***User Rights Amendment Principles 2011 (No. 3)* – Amendments to regulatory arrangements for Aged Care Accommodation Bonds**

REGULATION IMPACT STATEMENT

1. *Background*

This Regulation Impact Statement (RIS) should be read in conjunction with the *Aged Care Amendment Act 2011* RIS, refer Appendix 1.

This RIS considers amendments to the *User Rights Principles 1997* (the Principles) which are intended to complement the changes made to the *Aged Care Act 1997* (the Act) by the *Aged Care Amendment Act 2011* (Amending Act).

In addition to the broader requirements with which aged care providers (approved providers) must comply (such as the *Corporations Act 2001*), the Act describes the regulatory framework within which Australian Government-subsidised approved providers must operate in order to obtain funding. The Act prescribes the rules relating to the charging and use of accommodation bonds (bonds).

Bonds are in effect unsecured, interest-free loans paid by care recipients to approved providers, which must be used for permitted uses, and refunded upon the care recipient leaving the service (less permitted deductions). The original policy intent was that bonds be used for capital funding for investment in building stock (and retirement of associated debt).

Since the introduction of the Act in 1997, there has been strong growth in the value of bonds. In the four years between 2006 and 2010, the total value of bonds increased by around 20 per cent per annum, to more than $10.6 billion. As at 30 June 2010, approximately 950 approved providers held bonds on behalf of more than 63,000 aged care recipients (there were 1,150 approved providers of residential and/or flexible aged care services at 30 June 2010). The average bond agreed with a new care recipient in 2009-10 is estimated to be $232,000 and the median new bond amount is estimated to be $220,000. The average total bond holding by an individual approved provider in 2009-10 was $11.2 million. There are a small number of approved providers that hold bonds in the hundreds of millions of dollars.

In response to the growth of bond holdings the Australian Government established three Prudential Standards in 2006. The Prudential Standards, made under the Principles, are designed to assist approved providers to comply with their requirements to refund bonds when they fall due, maintain records for the tracking of, and reporting on, bonds and disclose appropriate information to the Department of Health and Ageing (the Department) and to care recipients, prospective care recipients and their representatives.

In 2006 the Australian Government also introduced the Accommodation Bond Guarantee Scheme (Guarantee Scheme). Under the Guarantee Scheme the Australian Government guarantees repayment of bonds to care recipients if an insolvent or bankrupt approved provider defaults on its obligation to refund bonds. In the event of the Guarantee Scheme being triggered, there is provision for the Australian Government to levy approved providers to recoup the monies repaid and any administrative costs. Since its inception in 2006, the Guarantee Scheme has been triggered five times at the cost to the Australian Government of around $24.5 million. The Australian Government has not elected to levy approved providers

to date, however, the aged care industry is aware that the Government has the capacity to do so.

In its 2009 report, *Protection of Residential Aged Care Accommodation Bonds,* the Australian National Audit Office (ANAO) recommended that the Department improve its regulatory approach to include reviews of whether approved providers are using bonds for the purposes required under the Act.

The combination of the triggers of the Guarantee Scheme and the exponential growth in bond holdings led the Australian Government to announce in April 2010, as part of the *More Support for Older Australians* component of the *National Health and Hospital Network,* that it would move to strengthen the prudential arrangements for bonds.

The Amending Act, which received Royal Assent on 26 July 2011, amends the Act to:
- limit the permitted uses for bonds (such that approved providers may use bonds for capital works, investment in financial products, loans for these purposes and refunding bonds)
- introduce new criminal offences where misuse of bonds has been identified and the approved provider has failed financially while owing bond refunds
- introduce new information gathering powers to enable the Secretary of the Department to better monitor approved providers that may be experiencing financial difficulties or using bonds for non-permitted uses
- remove restrictions on the use of income derived from bonds, retention amounts and accommodation charges. This provides approved providers with greater flexibility in managing their cashflows and assists to offset the restrictions on use of the lump sum element of bonds.

A two year transition period was introduced to allow approved providers to make adjustments to comply with the permitted use requirements.

Provision to expand the list of permitted uses (by way of the Aged Care Principles) was included in the Amending Act. The Government was acutely aware of the risks associated with creating a definitive list and of having an unintended negative impact on the aged care sector.

During consultation on the Amending Act, additional legitimate permitted uses were identified and it was flagged that strengthening the Prudential Standards through amendments to the Principles was also under consideration.

Stakeholders agreed that the proposed changes in the Amending Act provided greater clarity and expressly allowed activities such as the investment of bonds in financial products (previously a grey area). It was also understood that further changes to the Principles were necessary to complement the amendments to the Act by way of increased transparency and improved governance requirements.

2. *Problem*

The original policy intention was that bonds be used for capital funding for investment in building stock (and retirement of associated debt). Until changes introduced in the Amending Act, this had not been clearly articulated in the legislation.

