

Residential Aged Care Pricing Advice 2023-24

Technical Specifications

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Residential Aged Care Pricing Advice 2023-24 Technical Specifications — May 2023

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Glossary

Acronym/abbreviation	Description
ABS	Australian Bureau of Statistics
ACFI	Aged Care Funding Instrument
ACFR	Aged Care Financial Report
AN-ACC	Australian National Aged Care Classification
BDF	Basic Daily Fee
Commission	Aged Care Safety and Quality Commission
CPI	Consumer Price Index
Department	Department of Health and Aged Care
EN	Enrolled Nurse
FWC	Fair Work Commission
Government	Commonwealth Government
IHACPA	Independent Health and Aged Care Pricing Authority (formerly IHPA)
IHPA	Independent Hospital Pricing Authority (now IHACPA)
NHR Act	<i>National Health Reform Act 2011</i>
NWAU	National weighted activity unit
OBD	Occupied bed day
RACPA23	Residential Aged Care Pricing Advice 2023-24
RN	Registered Nurse
Schedule	Schedule 1—Care and services for residential care services of the <i>Quality of Care Principles 2014</i> under section 96-1 of the <i>Aged Care Act 1997</i>
UOW	University of Wollongong

1 Overview

1.1 Purpose

This document has been produced as an accompaniment to the Residential Aged Care Pricing Advice 2023-24 (RACPA23). It provides the technical specifications for how the Independent Health and Aged Care Pricing Authority (IHACPA) developed the pricing advice provided to the Australian Government (the Government).

1.2 Background

The Independent Hospital Pricing Authority (IHPA) was established under the [National Health Reform Act 2011](#) (NHR Act) to improve health outcomes for all Australians.

Its primary responsibility has been to enable the implementation of national activity-based funding of public hospital services through the annual determination of the national efficient price and national efficient cost. These determinations play a crucial role in calculating the Commonwealth funding contribution to Australian public hospital services and offer a benchmark for the efficient cost of providing those services as outlined in the National Health Reform Agreement.

On 12 August 2022 amendments to the NHR Act came into effect changing IHPA's name to the Independent Health and Aged Care Pricing Authority (IHACPA) and expanding its role to include the provision of costing and pricing advice on aged care to the Government.

1.3 Residential aged care pricing advice process

1.3.1 Classification systems

A key element of the IHACPA's residential aged care and residential respite care pricing advice relates to the Australian National Aged Care Classification (AN-ACC) funding model.

The University of Wollongong (UOW) was commissioned by the Department of Health and Aged Care (the Department) to develop a new classification system for residential aged care in Australia. Following a series of studies known as the Resource Utilisation and Classification Study, UOW developed the AN-ACC. The Government introduced the AN-ACC funding model to calculate residential aged care and residential respite care subsidies from 1 October 2022, replacing the Aged Care Funding Instrument.

The elements of care that are in scope for the AN-ACC funding model are specified in Part 2 and Part 3 of Schedule 1—Care and services for residential care services (the Schedule) of the [Quality of Care Principles 2014](#) under section 96-1 of the [Aged Care Act 1997](#).

The two components of IHACPA's AN-ACC pricing advice include the recommended:

- AN-ACC price, which is a single price per national weighted activity unit (NWAU)
- AN-ACC price weights, measured in NWAU.

1.3.2 Data sources

RACPA23 was informed by several different data sources provided by the Department, including:

- Aged Care Financial Report (ACFR) 2020-21, with data quality checks and data preparation functions performed by StewartBrown
- Aged care sector wage estimation tool
- Resource Utilisation and Classification Study by University of Wollongong
- AN-ACC assessment and shadow assessment data
- Aged Care Financial Instrument Claims 2020-21
- Aged Care Funding Instrument 2020-21 assessments and claims
- National Approved Provider System facility characteristics

In addition, several other publicly available data sources were used:

- [Australian Bureau of Statistics \(ABS\) Consumer Price Index series](#)
- [ABS Wage Price Index series](#)
- [Aged Care Quality and Safety Commission non-compliance register and sanction notices](#)
- [The Fair Work Commission \(FWC\) decision on the interim wage rise for direct care workers](#)

The primary data source used was the ACFR Residential Income and Expenses items, as listed in the [ACFR Definitions for 2020-21](#). All care expense items in the ACFR are considered in scope for AN-ACC funding, aligning with Parts 2 and 3 of the Schedule. All elements of the ACFR listed as hotel service expenses are considered in scope for the hotel gap analysis, described in section 6 of this paper, aligning with Part 1 of the Schedule. Administration expenses reported in the ACFR have been apportioned between care, hotel, and accommodation using the proportions published in the StewartBrown [Aged Care financial Performance Survey Report \(September 2022\)](#).

1.3.3 Methodology overview

IHACPA has developed an interim methodology for RACPA23. The methodology is interim because of the lack of recent cost data and limited activity data following the implementation of the AN-ACC funding model on 1 October 2022. This interim methodology will be reassessed once new data becomes available for future editions of IHACPA's Residential Aged Care Pricing Advice.

The interim methodology commences with the Department's initial price of \$216.80 (ACP22) as a starting point which is then updated based on forecast cost impacts in the delivery of residential aged care and residential respite care services, interim FWC decisions as well as feedback from Department on the draft RACPA23.

The key aspects considered in this interim methodology include:

- Bundling of, and subsequent Department feedback on the Government's proposed decision to unbundle, the Basic Daily Fee (BDF) supplement of \$10 per occupied bed day from the AN-ACC price from 1 July 2023
- Inflation and wage increases in 2021 and 2022 that were not fully captured in ACP22
- Updated minimum care minute requirements intended to be implemented as advised by the Department
- 21 February 2023 Stage 2 FWC interim decision to increase wages for direct care aged care workers and recreation/lifestyle officers
- Superannuation Guarantee increase
- Indexation of historical cost data to account for underlying price inflation
- Analysis of any potential shortfall in funding for hotel costs.

The Department have confirmed that their initial price includes additional funding to account for the cost of building up the workforce and meeting [mandated minimum care minutes requirements](#) which come into effect from 1 October 2023.

IHACPA has included prospective adjustments costs reported in the ACFR to account for expected impacts of the FWC interim decision, Superannuation Guarantee increase, and underlying price inflation, and the funding requirements to meet the minimum care minute requirements.

These adjustments are implemented by first removing the BDF supplement from ACP22, adjusting the result to account for historical inflation and wage increases which were not captured in ACP22, and then apportion the resulting adjusted ACP22 into labour (nursing), labour (personal care worker and recreation/lifestyle officer), labour (other), and non-labour direct costs. Each of these cost components is then further adjusted to reflect the expected impact of the factors outlined above.

IHACPA has also provided analysis of the potential shortfall in funding for hotel costs, which has been provided as a separate output in RACPA23.

2 Data preparation

2.1 Data cleansing

The primary data source used for the Residential Aged Care Pricing Advice 2023-24 is the Aged Care Financial Report 2020-21 (ACFR). The ACFR provided to the Independent Health and Aged Care Pricing Authority (IHACPA) had undergone cleansing and preparation by StewartBrown in consultation with the Department of Health and Aged Care (the Department).

