

4 Commission’s approach to developing detailed pricing principles

In developing the detailed pricing principles, the Commission has combined a ‘top down’ approach and a ‘bottom up’ approach.

The ‘top down approach’ uses economic concepts about competition and efficiency to ensure that its pricing principles will promote the effective operation of a competitive market and result in a level playing field.

The ‘bottom up’ approach uses detailed information about the activities involved in supplying crematorium services and related goods and services, the inputs to these activities, and the costs of these inputs and how they are sourced. The ‘bottom up’ approach complements the ‘top down’ approach by ensuring that the pricing principles recognise the operating conditions for public and private crematorium operators and are consequently practical and tailored for the industry.

4.1 The Commission’s ‘top down’ approach

As outlined in chapter 2, the main aim of competitive neutrality is to promote fair and effective competition in markets where government-owned and private businesses are competing so that there is a level playing field. There are two main benefits to consumers from fair and effective competition:

- Consumers will benefit from a greater choice of products and services because the businesses operating in the market will have an incentive to meet the diverse needs and preferences of consumers. Businesses will typically offer a range of services with different features that cater to different market segments. Individual businesses may choose to specialise in certain services or offer different types of services to differentiate themselves from their competitors.
- Effective competition promotes efficiency, which reduces costs and results in lower prices for consumers (for a given level of quality and service features).

As noted in chapter 2, competitive neutrality does not require that all businesses competing in a market should be the same—that they should have the same business structure or operating practices or offer the same types of products and services. On the contrary, consumers benefit from having a choice of products and services with differing characteristics so they can choose what will best meet their needs.

Differences between businesses in their business structures or operating practices encourage competing businesses to look for efficiencies that will help to reduce costs. Chapter 3 and Appendix 4 describe the main differences in business structures and operating practices within the cemeteries and crematoria industries across Australia.

The operations and costs of the ACT public crematorium may be affected by factors that are specific to the facility, such as: (a) its location within the existing cemetery site, which may have efficiency implications, and (b) the public crematorium may offer services designed to meet the needs of particular segments of the ACT community, such as bariatric cremations and a specially designed viewing room. (Chapter 6 discusses these factors in more detail.)

Similarly, private crematorium operators may have competitive advantages or disadvantages compared to the public operator because of the way those businesses operate. For example, private crematoria that are vertically integrated with other businesses in the funeral supply chain may gain cost advantages and a higher volume of business which in turn allows them to benefit from economies of scale. These competitive advantages may allow a private operator to offer relatively lower prices than the public crematorium.

It is important to note that unlike the Commission's regulatory price decisions, the purpose of developing the detailed pricing principles is to ensure competitive neutrality, not to ensure that prices are based on efficient costs. However, as noted above, competition promotes efficiency and competitive neutrality promotes effective competition. Therefore, the Commission expects that competitive neutrality is likely to promote efficiency, both for the government-owned crematorium facility and within the ACT industry.

In addition, the Commission considers that prices that recover efficient costs are likely to also achieve competitive neutrality. For example, prices that are below efficient costs would be unable to sustain a private operator in the same position and would therefore not be competitively neutral. The Commission considers that prices below efficient costs could only be sustained by a government-owned business if it was receiving some type of competitive advantage as a result of its government ownership—this would not meet the competitive neutrality requirements.

In developing the detailed pricing principles set out in chapter 5, the Commission has considered the objectives of the ACT Government's Competitive Neutrality Policy. In its issues paper, the Commission suggested that these objectives could be viewed as broad pricing principles. The objectives are consistent with the Commission's 'top down' approach as they are based on economic principles:

- Prices should recover the full costs of providing crematorium services.
- Shared costs and overheads should be appropriately attributed.
- Prices should allow for an appropriate commercial rate of return to be achieved.
- The government-owned business must pay debt guarantee fees if in receipt of concessional interest rates that reflect its government ownership rather than its commercial status.
- The government-owned business must pay all Commonwealth and Territory tax or tax equivalent payments.

- The government-owned business must comply with the same regulations that apply to its private sector counterparts.

4.2 The Commission's 'bottom up' approach

The 'bottom up' approach involves developing a good understanding of the activities involved in supplying crematorium services and associated goods and services (including memorialisation services and products), the inputs to these activities, and the costs of these inputs and how they are sourced. The Commission's findings from its examination of the activities undertaken in, and costs of, providing cremation and associated services are set out in chapter 6.

Using a 'bottom up' approach ensures the detailed pricing principles are tailored to the provision and pricing of crematorium services and the specific operating environment for a public crematorium facility in the ACT.

In considering the costs of activities, resources and goods and services that may be used by the public crematorium facility, the Commission has considered:

- the activities and resources required to deliver crematorium services at an ACT public crematorium, including related services and products such as memorialisation, and how they are sourced
- any goods or services directly provided by, or potentially provided, by the ACT Government to Canberra Cemeteries that may affect the costs of operating the crematorium
- activities undertaken by Canberra Cemeteries in relation to its provision of cemetery and ashes interment services, such as corporate functions, that may be shared in operating the public crematorium facility and affect the costs of operating the facility
- any differences in regulatory obligations resulting from the facility being publicly owned and operated.

5 Final pricing principles

As explained in chapter 1, the first stage of the Commission’s advice involves developing detailed pricing principles to guide the setting of prices for the goods and services supplied by the public crematorium facility that will be consistent with the ACT Competitive Neutrality Policy. This chapter sets out the Commission’s final pricing principles, which are unchanged from the draft report.

As described in chapter 2, competitive neutrality requires that government businesses should not enjoy net competitive advantages over their private sector competitors simply by virtue of their public sector ownership. This means that a public business must set prices to recover the same costs that a private operator would face if the government-owned business was in the same position as the private operator.

5.1 Submissions

In the issues paper, the Commission set out some broad pricing principles (a ‘top down’ approach) and described the broad categories of costs and activities involved in providing crematorium and associated services (a ‘bottom up’ approach). The draft report described in more detail the Commission’s approach to developing detailed pricing principles and set out its draft pricing principles for stakeholder consideration and feedback.

Issues paper

Canberra Cemeteries submitted that the Commission’s proposed approach to developing detailed pricing principles was sound, while InvoCare saw ‘no issues with the Commission developing detailed pricing principles for the ACT public crematorium’.⁴⁴

The Cemeteries and Crematorium Association of NSW stated that it:

[...] endorses the principle outlined on Page 12 “To ensure competitive neutrality, the prices charged by Canberra Cemeteries for crematorium and related services must recover the full costs incurred in providing those services.”

In that context, a critical element is what is included in “full costs”. Canberra Cemeteries, like other cemeteries nationally, already provides for cremation memorialisation. Consequently, the related memorialisation costs are distinct from the actual costs of establishing and operating a crematorium.

For consistency, the act of cremation should be treated as a distinct business activity. It is separate from the use of related services e.g. chapels and refreshment facilities and also from

⁴⁴ Canberra Cemeteries issues paper submission, p. 2; InvoCare, p. 1

memorialisation services. Bundling fees together makes it more difficult for client families to compare prices and diminishes transparency.⁴⁵

Norwood Park stated that: ‘We agree with the broad pricing principles identified by the Commission’.⁴⁶

Draft report

The Cemeteries and Crematoria Association of NSW expressed its continuing support for applying competitive neutrality principles in the cemeteries and crematoria industry. It advocated for pricing transparency of cemetery, crematoria and funeral director services.⁴⁷ The Cemeteries and Crematoria Association of NSW stated that the public crematorium should be required to recover land costs related to the crematorium only.

Canberra Cemeteries stated that it ‘is broadly supportive of the draft pricing principles, and the requirement to maintain competitive neutrality in the provision of public crematorium services’.⁴⁸ Canberra Cemeteries’ submission outlined the approaches it intends to use to implement the draft pricing principles in developing its costing methodology and proposed prices for stage two of the Commission’s advice.⁴⁹ The submission did not raise any significant practical implementation concerns.

Canberra Cemeteries agreed with the Commission’s draft pricing principle that land costs should be recovered and suggested that these costs should include the opportunity cost of land from foregone gravesite revenue.⁵⁰ Canberra Cemeteries agreed with the Commission’s draft pricing principle that prices should recover land holding costs.⁵¹

Canberra Cemeteries stated that some of the draft pricing principles are consistent with its existing practices. For example, Canberra Cemeteries stated that it already recovers the full cost of memorialisation goods, as required by the draft pricing principle for memorialisation goods.

