Amid Allegations of Enron-style Fraud

Major Australian child care corporation at risk of bankruptcy

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30 September 2008

Australia's largest child care provider ABC Learning, also the world's largest publicly traded child care corporation, stands on the brink of collapse. The company's crisis, first triggered by the world financial markets' turmoil, has exposed a series of allegedly improper accounting practices, recalling the Enron scandal.

Shares in the company sold for just 54 cents each, down from last year's peak price of $8.80, before trading was suspended on August 21. ABC requested the suspension shortly before it announced that it would be unable to meet a deadline to submit information on its 2008 earnings. This is expected to reflect an even greater loss than the $470 million forecast a month earlier. The company's new auditors, Ernst & Young, reportedly may also force a restatement of ABC's accounts over the last two years. ABC Learning had promised to release the updated earnings figures by the end of September but it remains unclear whether this will be further postponed. Only when the share trading suspension is lifted will it become clear whether the company can avoid insolvency.

Whatever the immediate outcome, the crisis underscores the destructive irrationality of the private child care industry, which has been promoted by successive Labor and Liberal governments. The care of young children is a vital social service for working parents that ought to be freely provided and universally accessible. Moreover, children's early experiences and the quality of their interactions with adults are crucial to their long-term well being and future intellectual, emotional, and cultural development. But child care is now a business like any other, based on maximising profit and the private wealth of a few corporate CEOs and major investors.

ABC Learning operates more than 1,100 child care centres—30 percent of the national total—in Australia. Their future, along with that of the company's employees, is now in doubt. It is reportedly more likely, however, that the centres will be sold off to other private investors rather than shut down in the event that receivers are called in.

ABC Learning's troubles were first exposed in February after the company announced half yearly profits that were lower than anticipated. This triggered a massive sell-off, with share prices down by more than 40 percent, because investors feared the company would be unable to service its debt under conditions of the deepening global credit crunch, triggered by the US sub-prime mortgage sector collapse. ABC subsequently negotiated an emergency sale of its US assets (valued at $250 million) to reduce debt and interest costs.

These moves staved off bankruptcy but were also accompanied by greater scrutiny from investors and regulators. Litigation firm IMF Australia is now considering whether to launch a class action on behalf of shareholders. IMF's John Walker claimed that, contrary to ABC Learning's rosy financial reports, "we found that the company never really made money over the last four years".

According to the Fairfax press, ABC is also under investigation by the Australian Securities and Investments Commission (ASIC) for potential violations of its continuous disclosure requirements.

It has also been revealed that ASIC received a letter of complaint in May 2006 from an unnamed source, alleging that ABC's practice of claiming its child care licences as an asset—despite these licences having no intrinsic value—"may be misleading to potential advisors in the company". The dubious accounting method added an additional $390 million to the company's value between 2001 and 2005. "The apparent strength of its balance sheet played a major role in ABC's subsequent expansion," the *Age* noted, with its expansion into the US based on taking on debts that increased from $380 million to $1.8 billion in 2006. "The strategy played a leading role in ABC's subsequent downfall."

ASIC declined to investigate the 2006 complaint.

The Australian Broadcasting Corporation's "7.30 Report" program, broadcast on August 26, shed further light on ABC's valuation of child care licences. The program reported that the company paid more than $1 billion to buy leases and child care licences from "so-called developers" who "would return funds back to the centre to achieve its budgeted revenue". What ABC later described as "fees paid by child-care developers" to "support centres during occupancy growth" totalled 20 percent of the company's revenue.

An article in the Fairfax business press on September 5 explained: "The current system works like this: a developer buys the land and builds a child-care centre. On most occasions, the land would be sold off to a listed real estate trust which would have a long-term lease from the centre's operator, ABC Learning. ABC then buys the business, but receives payments from the developers akin to 'rental guarantees' paid to property investors. In basic terms, loss-making centres are subsidised by developers until they hit certain occupancy levels."

Developers are supposedly independent from child care operators. But the bulk of ABC's revenues flowing to and from the developers went to Don Jones, a former army lieutenant colonel turned child care developer. Some of Jones's companies operated from ABC's headquarters or premises.

The end result of these financial manoeuvres was that ABC earnings, which the markets believed had been generated from parents' child care fees, were in fact "restated value" from property developers. There seems little doubt that ABC Learning encouraged the lack of clarity—in 2004 it ceased reporting the occupancy rate of its child care centres, a key measure of their profitability.

Further revelations of ABC's "unorthodox" methods are likely to emerge. Last month it became known that the company operated with what the Fairfax press described as a "labyrinthine" corporate structure involving hundreds of regional management sub-companies. These were designed to be small enough to fall under the payroll tax threshold. As a result, the company paid no payroll tax despite employing 16,000 staff in more than 1,100 child care centres in Australia.