Aged care regulation provides the only legislative guidance on bonds (as no other legislation contains a notion of 'bonds' for the purposes of aged care). As such, the Government cannot look to the *Corporations Act 2001* or any other legislative framework, to ensure these funds are used appropriately.

As noted above, bonds are, in essence, an unsecured loan paid by care recipients to the approved provider, which the approved provider is required to pay back when the care recipient leaves the home (subject to certain permitted deductions being made). The legislation requires approved providers to refund bonds as they fall due, however, in 2009-10 approximately 9.7 per cent of approved providers self-reported the late repayment of bonds.

The late repayment of bonds creates problems beyond the potential financial value of the loss to Government (through the triggering of the Guarantee Scheme). For care recipients, who are usually frail and elderly, the uncertainty regarding their life savings can create significant stress. In instances where the Guarantee Scheme has been triggered, this can also result in residents needing to be relocated to a new facility. In all instances, the late payment of bonds affects confidence in the sector and the source of capital funding that bonds represent.

Analysis of a sample of complaints taken by the Department in relation to bond refunds indicates that these events cause distress to care recipients and their representatives. One care recipient's representative reported to the Department that a late refund was causing hardship from the stress of not being able to pay the bond amount owed to a new facility and the safety of the bond balance. Another complaint from a law firm representing a care recipient reported to the Department that the care recipient was incurring legal fees while the firm corresponded with the approved provider about an absent bond refund.

The Department has also received complaints from approved providers regarding care recipients entering a new bond agreement after transferring from a closed service. The nature of these complaints was that the former service had not transferred the bond to the new service. This negatively affects the new service as it does not have the bond at its disposal and creates additional administrative burden to the approved provider through seeking transfer of the bond from the former service.

The Department's compliance monitoring program has identified ineffective governance as the key driver for both the late repayment of bonds and the triggering of the Guarantee Scheme.
While the changes to the Act commencing on 1 October 2011 put in place additional limits on the use of bonds, they did not require additional governance or monitoring arrangements (because these types of arrangements are generally addressed in delegated legislation (Principles) rather than the Act).

The question arises as to whether the changes to the Act are, on their own, adequate to achieve the policy objectives underpinning the changes. This problem should be understood in the context of compliance and governance failures occurring in the aged care sector, that occurred under the previous less stringent arrangements in the Act and current Principles that led to the need for change.

The question also arises as to whether the opportunity should be taken to promote better targeted information and informed choice on the part of prospective care recipients.

- **Governance in Aged Care**

Completion of an Annual Prudential Compliance Statement (APCS) is a requirement of the Disclosure Standard. In the 2009-10 financial year, 13 per cent of approved providers reported non-compliance with refund requirements, interest payments, bond agreement requirements and the Prudential Standards in their APCS. The most common area of non-compliance was the late repayment of bonds, with 9.7 per cent of approved providers reporting this. This rate has decreased from 13 per cent in 2007-08 and has stabilised between 2008-09 (10 per cent) and 2009-10 (9.7 per cent). Follow-up action by the Department found that late bond refunds were usually due to approved providers' inadequate administrative controls regarding the refund processes or a lack of knowledge by staff of refund obligations. These are circumstances where inadequate governance arrangements were the root cause of non-compliance.

Four of the five approved providers that triggered the Guarantee Scheme were single service approved providers and were all companies in which the shareholders were both directors and executive managers. In the majority of these cases the administrators and/or liquidators identified a poor state of record keeping, lack of senior executive oversight, poorly managed loans and investments and poor accounting records as having contributed to the failures. These issues were predominantly attributable to inadequate governance practices.

While the incidence of approved providers triggering the Guarantee Scheme is proportionately low, the effect on care recipients, who have trusted a significant portion of their life savings to the approved provider, is not. The need to find new accommodation, the adjustment to lifestyle from being forced to move away from friends and familiar staff, the process of moving and the uncertainty of the protection of their life savings can create significant stress. This stress does not accord with the objectives of the Act which include: "to protect the health and well-being of the recipients of aged care services."

Additionally, the refund of bonds through the Guarantee Scheme does little to address the moral hazard and high impact of the closure of residential care facilities on care recipients, their families and staff due to poor governance arrangements, mismanagement of bonds and insufficient disclosure arrangements.

Triggering the Guarantee Scheme should be seen as safety net only, as while the care recipients' funds are protected via this mechanism, the triggering of the Guarantee Scheme undermines public confidence in the sector and creates uncertainty for approved providers. The threat of the Commonwealth imposing a levy to recoup the costs of the Guarantee Scheme is of significant concern to many approved providers. Based on 2009-10 figures an approved provider holding $359 million in bonds would face a bill in excess of $829,000 should the levy be applied proportionate to bond holdings.