However, Canberra Cemeteries stated that some draft pricing principles may not currently be applicable. Specifically, the draft pricing principles relating to borrowing costs and a return on any equity provided by the ACT Government are not expected to apply because the crematorium will be financed solely from retained earnings.

In regard to the draft pricing principle that the public crematorium operator must be subject to, and comply with, the same or equivalent regulations that apply to its private

⁴⁵ Cemeteries and Crematorium Association of NSW issues paper submission, p. 3

⁴⁶ Norwood Park p. 2

⁴⁷ Cemeteries and Crematorium Association of NSW draft report submission, p. 2

⁴⁸ Canberra Cemeteries draft report submission, p. 2

⁴⁹ Canberra Cemeteries draft report submission, p. 1

⁵⁰ Canberra Cemeteries draft report submission, p. 5

⁵¹ Canberra Cemeteries draft report submission, p. 5

sector counterparts, Canberra Cemeteries stated that, on a net basis, the cost of regulation is likely to be greater for public operators than for private operators.⁵² It stated that it would investigate this further to inform its proposed prices and costing methodology.

Canberra Cemeteries submitted that it intends to annually review its prices and costs to ensure they continue to be consistent with the Commission's pricing principles.⁵³

5.2 Commission's pricing principles

The Commission has confirmed the detailed pricing principles set out in its draft report. The Commission accepts Canberra Cemeteries' comment that all of the pricing principles may not be applicable at any particular time. However, the Commission considers it is important that the pricing principles are comprehensive and can accommodate any future changes in the financing arrangements for Canberra Cemeteries.

Pricing principle 1: Prices should recover the full costs of providing crematorium services. This includes direct costs associated with the crematorium and a portion of relevant costs that are shared between the crematorium and cemetery.

Pricing principle 1.1: The costing methodology to be developed by Canberra Cemeteries and used to set prices should accurately identify and quantify all the costs of supplying services by the public crematorium facility.

To ensure competitive neutrality, the prices charged by Canberra Cemeteries for cremation and related services must recover the full costs incurred in providing those services. Importantly, these costs include those directly attributable to the crematorium and those that are expected to be shared between the cemetery and crematorium (such as corporate overheads and administration buildings).

Canberra Cemeteries will need to demonstrate that its costing methodology will accurately identify and quantify all these costs. As outlined in chapter 6, these costs include operating costs and capital costs. Operating costs are expenses associated with running the business on a day-to-day basis, while capital costs relate to equipment and buildings and other infrastructure assets that are used over a number of years.

The Commission has noted Canberra Cemeteries' submission that it intends to capture both the full direct costs, and the relevant portion of shared costs attributable to the crematorium, in its costing methodology. These include operating and capital costs.

⁵² Canberra Cemeteries draft report submission, p. 9

⁵³ Canberra Cemeteries draft report submission, p. 3

Pricing principle 1.2: Canberra Cemeteries should demonstrate that inputs are sourced (a) through a competitive tender process or open marketplace, or (b) at prices comparable to market rates that would be paid by a similar private crematorium operator.

A key factor that affects competitive neutrality is how goods and services used by the crematorium are sourced. Goods and services that are sourced via a competitive tender process or via an open marketplace would reflect commercial costs and therefore meet the conditions for competitive neutrality. If goods and services are not sourced in this way (for example, if they are provided by the ACT Government), then Canberra Cemeteries will need to demonstrate that the costs reflect market rates and are competitively neutral.

In its pricing proposal, Canberra Cemeteries should provide evidence where inputs used in providing crematorium services were bought on the market or procured via a competitive tender process. For goods and services sourced in other ways, Canberra Cemeteries will need to provide evidence that prices reflect commercial rates. Such evidence could, for example, be obtained by using a benchmarking approach.

The Commission has noted Canberra Cemeteries' submission that it intends to source good and services at market rates, in line with ACT Government procurement processes.⁵⁴ The Commission has also noted that Canberra Cemeteries intends to undertake further analysis to determine an appropriate cost for services provided by the ACT Government in order to develop competitively neutral prices.⁵⁵

Pricing principle 1.3: The prices charged by the public crematorium should recover the costs of land, including land holding costs.

The Commission understands that the public crematorium will be built on existing land at the Gungahlin Cemetery. To satisfy competitive neutrality, the prices charged by the public crematorium should recover the cost of the land as this is what a private operator in the same position would be required to do. In estimating land costs, Canberra Cemeteries could consider what a private operator would be required to pay at market rates for equivalent land, taking into account the impact of zoning on the market value of the land.

Canberra Cemeteries submitted that it would be appropriate to include the opportunity cost of foregone gravesite revenue in the land cost.⁵⁶ In discussions with the Commission, Canberra Cemeteries indicated that including this opportunity cost in the land value would mean it recovers the 'improved value' of the land rather than its 'unimproved value' only. The Commission notes that the market value of land will include the expected net present value of the revenue stream from the next best use of

⁵⁴ Canberra Cemeteries draft report submission, p. 3

⁵⁵ Canberra Cemeteries draft report submission, p. 3

⁵⁶ Canberra Cemeteries draft report submission, p. 5 and discussions with Canberra Cemeteries

the land, taking into account its zoning, and that market value will therefore include the opportunity cost of alternative uses of the land. The Commission notes that improved and unimproved land values are typically used for the purposes of calculating land taxes and local government rates and may not necessarily reflect the current market value of the land.

In addition to land value, there is a cost of holding land that is used for memorialisation before it is used to provide services, for example, garden space that will be used for ashes interment in the future. The holding cost is the cost of financing the purchase of the land until it is used to provide services by the crematorium operator (see chapter 6).

Pricing principle 1.4: The price of memorialisation goods and services should at least recover their costs of supply and any other directly attributable costs. These prices may also include a contribution to shared costs and a commercial profit margin.

Economic efficiency requires that the price of a product or service should at least recover the direct costs of supplying it; the direct costs are the costs that would be avoided if the product or service was not supplied. Put simply, if consumers are not willing to pay the direct costs of supplying the product or service, it would be better to use the resources to produce a different product or service that consumers value enough to pay its costs of supply.

For memorialisation products, this means that prices should at least cover the costs of the products themselves (where they are purchased from an external supplier, such as urns and plaques) and any other direct costs that can be identified as incurred in supplying the product to the bereaved. For memorialisation services, the prices should at least recover costs that Cemeteries Canberra would not incur if it did not supply the services. For example, for ashes interment in a garden area, the direct costs of supplying these memorialisation services are the direct costs involved in interring the ashes, the foregone revenue that would be earned if the garden area was used for a different purpose, and the maintenance costs of maintaining the garden (usually in perpetuity).

It may also be appropriate for the prices of memorialisation products and services to contribute to the profit margin earned by Canberra Cemeteries and to pay a portion of relevant shared costs, such as corporate overheads. Economic efficiency requires that businesses should recover their full costs and earn an appropriate commercial rate of return across their products and services overall. It is a commercial decision as to how much of these costs, if any, are allocated to individual products and services.

Canberra Cemeteries' pricing proposal will need to demonstrate that its prices for memorialisation products and services will recover at least the direct costs of providing these products and services. It will also need to explain whether the prices make a contribution to Canberra Cemeteries' profit margin and to relevant shared costs, and how Canberra Cemeteries reached its decision on the magnitude of the contribution (if any).

The Commission has noted Canberra Cemeteries' submission that it considers its current practices are already consistent with this pricing principles.

Pricing principle 1.5: The price of interring cremated remains should recover the associated perpetuity maintenance costs.

When ashes are interred at a cemetery or crematorium in the ACT, this interment is in perpetuity (forever).⁵⁷ Canberra Cemeteries currently offers interment of ashes at its Gungahlin Cemetery (as well as its Woden and Hall sites).

At the time of interment, fees are usually paid to: (a) recover the costs of the interment of ashes at the cemetery or crematorium, and (b) contribute to the perpetual care trust and perpetual care trust reserve, which are trusts used to fund the short-term and long-term maintenance of the cemetery or crematorium site (such as the grounds, roads and paths). To ensure the full direct costs of memorialisation services are recovered in prices for these services (pricing principle 1.4), it is important that an appropriate share (that can be attributed to the service) of the perpetuity maintenance costs is included in calculating the price of the service.