IHACPA identified several anomalies in the cleansed ACFR data provided by the Department and undertook some additional cleansing steps before using it for modelling.

For 2020-21, this was limited to the removal of duplicate records. Namely, where duplicate National Approved Provider System Identifier ID codes appear in the ACFR, duplicates were removed based on the following criteria:

- Where the 'Financial Year' field provided with the data is equal to '2020-2021'
- Where the rows were otherwise identified in the provided data as duplicates

This process removed a total of 6 records from 2,472 facilities provided in the data set. Hereafter, the ACFR dataset used excludes these 6 records, leaving a total of 2,466 facilities.

2.2 Data adjustments

2.2.1 Care minute target calculations

IHACPA have calculated care minute targets for each service based on new care minute requirements advised by the Department, not yet announced at the time of writing. IHACPA used Australian National Aged Care Classification (AN-ACC) assessment and shadow assessment data, current as of 20 January 2023, to estimate the case-mix profile of each service, and from there the care minute targets at a service level.

As the AN-ACC assessment data provided by the Department contains multiple assessments for some residents, and assessments of potential residents that are not necessarily in care. These data were filtered to include only the latest AN-ACC assessment for persons identified as being currently in care.

2.2.2 Cost adjustment in ACFR

IHACPA has adjusted the labour costs in the ACFR 2020-21 dataset in recognition that care minute requirements were not mandated in 2020-21, and therefore the labour costs reported in ACFR 2020-21 will not accurately represent the costs that would be incurred had the minimum care minutes been met. This allows IHACPA to estimate cost proportions for labour and non-labour direct care costs using the Residential Expenses section of the ACFR 2020-21, accounting for the expected increase in labour costs after meeting the minimum care minute requirements.

The adjustment uses the ‘Occupied bed days’ (OBD) data item, denoted D_O , and the following items from the ‘Care Expenses’ section of the ACFR:

- Registered nurse (RN) labour costs (C_R)
- Other direct care, defined as the enrolled nurses (EN) and personal care workers (PCW), labour costs (C_L)
- RN labour hours (H_R)
- Other direct care labour hours (H_L)

For a given residential aged care service, the RN care minute target per OBD, denoted $M_{R,D}^T$, is calculated as the mean required RN care minutes of all assessed residents. Similarly, the total direct care minute target per OBD, denoted $M_{L,D}^T$, is calculated similarly as the total direct care minutes of all assessed residents.

Nationally, the average RN care minute target per OBD is equal to 39.7 and the average other direct care minute target per OBD is 197.1.

The average actual RN care minutes per OBD, denoted $M_{R,D}$, is calculated as

$$M_{R,D} = \frac{60 \times H_R}{D_O}.$$

The average total direct care minutes per OBD, denoted $M_{L,D}$, is calculated similarly.

The care minute adjustment to the ACFR data is implemented in four steps. For each facility in the ACFR:

- a. Identify the increase required in RN care minutes per OBD, if any, for the RN care minutes to be at least $M_{R,D}^T$.
- b. Inflate both RN care minutes and RN care costs by the factor identified in (a).
- c. Identify the increase required in non-RN, residual, care minutes, if any, to meet the total care minutes to be at least $M_{L,D}^T$ minutes.
- d. Inflate the residual care minutes and costs (after accounting for step (b) above) by the factor identified in (c).

These steps are accomplished as follows. Define k_R to be the increase required for RN care minutes to meet at least 40 minutes. That is,

$$k_R = \max\left(1, \frac{M_{R,D}^T}{M_{R,D}}\right).$$

Then the imputed RN care minutes per day is defined as $M'_{R,D} = k_R M_{R,D}$. Then

$$\begin{aligned} M'_{R,D} &= k_R M_{R,D} \\ &= \begin{cases} M_{R,D} & \text{if } M_{R,D} \geq M_{R,D}^T, \\ M_{R,D}^T & \text{otherwise.} \end{cases} \end{aligned}$$

Similarly, the imputed RN labour costs are defined as $C'_R = k_R C_R$. The impact of this adjustment to RN hours and costs is shown in Table 1.

Table 1: Impact of registered nurse time and cost adjustments on ACFR 2020-21

	Source data			After RN adjustment		Impact	
	Facilities	RN mins per OBD	Total RN cost	RN mins per OBD	Total RN cost	RN mins per OBD	Total RN cost
No data	11	-	-	-	-	-	-
Less than RN target min per OBD	1,864	25.8	\$1,416.1m	39.6	\$2,171.5m	13.87	\$755.4m
At least RN target min per OBD	591	59.8	\$564.7m	59.8	\$564.7m	-	-
Total	2,466	33.7	\$1,980.7	44.2	\$2,736.2m	13.87	\$755.4m

The increase in residual care minutes k_L can then be calculated as

$$k_L = \max\left(1, \frac{M_{L,D}^T - M'_{R,D}}{M_{L,D} - M'_{R,D}}\right).$$

Note that if $M_{L,D} \geq M_{L,D}^T$, then $k_L = 1$. Now the imputed total direct care minutes per day can be defined by $M'_{L,D} = k_L(M_{L,D} - M'_{R,D}) + M'_{R,D}$, which satisfies

$$\begin{aligned} M'_{L,D} &= k_L(M_{L,D} - M'_{R,D}) + M'_{R,D} \\ &= \begin{cases} M_{L,D} & \text{if } M_{L,D} \geq M_{L,D}^T, \\ M_{L,D}^T & \text{otherwise.} \end{cases} \end{aligned}$$

Similarly, the imputed total direct care labour cost is $C'_L = k_L(C_L - C'_R) + C'_R$. The impact of this adjustment to direct care time and costs is shown in Table 2

Table 2: Impact of residual direct care time and cost adjustments on ACFR 2020-21

		After RN adjustment			After care labour adjustment		Impact	
		Facilities	Care mins per OBD	Care labour	Care mins per OBD	Care labour	Care mins per OBD	Care labour
No data		-	-	-	-	-	-	-
Less than total target min per OBD		1,392	173.8	\$5,130.6m	200.0	\$5,819.9m	26.1	\$689.3m
At least total target care min per OBD		1,074	228.2	\$4,034.7m	228.2	\$4,034.7m	-	-
Total	2,466	197.7	\$9,165.3m	212.4	\$9,854.6m	26.1	\$689.3m	

For all aspects of the residential aged care pricing advice calculations hereafter, the imputed RN cost (C'_R) and care time ($M'_{R,D}$) and imputed total direct care labour cost (C'_L) and imputed total direct care labour minutes ($M'_{L,D}$) are used in place of their source counterparts reported in the ACFR.

3 Sample selection

3.1 Trimming rules

Before modelling, the Aged Care Financial Report (ACFR) 2020-21 data is trimmed to exclude facilities that have anomalous or unexpected values for fields used in the model. The Independent Health and Aged Care Pricing Authority (IHACPA) has developed a list of rules which trim out facilities according to a list of reasonably conservative rules. The list of rules and their impact on the ACFR sample is shown in Table 3.