As well as direct effects of service failure, ability to repay bonds is part of a broader matter of financial health of services, which is necessary to ensure appropriate and quality care for older Australians in residential aged care. Good governance underpins good quality of care as well as supporting compliance.

From 1 October 2011 the Act will permit the application of bonds to permitted uses including in a wide range of financial products. Approved providers may invest bonds in financial

investments without appropriate consideration of the risks of those investments to liquidity. This may affect the ability of approved providers to repay bonds when they fall due.

From 1 October 2011, where an approved provider becomes insolvent owing bonds and a misuse of bonds has been identified, both the approved provider and its relevant key personnel can face criminal prosecution. A key to avoiding prosecution is to ensure that key personnel with responsibilities in relation to bonds clearly understand their responsibilities. The Department's monitoring in relation to the late repayment of bonds has found that poor governance is a significant factor that will increase the exposure of approved providers and their key personnel to the risk of criminal sanctions.

As noted above, there is currently no requirement on approved providers to have sound governance arrangements in place to manage bonds.

- ***Disclosure to Care Recipients***

Feedback from the aged care sector and consumer groups has identified issues with the current disclosure requirements, namely that the information provided is not well targeted to the needs of current and prospective care recipients and is not well understood. At the same time, providing this information to care recipients places a burden on the aged care sector. Without clearly framed and targeted information residents cannot make informed choices. In addition, there is currently no mechanism to enable care recipients, prospective care recipients or their representatives to monitor how approved providers invest bonds, their compliance with permitted uses or their governance arrangements. Consequently, the ability of people to make informed decisions about their own exposure to the risk of late bond repayments is limited.

- ***Disclosure to the Department***

Despite the introduction of permitted uses for bonds from 1 October 2011, there is no mechanism to periodically monitor approved providers in relation to the use of bonds. The improved monitoring powers provided for in the Amending Act only allow for monitoring where the Secretary believes on reasonable grounds that an approved provider is in financial difficulty or has used a bond for a use that is not permitted.

On the face of it, given past compliance and governance failures mentioned above, lack of transparency on bond use increases the risk of, and opportunity for, bond misuse. In order for the Department to monitor compliance and prudential risk under the new arrangements, it is important to gather and analyse information on compliance with permitted use provisions. As noted above, in instances where there is no reason for concern, there is no provision for information on bond usage to be routinely made available to the Department.

- ***Additional Permitted Uses of Bonds***

In addition to the matters detailed above, consultations have identified two potential additional uses of bonds that would support policy objectives for charging bonds, and avoid the need for unnecessary business restructuring to meet the requirements of the Act:

– some approved providers establish unregistered schemes in order to aggregate funds for the building of aged care facilities. Permitted uses allow only for registered schemes and therefore stop the use of bond funds to be invested in a current legitimate investment.

– capital investment is required during the start up of an aged care facility, including where a new facility opens and where an approved provider acquires an existing facility. Restricting the use of bonds to not include assisting to cover losses at start-up could be perceived as an unnecessary limitation on their use.

The additional uses potentially pose more risk than those in the Act, and extension to these may need to be balanced against governance, compliance and monitoring arrangements that may be in place.

3. *Objectives*

The objective of this RIS is to complement the changes made in the Amending Act to identify the best means by which to:

– ensure, as far as possible, that approved providers repay bonds when they fall due
– protect the more than $10.6 billion in bonds being held on behalf of care recipients
– protect the health and well-being of care recipients of aged care
– ensure that care recipients, prospective care recipients and their representatives have sufficient, targeted information to inform their decision-making in selecting an approved provider
– ensure that the Department is able to undertake effective risk-based regulation of the approximately 950 approved providers that hold bonds
– keep the regulatory burden on approved providers as low as possible
– promote public confidence in the aged care system
– ensure that bonds continue to be available as a capital source of funding to support investment in aged care infrastructure.

4. *Options*

Options considered during the policy development and consultation process included:

– the provision of education. This would assist key personnel of approved providers who want to comply with the current arrangements to do so. However, it would not address the significant issue of insufficient governance being a key factor in approved provider non-compliance. It would not provide the necessary impetus for change among poorly performing approved providers and would not strengthen the prudential arrangements for bonds.
– the reporting of permitted use expenditure of bonds through the General Purpose Financial Report (GPFR). Reporting permitted use expenditure through the GPFR process would have required amendments to the *Residential Care Subsidy Principles 1997*. Those Principles relate to subsidies and not the management and reporting of bonds.
– reporting of bond expenditure on permitted uses. This was strongly objected to by approved providers as it would require them to track bonds separately from other sources of revenue and would impose significant regulatory burden.
– the requirement for separate bank accounts for approved providers to deposit all bond funds. Stakeholder consultation showed this option would impose an unwanted financial and administrative burden on approved providers.