Canberra Cemeteries submitted that its existing practice for interring cremated remains would comply with this pricing principle.⁵⁸

In the ACT, the Minister, under Section 11 of the *Cemeteries and Crematoria Act*, determines on a regular basis (usually every five years) the percentage of revenue that interment providers must put aside in the perpetual care trust and perpetual care trust reserve. This requirement is competitively neutral as it applies equally to both public and private operators.

Pricing principle 2: Shared costs and overheads should be appropriately attributed.

As discussed in Chapter 2, the public crematorium facility is likely to share some of the services that are provided at the Gungahlin Cemetery. For example, some activities, such as corporate overheads, the provision of shared physical assets (such as roads), and potentially the purchase and sale of memorialisation products, are likely to be undertaken by Canberra Cemeteries for both its cemeteries operations and its public crematorium operations. In developing its costing methodology, Canberra Cemeteries will need to demonstrate that it has allocated its shared costs and overheads in a competitively neutral manner.

⁵⁷ *Cemeteries and Crematoria Act* 2003, section 8 (1)

⁵⁸ Canberra Cemeteries draft report submission, p. 6

Pricing principle 2.1: Canberra Cemeteries should employ an appropriate allocation methodology to assign shared costs to the crematorium facility. An activity-based allocation method or method based on appropriate cost drivers is likely to be a pragmatic and appropriate cost allocation method.

There are several approaches that can be used to allocate shared costs and overheads. As explained in chapter 6, the Commission considers that an allocation based on a measure of use is likely to satisfy competitive neutrality and be economically efficient. The pricing proposal and costing methodology developed by Canberra Cemeteries should explain how it has determined its allocation methodology and the evidence used to apply the methodology.

The Commission has noted that Canberra Cemeteries has proposed to use an activity-based costing methodology to accurately identify and quantify all the costs of supplying crematorium services.⁵⁹

Pricing principle 2.2: The crematorium facility's accounts should be ring fenced from the accounts of the cemetery operations.

Ring-fencing means that Canberra Cemeteries would maintain financial accounts for the crematorium facility and for its cemetery operations that sufficiently separate the accounts to:

- allow for easy identification of the costs charged to the crematorium operations and the source, nature and timing of those costs
- give transparency about how costs are attributed between the crematorium facility and Canberra Cemeteries' other business activities
- allow for verification that the allocation methodology has been applied as described in Canberra Cemeteries' documentation of its methodology.

Effective ring fencing does not require full operational separation. The Commission notes that full operational separation may not be cost effective and that ring fencing of the crematorium's costs within Canberra Cemeteries' financial accounts, if implemented appropriately, can achieve the three points listed above.

In the context of competitive neutrality, ring-fencing will simplify the process of checking that Canberra Cemeteries has correctly applied the pricing principles. Ring-fencing will help ensure that crematorium activities do not enjoy a competitive advantage as a result of cross-subsidisation of its costs by Canberra Cemeteries' cemetery operations.

Canberra Cemeteries submitted that it intends to use a 'hybrid model' to manage the financial governance of the crematorium. Under this model, the crematorium would be

⁵⁹ Canberra Cemeteries draft report submission, pp. 2-3

established as a separate business unit. It stated that this would remove the need for separate standalone accounts or financial reporting.⁶⁰

Pricing principle 3: The prices charged by the public crematorium should recover the costs of financing its investments in capital assets, including both an appropriate commercial rate of return that includes an appropriate risk allowance and an appropriate allowance for depreciation.

The costs of financing a business' investments in capital assets typically include interest payments on loans, an allowance for the depreciation of assets over time which generates a return of the initial capital investment, and a commercial profit margin that provides a return on the investments required to run the business. Competitive neutrality requires that the prices charged by the public crematorium recover equivalent capital financing costs that a private operator in the same position would face.

As explained in chapter 6, several approaches are available to determine an appropriate commercial rate of return. In its pricing proposal, Canberra Cemeteries will need to explain the method it has applied for determining the rate of return and the reasons for why its method is appropriate. The pricing proposal should include evidence and reasons for supporting the inputs used in estimating the rate of return.

The Commission considers that a pragmatic method would be to estimate an appropriate weighted average cost of capital (WACC). A possible option is to use the WACC developed by IPART during its review of interment services in NSW (discussed in chapter 6).

Pricing principle 3.1: The prices charged by the public crematorium should generate an appropriate rate of return on retained earnings used to fund the construction of the crematorium.

Canberra Cemeteries has advised that it intends to fund the construction of the crematorium from existing retained earnings.⁶¹ These retained earnings were accumulated from profits on its cemeteries business operations.

Economic efficiency requires that the price of a product or service should generate an appropriate rate of return on the funds used to finance the capital investments used in supplying the products or services. Such funds include retained earnings. Put simply, if consumers are not willing to pay prices that recover these costs, the funds would be better used to invest in assets that produce products or services that consumers value enough to pay prices that recover its financing costs (and other relevant costs).

A private business would not be able to continue in operation on a sustained basis if it was unable to earn a commercial return on its investments, including an appropriate risk

⁶⁰ Canberra Cemeteries draft report submission, p. 7 and discussions with Canberra Cemeteries

⁶¹ Based on discussions with Canberra Cemeteries.

premium. Private businesses typically use an appropriate risk-adjusted commercial rate of return as a ‘hurdle rate’ in deciding whether to proceed with proposed investments; investments that are not expected to earn at least the ‘hurdle rate’ do not proceed.

Canberra Cemeteries’ costing methodology will need to ensure that its prices generate an appropriate risk-adjusted commercial return on retained earnings used to finance crematorium facility investments in order to satisfy competitive neutrality.

The Commission has noted Canberra Cemeteries’ submission that it intends to use an appropriate risk-adjusted commercial rate of return on the retained earnings used to finance the crematorium investment.⁶²

Pricing principle 3.2: The prices charged by the public crematorium should recover a commercial rate of interest on any borrowings. If the public crematorium operator receives any interest rate concessions as a result of its government ownership, prices must include an allowance to offset the financial savings from any such concessions.

As for retained earnings, the price of a product or service should generate an appropriate rate of return on any borrowings used to finance the capital investments used in supplying the products or services.

Debt neutrality is important because government businesses may be able to borrow through a government treasury and take advantage of a lower risk premium that reflects the (better) risk rating of the government as a whole compared to the business if it were to borrow in its own right. A lower risk premium would reduce the costs to the government business and confer a competitive advantage as a result of its government ownership.

If Canberra Cemeteries were to borrow through the ACT Government, it would need to demonstrate that it has not received any interest rate concessions as a result of its government ownership. Many government treasuries charge government businesses a debt guarantee fee to offset the interest rate discount received as a result of borrowing through whole-of-government arrangements to ensure the borrowing is at commercial rates and competitive neutrality requirements are satisfied.

The Commission has noted Canberra Cemeteries’ submission that it does not intend to borrow to finance the crematorium.⁶³

⁶² Canberra Cemeteries draft report submission, p. 7

⁶³ Canberra Cemeteries draft report submission, p. 8

Pricing principle 3.3: The prices charged by the public crematorium should allow for an appropriate rate of return on any equity provided by the ACT Government as its shareholder.

The shareholders of private businesses expect to receive an appropriate risk-adjusted return on the equity they have provided to the business to finance its investments and operations. Without such a return on their equity, the shareholders would sell their shares and transfer their funds to investments that do provide an appropriate rate of return.

For competitive neutrality, the prices charged by the public crematorium should recover a commercial rate of return on any equity invested by its shareholder, the ACT Government.

The Commission has noted Canberra Cemeteries' submission that it does not expect to receive an equity injection from the ACT Government for the construction of the crematorium facility.⁶⁴

Pricing principle 3.4: The prices charged by the public crematorium should, over time, recover depreciation of capital assets. Depreciation allowances should be consistent with generally accepted accounting principles and based on appropriate asset lives.

Depreciation allowances recover the capital invested in an asset over the life of that asset. Together, the rate of return earned on the funds used to finance the investment in an asset, and depreciation of the cost of constructing or purchasing the asset, ensure that the full costs of capital assets are recovered.

There are four main ways to recover depreciation which are consistent with generally accepted accounting principles. Three of these methods are based on time and the fourth is based on usage of the asset. The most commonly used, and most straightforward method, is straight-line depreciation. Canberra Cemeteries' costing methodology will need to explain which method it has chosen and why, and ensure the chosen method is applied consistently over the life of the asset.