Table 3: Trimming rules and their impact on ACFR data

Trimming Rule	Records
ACFR data with duplicates removed	2,466
1. Registered Nurse (RN) cost per hour of labour less than the minimum RN award rate of \$42.96	-130
2. Enrolled Nurse (EN) cost per hour of labour less than the minimum EN award rate of \$40.22	-943
3. Labour costs are reported with zero care hours, or care hours reported with zero cost	-154
4. Facility had a sanction imposed by the Aged Care Safety and Quality Commission (the Commission) in 2020-21	-10
5. Facility was non-compliant with one or more aged care responsibilities under the <i>Aged Care Act 2017</i>	-50
Trimmed ACFR data	1,179

4 Adjustments

The Residential Aged Care Pricing Advice 2023–24 (RACPA23) uses an interim methodology developed by the Independent Health and Aged Care Pricing Authority (IHACPA) because of the lack of recent cost data and limited activity data following implementation of the Australian National Aged Care Classification (AN-ACC) funding model on 1 October 2022. This interim methodology will be reassessed when providing Residential Aged Care Pricing Advice for 2024–25.

The Department of Health and Aged Care's (the Department's) initial price of \$216.80 (ACP22) was used as a starting point and was updated based on forecast cost impacts in the delivery of residential aged care and residential respite care services.

The key aspects considered in this interim methodology included:

- Bundling of, and subsequent Department feedback on the Government's proposed decision to unbundle, the Basic Daily Fee (BDF) supplement from the AN-ACC price
- Inflation and wage increases in 2021 and 2022 that were not fully captured in ACP22
- 21 February 2023 Stage 2 Fair Work Commission (FWC) interim decision to increase wages for direct care aged care workers and recreation/lifestyle officers
- Superannuation Guarantee increase
- Indexation of historical cost data to account for underlying price inflation
- Analysis of any potential shortfall in funding for hotel costs.

The FWC decision and Superannuation Guarantee increase are both prospective adjustments. Prospective adjustments have been an important aspect of the interim methodology but as costing data improves may not necessarily be required on an ongoing basis. These adjustments are discussed further in subsections 4.4 and 4.5 below. Indexation and the analysis of hotel costs are presented in their own sections (sections 5 and 6 respectively).

Before making any of the prospective adjustments, ACP22 is adjusted to unbundle the BDF Supplement and account for inflation and wage increases in 2021 and 2022. The result is then disaggregated into labour and non-labour components which can then be adjusted separately.

4.1 Unbundling of BDF Supplement

On 1 July 2021, the Government introduced a BDF Supplement of \$10 per occupied bed day (OBD) to account for reports of a shortfall in funding for hotel related costs. The BDF supplement was bundled into the AN-ACC funding model from 1 October 2022, so that ACP22 effectively included some proportion of funding to cover hotel related costs. Department feedback received in the development of RACPA23 indicated that the BDF Supplement will be removed from the AN-ACC funding model, and instead paid as a separate supplement per OBD from 1 July 2023.

To account for this change, the ACP22 is adjusted by removing \$10 per OBD, resulting in a restated ACP22 excluding the BDF Supplement of \$206.80.

4.2 Adjusting for historical inflation and wage increases

In setting ACP22, the Department indexed 2020-21 costs to 2022-23 based on Wage Cost Index 9 (WCI-9). This gave a total inflation of the two-year period of 2.82 per cent.

IHACPA has constructed specific indexes based on Australian Bureau of Statistics Wage Price Index (WPI) and Consumer Price Index (CPI) expenditure subgroups. These are discussed in detail in section 5. Using these indexes, growth in labour and non-labour care from 2020-21 and 2022-23 can be calculated.

Using the labour cost index, the two-year growth in labour costs to the September 2022 quarter is equal to 5.93 per cent. Similarly, non-labour cost growth to the December 2022 quarter is estimated at 6.84 per cent. Different quarters are used as these indexes are based on the latest available ABS index data, which at the time of development was September 2022 for WPI and December 2022 for CPI.

Accounting for the 2.82 per cent growth already reflected in ACP22, IHACPA has made a further adjustment of 3.03 per cent for labour costs and 3.93 per cent for non-labour costs. The effect of this adjustment is shown in Table 4.

Table 4: Adjusting ACP22 for historical inflation and wage increases

Price component	Total (ACFR 2020-21)	Proportion	ACP22 (2022-23 dollars)	Adjustment	Adjusted ACP22 (2022-23 dollars)
Total labour costs (imputed)	\$5,932.2m	87.4%	180.69	3.03%	186.17
Total non-labour costs	\$857.2m	12.6%	26.11	3.91%	27.13
Total	\$6,789.4m	100%	206.80	3.14%	213.30

*Components may not add to total due to rounding

4.3 Identifying cost proportions

To apportion the adjusted ACP22 of \$213.30 into relevant components, the proportion of relevant expense items are calculated using the Aged Care Financial Report (ACFR), adjusted to reflect the cost of meeting the Department's care minute targets as described in section 2.2, and trimmed to a more robust sample of data as described in section 3.1. The expenditure components needed for the adjustments are:

- Nursing (registered and enrolled)
- Personal care worker (PCW) and recreation/lifestyle officers (Rec)
- Other labour
- Other direct care

As discussed in subsection 1.3.2, all care expense items in the ACFR have been considered in scope in RACPA23.

The total of each in scope component from the ACFR 2020-21 is shown in Table 5.

Table 5: Proportion of in scope costs from the trimmed and adjusted ACFR 2020-21

Price component	Total (ACFR 2020-21)	Proportion	Adjusted ACP22 (2022-23 dollars)
Nursing	\$2,044.7m	30.1%	64.17
Personal care workers and recreational activity officers	\$3,270.4m	48.2%	102.63
Other labour	\$617.1m	9.1%	19.37
Other direct care costs	\$857.2m	12.6%	27.13
Total*	\$6,789.4m	100%	213.30

*Components may not add to total due to rounding

4.4 Fair Work Commission interim decision

The FWC wage case relates to the *Aged Care Award 2010*, *Nurses Award 2010*, and *Social Community, Home Care and Disability Services Industry Award 2010* (the Awards) for aged care workers. An interim FWC decision was handed down on 21 February 2022 to increase of 15 per cent to wages from 30 June 2023 for the follow employees under the awards listed above:

- Direct care workers under the Awards (defined as RNs, ENs, PCWs)
- Recreation Activity Officers and Lifestyle Officers
- Cooks and Chefs at level 4-7, provided they are the most senior chef or cook engaged at the facility

Noting that the final item does not affect the RACPA23 calculation, but may influence hotel cost gap analysis presented in section 6. The FWC will make further decisions relating to the case. These decisions have not yet been handed down and have not prospectively been accounted for in any way.

4.4.1 Aged care workers on non-award salaries

The [Commonwealth submission to the FWC case](#) states that most of the aged care work force are currently covered by enterprise bargaining agreements (EBAs), the majority of which have passed their nominal expiring dates. Therefore, most of workers under EBAs are paid at the award wage by default, as annual increases to the award have surpassed the EBA rate.

The submission goes on to state that a significant proportion of aged care nurses are on active EBAs and are broadly paid 15 per cent above awards. Estimates based on survey data indicate that 23.43 per cent of nurses are on active EBAs which are 15 per cent or more above the award.

