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27 September 2017

Mr Michael Bachelard
Investigations Editor
Fairfax Media
mbachelard@fairfaxmedia.com.au

Dear Mr Bachelard,

Re: Series of Fairfax Press Articles on Residential Aged Care

I am writing in relation to a series of articles published under your name that have appeared in various Fairfax Press publication's in relation to the residential aged care sector in Australia. In this regard, I am referring to certain statements made in the first article "Dawn's final days reveal aged care horror" and more specifically the article "Jyl's journey to aged care: "I feel like part of me is lost".

As has been correctly noted in the latter article, StewartBrown is an "accounting firm", and accordingly my responses in this letter will be directed to the financial commentary contained in the articles, as this is our area of expertise, and not on the other clinical and social issues raised.

It should firstly be noted that neither yourself nor any representative of Fairfax Press approached StewartBrown to seek permission to include selective references to our 2016 survey report or, of more relevance, to discuss with us any financial analysis relative to the report in order to gain further important insight and background into the financial performance and viability of the residential aged care sector.

Prior to providing a response on certain of the financial statistics and commentary included in the articles, I would like to clarify a few of the statements that referred to our June 2016 survey report:-

- The name of our firm is "StewartBrown" not "Stewart Brown"
- The financial performance survey is not "annual" it is a "quarterly" subscription survey
- The "Care Result" you have referred to is clearly not an indication of quality of care, nor is it intended to be, as this is a financial survey not a clinical survey (for which there are a number of benchmarking and quality related surveys). The "Care Result" as clearly explained in our survey report is to distinguish between the revenue and expense streams that directly relate to resident acuity and every-day-living expenses (Care) from Accommodation revenue and expenses that are not relational to resident acuity. Your statement could be misinterpreted in this regard
- Nowhere in the StewartBrown June 2016 report is the statement "…made an average of $18,121 per bed, per year, clear of expenses" as it is incorrect to include the additional comment "clear of expenses". The correct statement is an EBITDA of $18,121 and the difference is more than terminology, it is a very important distinction between "earnings clear of expenses" and EBITDA as depreciation and amortisation are large and important expense items, as is interest expense on borrowings
- Our survey report does not include any reference to "model homes" nor the comment (or similar comment) that "The model homes with big earnings spend less on nurses and chefs…"
- The graph included in relation to "Spending on food" does not include the name "StewartBrown" in relation to the source

<u>Response to Financial Commentary included in the Fairfax Articles</u>
One of the themes in the series of articles seems to be that certain providers are making substantial profits (or earnings) from residential aged care, and by extension this may have impacted on the quality of care provided. A detailed financial analysis of this sector requires significant commentary, so I will restrict my responses to be specifically directed at comments and statistics as included in the articles.

Preamble
The statement that it costs state governments $1,000 to $1,500 per day to keep someone in a hospital bed and the Commonwealth subsidy for residential aged care is only an average of $173 per bed per day is not only an accurate reflection, but in itself a major contributory cause of the financial issues in residential aged care. There is a clear disparity in funding at this level.

Profitability
The article makes a specific reference to “the most efficient “players” in both sectors take up to $25,000 in earnings before tax from each resident every year on profit margins of 20 per cent” is in our opinion inaccurate and unsupportable.

Some of the issues we have with such a statement are as follows:-

- The statement is confusing and mixes terminology
- Is the statement suggesting that each resident pays on average $25,000 each year (independent of government subsidies)? I assume this is not the case as the graphic in the article suggests that residents can pay up to $75,000 per year
- Accordingly, we are not aware of any provider organisation averaging an EBT (Earnings Before Tax) of $25,000 per bed per annum (or anywhere near this figure) for their facilities, and the Fairfax articles has not provided any support for such an erroneous claim
- The reference to “profit margins of 20 per cent” are not explained - is this the profit before tax as a percentage of operating revenue (not achievable) or some other margin matrix?
- From a financial analysis perspective, quoting EBIT in $ terms with no relationship to return on capital employed or return on equity is superfluous and misleading
- There is no reference to what the sector “average” results are, or equally importantly, the different financial performance for geographic regions

Proportion of For-Profit Providers
It is incorrect to make the statement “About half the nursing homes in Australia are run for profit, and the proportion is growing”. The recently released Aged Care Financing Authority (ACFA) annual report “*Fifth Report on the Funding and Financing of the Aged Care Sector*” which the Fairfax articles have referenced in a number of places, shows that the for-profit provider numbers represent 35% of the total providers (38% in 2010/11) and there has been little movement between the mix of for-profit and not-for-profit providers over the last 6-7 years.