Canberra Cemeteries' costing methodology will also need to explain how it has estimated the asset life for each of its capital assets and the evidence it has based its estimate on. An appropriate asset life is important as an excessively long asset life will artificially reduce the annual depreciation allowance and reduce the costs used in calculating prices. This would confer a competitive advantage.

Some of the assets used in supplying crematorium services by the public crematorium facility will be shared across Canberra Cemeteries' cemetery businesses. For example, shared capital assets will include some internal roads and administration buildings. Pricing principle 2 will apply to allocating depreciation for such shared assets.

⁶⁴ Canberra Cemeteries draft report submission, p. 8

The Commission considers that the costing methodology and prices to be developed by Canberra Cemeteries should include depreciation that reflects generally accepted accounting standards and appropriate asset lives. A similar approach should also apply to the amortisation of any non-tangible assets.

The Commission has noted Canberra Cemeteries' submission that it intends to recover depreciation costs in line with relevant accounting standards.⁶⁵

Pricing principle 4: The prices charged by the public crematorium operator must recover all Commonwealth and Territory taxes that a private operator, in the same position, would face.

An important element of competitive neutrality is that the public crematorium facility should face the same tax obligations as private crematorium operators. A government-owned business would obtain a competitive advantage if it was not subject to the same tax obligations as its private competitors.

Pricing principle 4.1: The prices charged by the public crematorium should include an allowance that is equivalent to the company tax that would be paid by a private operator in the same position.

For consistency with the ACT Competitive Neutrality Policy, the prices charged by the crematorium facility should include tax allowances that are equivalent to the taxes a comparable private crematorium operator would pay.

The Commission has found that Canberra Cemeteries is subject to the same taxation requirements as a private operator, with the exception that it is not required to pay company tax or make an equivalent payment under the National Tax Equivalent Regime (NTER) to the ACT Government (discussed further in Chapter 6).⁶⁶ This is due to Canberra Cemeteries' exemption from the NTER under Section 6 of the *Taxation Act*.⁶⁷

Ring-fencing (required by pricing principle 2.2) will facilitate the inclusion of equivalent tax allowances in the prices charged by the public crematorium facility, by allowing for the benefit from the NTER exemption to be restricted to cemetery operations only. This would ensure that the crematorium does not enjoy a competitive advantage from Canberra Cemeteries' NTER exemptions for its cemetery operations.

⁶⁵ Canberra Cemeteries draft report submission, p. 8

⁶⁶ The NTER requires that ACT Government businesses that are exempt from taxes make payments to the ACT Government that are equivalent to the taxes for which they are exempt.

⁶⁷ Section 3 *Taxation (Government Business Enterprises) Regulation 2003*

Pricing principle 5: The public crematorium operator must be subject to, and comply with, the same or equivalent regulations that apply to its private sector counterparts.

Regulations require businesses to undertake certain activities or restrict businesses from doing certain activities. Complying with regulations and reporting on compliance (if required), imposes costs on businesses subject to those regulations. Canberra Cemeteries would gain a competitive advantage if it was not subject to the same, or equivalent, regulations as private crematorium operators. Conversely, if Canberra Cemeteries was subject to more regulation, or more stringent regulations than private operators, it would have a competitive disadvantage.

Sometimes, different regulatory obligations apply to private unlisted companies, private companies that are listed on a stock exchange, and government-owned businesses. Some of these differences are discussed in chapter 6.

In some cases, the regulations may impose equivalent obligations, despite being framed differently for businesses with different ownership structures. For example, financial reporting and annual report regulations applied to ACT Government agencies have similarities with requirements in the private sector imposed by the Australian Securities and Investment Commission, and the Australian Securities Exchange (in the case of Australian Securities Exchange listed companies).

Canberra Cemeteries' pricing proposal and costing methodology should demonstrate that, in respect of its crematorium facility, it has complied with the same or equivalent regulations as its private sector counterparts.

The Commission has noted Canberra Cemeteries' submission that, on a net basis, it expects the costs of regulations specific to public sector entities are likely to be greater than the costs of regulations specific to a private sector operator and that it intends to investigate this further to inform its pricing proposal.⁶⁸

⁶⁸ Canberra Cemeteries draft report submission, p. 9

6 Costs

As explained in chapter 4, the Commission has combined a ‘top down’ approach and a ‘bottom up’ approach in developing the detailed pricing principles. Using a ‘bottom up’ approach ensures the detailed pricing principles are tailored to the provision and pricing of crematorium services and the specific operating environment for a public crematorium facility in the ACT.

This chapter describes in some detail the costs of activities, resources, and goods and services that are expected to be used by the public crematorium facility. The public crematorium facility has not yet been built and details of what services it will provide, what activities it will undertake, and what assets it will use, are not yet known precisely. This chapter therefore takes a broad approach to identifying costs that may be incurred.

6.1 Operating costs

Operating costs are expenses associated with running the business on a day-to-day basis. To ensure competitive neutrality, the prices charged by Canberra Cemeteries for crematorium and related services must recover the full operating costs incurred in providing those services.

As the crematorium will be operated by Canberra Cemeteries and located within an existing cemetery, some of the crematorium facility’s operating costs will be shared with the cemetery (for example, corporate overhead costs).

In its issues paper and draft report, the Commission identified a range of crematorium operating costs and sought feedback on these costs from stakeholders.

6.1.1 Submissions

Issues paper

Canberra Cemeteries and InvoCare agreed that the Commission had identified the main cost categories associated with crematorium operations.⁶⁹

Canberra Cemeteries questioned whether the costs of memorialisation products and consumables associated with memorial services (such as flowers and refreshments) should be included, given they are not specific to the crematorium.⁷⁰ Canberra Cemeteries submitted that cremation memorialisation is an existing service available at Canberra Cemeteries’ three locations. It also stated that:

Canberra Cemeteries is of the view that the market currently self regulates effectively regarding cremation and cremation memorialisation products. It is noted that in the recent

⁶⁹ Canberra Cemeteries issues paper submission, pp. 2-3 and InvoCare, p. 3

⁷⁰ Canberra Cemeteries issues paper submission, pp. 2-3

Interim Report into Costs and Pricing of Interment in NSW, the IPART observes that: “The market for cremation and ashes interment is workably competitive.” (IPART Interim Report, p. 8.)

Therefore, these products and services are considered to be effectively competitively neutral and, as part of the existing suite of products and services, notably separate to the Crematorium operations and should not form part of the hybrid model for the Crematorium, nor be subject to the pricing principles to be developed by the Commission.

Cremation memorialisation is subject to a perpetual maintenance fee, as the memorial gardens must be maintained in perpetuity. Current cremation memorialisation revenue therefore contributes to meeting perpetual maintenance obligations.⁷¹

Similarly, the Cemeteries and Crematoria Association of NSW stated:

Canberra Cemeteries, like other cemeteries nationally, already provides for cremation memorialisation. Consequently, the related memorialisation costs are distinct from the actual costs of establishing and operating a crematorium. For consistency, the act of cremation should be treated as a distinct business activity. It is separate from the use of related services e.g. chapels and refreshment facilities and also from memorialisation services.⁷²

In relation to the broader costs of operating a crematorium facility, the Cemeteries and Crematoria Association of NSW submitted that:

Whilst a public crematorium facility may be able to source some inputs at a lower price than the private sector, there are inputs where the bulk purchasing power of a private operator may generate a competitive advantage. Similarly, the public facility is likely to have reporting requirements and responsibilities to service the broader community, not just direct clients.