To account for the interim FWC decision, an increase has been applied to the labour cost proportion from Table 5. The increase is calculated separately for nurses and other labour cost proportions in ACFR using the follow methodology:

- 23.43 per cent of nursing costs are not inflated, and the remainder (76.57 per cent) are inflated by 15 per cent to align with the FWC interim wage increase

- PCW and recreational labour costs are inflated by 15 per cent
- Other labour costs are not inflated

The effect of this on the Department's initial price is shown in Table 6.

Table 6: Applying the interim FWC decision adjustment

Price component	Adjusted ACP22 (2022-23 dollars)	FWC adjustment	Price after adjustment (2022-23 dollars)
Nursing	64.17	11.5%	71.54
Personal care workers and recreational activity officers	102.63	15.0%	118.03
Other labour	19.37	0%	19.37
Other direct care	27.13	0%	27.13
Total*	213.30	10.7%	236.06

*Components may not add to total due to rounding

Table 6 shows that after accounting for the FWC decision of 15 per cent uniform award wage increase for direct care workers, and the proportion of nurses on EBAs which pay over 15 per cent of the award, results in an average increase of 10.7 per cent to the adjusted ACP22, giving a FWC commission adjusted price of \$236.06 in 2022-23 dollars.

4.5 Superannuation Guarantee increase

The [Superannuation Guarantee \(Administration\) Act 1992](#) stipulates in section 19(2) increases in minimum amount of superannuation an employer pays (the guarantee rate) by 0.5 per cent each year from 1 July 2021 until 1 July 2025.

IHACPA currently does not have data on which providers are paying superannuation at the guaranteed rate and which are on EBAs paying above the guaranteed rate.

In the absence of any data on superannuation contributions above the guaranteed rate in the aged care workforce, IHACPA have assumed that the workforce is paid at the guaranteed rate. This implies that there will be a 0.5 per cent (50 basis points) increase in the superannuation component labour costs between 2022-23 and 2023-24.

This adjustment is made by increasing the superannuation component of labour costs in the aged care price from 10.5 per cent to 11.0 per cent. The effect of this adjustment on labour costs is shown in Table 7.

Table 7: Applying Superannuation Guarantee increase

Labour cost component	Cost adjusted for FWC interim decision	Superannuation adjustment	Labour component after adjustment
Non-superannuation labour cost	189.08	-	189.08
Superannuation component	19.85	4.8%	20.80
Superannuation proportion	10.5%	+0.50%	11.0%
Total labour cost*	208.93	0.45%	209.88

*Components may not add to total due to rounding

The effect of this adjustment on the FWC adjusted price is shown in Table 8

Table 8: Applying the Superannuation Guarantee adjustment

Price component	FWC interim decision adjusted price (2022-23 dollars)	Superannuation adjustment	Price after adjustment (2022-23 dollars)
Labour costs (imputed)	208.93	0.45%	209.88
Non-labour costs	27.13	0%	27.13
Total*	236.06	0.40%	237.01

*Components may not add to total due to rounding

The Superannuation Guarantee is applied after the FWC adjustment so that it accounts for additional employer superannuation contributions subsequent to any wage increases.

As shown in Table 8, the Superannuation Guarantee adjustment has an overall impact of 0.4 per cent on the price after the FWC interim decision adjustment has been applied. This results in a 2022-23 price of \$237.01. For application from 1 July 2023, the next step is for this price to be indexed from the 2022-23 dollar value shown in Table 8. This process is shown in section 5.

5 Indexation

The Independent Health and Aged Care Pricing Authority (IHACPA) has identified the need to use an alternative index as an interim measure to account for input cost inflation for aged care separately for labour and non-labour components of cost.

In the absence of historical actual cost data, IHACPA has used more targeted indexes from the Australian Bureau of Statistics (ABS) to construct a more specific indexation rate that is relevant to the aged care sector. Individual indexation rates for labour costs, non-labour direct care costs, and hotel costs have been constructed separately. These are each discussed in their respective sections below.

5.1 Indexation model

In the context of the Residential Aged Care Pricing Advice 2023-24 (RACPA23), the objective of indexation is to identify trends in cost growth using historical data. These trends are used to derive an annual growth rate to forecast the 2022-23 cost components to be applicable in 2023-24.

Average annual growth rates are determined by fitting an exponential regression model to an underlying index series to calculate an annual growth rate. This is technically a similar approach used by IHACPA in indexation for the National Efficient Price for public hospital services. The model takes the form

$$\text{index}_n = b \times r^n + \epsilon_n$$

Where:

- index_n is the value of the underlying index series at time n
- n is the time unit, in this case the year and quarter for the index value
- b is the estimated value of the index when $n = 0$ (the intercept)
- r is the growth rate per unit change in n (in this case, per quarter)
- ϵ_n is the error term

The coefficient of interest in this model is the term r , which is the best estimate of the growth rate per quarter. This is converted to an annual indexation rate $i = r^4$.

Example: indexation application

Suppose for this example that the best estimate for quarterly growth in hotel costs is $r = 1.0126$. In other words, the hotel cost index series increases at an estimated rate of 1.126 per cent per quarter. If hotel costs are on average \$67.97 per resident bed day in 2020-21, then to estimate 2023-24 hotel costs per resident bed day, this value is indexed for 12 quarters. The 2023-24 hotel cost estimate would then be

$$\begin{aligned} \$67.97 \times r^{12} &= \$67.97 \times 1.0126^{12} \\ &= \$67.97 \times 1.1623 \\ &= \$78.99. \end{aligned}$$

Equivalently, using the annualised indexation rate $i = r^4 = 1.0514$, one can apply 3 years of annual indexation to the 2020-21 value:

$$\begin{aligned} \$67.97 \times i^3 &= \$67.97 \times 1.0514^3 \\ &= \$67.97 \times 1.1623 \\ &= \$178.99. \end{aligned}$$

Note that the calculations as written may not evaluate exactly as written due to rounding. This method is applied below to calculate separate annual indexation rates for Labour costs, non-labour direct care costs, and hotel costs.

5.2 Labour cost indexation

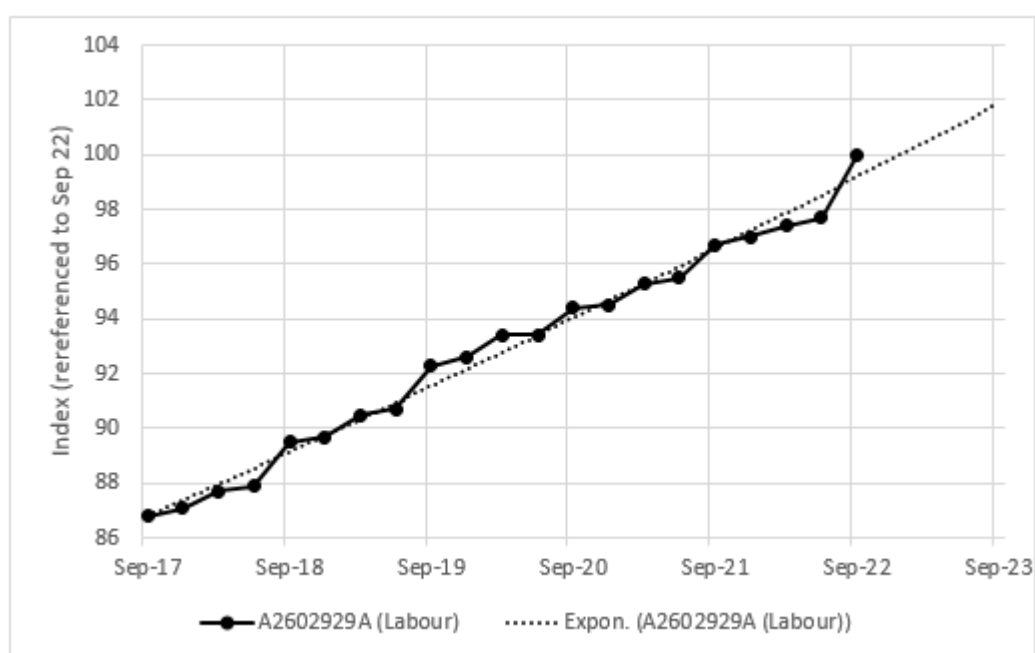
To determine an underlying growth rate for labour costs, IHACPA has used quarterly index numbers from the ABS index time series *6345.0 Wage Price Index, Australia*, September 2022.