Overall Sector Profitability
We would suggest that the use of financial results without due context can be subject to misinterpretation or is misleading. The comment in the first Fairfax article “The sector as a whole cleared $1.1 billion in 2016” is such an example. This statement (referenced from the ACFA report referred to above) did not include the full commentary as included in the ACFA report, being “Total net profit for the sector was $1.1 billion, including $1.3 billion of ‘other income’ which suggests operating profit is dependent on ‘other’ income, as in previous years”. The ACFA report makes further comment in section 9.3.1 “More particularly, at $1.335 million, it (other income) totals more than the reported NPBT of $1.063 million ($907 million in 2014-15) which suggests that aggregate EBIT is negative”. This, of course, presents an entirely different perspective on the profitability of the sector.

“Other income” is essentially non-operational and includes items such as revaluations, gains on disposal, investment income, donations and bequests as typical examples. By its nature it is not recurrent and accordingly should be segregated when assessing the operating performance and viability of the sector.

Supported ratio
The statement “one-tenth of the beds in each nursing home must be set aside for people who can’t afford to pay” is incorrect. The Fairfax article has included statistics derived from the July 2017 ACFA annual report and, accordingly, reference to section 5.8 “Supported residents” of the ACFA report states “During 2015-16, across all providers, the average proportion of residents (excluding those receiving extra services) who were supported residents, was 46.8 per cent” which is well in excess of the 10% (one-tenth) quoted in the article.

As can be imagined, having nearly 47% of residents who only pay the basic daily fee (85% of the single pension) means that to ensure viability, the remaining 53% must share additional financial burden.

Current Financial Trends
It should be noted that all the financial statistics as quoted in the Fairfax articles relate to the financial year ended 2016, now being some 15 months out of date. The StewartBrown *Aged Care Financial Performance Survey* report for the 2017 financial year is due to be released shortly.

A major impact on the financial performance since the 2016 year is related to changes in ACFI subsidy funding as a result of the government budget 2016-17 measures which flagged ACFI subsidy savings of $1.7 billion. The ACFI saving is to be generated through an indexation pause for all ACFI domains in 2017/18, and a 50% indexation pause on the Complex Health Care (CHC) domain in 2018/19.

In effect, the indexation pause will result not only in an effective revenue reduction in real terms, but the ACFI base for future indexation adjustments will be from the lower base which multiplies the effect year on year.

For the nine months ended March 2017, a summary of relevant financial results for the residential aged care sector are as follows:-

- Basic daily fee (every-day-living revenue) has increased to an *average* of $49.05 per bed day (pbd) (increase of 1.65% since June 2016)
- Every-day-living expenses have increased to an *average* of $80.56 pbd (increase of 3.36% since June 2016)
- ACFI subsidy has increased to an *average* of $170.39 pbd (increase of 2.53% since June 2016)
- Direct care costs have increased to an *average* of $129.91 pbd (increase of 3.3% since June 2016)
- *Top quartile* EBIT is $13,288 per bed per annum (pbpa) ($13,483 pbpa at June 2016)
- *Bottom 50%* EBIT is a loss of $2,402 pbpa (loss of $1,227 pbpa at June 2016)
- *Top quartile* EBITDA is $18,526 pbpa ($18,121 pbpa at June 2016)
- *Bottom 50%* EBITDA is $2,917 pbpa ($3,671 pbpa at June 2016)

As can be seen from the above financial operating results, it is clear that overall the residential aged care sector has some significant ongoing financial viability issues, and it would be an incorrect assumption to assume that these related to inefficiencies or cost overruns. In the circumstance whereby the bottom 50% of providers in the survey are running at continued and increasing operating losses, this represents a substantial number of facilities nationally.

It is important to note that the Basic daily fee ($49.05 being 85% of the single pension) does not meet the related daily every-day-living costs of $80.56 by $31.51 per resident per day, the difference being up to the provider to cover. Discussion around certain organisations charging for additional services to help reduce that gap must be taken in this context.

The stark reality is that the ACFI funding changes will have greater impact in the 2018 and onwards financial years and further erode profitability and increase the financial pressure on the bottom 50% of facilities and many of those in the second quartile.

In summary, we feel that a balanced analysis and reporting of the financial performance of aged care organisations must ensure that the full financial data is included rather than selective, and in many instances, incorrect or misleading statistics.

As the Fairfax articles have been widely circulated and due to the inclusion of selective statistics and tables sourced from the June 2016 StewartBrown *Aged Care Financial Performance Survey* we will be copying this response to Minister Wyatt, the Department of Health, Aged Care Financing Authority, aged care peak bodies and aged care providers to ensure that appropriate transparency is maintained.

Yours faithfully,
StewartBrown
Chartered Accountants

Grant Corderoy

Grant Corderoy
Senior Partner