Where the competing private crematorium is part of a larger entity (e.g. Propel or InvoCare), arguably those organisations already have the in-house legal, accounting and marketing expertise on tap, or have established consultants to efficiently service their needs. In those circumstances they have a competitive advantage compared to the overarching public sector, which may lack the industry technical expertise to cost effectively service their requirements.⁷³

Norwood Park submitted that, in addition to the operating costs identified by the Commission in its issues paper, the following costs are likely to form part of Canberra Cemeteries’ operating costs:

- fuel costs
- staff amenities and staff training
- uniforms
- cleaning expenses

⁷¹ Canberra Cemeteries issues paper submission, p. 4

⁷² Cemeteries and Crematoria Association of NSW issues paper submission, p. 3

⁷³ Cemeteries and Crematoria Association of NSW issues paper submission, p. 4

- bank and merchant fees (finance costs)
- legal and professional charges (consultancy/audit fees).⁷⁴

InvoCare submitted that ‘the Commission has adequately identified operational and capital costs associated with a crematorium facility. InvoCare agrees with the view of the Commission that prices should recover the full costs of providing crematorium services. In addition, InvoCare propose that prices should cover value-add memorial services.’⁷⁵

Draft report

Canberra Cemeteries’ submission outlined its intention ‘to undertake a further benchmarking and market analysis exercise as part of the process to finalise its future pricing structure, to determine and demonstrate the application of appropriate input costs at market rates’.⁷⁶

Canberra Cemeteries noted that there are a range of challenges in determining an appropriate rate to adjust for ‘Shared Services’ costs provided by ACT Government agencies.⁷⁷ Canberra Cemeteries stated:

On the one hand, Canberra Cemeteries accesses Shared Services at a rate determined by its Shared Service providers that are set to recover costs (i.e. no profit margin is applied) while on the other hand private sector operators have an equal opportunity to access commercially available Shared Services who can potentially provide services at a more economical cost than government. While Canberra Cemeteries acknowledges that prices of commercially provided Shared Services would include a mark-up on costs, it is possible that the mark-up is applied from a lower cost base.⁷⁸

6.1.2 Commission’s findings

Based on the submissions received, discussions with Canberra Cemeteries and research by the Commission, the Commission has identified relevant operating costs (Table 6.1). The Commission has separated these costs into direct costs to operate the crematorium facility (such as energy to operate the cremator) and costs that are likely to be shared between the crematorium and cemetery (such as administration costs and road maintenance). Some costs may fall into either category depending on their nature; for example, lawn and garden maintenance costs would be direct costs for the crematorium facility for lawns and gardens that are only used in providing crematorium services while the costs of maintaining the lawns and gardens surrounding the chapel and

⁷⁴ Norwood Park, p. 2

⁷⁵ InvoCare, p. 2

⁷⁶ Canberra Cemeteries draft report submission, p. 3

⁷⁷ Canberra Cemeteries draft report submission, pp. 3-4

⁷⁸ Canberra Cemeteries draft report submission, pp. 3-4

administration buildings would be shared between the crematorium facility and the cemetery.

Table 6.1: Operating costs relating to the supply of crematorium services

Category (a): direct operating costs	Category (b): operating costs that are shared between the crematorium and cemetery	Costs that are in both category (a) and category (b)
<ul style="list-style-type: none"> - staff salaries (specific to the operation of the crematorium facility) - purchase of chemicals - cost of energy used in the cremation process - maintenance costs for cremators and associated equipment - ICRC fees 	<ul style="list-style-type: none"> - administrative costs (e.g. payroll, human resources, marketing, bookings, purchasing, support) - information and communications technology costs - maintenance of shared assets - utilities (e.g. telecommunications, water, electricity, gas for heating of admin building) - salaries of administrative staff - uniforms - memorialisation products (non-interment specific such as plaques, flowers, service-related items) - insurance costs - regulatory and compliance costs - security costs - fuel costs 	<ul style="list-style-type: none"> - financing costs - lawn and garden maintenance - landscaping costs - staff training - cleaning - legal and professional charges

As set out in chapter 5, pricing principle 1 requires that the prices charged by Canberra Cemeteries for crematorium and associated products and services should recover the full costs of providing these products and services. Pricing principle 2 requires an appropriate attribution of costs that are shared between the cemetery and crematorium facility.

The Commission has noted the Cemeteries and Crematoria Association of NSW's comment that Canberra Cemeteries may not benefit from the same economies of scale as a large private business. However, as noted in chapter 4, differences in structure between private and government-owned businesses do not, in themselves, create competitive neutrality concerns. Such differences may allow different businesses to offer different types of products and services that better meet the needs and preferences of their clients. The implications of differences in business structure are a matter for shareholders.

As noted in chapter 5, the way in which the inputs to Canberra Cemeteries' operations are sourced can have implications for competitive neutrality. Those sourced via competitive tender processes or in open marketplaces are likely to have costs that reflect market rates and will therefore be compliant with competitive neutrality. In contrast,

goods or services provided by the ACT Government may not be charged at market rates. The Commission has identified particular inputs where Canberra Cemeteries will need to demonstrate that its costing methodology and pricing approach are consistent with pricing principle 1.2.

Staff costs

Based on discussions with Canberra Cemeteries, the Commission understands that the development of the crematorium is expected to result in the employment of an extra 1.7 full-time equivalent staff to operate the crematorium, perform sales and customer support functions, and management.⁷⁹ The Commission further understands that some Canberra Cemeteries staff will be trained in functions used for both the cemetery and crematorium operations.

In developing its costing methodology and prices, Canberra Cemeteries will need to account for staff costs, including the full costs of staff employed directly by the crematorium facility (such as staff to operate the cremator) (pricing principle 1.1), and determine an appropriate allocation of shared staff costs (such as staff employed on grounds maintenance and administration) (pricing principle 2.1).

The Commission has found that the pay and conditions for employees of private crematorium operators may be set by the relevant industry award, in this case the Cemetery Industry Award 2020, and the Clerk Private Sector Award 2010. Some large private operators, such as InvoCare, have negotiated their own enterprise agreements with their employees. As a government-owned business, the pay and conditions for Canberra Cemeteries' employees are determined by the relevant enterprise agreements for ACT public service employees. Staff costs for Canberra Cemeteries may therefore differ from staff costs for a private operator as a result of its public ownership.

ACT Government shared services

Canberra Cemeteries receives certain corporate services from the ACT Government that are known as 'Shared Services'.⁸⁰ Canberra Cemeteries obtains 'Shared Services' from two agencies. The Transport Canberra and City Services Directorate (TCCS) provides services through a Memorandum of Understanding with Canberra Cemeteries⁸¹ and provides shareholder services for Canberra Cemeteries and policy advice to the ACT Government in relation to the cemetery and crematorium sector. The Chief Minister, Treasury and Economic Development Directorate (CMTEDD) provides corporate services as part of whole of government arrangements. The 'Shared Services' provided by TCCS and CMTEDD include:

- Information Communication Technology, including infrastructure and IT support (CMTEDD)

⁷⁹ Discussions with Canberra Cemeteries

⁸⁰ ACT Government 2019b, p. 14

⁸¹ The Commission understands that this Memorandum of Understanding is currently being updated.

- Human Resources, including payroll, recruitment, reporting, HR systems and support, enterprise bargaining agreement negotiations, workforce reporting and salary packaging (CMTEDD)
- accounting and financial services, including accounts payable, accounts receivable, government budget management systems, financial reporting and taxation (CMTEDD and TCCS)
- learning and development (CMTEDD and TCCS)
- work health and safety (TCCS)
- board appointments and corporate governance (TCCS)
- record and mail services (CMTEDD).

For competitive neutrality, the prices charged by Canberra Cemeteries for crematorium services will need to include costs for these ‘Shared Services’ that reflect a commercial price, that is equivalent to the price that a private operator would pay for such services on the market.

The Commission has been advised that ‘Shared Services’, including those provided by TCCS and CMTEDD, are provided on a cost recovery basis. The Commission has found that these costs may differ from commercial rates for two reasons: the bulk purchasing power of the Government’s Shared Services providers and the absence of a profit margin on charges for these services.

The Commission understands that CMTEDD Shared Services area engages consultants every two years to benchmark the costs of the services it provides to ACT Government agencies, and to assess the overall operational efficiency of the Shared Services area. Deloitte undertook the most recent benchmarking exercise using the American Productivity and Quality Centre’s global public sector peer database, which includes data on Shared Services organisations in Australia and Canada. As the benchmarking exercise was undertaken against other public agencies, it is not possible to determine from Deloitte’s report whether the costs are consistent with commercial rates.

To ensure competitive neutrality, Canberra Cemeteries will need to demonstrate either that: the amounts it is charged for ‘Shared Services’ supplied by the ACT Government are equivalent to commercial rates for such services; or that it has made an adjustment to the cost of ‘Shared Services’ to reflect commercial rates for such services, consistent with pricing principle 1.2. The Commission has noted Canberra Cemeteries’ submission that it intends to undertake further analysis to determine appropriate market rates for ‘Shared Services’ and whether an adjustment is required for competitive neutrality.

