conversations with clients it has become clear that they are considering the implications for their businesses of recent changes to the Aged Care Act.

What has changed?

On 1 October 2011, changes to the Aged Care Act 1997 and User Rights Principles 1997 relating to aged care accommodation bonds came into effect. The aim of these changes is to protect the savings of residents, ensure the continued availability of capital funding for aged care infrastructure and promote public confidence in the aged care system.

It was considered that these changes were necessary in light of a number of financial failures by aged care service providers since 2006 and recommendations made by the Australian National Audit Office in 2009 to strengthen the regulatory approach so that funds from accommodation bonds were being used in line with the legislative requirements.

Essentially, these changes:

- Restrict the permitted uses of bonds to - capital works, investment in certain financial products, loans for these purposes and refunding bonds
- Introduce new criminal penalties for mis-use of bonds when there is subsequent financial failure
- Introduce new information gathering powers where there are signs that a provider may be experiencing financial difficulty
- Remove existing restrictions on the use of income derived from bonds, retention amounts and accommodation charges.

Key to these changes is that bonds must not be used to cover the normal day to day costs of operation.

Changes have also been made to the ability for an organisation to transfer the proceeds of bonds between entities within a group of companies. Loans of this nature must not be made to an individual, must be made on a commercial basis, must be appropriately documented and funds lent must only be used for aged care capital expenditure or investment in financial products.

While a range of restrictions have been introduced on the use of accommodation bonds, restrictions previously in place on the use of income derived from these bonds have been lifted.

Bonds acquired before 1 October 2011 can still be used in line with requirements that were in place prior to these changes being made, ie that these funds must be used for purposes related to aged care – including both capital and non-capital expenditure. There will be a two year transition period until the end of September 2013 to allow providers to make any necessary changes.

These changes will have an impact on the providers of aged care residential facilities.

What will be the impact of these changes?

Some providers may need to change their operating and financial management arrangements, which will impact on costs. The degree of adjustment required will depend on existing arrangements. For those providers that use bonds to intermittently meet operational expenses they may need to maintain high cash balances or draw on a credit facility to meet these variations in the future. Where providers regularly drawdown on bonds to support operations they are likely to have higher adjustment challenges and will need to identify alternative sources of financing or to make operational changes so that revenues and costs are more closely matched. Some may struggle in isolated cases.

These changes may cause providers to examine their property holding/operating business models, or at least push such structures, to ensure there is a tighter and closer relationship between the payment of the bond and the ability to recover the bond from related parties.

Changes to the permitted use of income streams from the investment of bonds are also significant. Providers will be able to use that income for any purpose and not necessarily in connection with the provision of aged care services. This may counter the effect of tighter restrictions around the use of the principal amount, mitigating the impact for some providers.

Increased accountability and disclosure measures are likely to have implications for a provider's reporting systems for some providers. Changes could also require the implementation of different accounting procedures and changes to data management and reporting systems to ensure that required data is captured and available.

The introduction of criminal sanctions represents a substantial change in the severity of penalties for non-compliance. It will not be necessary that non-permitted use of accommodation bonds actually cause insolvency for these penalties to apply. It must only be the case that a breach occurred within two years prior to an insolvency event. It is therefore of great importance that providers fully understand their obligations under the legislation and are in no doubt with regard to their compliance.

More changes to come

In June 2011 the Productivity Commission delivered its final inquiry report on the aged care sector, 'Caring for Older Australians'. This inquiry examined the social, clinical and institutional aspects of aged care. Adoption of the recommendations made in the report could significantly change Australia's aged care sector. Key recommendations relate to:

- Transparency – through improved access to information, including performance data and pricing
- Competition levels – constraints within the industry will be addressed, including the removal of the distinction between high and low care and allowing providers to charge market prices for services
- Funding – through changes to the use of accommodation bonds.

Aged care providers in Australia are facing the prospect of substantial change within the sector as a result of recommendations in the inquiry report. There are likely to be further changes to the funding of aged care and the accommodation bond system in addition to those that have already been made.

In addition to restrictions on the use of accommodation bond funds already introduced, service providers may need to adjust to alternative funding models. It is proposed that residents should have the option to make periodic payments rather than purchasing accommodation bonds and that their choice between these should essentially be financially neutral – rather than the current system which is biased towards accommodation bonds. This will change the capital structure of service providers and commercial sources of finance will need to be found to replace accommodation bonds.

As providers consider appropriate changes to manage the current transition they will need to be mindful of the potential for more substantial change. Providers should start making improvements to their funding and capital models (given the changes to bonds) and the suitability of their operating models (niche or large scale) now so they are already in place before any changes happen.

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