

Submission to Senate Inquiry into the Provision of Child Care

Deborah Brennan and Sue Newberry

This submission presents findings from joint research by a specialist in child care policy and a chartered accountant who have a common interest in public policy, accountability and child care.

Professor Deborah Brennan has been conducting research into child care policy for over twenty-five years. She was the inaugural convenor of the National Association of Community Based Child Care (now Australian Community Children's Services) and is the author of *The Politics of Australian Child Care: Philanthropy, Feminism and Beyond* (Cambridge University Press, 1998) and numerous other publications in the field. Last year, Deborah was invited to tour Canada, speaking to policy-makers and addressing audiences in six cities about the corporatisation of child care in Australia. She has also addressed UK Treasury officials about Australian child care policy.

Associate Professor Sue Newberry is a chartered accountant and has been conducting research into financial accounting theory and standard-setting for almost 20 years. Within this broader interest, she has conducted research into public sector reforms and particularly public sector financial management reforms for more than ten years. She has published widely on both topics.

As well as our common interest in child care policy we share a commitment to the effective and efficient use of public funds to meet public goals. We believe that the public interest is best served by transparency and accountability, especially in an area as vital to the community as the provision of child care.

Child care funding and public accountability

In the early days of Commonwealth support for child care, public funds were largely used to support the employment of qualified staff in non-profit centres. Operational subsidies kept fees relatively modest, and low-income parents received assistance to help with the costs. Since 1991 the Commonwealth has moved away from funding the *supply* of non-profit children's services and now distributes almost all its subsidies by way of individualised *demand* subsidies, effectively vouchers, that enable parents to purchase any type of approved child care. By encouraging a market in child care, the government believed it would introduce competition, stimulate greater variety of provision, improve quality and drive down fees (Brennan 2007). This approach to child care funding was endorsed by the Howard government, which went further, introducing Child Care Benefit in 2000. Child Care Benefit is provided without regard to the need for services in a particular area. It provides a stream of funding to providers and has been at the heart of the corporate expansion of child care in Australia. No other country in the world has a policy mechanism like this, and no other country has experienced such overwhelming dominance of child care provision by the corporate sector (i.e. by companies listed on the stock exchange).

Other organisations (notably those by the Work + Family Policy Roundtable, KU Children's Services and the National Foundation for Australian Women) have, in their submissions to this Inquiry, taken up the broader issues raised by the expansion of

corporate care in a climate of weak regulation and accreditation. We support the recommendations of these organisations, particularly their call for fresh thinking about policy mechanisms that will actually link public funds to the broader interest in well-planned, high quality provision. Here, we wish to focus upon three public accountability questions raised by the collapse of ABC Learning:

1. How does the Commonwealth evaluate the suitability and adequacy of its funding policy tools?
2. How does the Commonwealth hold to account those in receipt of large amounts of public funds?
3. What public accountability requirements should be demanded of those organisations receiving large amounts of Commonwealth funding?

Historically, Australia's financial reporting requirements were drawn from company law. They sought to encompass both accountability (stewardship) for expenditure in the relevant reporting period and an accurate statement of the current position. This approach to financial reporting involved awareness that those reporting have incentives to misrepresent financial information. For example, the salary and bonuses paid to a CEO and other executives may be based on the company's reported results, while transactions or arrangements with 'friendly' parties linked in some way to the company or its directors may provide a means to manipulate results. The traditional accountability approach required considerable information about both remuneration and related party transactions.

Over the years, accounting standard-setters have increasingly downplayed the significance of accountability (stewardship) ideas, favouring instead the view that financial reporting requirements should be directed more tightly towards the interests of financial market participants, and particularly towards information thought useful for pricing shares in financial markets. This involves a shift in the type of information provided in financial reports, and increasing reliance, for valuation purposes, on management predictions of future cash flows. Financial reports are increasingly dependent on management/board expectations and judgments. This shift has become particularly apparent with the adoption of International Financial Reporting Standards (IFRS) set by the International Accounting Standards Board (IASB).

To the extent that the IASB has retained any concept of public accountability, it is narrowly confined to financial market participation: 'An entity has public accountability if: (a) it files, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or (b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, securities broker/dealer, pension fund, mutual fund or investment banking entity.' The IASB's effective abandonment of accountability (stewardship) has prompted international debate that should be heeded in Australia.

Cambridge University's Professor Geoffrey Whittington (Price Waterhouse Chair of Financial Accounting at Cambridge from 1988-2001 and a full time member of the International Accounting Standards Board from 2001-2006) has written extensively

on this issue (Whittington 2008). Whittington's central theme is that accountability: 'entails more than the prediction of future cash flows...[It] is concerned with monitoring the past as well as predicting the future and is sometimes as much concerned with the integrity of management as with its economic performance... In other words, the focus [on predicted cash flows] leads to accounting standards that reject the past, and even the present, in financial reporting and, in the process, largely reject[s] the relevance of financial reporting to corporate governance.'