Electricity charges

In 2018-19, Canberra Cemeteries received an interest free loan from the ACT Government Carbon Neutral Government Loan Fund for installation of an on-site renewable electricity solar photo-voltaic system at the Gungahlin Cemetery.⁸² The

⁸² ACT Government 2019d

system was installed in the first half of 2018-19 and is expected to meet a proportion of the electricity consumption needs at the Gungahlin Cemetery.⁸³

The Commission understands that the Carbon Neutral Government Loan Fund is only available to ACT Government entities. As the loan is interest free and available only to government agencies, access to this loan gives Canberra Cemeteries a financial benefit. If this financial benefit is shared by the crematorium facility, it will have a competitive advantage that is obtained as a result of its government ownership.

To ensure competitive neutrality, Canberra Cemeteries will need to demonstrate that it has appropriately allocated electricity costs to the crematorium facility and to the cemetery, consistent with pricing principle 2.1. In setting prices for crematorium services, Canberra Cemeteries will need to make an adjustment to its electricity costs that results in a commercial rate of interest on the solar panels.

Audit and insurance fees

Canberra Cemeteries undertakes, or is subject to, a range of audits as part of operating in a proper, effective and efficient way.⁸⁴ Generally these audits fall into two main categories: internal performance and compliance audits (for example, of legal obligations, licence requirements or internal policies); and external financial audits (such as financial statements). Many private businesses are similarly audited to meet regulatory requirements.

Canberra Cemeteries engages KPMG as an independent provider to undertake its program of internal audits.⁸⁵ The Commission understands that KPMG (and any subject matter expert auditors) has been engaged through competitive tender processes or through market procurement. Sourcing internal auditors in this way is likely to be compliant with pricing principle 2.1.

In addition, under section 65 of the *Financial Management Act 1996*, Canberra Cemeteries must have its annual financial statements audited by the ACT Auditor-General. The Commission understands that the ACT Auditor-General's audit fees are based on cost recovery.⁸⁶

For competitive neutrality, Canberra Cemeteries will need to demonstrate that the ACT Auditor-General's audit fees are comparable to market rates or that an appropriate adjustment has been made to the audit fees, consistent with pricing principle 2.1.

The Commission understands that Canberra Cemeteries obtains insurance from the Australian Capital Territory Insurance Agency (ACTIA), which provides insurance cover (for public liability, property and physical assets, directors and officers liability,

⁸³ ACT Government 2019b, p. 20 and discussion with Canberra Cemeteries

⁸⁴ *Financial Management Act 1996*, section 77 (1) (c)

⁸⁵ ACT Government 2019b, p. 21

⁸⁶ ACT Government 2019d, p. 127

and so on) for all ACT Government agencies.⁸⁷ ACTIA operates on a cost recovery basis to meet the costs of anticipated claims (including maintaining adequate reserves).⁸⁸ As no profit margin is applied by ACTIA, the costs of insurance faced by Canberra Cemeteries may differ from commercial rates.

For competitive neutrality, Canberra Cemeteries will need to demonstrate that ACTIA insurance premiums are comparable to market rates for the same coverage (and conditions) or that an appropriate adjustment has been made to insurance costs, consistent with pricing principle 2.1.

Memorialisation products and services

Canberra Cemeteries currently sells a range of memorialisation products, such as plaques and raised blocks, that can be placed where ashes (or a body) are interred at a cemetery or crematorium. The prices charged by Canberra Cemeteries for memorialisation products are approved by the responsible Minister and published in an annual determination.⁸⁹ As part of the price determination process, Canberra Cemeteries proposes prices to the Minister for approval. The Commission understands that these prices reflect the direct cost of the goods, a mark-up for staff time (for ordering, managing and selling memorialisation products), plus overheads and an allowance to include a commercial profit margin.⁹⁰

For competitive neutrality, Canberra Cemeteries will need to demonstrate that the prices charged for memorialisation goods and services will at least recover their costs of supply and any other directly attributable costs, consistent with pricing principle 1.4. The prices may also include a contribution to shared costs and a commercial profit margin.

Perpetual maintenance costs

As noted in chapter 3, when ashes (or a body) are interred at a cemetery or crematorium in the ACT, this interment is in perpetuity.⁹¹ Canberra Cemeteries currently offers interment of ashes at its Gungahlin Cemetery (as well as its Woden and Hall sites).

At the time of interment, a fee is usually paid by the bereaved to: (a) fund the actual interment of ashes at the cemetery or crematorium, and (b) contribute to the perpetual care trust and perpetual care trust reserve, which are trusts used to fund the short-term and long-term maintenance of the cemetery or crematorium site (e.g. grounds, roads and paths). Under section 11 of the *Cemeteries and Crematoria Act 2003*, the Minister determines on a regular basis (usually every five years) the percentage of revenue that interment providers must put aside in the perpetual care trust and perpetual care trust

⁸⁷ ACT Government 2020d

⁸⁸ ACT Government 2019e, p. 129

⁸⁹ *Cemeteries and Crematoria (Public Cemetery Fees) Determination 2019 (No 1)*

⁹⁰ Canberra Cemeteries draft report submission, p. 6

⁹¹ *Cemeteries and Crematoria Act 2003*, section 8 (1)

reserve. This applies equally to both public and private operators. As the perpetuity maintenance requirements are the same for both private and public operators, the Commission considers the requirements satisfy competitive neutrality.

In setting prices for memorialisation services, Canberra Cemeteries will need to demonstrate that the prices charged for memorialisation services are consistent with pricing principle 1.5.

ICRC fees

As outlined in chapter 1, the ACT Government has asked the Commission to provide advice on ensuring that Canberra Cemeteries crematorium facility operates in a manner consistent with competitive neutrality. The ACT Government has agreed that Canberra Cemeteries will be billed for the cost of this advice. This represents an establishment cost for the crematorium.

In setting prices for memorialisation services, Canberra Cemeteries will need to include these fees, consistent with pricing principle 1.1.

6.2 Capital costs

Capital costs relate to equipment, buildings, vehicles, infrastructure (such as internal roads and paths), and other assets that are used to operate a crematorium facility. Such assets are used over a number of years; this is each asset's 'life'. While operating costs are typically recovered in the year in which they are incurred, capital costs are recovered over time through depreciation and a return on investment (which allows for the recovery of the financing costs for those capital assets).

In the issues paper, the Commission identified relevant capital costs and sought feedback from stakeholders. As with operating costs, some capital costs may be shared between the crematorium and the cemetery, such as the cost of roads and administration buildings.

In the draft report, the Commission noted that the fee for contract management services provided by Major Project Canberra is a capital cost to the public crematorium facility.

6.2.1 Submissions

Issues paper

Canberra Cemeteries and InvoCare agreed that the Commission had identified the relevant capital costs associated with crematorium operations.⁹²

⁹² Canberra Cemeteries issues paper submission, pp. 2-3 and InvoCare, p. 3

Canberra Cemeteries noted that roads, buildings, paths and fences may warrant inclusion in capital costs insofar as they relate to the crematorium.⁹³

Norwood Park submitted that, in addition to the capital costs identified by the Commission, the capital costs associated with refurbishment and maintenance of cremation equipment, buildings, grounds and equipment should be considered.⁹⁴

Draft report

The Cemeteries and Crematoria Association of NSW stated that the size of the land included in land costs should not be greater than what a private sector operator would account for.⁹⁵

Canberra Cemeteries submitted that it is important to identify and recover the costs of purchasing land and proposed to include the opportunity cost of using the land for the crematorium facility (such as the lost expected revenue from use as grave sites).⁹⁶

Canberra Cemeteries stated that most functions provided by Major Projects Canberra, which are funded through a levy, 'are public-sector centric and are often more onerous than any similar processes undertaken by its private sector counterparts'.⁹⁷ It stated:

... that private sector operators are not subject to an equivalent levy requirement. However, it acknowledges that private sector operators may also undertake some of the same activities as those undertaken by MPC [Major Projects Canberra]. Canberra Cemeteries is of the view that these are more likely to be less onerous than the public-sector requirements fulfilled by MPC. Given this, and the relative immateriality of any potential adjustment to reflect cost differential, Canberra Cemeteries suggests that no further adjustment in regards to the MPC levy is required.⁹⁸

6.2.2 Commission's findings

Based on the submissions received, discussions with Canberra Cemeteries and research by the Commission, the Commission has identified relevant capital costs (Table 6.2). The Commission has separated these costs into direct capital costs for assets that are only used by the crematorium facility (such as the cremator and the building housing the cremator) and capital costs for assets that are likely to be shared between the crematorium and cemetery (such as a memorial hall, chapel and information technology system). Some costs may fall into either category depending on their nature. For example, the costs of roads, car parks and paths that are only used by visitors to (and staff of) the crematorium facility are direct costs for the crematorium facility, while the

⁹³ Canberra Cemeteries issues paper submission, p. 3

⁹⁴ Norwood Park, p. 2

⁹⁵ Cemeteries and Crematorium Association of NSW draft report submission, pp. 2-3

⁹⁶ Canberra Cemeteries draft report submission, p. 5

⁹⁷ Canberra Cemeteries draft report submission, p. 4

⁹⁸ Canberra Cemeteries draft report submission, p. 4

costs of roads, car parks and paths used by visitors to the chapel and administration buildings would be shared between the crematorium facility and the cemetery.