The consideration of these issues led to their distillation into two options.

Option A: Do nothing
Option A would maintain current governance and monitoring arrangements under the Principles; in effect not costing any additional requirements or monitoring in relation to the primary legislative changes.

This option would only allow the periodic monitoring of compliance with permitted uses in instances where the Department has reasonable grounds for concern that an approved provider is using bonds for non-permitted purposes or is likely to be unable to repay bonds.

Option B: Improved Risk Management Approach
Option B proposes to amend the Principles so that:
- a new Governance Standard is introduced, including the requirement for approved providers to have an investment management strategy (IMS) if they invest bonds in particular financial products
- the Disclosure Standard is amended to improve disclosure to the Department, care recipients, prospective care recipients or their representatives.
- permitted uses are expanded to allow for appropriate capital expenditure.

Each of these elements is designed to complement the arrangements that take effect as of 1 October 2011. These elements are described in further detail below.

Governance Standard
The proposed Governance Standard would require approved providers that hold one or more bonds to implement and maintain a governance system in relation to bond management.

Approved providers would not be required to adopt a particular governance system, but meet specified outcomes. The system would be outcomes based and ensure that appropriate mechanisms are in place relative to the size, nature and complexity of the approved provider's business model. This would provide flexibility to implement governance systems that fit all corporate structures.

As a minimum, the system would be required to achieve the following outcomes:
- allocating roles and responsibilities to the key personnel of the approved provider in relation to the management of bonds held by the approved provider
- monitoring and controlling any delegation or outsourcing of the allocated responsibilities
- reporting mechanisms for the allocated responsibilities that ensure the key personnel who are responsible for the executive decisions of the approved provider can effectively monitor and control the use of bonds
- ensuring that relevant staff are aware of the requirements of the Act and the Principles in relation to bonds
- detecting, recording and responding to any failure to comply with those requirements.

Approved providers would be required to keep written documentation describing the system and the results of any assessment or review of the system. Approved providers would be required to modify or replace the system if it no longer complied with the requirements.

Where an approved provider invests in financial products, other than a deposit taking facility (made available by an Authorised Deposit-taking Institution (ADI) in the course of its banking business), the approved provider would be required to implement an IMS. The IMS

would be outcomes based and depend on the sophistication and risks of the investment approach.

The IMS would include:
- the approved provider's investment objectives, including the level of assessed investment risk
- a strategy for achieving the objectives while also ensuring that the approved provider retains the capacity to refund bonds in accordance with the legislation
- the asset classes that the approved provider intends to invest in and appropriate investment limits for each asset class
- key personnel responsible for implementing the IMS.

An approved provider would be required to ensure that any investment of bonds is in accordance with the IMS. It would be required to ensure that the IMS is up to date and complies with the requirements. It would be required to modify, or replace, the IMS if it no longer complied with the requirements.

- ***Disclosure to Care Recipients, Prospective Care Recipients and their Representatives***

Disclosure to care recipients, prospective care recipients and their representatives would occur at the same times as currently – on entry, annually and on request – but much of the information would be provided on request, thereby reducing the administrative burden of disclosure.

Information currently available would continue to be available. Additional information would be available including:
- a summary of the permitted uses for which bonds have been used during the previous financial year
- information about whether the approved provider has, during the most recent financial year, complied with permitted use requirements
- if the approved provider is investing bonds in a financial product other than a deposit with an ADI, the approved providers' investment objectives and the asset classes the approved provider may invest in.

The intent is for no additional information to be generated to meet these requirements. This information will already be generated through documenting the governance system, the IMS and the APCS.

- ***Disclosure to the Department***

Approved providers provide financial information to the Department annually through an APCS and a GPFR. It is proposed that approved providers would disclose information on expenditure on permitted uses in the APCS.

With the exception of gross bond receipts and refunds, bonds would not be reported separately from other sources of income. Rather, the reporting would be of *permitted uses* as defined by the Amending Act.

This option would require the reporting of bond receipts and refunds, and expenditure on permitted uses from any funding source, in an annual cash statement in the APCS. The cash statement would include information on the value of bonds received during the year, the value of the bond balances refunded and the value of permitted deductions. This would give a

value of bonds available to the approved provider for expenditure on permitted uses. The permitted uses, as defined by section 57-17A of the amended Act, would be line items in the cash statement and expenditure by the approved provider on these items would be reported. A line item would be the value invested in financial products since 1 October 2011 that has been returned to the approved provider from the sale, disposal or redemption of such products.

The following would also be included in the APCS:
– the total amount identified in the approved provider's liquidity management strategy (LMS) as being required to ensure that the approved provider has sufficient liquidity for the purposes of repaying bonds
– the total amount deducted in accordance with section 57-19 from all bonds during the financial year.