We agree that there is significant public interest in a broader notion of accountability. Governments that allocate large amounts of taxpayer money (whether directly to providers or indirectly through parent subsidies) should insist upon public accountability for these funds. Government should also require, as far as possible, that funds are spent appropriately and invested in sustainable, high quality services.

This IASB's narrow focus on the needs and interests of financial market participants should be a matter of concern to the Senate and an issue that should be explored in any future re-casting of child care policy. The implications of failing to impose suitable public accountability requirements are highlighted in the case of ABC Learning's collapse. Two weaknesses in accounting standards identified by Professor Whittington have been significant in ABC Learning's collapse: (i) the values at which intangible assets are reported and (ii) the role of related parties.

- i. The reported values of intangible assets hinge on a forward-looking approach to valuation, which involves estimations of future cash flows. The reported values of those assets are compared with the estimations of future cash flows, and the values are considered acceptable provided they do not exceed the estimations of future cash flows. According to Whittington (2008), reliance on predicted cash flows encourages over-optimism, because it allows asset values to be set at what the management/boards would like them to be. In the case of ABC Learning, where intangible assets such as licences to operate child care centres comprised the bulk of the reported assets, the dangers are apparent.

Financial reports prepared in accordance with IFRS are difficult, if not impossible, for the average citizen to comprehend. In the case of ABC Learning, childcare policy experts who know the licensing process for childcare were puzzled about the values attributed to childcare licences in ABC Learning's financial reports. Had broader publicly accountability requirements been established so that the wider public was not effectively disenfranchised, the questionable nature of these "assets" may have been brought to public attention long before they were. [We note, however, that an anonymous submission to ASIC, which raised concerns about the nature of those licences and ABC's valuation practices for these 'intangible assets' appears not to have resulted in any action on the part of ASIC (Chenoweth, 2008).

- ii. For governments with a commitment to accountability and transparency, disclosure of information about related parties and transactions and arrangements with them is crucial. In the case of ABC Learning, information has emerged (and continues to emerge almost daily) suggesting that significant relationships and arrangements were not disclosed. News media reports have

included: exclusive arrangements for ABC Learning centres to purchase toys from a company related to ABC Learning; contracts for maintenance and cleaning being awarded to companies owned by friends and relatives of ABC directors; and the acquisition and disposal of childcare centres through arrangements involving friends and relatives of ABC directors. Arrangements such as these provide ways to manipulate financial results as well as to siphon money from one company to another. Whether ABC's arrangements were all *bona fide* is yet to be determined, but the dangers are apparent and the lack of disclosure a matter for concern.

It is our contention that IFRS are unsuitable for discharging reasonable public accountability expectations for any organisation (including companies such as ABC Learning) in receipt of significant amounts of Commonwealth funding. The rules are becoming even more unsuitable for these public purposes as the IASB narrows its focus to the provision of future-oriented information needed for financial market (share pricing) purposes. Accordingly, we make the following proposals:

- 1) In relation to Term of Reference (c): that the role of government in child care, and indeed in all demand-side funded community services, should include specification and enforcement of suitable public accountability requirements for those receiving this form of Commonwealth funding, and public access to that information.
- 2) In relation to Term of Reference (d): that any national authority established to oversee the childcare industry in Australia, be required as part of its role to monitor the financial accountability of the industry.

Time constraints have prevented us from providing a more detailed submission to the Senate. However, we have included two other papers, one by Brennan examining the rise of corporate child care in Australia and another by Brennan and Newberry setting out our joint analysis of the relationship between public policy and the ABC business model in more detail. We ask that these papers be considered part of our submission. We have also appended an article by Professor Whittington.

We thank the Committee for this opportunity to put our views before the Inquiry. As indicated, we would be happy to meet with members of the Inquiry and/or to appear at a public hearing to discuss our submission and our ongoing research.

The views expressed in the submission and paper are our own, and do not necessarily represent the views of the universities in which we are employed.

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Attachments:

Brennan, D. (2007). 'The ABC of Child Care Politics', *Australian Journal of Social Issues* 42(2): 213-225.

Brennan, D. and Newberry, S. (2008) Economic and Social Policy Tensions: early childhood education and care in a marketised environment, unpublished working paper.

Whittington, G. (2008) 'Harmonisation or discord? The critical role of the IASB conceptual framework review', *Journal of Accounting and Public Policy*, 27, 495-502.