Table 6.2: Capital costs relating to the supply of crematorium facilities

Category (a): capital directly related to the crematorium	Category (b): capital that is shared between the crematorium and cemetery	Capital that falls into categories (a) and (b)
<ul style="list-style-type: none"> - cremator unit(s) (or furnaces) - a processor (for reducing remains into ash) - scissor trollies for moving coffins between the chapel and crematorium - pans for collection - cool room for storage of corpses - drying machine (e.g. for ashes that have been placed for display purposes in a temporary memorial) - crematorium building, including viewing room, administration space, covered delivery space - the capitalised value of one-off project management, contract management and procurement costs associated with the construction of the crematorium facility - refurbishment costs 	<ul style="list-style-type: none"> - memorial halls, chapels, rooms for functions following the services, facilities for clergy and funeral directors, lounges for the bereaved, and rooms for reflection - vehicles - trolley hoists and gantries associated with memorialisation - audio-visual equipment for use during the service - information communications and technology assets 	<ul style="list-style-type: none"> - lawn and garden maintenance equipment - land costs - refurbishment costs - roads, car parks, paths, and fences

As noted in chapter 5, pricing principle 1 requires that the prices charged by Canberra Cemeteries for crematorium and associated products and services should recover the full costs of providing these products and services. Pricing principle 2 requires an appropriate attribution of costs that are shared between the cemetery and crematorium facility.

The Commission understands that the public crematorium facility may offer a different range of services than the existing private operator. The Commission has been advised that Canberra Cemeteries intends to install a bariatric cremator that allows for the cremation of large bodies. These cremators are generally more expensive than standard cremators. Canberra Cemeteries also intends to install a purpose-built viewing room to

cater for the needs of certain segments of the ACT community.⁹⁹ Providing additional services may increase costs and the prices of some services offered by the public crematorium. Canberra Cemeteries will need to demonstrate in its pricing proposal that its prices recover the full costs of supplying crematorium services, consistent with pricing principle 1. As discussed in chapter 4, differences in the services offered by competing crematorium operators will give the bereaved more choices to meet their needs and preferences.

How Canberra Cemeteries sources infrastructure assets and equipment can have implications for competitive neutrality. Those sourced via competitive tender processes or in open marketplaces are likely to have costs that reflect market rates and will therefore be compliant with competitive neutrality. In contrast, goods or services provided by or through the ACT Government may not be charged at market rates.

Canberra Cemeteries' pricing proposal should describe how it sourced its capital assets and ensured that the asset costs used in setting prices for crematorium services reflect market rates, consistent with pricing principle 1.2. The Commission has identified certain capital assets where it will be particularly important that Canberra Cemeteries demonstrates that its costing methodology and pricing approach are consistent with pricing principle 1.2.

Contract and procurement management fees

Contract and procurement management for the construction of the crematorium facility will be provided by Major Projects Canberra on behalf of Canberra Cemeteries. Major Projects Canberra is the central capital works manager for the ACT Government. Government agencies are required to use Major Projects Canberra to assist in the procurement and contract management of construction related projects.¹⁰⁰

Major Projects Canberra is funded through a four per cent levy that is applied to the total project capital costs for ACT Government Directorates. Based on discussions with Major Projects Canberra, the Commission understands that this levy has been in place for some time.¹⁰¹

To ensure competitive neutrality in setting prices for crematorium services, Canberra Cemeteries will need to demonstrate either that the levy represents a market rate for the services provided by Major Projects Canberra, or that in setting prices, it has made an adjustment to the fees paid to Major Projects Canberra to reflect commercial rates for such services, consistent with pricing principle 1.2.

The Commission has noted Canberra Cemeteries' submission on the fee paid to Major Project Canberra. In its pricing proposal for stage two of the Government's request for

⁹⁹ Discussions with Canberra Cemeteries

¹⁰⁰ ACT Government 2020e

¹⁰¹ Discussions with Major Projects Canberra

advice, Canberra Cemeteries should provide evidence to support its view that no adjustment is required to prices to ensure compliance with pricing principle 1.2.

Land

The ACT Government has announced that the public crematorium facility will be built on vacant land at the Gungahlin Cemetery. For compliance with pricing principle 1.1, Canberra Cemeteries will need to estimate the costs of the land used (including reasonable assumptions about the size of the site footprint) for the crematorium facility and explain in its costing methodology how it will estimate these costs.

In estimating land costs, Canberra Cemeteries could consider what a private operator would be required to pay at market rates for equivalent land, for example, by considering sales of nearby vacant land with a similar zoning. As noted in chapter 5, the market value of land will include the expected net present value of the revenue stream from the next best use of the land, taking into account its zoning, and that market value will therefore include the opportunity cost of alternative uses of the land.

In addition, as discussed in chapter 5, there is a cost of holding land until it is used.¹⁰² The holding cost is the cost of financing the purchase of the land until it is used to provide services by the crematorium operator. These costs might include the costs of holding land that has been allocated for the crematorium facility before the facility has been built, such as during the design and construction phase. In addition, there is a cost of holding land for memorialisation before it is used to provide services, for example, garden space that will be used for ashes interment in the future.

In setting prices for crematorium services, Canberra Cemeteries will need to demonstrate that the prices include appropriate allowances for land costs, consistent with pricing principle 1.3. The pricing principle for calculating an appropriate holding cost is discussed in section 6.3 below.

Depreciation costs

Depreciation allowances recover the capital invested in an asset over the life of that asset. Together, the rate of return earned on the funds used to finance the investment in an asset (discussed below in section 6.3) and depreciation of the cost of constructing or purchasing the asset, ensure that the full costs of capital assets are recovered. This ensures consistency with pricing principle 1.

Depreciation allowances for assets that are used only for the crematorium should be recovered in prices charged for crematorium and related services. For assets that are shared by the crematorium and the cemetery, an appropriate share of depreciation should be allocated to the crematorium facility.

¹⁰² IPART 2019

The Commission has considered the accounting standards and taxation rules for depreciation and found that it is unlikely that Canberra Cemeteries will have a competitive advantage as a result of its government ownership. For example, depreciation reported in financial statements must be developed in accordance with accounting and taxation standards that limit the type of depreciation methodologies that can be used. Further, auditors have a legal obligation to ensure that asset values used in financial statements are accurate, including using appropriate asset lives.

In setting prices for crematorium services, Canberra Cemeteries will need to demonstrate that its prices include appropriate allowances for depreciation, consistent with pricing principle 3.4.

6.3 Appropriate commercial rate of return

Competitive neutrality requires that a government-owned business should earn a commercial rate of return that is equivalent to the rate of return earned by a private business in the same position. The commercial rate of return should include an appropriate risk allowance.

If Canberra Cemeteries was not required to earn a commercial rate of return on its investments, this would give it an advantage in competing with private businesses. Similarly, if the rate of return included a lower risk allowance due to the government ownership of the business, Canberra Cemeteries would gain a competitive advantage compared to private crematorium operators.

A further consideration is whether the government business is required to pay a commercial rate of return on any equity contributed by government. Since shareholders in a private business expect an appropriate risk-adjusted return on their investment, a government-owned business would have a competitive advantage if it was not required to make equivalent returns on any equity investment from government.

In the issues paper and draft report, the Commission outlined several options for determining an appropriate commercial rate of return in the issues paper, including:

- developing a weighted average cost of capital (WACC)—this approach would estimate an appropriate risk-adjusted commercial return on debt (interest payments) and an appropriate risk-adjusted return on equity (return to shareholders), and weight these by a standard debt-equity ratio that reflects a typical business operating in the industry
- benchmarking against the commercial rate of return earned by comparable businesses operating in the industry—this would require good information on the rate of return for the provision of crematorium services (not the rate of return for a diversified business that provides crematorium services as well as other services)
- implied rate of return calculated using information on assets and acquisition prices for companies in the industry—this would require good information on

the rate of return for the provision of crematorium services (not the rate of return for a diversified business) and would need to adjust for any acquisition premium paid above the prevailing commercial rate of return for the industry.