In accordance with the transitional arrangements, the permitted uses able to be reported on in 2011-12 and 2012-13 would include the provision of residential and flexible aged care to residential and flexible aged care recipients.

This information would be readily retrievable from existing mechanisms (i.e. the LMS and the bond register, both of which approved providers are required to maintain). Information would be provided in the APCS document stating that presenting the information in the GPFR would be taken as compliance with the reporting requirement.

- ***Additional Permitted Uses of Bonds***

The Department has noted that some approved providers set up unregistered schemes and that these schemes are aggregating funds for the building and operation of facilities. The amended Act allows only for registered schemes and would, therefore, stop the use of bond funds to be invested in a current legitimate investment. Capital investment is required during the start up of an aged care facility, including where a new facility opens and where an approved provider makes changes to the business operations of a purchased existing facility. These are legitimate uses for bonds not currently permitted by the amended Act.

5. ***Impact Analysis***

The following groups are potentially affected by the options outlined above:
- ***Care recipients, prospective care recipients and their representatives*** – there are approximately 183,000 operational residential care places in operational Australian Government funded aged care places and 63,000 care recipients occupying these places have paid bonds
- ***Approved providers***– there are approximately 1,150 approved providers of residential and/or flexible aged care services in Australia and over 950 of these approved providers hold bonds
- ***Government*** – the Australian Government funds aged care and regulates approved providers of Australian Government funded aged care. It underwrites the repayment of bonds through the Guarantee Scheme.

6. *Summary of impact of regulatory changes*

Option A: Do nothing

Care recipients, prospective care recipients and their representatives – The Australian Government would continue to guarantee bond refunds through the Guarantee Scheme. This would continue to ensure that care recipients are not significantly financially disadvantaged where an approved provider fails financially, owing bonds. Doing nothing would not limit exposure to the emotional and physical risks to care recipients from commercial failure and poor governance.

Doing nothing would not provide care recipients, prospective care recipients and their representatives with targeted information about approved providers' governance arrangements or investment model. This would limit their ability to exercise informed decision making when deciding on an approved provider.

Approved providers – Doing nothing would not impose any additional requirements on approved providers and, as noted below, would avoid a minor additional regulatory burden. It would allow a capital source of funding, and the investment of that funding only in the new particular permitted uses. Approved providers would continue to have access to bonds as a capital source of funding without any requirement to ensure appropriate systems are in place to manage them.

It would be optional for approved providers to have arrangements in place to assess the risks of permitted financial investments to their liquidity or to respond to changing risk.

Approved providers would be required to maintain their own records on expenditure on bonds on permitted uses, but would only be required to provide those to the Department on request.

Doing nothing would ensure that approved providers are compelled to provide care recipients with extensive information automatically. Conservatively estimated at $20 per care recipient per year, this equates to a $1.26 million impost on approved providers.

By limiting permitted uses to those in the amended Act, approved providers would not be able to use bonds to meet start up costs or invest in unregistered schemes for the purposes of building and acquiring aged care infrastructure. This could have the potential to inhibit capital expenditure in the sector and is contrary to the policy intent for bonds.

Government – Doing nothing would not require approved providers to have in place appropriate governance arrangements for managing bonds. Poor governance has been identified as a key factor in non-compliance with prudential requirements and in triggers of the Guarantee Scheme. Retention of the status quo would not reduce the Government's exposure to the risks of underwriting the sector through the Guarantee Scheme, which has costed the Australian Government $24.5 million since its commencement in 2006.

Under this option, the Department would not receive information on how bonds are being used by the aged care sector and would not be able to monitor compliance with permitted uses. It would only be able to periodically monitor approved providers that may be experiencing financial difficulties or using bonds for non-permitted uses. Therefore, this option would not address the deficiencies identified in the context of the previous, less

stringent requirements of the Act, by the ANAO and the Department's own regulatory experience.

In addition, as the Department would not be able to routinely monitor indicators of the misuse of bonds, it would not be able to identify and respond to emerging financial risk.

Option B: Improved risk management approach

Care recipients, prospective care recipients and their representatives - Given that care recipients are entrusting increasingly large amounts of money to their approved providers (approximately $232,000 on average in 2009-10) there is a need to ensure that care recipients, prospective care recipients and their representatives are provided with adequate information to inform their choice of approved provider.

Under Option B, consumers would receive better, more targeted information to be able to make more informed choices. This would assist them to reduce their exposure to the consequences of non-compliance with prudential requirements, including the late repayment of bonds, and the stress caused by absent or late repayment of bonds and the triggering of the Guarantee Scheme.

Option B places a greater emphasis on information being provided upon request while ensuring that the information is received by those who require it. This would allow for access to better information for those who seek it and ensure that those who do not have an interest are not burdened with the information.