As approximately 90 per cent of aged providers are private entities, and as such it is reasonable to expect that public providers are compete with private wages. Therefore, IHACPA has selected the series *Quarterly Index; Total hourly rates of pay excluding bonuses; Australia; Private; Health care and social assistance* (Series ID A2602929A) to determine wage price growth.

All earnings statistics published by the ABS, including the Wage Price Index, exclude employers' social contributions such as superannuation¹, and therefore the superannuation increase will not be double-counted through this indexation process.

IHACPA has fit an exponential growth curve to this index series, using values from the September 2017 quarter to the September 2022 quarter, to estimate the growth over a 5-year period. This is shown in Figure 1.

Figure 1: Index series used for labour cost growth



¹ <https://www.abs.gov.au/statistics/understanding-statistics/guide-labour-statistics/earnings-guide>

Figure 1 shows a plot of the *Quarterly Index; Total hourly rates of pay excluding bonuses; Australia; Private; Health care and social assistance* series from September 2017 to September 2022, together with the exponential regression curve fit as a best estimate of growth over that period. Note that the values of the index series have been referenced to equal 100.0 in the September 2022 quarter. Although not strictly necessary for labour cost indexation, this is applied for consistency, as it is required for the two other indexation rates derived for RACPA23. This is discussed further in section 5.3 below

The resulting model for the labour cost index is

$$\text{index}_n = 99.1746 \times 1.0067^n.$$

This model gives an annual labour cost indexation rate i_L of

$$i_L = 1.0067^4 = 1.0270.$$

Note that this expression may not evaluate exactly as written due to rounding. Therefore, the annualised growth rate used for inflation in labour costs is 2.70 per cent.

5.3 Non-labour direct care cost indexation

The non-labour proportion of direct care costs in the Aged Care Financial Report (ACFR), according to the ACFR 2020-21 definitions, consist of:

- Resident expenses, including medical supplies, incontinence supplies, nutritional supplements, and other resident expenses.
- Insurance expenses, such as WorkCover premiums.
- Other direct care expenses, including agency (non-salary) fees, payroll tax, external costs for quality and compliance and training, chaplaincy/pastoral care, and other direct care expenses.

As there is no single index that reflects this mix of product, IHACPA has constructed a composite index from Consumer Price Index (CPI) subgroups. IHACPA has used the quarterly index numbers from the Australian Bureau of Statistics (ABS) index time series *6041.0 Consumer Price Index, Australia*, December 2022. After constructing the composite index series, the model used to derive this index is methodologically the same as the hotel cost index construction in section 5.4 below.

The selected CPI subgroups for each component of non-labour care direct costs are shown in Table 9.

Table 9: CPI Subgroups selected for non-labour direct care costs

Non-labour care cost component	CPI Index subgroup	Series ID
Resident non-labour expenses	Index Numbers; Medical products, appliances, and equipment; Australia	A3604438R
Insurance expenses	Index Numbers; Insurance; Australia	A3602878J
Other direct care expenses	Index Numbers; Other financial services; Australia	A2332776R

IHACPA has weighted and combined these to indexes to form a single non-labour direct care index, which is then used in the annual growth estimate.

Composing index series

The CPI series are generally referenced to 2011-12 financial year. That is, they are expressed such that the annual index for 2011-12 is equal to 100.0. For example, the *Other financial services* index number for December 2022 is 121.3, indicating that the consumer price for that subgroup is 21.3 per cent higher in December 2022 than in the 2011-12 financial year.

If index series for subgroups published by ABS are combined directly, there is an implicit assumption that the relative cost for each group has been equal since the reference year in 2011-12. This in general is not the case, so each index series must be weighted before combining to reflect the cost proportions in the period of interest.

IHACPA has addressed this in two stages. Firstly, each index series is re-referenced to the latest available quarter. Then the re-referenced indexes series are weighted and combined.

Example of re-referencing index

For example, the index series A3604438R (Medical products, appliances and equipment; Australia) used for resident non-labour expenses has a value of 105.0 in December 2021, and 107.4 in December 2022, giving a growth of 2.3 per cent in that year. To re-reference this index to 100.0 in December 2022, all index numbers are divided by the December 2022 number and multiplied by 100. Then the new December 2021 index number is 97.8, and the new December 2022 number is 100.0. The change between the two quarters is still 2.3 per cent.

Then, each of the re-referenced index series are weighted according to the relative cost in each group, calculated using the trimmed, adjusted ACFR 2020-21. The costs proportions for each group are summarised in Table 10.

Table 10: Care cost proportions in the trimmed, adjusted ACFR 2020-21

Price component	Total (ACFR 2020-21)	Proportion / weight
Insurance expenses	\$110.0m	12.83%
Resident non-labour expenses	\$223.0m	26.01%
Other direct care expenses	\$524.3m	61.16%
Total*	\$857.2m	100.00%

*Components may not add to total due to rounding

In the ACFR, insurance expenses account for approximately 12.8 per cent of non-labour direct care costs, resident expenses account for approximately 26.01 per cent of non-labour direct care, and other direct care expenses (including administration) account for approximately 61.16 per cent. The weights shown in Table 10 are used to combine the re-referenced index series, resulting in a composite index series for non-labour direct care costs. The re-referencing and weighting of the non-labour direct care index series used are given in Appendix A.

Using the same method described for the labour cost indexation above, IHACPA has fit an exponential growth curve to the non-labour direct care index series to measure average annual growth. The non-labour direct care cost index series along with the three contributing CPI subgroups are shown in Figure 2.

