Accounting for Residential Aged Care:
Bed Licences - Do they have value?

July 2013
Overview

Bed licences (technically known as Approved Places) are the basis upon which many aged care providers derive a significant amount of their revenue.

Following the implementation of International Financing Reporting Standards (IFRS) and the Department of Health and Ageing Conditional Adjustment Payment (CAP) financial reporting requirements, many aged care providers have placed a value on their bed licences to comply with the financial reporting framework.

In boom times prior to the ‘global financial crisis’ specialist consultants acted as brokers buying and selling bed licences. These circumstances led many people to believe there was an “active” market for the licences and that under Australian Accounting Standard AASB 138 “Intangible Assets”, bed licences could be revalued by reference to that market.

In recent years, the market for trading the licences has been patchy and in some cases there have been stories of aged care providers handing back licences to DOHA. This situation was further aggravated by the Productivity Commission Inquiry Report in 2011 which recommended removal of the restrictions limiting the number of bed licences.

Indeed, the concept of whether an active market exists for bed licences has been discussed at many levels. The general conclusion is that there is no active market, a fact confirmed by The Australian Securities and Investment Commission in its media release ASIC focuses attention on 2010 financial reports (media release 10-147MR).

In light of the above, many in the industry have been struggling with the question: do residential aged care bed licences have a value and how should they be accounted for?
Value Proposition

Even though no “active” market exists for bed licences, this does not mean that they have no value. What it does mean is that the bed licences don’t qualify for revaluation under the Revaluation Model in paragraph 75 of AASB 138.

However, it would be hard to argue that they have no value due to the following:

- Aged care facilities need bed licences to provide Commonwealth-funded aged care services to their residents. Without the bed licences, the aged care facility would receive no funding from the Government and would not be able to operate;
- Bed licences generate cash flows in the form of Commonwealth subsidies;
- Following implementation of the Productivity Commission’s report, the Government did not accept the recommendation to remove the restrictions limiting the number of bed licences and in essence, the licencing system has been retained.
- Bed licences represent one of the barriers to entry for new market providers of residential aged care in a highly regulated market place.
- The annual allocation process (Aged Care Approvals Round (ACAR) is competitively sought after.
- Bed licences enable the Approved Provider to access interest free consumer capital funding via Refundable Accommodation Deposits (RADs) and/or Daily Accommodation Payments (DAPs).

“Based on these facts, it is clear that bed licences have a value.”
Accounting Treatment

Paragraph 24 of AASB 138 states an intangible asset shall be measured initially at cost. For not-for-profit providers, paragraph 24.1 of AASB 138 states:

“where an asset is acquired at no cost, or for nominal cost, the cost is its fair value as at the date of acquisition.”

Bed licences represent an intangible asset with an indefinite useful life. Consequently, if the licences are recognised at cost or valuation in the provider’s financial report they are required to be subjected to an annual impairment test under paragraph 10 of AASB 136 “Impairment of Assets”.

The following scenarios could apply to organisations that hold bed licences:

1. **Licences Separately Purchased**
   Bed licences were acquired from another provider at an arm’s length consideration. Applying paragraph 24 of AASB 138 – these licences would be recorded at cost in the providers’ accounts and subject to annual impairment testing under AASB 136.

2. **Bed licences obtained for nil consideration during the Aged Care Approvals round**
   In the case of a for profit provider – the licences would be recorded at the costs incurred in obtaining them e.g. consulting fees in preparing ACAR submissions, and tested annually for impairment under AASB 136.

   However, for a not-for-profit provider, the “fair value at the date of acquisition” would need to be determined. In these circumstances the principles in AASB 13 “Fair Value Measurement” would apply. In a lot of cases, organisations obtain an independent valuation of the aged care business as a going concern. This valuation is usually based on a discounted cash flow basis, with the value of the licences determined after the fair value of the tangible assets is deducted from the valuation.

   Alternatively, recent data from a trader in bed licences in a similar locality may serve as a reasonable benchmark value. This valuation would be regarded as deemed cost and would be subject to an annual impairment test under AASB 136.
Bed licences obtained by the service provider many years ago were valued on implementation of IFRS and were revalued at periodic intervals (usually three or five years) with reference to the alleged “active” market values.

As there is no “active” market the concept of increasing the value of the bed licences is not valid. Consequently, the licences should not be subject to regular periodic revaluation but rather their value needs to be tested annually for impairment. These so-called market values can only serve as an indication that the licences are or are not impaired. However, the best method of testing for impairment is completion of a net present value cash flow projection as specified under AASB 136.