Option B also proposes increased scrutiny of how approved providers are using bonds and monitors their compliance with the permitted uses. This approach will help ensure bonds are used appropriately, which builds care recipients confidence in the aged care sector and has the potential to lead to improvements in the aged care services in which care recipients reside.

Additionally, the changes proposed under Option B aim to ensure, as far as possible, that bonds are refunded to care recipients when they fall due. This option has the potential to reduce the risk of late repayment of bonds and the associated impact on care recipients.

Approved providers – Option B would introduce an improved regulatory framework for approved providers that would assist in limiting their exposure to the negative public reaction to the aged care sector from triggers of the Guarantee Scheme and reduces risks to their financial position (through the levy being charged) as well as risks of financial and business failure and, ultimately, potential fines and imprisonment for contraventions of the Act.

The proposed new Governance Standard would have minimal burden for approved providers with appropriate governance practices; for these approved providers it would be a matter of documenting current arrangements.

The Governance Standard would strengthen the business practices for poorly performing approved providers and compel them to adopt governance arrangements commensurate to the risk of managing bonds. Such sound corporate governance practices would be expected of any business managing significant amounts of other people's money. The Governance Standard has been designed in consultation with the aged care sector to be readily achievable without the need for significant additional expenditure.

Approved providers that do not make financial investments with bonds would have lower compliance requirements through not being required to implement an IMS.

The Department has undertaken extensive consultation with a range of stakeholders, including approved providers, banks, financiers, consumer advocacy groups and others to gain an understanding of potential compliance costs that may be incurred by the aged care sector if Option B is introduced.

Disclosure to the Department was the part of Option B that created the most discussion during consultations. The initial proposal was for the reporting of expenditure of bonds on permitted uses. The principal concern was that many approved providers 'pool' their incomes and do not track bonds separately form other sources of income.

In relation to the initial proposal, one approved provider with over 1000 places estimated an additional audit cost of $6,000 to $10,000 per year. Another with over 500 places estimated additional costs of $10,000 per year. Another approved provider with 87 places estimated an increase of $2,000 in annual audit fees. These figures were 'off the cuff' estimates and did not contain a sufficient level of detail to allow the Department to accurately gauge the actual compliance burden. The aged care sector was invited to provide details of estimated costs of compliance, but no responses were provided.

In response to the concerns the proposed reporting mechanisms were amended to not be of expenditure of *bonds* on permitted uses but of expenditure from *any source* on permitted uses. Aged care sector representatives indicated that the amended proposal in Option B would impose some costs but that compliance would be achievable and costs minimal.

While it is proposed that approved providers report on their permitted use expenditure, this does not override the requirement of approved providers to only expend bonds on permitted uses. An approved provider can be asked to provide evidence of their compliance with this at any time and it is beholden on the approved provider to be able to demonstrate compliance with this requirement.

Through the Business Cost Calculator, the Department has assessed the compliance costs of the proposed changes to the Disclosure Standard. The average cost to approved providers (with the average approved provider holding $11.2 million in bonds) for initial start up was estimated to be $1,000 per business, assuming the approved provider procured the services of a consultant to set up chart of accounts and relevant reports. The average ongoing compliance cost was also estimated to be $1,000 per year. This analysis was based on an average of four hours of a consultant's time on either the initial start up or ongoing compliance. For approved providers with more sophisticated accounting systems that process a large volume of transactions, the ongoing compliance cost is estimated to be approximately $10,000 per year.

The amendments to the Act remove the restrictions on the use of income derived from bonds, retention amounts and on accommodation charges. The following is a conservative break down of the amount of income derived from a bond and retention amounts at the end of the year from one new bond, should that bond be invested in a one-year term account.

Based on the:
- average bond for a new care recipient in 2009-10 of $232,000
- average advertised one-year term deposit interest rate of 6 per cent per annum

– maximum retention amount at 1 July 2011 of $318 per month

The combination of the anticipated interest rate and the retention amounts would mean an approved provider could conservatively expect to receive in excess of $17,500 in unregulated income derived and retention amounts in the first year of receiving the bond. Similar income is able to be made for the full five years where the approved provider is entitled to retention amounts. Therefore, the income from a single new bond of average size would be more than sufficient to offset the additional cost of compliance with Option B.

For the changes in disclosure of information to care recipients, prospective care recipients and their representatives, no new information would be required to be generated to disclose the information. The information to be disclosed would have already been generated through compliance with the Prudential Standards. By providing for information to be available on request, it would balance the increased reporting with a significant reduction in the administrative burden to approved providers.

From information gathered through the consultation process, Option B is likely to result in a low overall compliance cost impact, comprised of a low implementation impact and a low increase in ongoing costs for the affected group.