Figure 2: Index series used for non-labour direct care cost growth

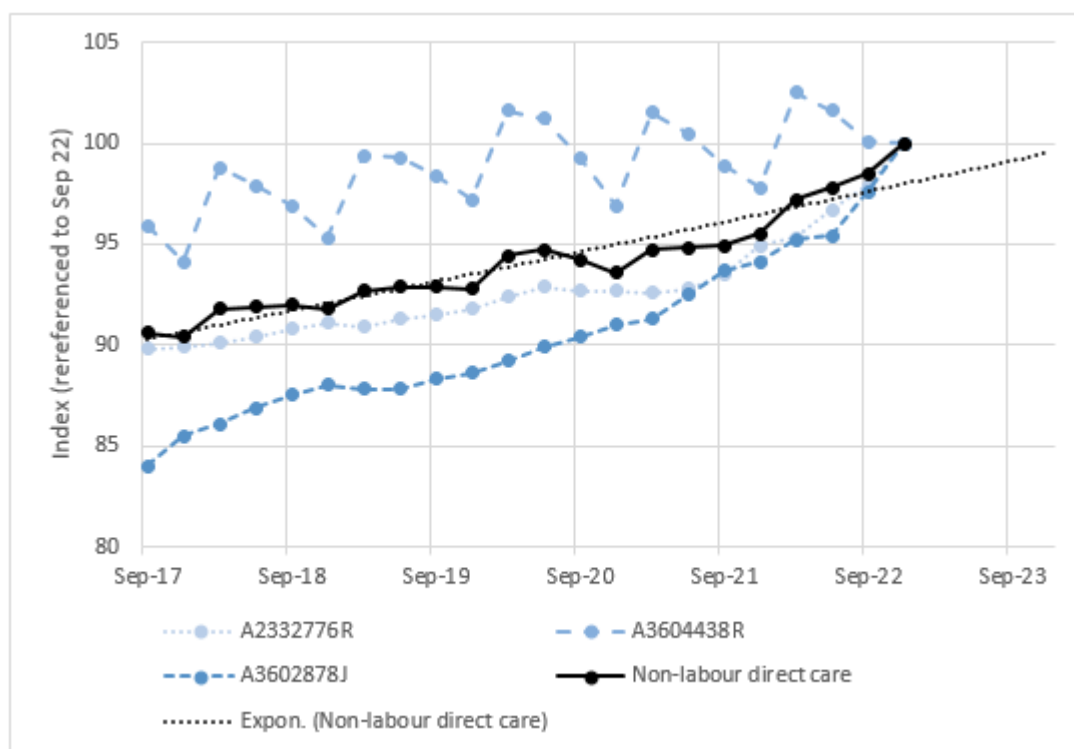


Figure 2 shows a plot of the non-labour direct care index, together with the three CPI sub-group indexes which were used to construct it. IHACPA notes the clear seasonality of the medical supplies index, which is driven by variation in consumer pharmacy costs, which, in turn, is likely to be driven by the effect of Pharmaceutical Benefits Scheme's Safety Net.

The dotted line shows the exponential regression curve fit to the non-labour direct care index as a best estimate of average annual non-labour direct care cost over that period.

The resulting model is

$$\text{index}_n = 98.0282 \times 1.0039^n.$$

This model gives an annual non-labour direct care cost indexation rate i_c of

$$i_c = 1.0039^4 = 1.0158$$

Note that this expression may not evaluate exactly as written due to rounding. Therefore, the annualised growth rate used for inflation in non-labour direct care costs is 1.58 per cent.

This model gives an annual indexation rate of 1.58 per cent for growth in non-labour direct care costs, which will be used to index the non-labour direct care component of the aged care price.

As the Department of Health and Aged Care's price has been calculated to apply for the 2022-23 year, and RACPA23 will apply from 2023-24, IHACPA has used these growth rates to index the relevant cost proportions for 12 months.

The result of applying these indexation rates to relevant proportions of the price is summarised in Table 11.

Table 11: Applying indexation to labour and non-labour components

Price component	Fair Work Commission interim decision and Superannuation Guarantee adjusted price (2022-23 dollars)	Indexation	Price after indexation (2023-24 dollars)
Labour costs (imputed)	209.88	2.70%	215.54
Non-labour costs	27.13	1.58%	27.56
Total*	237.01	2.57%	243.10

*Components may not add to total due to rounding

This methodology results in a residential aged care priced for RACPA23 of \$249.07 per national weighted activity unit.

5.4 Hotel cost indexation

The indexation rate for hotel costs is constructed similarly to the non-labour direct care cost index in section 5.3 above, although hotel costs have a different composition to non-labour direct care costs, so different index series are used. According to Parts 2 and 3 of Schedule 1—Care and services for residential care services of the *Quality of Care Principles 2014* under section 96-1 of the *Aged Care Act 1997* (the Schedule). While the Schedule includes maintenance as part of hotel costs, the Government and StewartBrown have both re-categorised maintenance as an accommodation cost. Therefore, the hotel costs used for indexation the hotel cost analysis for RACPA23 comprise:

- Labour for catering, cleaning, laundry, and maintenance
- Catering consumables and contracts
- Cleaning consumables and contracts
- Laundry consumables and contracts
- Utilities, including electricity, gas, council rates and rubbish removal
- Motor vehicle operation, maintenance, and repair (e.g., bus)
- Other administrative expenses, including WorkCover premiums for hotel staff
- Corporate administrative expenses, and
- Other hotel expenses not covered above.

Administrative expenses have been apportioned to hotel according to the proportions published in the StewartBrown Aged Care Financial Performance Survey Report.

IHACPA has used quarterly index numbers from the ABS index time series:

- 6345.0 *Wage Price Index, Australia*, September 2022, and
- 6041.0 *Consumer Price Index, Australia*, December 2022.

IHACPA have selected following index series, predominately CPI subgroups, to construct a specific index for series hotel costs. This have been selected to aligns as closely as possible with the hotel cost components listed above. These are summarised in Table 12.

Table 12: Index series selection for hotel cost indexation

Hotel cost component	Selected Index	Series ID
Hotel labour	Total hourly rates of pay excluding bonuses; Private; Health care and social assistance	A2602929A
Catering consumables and contracts	Food and non-alcoholic beverages	A2325891R
Cleaning consumables and contracts	Furnishings, household equipment and services	A2326026R
Laundry consumables and contracts	Cleaning, repair and hire of clothing and footwear	A2328051C
Utilities, including electricity, gas, council rates and rubbish removal	Utilities	A2326521X
Motor vehicle operation, maintenance, and repair	Private motoring	A2326656J
WorkCover premiums for hotel staff	Insurance	A3602878J
Other administrative expenses, including corporate recharge	Other financial services	A2332776R
Other hotel expenses not covered above	Audio, visual, and computing equipment and services	A3604423X
	Newspapers, books, and stationery	A3604408A
	Other recreation, sport, and culture	A2331381C

As with the non-labour direct care index series construction described in section 5.3 above, a composite index series (the hotel index series) was constructed using the above ABS index series, re-referenced to equal 100.0 in the December 2022 quarter, and weighted according to the cost proportions in the trimmed, adjusted ACFR 2020-21. These cost proportions are summarised in Table 13.