The bed licences are acquired as part of a business acquisition. In these circumstances, the acquisition is required to be accounted for in accordance with the principles in AASB 3 “Business Combinations”. AASB 3 requires separate identifiable intangible assets within the business combination to be recognised and measured at fair value on acquisition. AASB 138 provides guidance on recognising a fair value for intangible assets acquired.

In particular, paragraph 40 of the standard states:

“If no active market exists for an intangible asset, its fair value is the amount that the entity would have paid for the asset, at the acquisition date, in an arms-length transaction between knowledgeable and willing parties, on the basis of the best information available. In determining this amount, an entity considers the outcome of recent transactions for similar assets.”

In these circumstances, recent data from a trader in bed licences in a similar locality may serve as a reasonable benchmark value. Another way of dealing with this is an independent valuation of the aged care business as a going concern. This valuation is usually based on a discounted cash flow basis, with the value of the licences determined after the fair value of the tangible assets is deducted from the valuation.

Licences recognised in this manner in a business combination at fair value are regarded as being recognised at “deemed cost” and are required to be tested for impairment annually.
The above scenarios and the relevant treatment can be summarised in the following table:

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Organisation Classification</th>
<th>Annual Revaluation Required</th>
<th>Measurement on Initial Recognition</th>
<th>Measurement After Initial Recognition</th>
<th>Annual Impairment Test Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Licences separately purchased</td>
<td>For profit</td>
<td>No</td>
<td>At cost</td>
<td>Initial cost less accumulated impairment losses</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Not for profit</td>
<td>No</td>
<td>At cost</td>
<td>Initial cost less accumulated impairment losses</td>
<td>Yes</td>
</tr>
<tr>
<td>2. Licences obtained through ACAR Application</td>
<td>For profit</td>
<td>No</td>
<td>At cost</td>
<td>Initial cost less accumulated impairment losses</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Not for profit</td>
<td>No</td>
<td>At fair value</td>
<td>At initial fair value less accumulated impairment losses</td>
<td>Yes</td>
</tr>
<tr>
<td>3. Licences recognised on implementation of IFRS</td>
<td>For profit</td>
<td>No</td>
<td>At fair value</td>
<td>At initial fair value less accumulated impairment losses</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Not for profit</td>
<td>No</td>
<td>At fair value</td>
<td>At initial fair value less accumulated impairment losses</td>
<td>Yes</td>
</tr>
<tr>
<td>4. Licences acquired in a business combination</td>
<td>For profit</td>
<td>No</td>
<td>At fair value</td>
<td>At initial fair value less accumulated impairment losses</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Not for profit</td>
<td>No</td>
<td>At fair value</td>
<td>At initial fair value less accumulated impairment losses</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**Annual Impairment Test**

As mentioned previously, the recorded value of bed licences is required to be tested annually by completion of an impairment test under AASB 136. Paragraph 10 of the standard requires the carrying amount of the bed licences to be compared to their recoverable amount.

Under paragraph 18, the recoverable amount is determined as the “higher of an asset’s or cash generating unit’s fair value less costs to sell and its value in use”. Paragraph 19 makes it clear that it is not necessary to calculate both the fair value of the bed licences and their value in use. If either of those values exceeds the carrying amount of the bed licences then the asset is not impaired.

The value in use calculation generally requires a discounted cash flow (DCF) analysis of the future cash flows of the business to be undertaken and this is compared to the identifiable assets (including intangibles) for the Cash Generating Unit. A relevant discount rate to use in this DCF analysis would be the organisation’s calculated Weighted Average Cost of Capital.

Alternatively, if the fair value approach is taken, testing for impairment could be achieved by referring to recent data from a trader in bed licences in a similar locality to estimate a fair value amount.
Bentleys offers a broad range of services including business management, improvement and corporate advisory, accounting tax, corporate recovery strategies and aged care specific audit and risk programs. We also undertake significant aged care projects including financial viability assessments and analysis across the industry. Since 1994, the Bentleys Aged Care Survey has been benchmarking the financial health of the aged care industry to guide the decision making of providers, the government and the financial sector. Find out more at www.agedcaresurvey.com.au

To receive an electronic copy of this and other white papers, please join our mailing list at www.agedcaresurvey.com.au

CONTACT US

For further information

If you would like to discuss this report please contact Martin Power, Audit Director or the Bentleys Office on:

T: 07 3222 9777
E: MPower@bris.bentleys.com.au

About the Author

Martin Power is a Director within Bentleys Audit and Corporate Advisory Services division. He has over twenty-five years’ experience in public accounting, specialising in the provision of Internal and External Audit, Assurance and Forensic Accounting services. He works with a diverse range of clients including health and aged care providers, education providers, religious orders and not-for-profit organisations. If you would like to discuss this report or your accounting and finance needs please contact Martin.