Government **-** The major benefit of Option B to Government is that it would provide the Department with better information for improved monitoring of the use of bonds. Combined with the amendments to the Act, these changes would provide a regulatory framework that is commensurate with the risks associated with the exponential growth of bond holdings. This will assist in improving prudential compliance, give greater confidence in the aged care system and increase the capacity of the Department to intervene before approved providers face financial failure.

The introduction of compulsory governance arrangements for approved providers holding bonds may decrease the likelihood of the Australian Government refunding bonds through the Guarantee Scheme.

There would be costs associated with the implementation of a Departmental communications strategy targeting approved providers and consumer groups.

7. Consultation

Summary of consultation with consumer groups on the proposed changes

The proposed changes to the regulation of bonds have been the subject of extensive consultation with consumer groups, peak bodies, approved providers and the financial services sector. Overall, the response has been supportive of the prudential reforms.

Consultation commenced with the release of an Issues Paper in October 2010. The Issues Paper predominantly sought input on the reforms associated with the Act amendments but also outlined and sought views on reporting to the Department and to care recipients on the use of bonds. A total of 33 submissions were received. There was general consensus on improved reporting requirements to the Department and to care recipients. The majority of submissions agreed that the APCS was best placed to incorporate any additional reporting required to the Department.

The February 2011 consultation paper *Enhanced Prudential Regulation of Accommodation Bonds* also outlined the proposed Governance Standard (including the IMS for approved

providers investing in financial products), improved financial reporting through the APCS and improved disclosure to care recipients, prospective care recipients and their representatives. Many of the 25 consultation meetings for the consultation paper canvassed the amendments proposed in this RIS.

Consultation for the development of this RIS was undertaken with key stakeholders and sector representatives in Canberra, Sydney, Melbourne, Adelaide and Perth. Twenty three consultations specifically canvassing the proposed amendments to the Principles were held in June to August 2011. The consultations included discussions with:

– ten not-for-profit approved providers
– five for-profit approved providers
– five sector peak bodies
– four consumer groups
– three accountants
– two consultants
– two banks.

Overall, the response has been supportive of Option B, with stakeholders acknowledging the balance that the proposed changes strike between enabling approved providers access to a capital source of funding and protecting the life savings of care recipients.

In particular:

- Consumer groups were supportive of the proposed changes outlined in Option B. Consumer groups supported the disclosure of additional information to care recipients, prospective care recipients and their families and making much of the information available on request.

- In relation to the proposed Governance Standard – the most common comment across the aged care sector and others was that it was good practice that is already undertaken by approved providers with appropriate arrangements.

- In relation to the requirement for an IMS, stakeholders were also generally positive. Some raised that having an IMS would not prevent risky investments with one commenting that some approved providers may have little knowledge and experience relating to financial investments.

- In relation to disclosure to the Department, it was noted that some approved providers would find it difficult and costly to report on permitted use expenditure of bonds. This is a result of approved providers ‘pooling’ income and not tracking individual dollars as coming from bonds or other sources.

  Option B responds to this by requiring reporting of gross bond receipts and refunds, and requiring the reporting of permitted uses (as defined by the amended Act) from any source of funding. This would provide indicative information to the Department using existing reporting mechanisms at a low cost to approved providers. There were no strong objections to providing additional reporting of bond income and permitted uses in the APCS.

- In relation to reporting to care recipients, prospective care recipients and their representatives, both aged care sector and consumer groups were supportive of the reforms.

- In relation to the proposed permitted uses, the aged care sector was supportive of, and advocated for, the arrangements. No objections were received from any party.

- Many stakeholders expressed the desire for appropriate guidance material for consumers and approved providers.

8. ***Conclusion and preferred option***

The major disadvantage of Option A is that it does not address the current inadequacies of the legislation or the problems identified in this RIS. Furthermore, amendments were made to the Act in the context of the recognised need for mandatory governance arrangements and the monitoring of permitted use requirements (via amendments to the Aged Care Principles). These are important elements of the bond system and, given the structure of the aged care legislation, were not addressed in the amendments to the Act.

Option A would see a situation where the permitted uses for bonds are clearly articulated (with criminal penalties associated with misuse) but would not provide a method to report against these uses or to monitor compliance.

Option B addresses the problems identified and is therefore the preferred option. This option:
- reduces the risk of late repayment of bonds when they fall due
- ensures that appropriate governance arrangements are required to be in place to protect the more than $10.6 billion in bonds being held on behalf of more than 63,000 care recipients
- ensures that care recipients, prospective care recipients and their representatives have sufficient and targeted information available to them to inform their decision making
- ensures that the Australian Government is able to undertake effective risk-based regulation commensurate with the risk of its guarantee of the $10.6 billion in bonds
- ensures approved providers have available a capital source of funding to support investment in aged care infrastructure
- achieves the above outcomes with minimal regulatory and cost burden.