Table 13: Hotel cost proportions in the trimmed, adjusted ACFR 2020-21

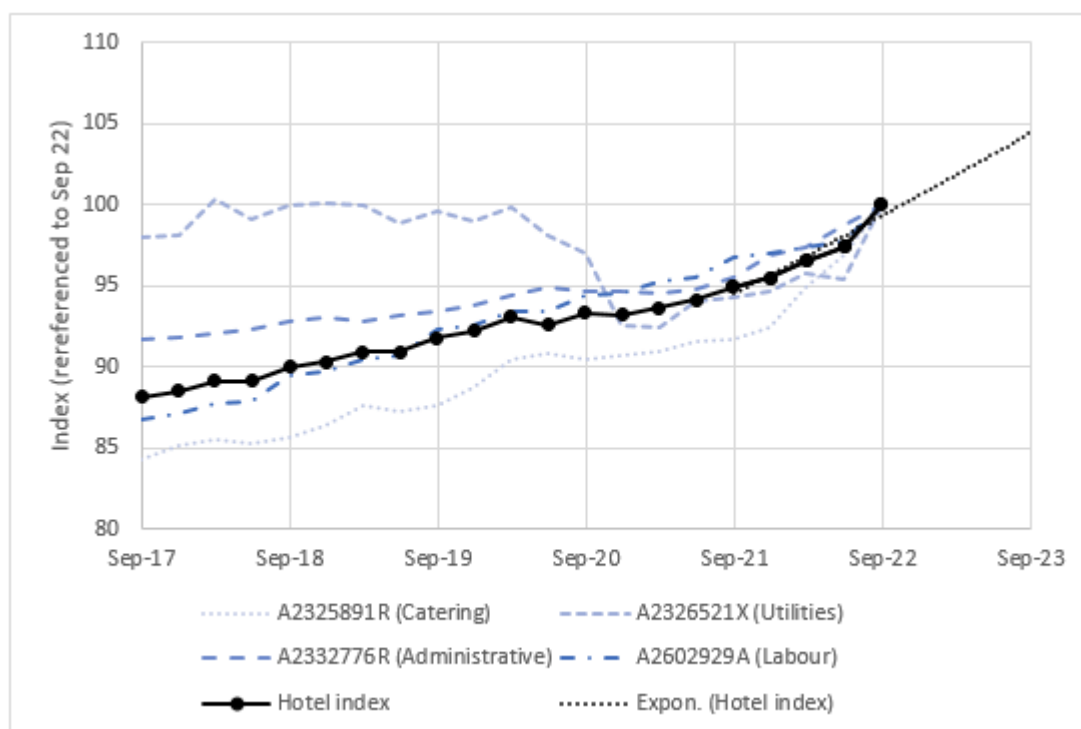
Hotel cost component	Total (ACFR 2020-21)	Proportion / weight
Hotel labour	\$975.1m	43.73%
Catering consumables and contracts	\$492.5m	22.09%
Cleaning consumables and contracts	\$110.2m	4.94%
Laundry consumables and contracts	\$54.7m	2.45%
Utilities, including electricity, gas, council rates and rubbish removal	\$220.7m	9.90%
Motor vehicle operation, maintenance, and repair	\$6.3m	0.28%
WorkCover premiums and insurance	\$19.8m	0.89%
Other administrative expenses	\$340.3m	15.26%
Other hotel expenses not covered above	\$30.6m	0.46%
Total*	\$2,250.4m	100%

*Components may not add to total due to rounding

As with the non-labour direct care index series construction described in section 5.3 above, the re-referenced index series from Table 12 are combined using the weights shown in Table 13. The resulting composite index series for hotel care costs is shown in detail in Appendix A.

Using the same method described for the non-labour direct care cost indexation 5.3 above, IHACPA has fit an exponential growth curve to the hotel cost index series to measure average annual growth. The hotel cost index series along with the highest contributing index series are shown in Figure 3.

Figure 3: Index series used for hotel cost growth



Unlike the non-labour index presented in Figure 2, the hotel cost index series shows that more recent observations reflect the higher inflation rate observed in the Australian economy. For this reason, IHACPA has used only the most recent year of the index series when fitting the growth model for hotel costs. This ensures that recent inflation is more accurately reflected.

The resulting model is

$$\text{index}_n = 99.3048 \times 1.0126^n.$$

This model gives an annual hotel cost indexation rate i_H of

$$i_H = 1.0126^4 = 1.0514$$

Note that this expression may not evaluate exactly as written due to rounding. Therefore, the annualised growth rate used for inflation in hotel costs is 5.14 per cent.

6 Hotel cost gap

The Independent Health and Aged Care Pricing Authority (IHACPA) is required to provide advice to the Department of Health and Aged Care on the gap between the costs of delivering required hotel services, and the revenue received from the basic daily fee (BDF).

The Aged Care Financial Report (ACFR) 2020-21 includes all necessary data items related to the cost for hotel services, and the revenue received for hotel related services. These items together allow the gap between hotel costs and revenue to be calculated to inform the Residential Aged Care Pricing Advice 2023-24.

As hotel costs are reported at a highly aggregated level (e.g., “Total Hotel Expenses” and “Total Administration Expenses”), rather than having to rely on more nuanced breakdowns used for the pricing setting, the entire ACFR 2020-21 data set is used to derive hotel costs and revenue.

IHACPA’s approach to quantifying cost and revenue is detailed in respective sections below.

6.1 Hotel costs

Elements of hotel costs in scope are outlined in Part 1 of the Schedule 1—Care and services for residential care services of the *Quality of Care Principles 2014* under section 96-1 of the *Aged Care Act 1997* (the Schedule). The relevant fields in the ACFR 2020-21 are listed at the beginning of section 5.4.

The total hotel costs (\$4,348.1m) are divided by the total number of OBDs (64.0m) to determine the hotel costs per resident bed day. This figure is then indexed to 2023-24 dollars using the hotel cost indexation rate of 4.78 per cent calculated in section 5.4 above. The results of this process are shown in Table 14.

Table 14: Hotel cost estimate using ACFR 2020-21

Hotel cost component	ACFR 2020-21 Total	2020-21 cost per OBD	Estimated 2023-24 cost per OBD
Hotel costs	\$3,531.6m	\$55.20	\$64.16
Corporate administrative costs	\$816.5m	\$12.76	\$14.83
Total*	\$4,348.1m	\$67.97	\$78.99

*Components may not add to total due to rounding

6.2 Hotel revenue

Hotel costs for residents are funded through payment of the BDF. The BDF is up to 85 per cent of the basic aged care pension with all residents required to pay or apply for hardship or alternative payment options.

Additional and/or extra hotel services, such as higher quality meals, bedding, furnishings, or preferred brands of toiletries can be offered and paid for by residents through additional service fees, and/or extra service fees.

In July 2021, the BDF Supplement was introduced in response to the Royal Commission into Aged Care Quality and Safety in the form of a \$10 per occupied bed day (OBD) supplement, intended predominantly to improve the quality of food and nutrition for residents, among other objectives. This funding was consolidated into the Australian National Aged Care Classification (AN-ACC) price as of 1 October 2022. Subsequent advice from Government is that the BDF Supplement will be paid as a separate supplement of \$10 per OBD.

The ACFR provides information on the BDF, extra service fee and additional service fee revenue, and the revenue from the 2023-24 BDF Supplement can be calculated based on total OBD information in the ACFR. The estimation of hotel revenue is shown in Table 15.