Child care privatisation

ABC Learning's senior executives are certainly responsible for the company's crisis, and for whatever criminal practices—if any—have been carried out. But true responsibility for the debacle lies with the Labor and Liberal parties, who jointly established a profit-driven child care system.

Prior to 1991, all government funding was directed to child care providers operating specifically on a non-profit basis. Then the Labor government of Prime Minister Paul Keating began funding private operators under the banner of providing parents with greater "choice". The Keating government also introduced the Child Care Cash Rebate in 1994, which provided parents with a rebate for their child care costs. The measure further promoted the rise of private operators while doing nothing to alleviate the growing costs faced by parents. Child care companies simply increased their fees, swallowing up the value of the public rebate.

The 1996 election of the John Howard Liberal government saw the further extension of the privatisation drive. Howard's government removed the last vestiges of public support for non-profit child care operators by abolishing operational subsidies to community-based long-day centres in 1997. Four years later, Howard combined child care subsidies into a single payment called the Child Care Benefit (CCB), which was paid either directly to the private provider, who was then supposed to reduce the fee by the appropriate amount, or to families at the end of the financial year. The CCB marked an essential step towards the complete privatisation of child care in Australia, with government funding disconnected from infrastructure development and directly issued to private operators.

In 2004, the Howard government offered a pre-election bribe of a 30 percent Child Care Tax Rebate (CCTR) on top of the Child Care Benefit. The CCTR is now paid to families up to 18 months after costs have been incurred.

The new Labor government under Prime Minister Kevin Rudd has committed to accelerating the privatisation drive, with the CCTR boosted to 50 percent and the Child Care Benefit maintained in full.

As a result of these processes, since 1991, child care provision has been entirely transformed. Whereas 85 percent of child care was delivered on a non-profit basis in 1990, by 2005, 70 percent was controlled by private companies. This proportion increases each year as non-profit centres struggle to survive with grossly inadequate government support, while private operators continue to expand their operations.

Demand for child care has greatly increased in recent years, with most families now pressured to have both parents in paid employment in order to survive financially. More than 700,000 Australian families have their children in formal care, with 600,000 children now attending long-day care, 150,000 in family day care, and a further 15,000 in occasional care. Demand continues to outstrip supply, with an estimated 50,000 children missing out each day.

Parents are faced with escalating fees, now typically ranging between \$55 and \$105 per day. From June 2006 to June 2007, fees rose by 12.8 percent. This was the fifth consecutive year in which costs rose by more than 10 percent, and represents a cumulative five-year increase of 88 percent—an inflation rate far higher than for other goods and services.

ABC Learning positioned itself as the prime beneficiary of the privatisation drive. In 2001 the company was floated on the Australian stock exchange and embarked on an aggressive expansion strategy, based on eliminating smaller and non-profit providers.

ABC's rise was a direct result of the billions of dollars in public money funnelled into the private child care industry. It derived nearly half of its \$1 billion annual income from the guaranteed stream of Child Care Benefits paid by the federal government. *Business Review Weekly* noted in 2003: "With profit margins of up to 50% and \$1.6 billion of taxpayers' money flowing into the sector, everyone wants a piece of the child care action. Diamond-miners, dot-com pioneers and real estate agents are getting on board."

ABC Learning's founder Eddie Groves amassed an enormous personal fortune through this process. He first made it onto *Business Review Weekly*'s annual Rich 200 List in 2002, and by 2006 had topped the "Young Rich List" (for those aged under 40). His personal wealth was last year estimated at \$295 million, though this is understood to have since plunged along with ABC's share price. Groves, nicknamed "Fast Eddy" in financial circles, was described in a 2006 *Sydney Morning Herald* profile as a "colourful Queensland businessman who favours alligator-skin boots, commutes by helicopter, drives a Ferrari and has impeccable Coalition connections".

ABC Learning also boosted profits by suppressing its workers' wages. Child care employees throughout the sector are among the lowest paid section of the Australian working class, usually earning between \$13.90 and \$17 per hour, with junior child care workers paid as little as \$6.50 per hour. In a notorious episode in 2003, Groves sued the child care workers' union for defamation after being criticised for forcing his lowly paid child care workers to clean toilets and purchase their own uniforms.

ABC staff have reported being grossly overworked. A survey conducted by the Australia Institute in 2006 revealed that ABC centres mostly operated with an adult-to-child ratio at the bare legal minimum limit (one to five). Staff said that they did not have the opportunity to develop meaningful relationships with the children in their care, due to the lack of staff and ABC's additional duties such as paperwork and cleaning.

The rise and fall of ABC Learning underscores the disastrous impact of the relentless drive by the ruling elite to subject every sphere of social life to the dictates of the market.