The risk of commercial failure, the triggering of the Guarantee Scheme and subsequent enactment of the levy is greater with Option A than Option B. Option A would allow current practices that contribute to compliance failures and financial difficulties amongst some approved providers to continue.

The risk to care recipients and their families that their bonds will not be paid when they fall due is reduced with Option B. The risk of triggering the Guarantee Scheme, and the effect of that on well-being, is also reduced.

Option B would promote good corporate governance practices that are essential to ensuring approved providers are able to refund bonds when they fall due. The ongoing compliance cost would be approximately $1,000 per annum for the average approved provider. From 1

October 2011 approved providers will also have unrestricted use of income from bonds, retention amount and the accommodation charge. The approximately $17,000 annual income available from a single average-sized bond invested conservatively more than offsets compliance costs of the proposed amendments. Additionally, good governance supports sustainability, access and quality in the sector.

The requirement for an IMS would ensure that the approved provider and its board or governing body have considered and addressed the prudential and other risks that these investments may pose to the approved provider. The introduction of the IMS would ensure that a broad range of financial investment options continue to be available to approved providers.

Given that the average value of bonds held by an approved provider is $11.2 million, an approved provider of average size triggering the Guarantee Scheme would potentially create a much greater impost through the levy than any of the five that have activated it to date. Based on 2009-10 figures, one approved provider would have a liability of more than $379,000 should such an event occur and the levy be applied proportionate to bond holdings. An approved provider with an average bond holding would be charged approximately $11,800. Under Option B, the risk of the Guarantee Scheme being triggered is reduced - it is arguable that imposition of the levy would represent a far greater impost on many approved providers than the cost of the proposed changes.

Given the significant funds lent by care recipients to approved providers, it is appropriate that there is greater transparency about how approved providers manage those bonds. This would promote consumer confidence in the aged care system.

The proposed measures would support compliance with, and would complement, the new arrangements set out in the amended Act. In addition, the proposed changes are expected to improve financial management in aged care, and ensure greater transparency and accountability for accommodation bonds.

Combined with the amendments to the Act, the changes would provide a regulatory framework commensurate with the risks associated with the exponential growth of bonds and the effect of commercial failure on care recipients and the aged care sector.

Through implementation of these changes and action already taken through amendments to the Act, consumers could have greater confidence in the ability of the aged care sector to manage their funds and in the Government’s ability to effectively regulate the approved providers holding bonds.

Option B delivers the best approach to strengthening consumer protections for bonds at a modest cost to approved providers.

9. *Implementation and Review*

It is proposed that the changes will start to take effect from 1 October 2011 to coincide with new arrangements set out in the Act, with compliance with the Governance Standard commencing on 1 February 2012. This expectation will be communicated to the sector. Approved providers would be expected to meet the new requirements for bonds taken on or after 1 October 2011. While most approved providers are expected to be well placed to meet

the new requirements, there may be some approved providers that will need to make adjustments in order to comply with the new permitted uses requirements.

As part of the Amending Act, a two year transition period is included until the end of September 2013 for compliance with the permitted use provisions. The transition period allows for the sector time to become familiar with the new requirements relating to the permitted uses of bonds. During the transition period, approved providers will continue to be able to use bonds in line with the current regulatory requirements. Approved providers will be required to disclose relevant information on expenditure on permitted uses in the reporting period for 2011-12 as part of their annual APCS reporting. This reporting is due for almost all approved providers by 31 October 2012. As already noted, the option would be available to report this information through the GPFR should the approved provider governing body prefer. The reporting requirements would not override the requirement to expend bonds only on permitted uses (or through the transition arrangements), and evidence of compliance with this requirement can be sought at any time.

In 2010-11 the Department expanded its regulatory intelligence and monitoring capabilities of prudential regulation of bonds. It is envisaged that the proposed amendments to the Principles will form a part of the additional monitoring and enforcement activities. The proposed amendments to the Principles will complement new arrangements in the Act and better position the Department to monitor the use of bonds.

Education and support will be provided to assist approved providers to comply with their prudential obligations. A communication strategy has been developed. Key elements of the communication strategy include:

- updates to existing information sheets for consumers
- the development of new information sheets for approved providers
- information for financiers and auditors
- updates to the Residential Care Manual
- the utilisation of communication vehicles including the internet, stakeholder forums and publications
- electronic delivery of information packages to all approved providers
- hard-copy registered mail delivery of information packages to high risk approved providers and the 100 approved providers with the largest bond holdings
- personal liaison with key stakeholders including peak bodies, consumer groups and particular approved providers.

It is proposed that the effectiveness of any changes to the legislation be monitored by the Department. This will include seeking feedback from the aged care sector and consumer bodies and other advisory bodies such as the Ageing Consultative Committee.

A review will be conducted following the two-year transition period for permitted uses detailed in the Amending Act. It is anticipated that the review will be conducted in 2014–15.