Table 15: Hotel revenue estimating using ACFR 2020-21

Hotel revenue component	Total revenue	Revenue per OBD	
		2020-21	2023-24 (estimate)
Basic daily fees	\$3,369.4m	\$52.67	\$61.21
Extra services fees	\$120.4m	\$1.88	\$2.19
Additional services fees	\$127.5m	\$1.99	\$2.32
Other hotel revenue	\$21.0m	\$0.33	\$0.33
BDF Supplement	N/A	N/A	\$10.00
Total*	\$3,638.4m	\$56.87	\$76.10

*Components may not add to total due to rounding

Comparing Table 14 and Table 15 then shows that in 2023-24, hotel costs are estimated to be \$2.89 greater than hotel revenue per OBD. Note that this gap excludes maintenance costs, which are estimated at \$10.32 per OBD for 2023-24.

Appendix A Index Numbers

Table 16: Wage price index numbers (A2602929A)

Quarter	Source index numbers	Re-referenced index numbers
	A2602929A	A2602929A
SEP2017	129.4	86.8
DEC2017	129.8	87.1
MAR2018	130.6	87.7
JUN2018	131.0	87.9
SEP2018	133.3	89.5
DEC2018	133.7	89.7
MAR2019	134.9	90.5
JUN2019	135.2	90.7
SEP2019	137.5	92.3
DEC2019	138.0	92.6
MAR2020	139.1	93.4
JUN2020	139.1	93.4
SEP2020	140.6	94.4
DEC2020	140.8	94.5
MAR2021	142.0	95.3
JUN2021	142.3	95.5
SEP2021	144.1	96.7
DEC2021	144.6	97.0
MAR2022	145.1	97.4
JUN2022	145.5	97.7
SEP2022	149.0	100.0

Table 17: Non-labour direct care price index numbers

Quarter	Source index numbers			Re-referenced index numbers			Contribution to final index			
	A3604438R	A3602878J	A2332776R	A3604438R	A3602878J	A2332776R	A3604438R	A3602878J	A2332776R	Composite
DEC2017	101.1	127.2	109.0	94.1	85.5	89.9	24.5	11	55	90.4
MAR2018	106.1	128.0	109.3	98.8	86.1	90.1	25.7	11	55.1	91.8
JUN2018	105.1	129.2	109.7	97.9	86.9	90.4	25.5	11.1	55.3	91.9
SEP2018	104.1	130.1	110.2	96.9	87.5	90.8	25.2	11.2	55.6	92
DEC2018	102.4	130.9	110.5	95.3	88	91.1	24.8	11.3	55.7	91.8
MAR2019	106.8	130.5	110.3	99.4	87.8	90.9	25.9	11.3	55.6	92.7
JUN2019	106.6	130.6	110.7	99.3	87.8	91.3	25.8	11.3	55.8	92.9
SEP2019	105.7	131.3	111.0	98.4	88.3	91.5	25.6	11.3	56	92.9
DEC2019	104.4	131.8	111.4	97.2	88.6	91.8	25.3	11.4	56.2	92.8
MAR2020	109.1	132.7	112.1	101.6	89.2	92.4	26.4	11.4	56.5	94.4
JUN2020	108.7	133.7	112.7	101.2	89.9	92.9	26.3	11.5	56.8	94.7
SEP2020	106.7	134.4	112.5	99.3	90.4	92.7	25.8	11.6	56.7	94.2
DEC2020	104.1	135.3	112.4	96.9	91	92.7	25.2	11.7	56.7	93.6
MAR2021	109.0	135.8	112.3	101.5	91.3	92.6	26.4	11.7	56.6	94.7
JUN2021	107.9	137.6	112.6	100.5	92.5	92.8	26.1	11.9	56.8	94.8
SEP2021	106.2	139.3	113.4	98.9	93.7	93.5	25.7	12	57.2	94.9

Quarter	Source index numbers			Re-referenced index numbers			Contribution to final index			
	A3604438R	A3602878J	A2332776R	A3604438R	A3602878J	A2332776R	A3604438R	A3602878J	A2332776R	Composite
DEC2021	105.0	139.9	115.1	97.8	94.1	94.9	25.4	12.1	58	95.5
MAR2022	110.1	141.5	115.6	102.5	95.2	95.3	26.7	12.2	58.3	97.2
JUN2022	109.1	141.9	117.3	101.6	95.4	96.7	26.4	12.2	59.1	97.8
SEP2022	107.5	145.1	118.8	100.1	97.6	97.9	26	12.5	59.9	98.5
DEC2022	107.4	148.7	121.3	100	100	100	26	12.8	61.2	100

Table 18: Hotel price index numbers – source

Quarter	Source index numbers										
	A2325891R	A2326026R	A2326521X	A2326656J	A2328051C	A2331381C	A2332776R	A2602929A	A3602833C	A3604408A	A3604423X
SEP2021	114.2	111.1	128.5	113.2	127.4	117.6	113.4	144.1	139.3	117.2	68.6
DEC2021	115.0	112.3	128.9	116.6	127.9	117.7	115.1	144.6	139.9	115.9	69.3
MAR2022	118.2	113.5	130.3	121.6	130.2	119.9	115.6	145.1	141.5	118.2	69.0
JUN2022	120.6	116.3	130.0	124.7	133.9	121.4	117.3	145.5	141.9	118.7	69.8
SEP2022	124.5	119.6	136.2	123.9	136.1	121.4	118.8	149.0	145.1	121.6	70.2

Table 19: Hotel price index numbers – re-referenced

Quarter	Re-referenced index numbers										
	A2325891R	A2326026R	A2326521X	A2326656J	A2328051C	A2331381C	A2332776R	A2602929A	A3602833C	A3604408A	A3604423X
SEP2021	91.70	92.90	94.30	91.40	93.60	96.90	95.50	96.70	96.00	96.40	97.70
DEC2021	92.40	93.90	94.60	94.10	94.00	97.00	96.90	97.00	96.40	95.30	98.70
MAR2022	94.90	94.90	95.70	98.10	95.70	98.80	97.30	97.40	97.50	97.20	98.30
JUN2022	96.90	97.20	95.40	100.60	98.40	100.00	98.70	97.70	97.80	97.60	99.40
SEP2022	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Table 20: Hotel price index numbers – contribution and final index

Quarter	Contribution to final index											
	A2325891R	A2326026R	A2326521X	A2326656J	A2328051C	A2331381C	A2332776R	A2602929A	A3602833C	A3604408A	A3604423X	Composite
SEP2021	20.3	4.6	9.3	0.3	2.3	0.1	14.6	42.3	0.9	0.1	0.1	94.9
DEC2021	20.4	4.6	9.4	0.3	2.3	0.1	14.8	42.4	0.9	0.1	0.2	95.5
MAR2022	21.0	4.7	9.5	0.3	2.3	0.2	14.8	42.6	0.9	0.1	0.2	96.5
JUN2022	21.4	4.8	9.4	0.3	2.4	0.2	15.1	42.7	0.9	0.1	0.2	97.4
SEP2022	22.1	4.9	9.9	0.3	2.5	0.2	15.3	43.7	0.9	0.2	0.2	100.0

*Components may not add to total due to rounding



Independent Health and Aged Care Pricing Authority

Eora Nation, Level 12, 1 Oxford Street
Sydney NSW 2000

Phone 02 8215 1100

Email enquiries.ihacpa@ihacpa.gov.au

Twitter [@IHACPA](https://twitter.com/IHACPA)

www.ihacpa.gov.au