In the draft report, the Commission drew attention to the WACC estimate developed by IPART in its investigation into interment costs and pricing in New South Wales.

6.3.1 Submissions

Issues paper

Stakeholder submissions supported the Commission's approach that Canberra Cemeteries should achieve an appropriate commercial rate of return on its crematorium facility investments as a principle of competitive neutrality. However, stakeholders had different views on the preferred way to develop an appropriate rate of return.

Canberra Cemeteries agreed that the three options put forward in the Commission's issues paper for determining a rate of return were appropriate and each approach had limitations.¹⁰³ Canberra Cemeteries noted the development of a WACC may be problematic given the thinness of markets and lack of publicly traded crematorium businesses.¹⁰⁴ It also stated that a benchmarking approach may be difficult to implement because:

there are not many for-profit crematoriums, and they may not disclose their profits in a transparent way, and/or may have varying operating models which would make it difficult to determine their revenue and profit based on operating a crematorium facility alone; and the legislative and regulatory environment varies nationally. In some jurisdictions, crematoria are publicly operated with a strong not-for-profit ethos.¹⁰⁵

Canberra Cemeteries suggested an alternative approach to estimating a rate of return, using:

a whole of ACT Government approach—take the rate of return figures for other government owned businesses that have competitive neutrality arrangements in place, average these, then discount the average rate calculated to take account of the lower risk associated with a crematorium business compared with other government businesses.¹⁰⁶

Norwood Park submitted that 'given the start-up nature of the project, it is doubted that debt would be available and therefore would have to be entirely equity funded'.¹⁰⁷

¹⁰³ Canberra Cemeteries issues paper submission, p. 3

¹⁰⁴ Canberra Cemeteries issues paper submission, p. 3

¹⁰⁵ Canberra Cemeteries issues paper submission, p. 3

¹⁰⁶ Canberra Cemeteries issues paper submission, p. 3

¹⁰⁷ Norwood Park, p. 4

Draft report

Canberra Cemeteries' submission outlined its intention to include an appropriate risk-adjusted commercial rate of return, including on retained earnings. It noted that IPART has developed a WACC for cemetery businesses.¹⁰⁸

6.3.2 Commission's findings

The Commission agrees with submissions that the implied rate of return and benchmarking approaches are likely to be difficult to implement, due to the thin market in publicly traded crematorium businesses and because private crematorium operators have vertically integrated operations in the broader funeral sector.

The Commission considers that an implied rate of return or benchmarking approach based on newly acquired crematoria may not be appropriate for estimating a commercial rate of return. This is because the implied rates of return based on acquisition of companies typically reflect a buyer's premium and are therefore higher than a normal commercial rate of return.¹⁰⁹

The Commission notes that Canberra Cemeteries has proposed to use a benchmarking approach based on other public agencies with competitive neutrality arrangements in place. The Commission considers that this approach may be difficult to implement given that the crematorium industry has a different risk profile to other government-owned businesses.

A potential approach to calculating an appropriate commercial rate of return is to develop a WACC. As part of its review of interment prices in New South Wales, IPART has developed a WACC for cemetery businesses.¹¹⁰ The Commission considers that crematorium facilities are likely to have a similar risk profile to cemeteries, reflecting similar industry and demand characteristics. Demand for the services provided by both crematoria and cemeteries is relatively stable due to the certainty of death, a stable death rate that changes only slowly over time, and a shift over time to a preference for cremation over burial.¹¹¹ This approach is consistent with IPART's assessment of industry risk in its current interment costs and pricing review.¹¹²

The WACC recently estimated by IPART, including the relevant parameters, is shown in Table 6.3 below. The key parameters are:

¹⁰⁸ Canberra Cemeteries draft report submission, p. 7

¹⁰⁹ Black 1989

¹¹⁰ IPART 2019c, p. 73

¹¹¹ Canberra Cemeteries issues paper submission, p. 3

¹¹² IPART 2019c, p. 73

- the market risk premium—this refers to the difference between the expected return of the business and the risk-free rate. It is likely to be similar between cemeteries and crematoria given the similar levels of risk
- equity beta—this refers to the volatility of returns compared to stock market returns. This is likely to be similar between cemeteries and crematoria given that they both have stable demand
- nominal risk-free rate—this is the rate of return on a low risk asset, usually a government bond, and is common across all industries
- debt and equity ratio—this measures the relative shares of debt and equity. Debt/equity ratios were estimated by IPART after examining cemetery businesses (including cemeteries with on-site crematoria)
- gamma—this refers to tax imputation credits (that is, tax offsets related to equity).

Table 5.3 IPART WACC calculation

	Current market data
Nominal risk free rate	2.5%
Inflation	2.4%
Implied Debt Margin	2.2%
Market Risk premium	8.8%
Debt funding	45%
Equity funding	55%
Total funding (debt + equity)	100%
Gamma	0.25
Corporate tax rate	30%
Effective tax rate for equity	30%
Effective tax rate for debt	30%
Equity beta	0.45
Cost of equity (nominal post-tax)	6.5%
Cost of equity (real-post tax)	4.0%
Cost of debt (nominal pre-tax)	4.7%
Cost of debt (real pre-tax)	2.2%
Nominal Vanilla (post-tax nominal) WACC	5.7%
Post-tax real WACC	3.2%
Pre-tax nominal WACC	6.7%
pre-tax real WACC point estimate	4.2%

Source: IPART 2019c, p. 74

In setting prices for crematorium services, Canberra Cemeteries will need to demonstrate that its prices allow for an appropriate commercial rate of return that includes an appropriate risk allowance, consistent with pricing principle 3. The pricing proposal should include an explanation of how Canberra Cemeteries decided on its methodology for estimating an appropriate risk-adjusted rate of return. The proposal should also include evidence supporting the inputs used in applying the methodology.

6.4 Borrowing rates

Private businesses can borrow to fund their capital investments and will pay a commercial borrowing rate that reflects the risk rating of the business, the expected return on the particular investment and any specific risk associated with the investment.

The Commission's issues paper noted that a government-owned business may be able to borrow through a government treasury and take advantage of a lower risk premium that reflects the (better) risk rating of the government as a whole compared to the business if it were to borrow in its own right. A lower risk premium would reduce the costs to the government business and confer a competitive advantage as a result of its government ownership.

Typically, to ensure competitive neutrality, government businesses are required to pay debt guarantee fees to the government treasury to offset the competitive advantage that it would otherwise gain when they borrow through the government treasury.

6.4.1 Submissions

Issues paper

Norwood Park submitted that a financier would usually have regard to the borrower's credit risk profile (track record, management capability, etc) and security (directors' guarantees, cash-based collateral, etc). It stated that:

In this instance, if Canberra Cemeteries were to be a private enterprise, then it is questionable that a financier would get comfort on many of these factors, and therefore the cost of debt, to the extent it was accessible at all, would be high.¹¹³

Draft report

Canberra Cemeteries submitted that it does not intend to borrow to finance the development of the crematorium facility and noted that should this approach change in the future, it would seek to include a commercial rate of interest in any borrowings obtained through the ACT Treasury.¹¹⁴

6.4.2 Commission's findings

The Commission understands that Canberra Cemeteries currently holds no outstanding loans and intends to fund the crematorium investment from existing retained earnings.¹¹⁵ In setting prices for crematorium services, Canberra Cemeteries will need to demonstrate

¹¹³ Norwood Park, p. 4

¹¹⁴ Canberra Cemeteries draft report submission, p. 8

¹¹⁵ Based on discussions with Canberra Cemeteries.

that its prices will generate an appropriate rate of return on these retained earnings, consistent with pricing principle 3.1.

Should Canberra Cemeteries decide in the future to borrow to fund investments in capital assets used in supplying crematorium services, it will need to set prices to recover a commercial rate of interest on any borrowings, consistent with pricing principle 3.2.

There are two ways Canberra Cemeteries can borrow. First, it could borrow through the ACT Treasury. In this case, Canberra Cemeteries would need to demonstrate that its prices include an adjustment to offset any interest rate concession or debt guarantee. Typically, government-owned businesses pay a debt guarantee fee that ensures the borrowing is at a commercial rate. The debt guarantee fee is calculated by the ACT Treasury and is designed to ensure that the borrowing satisfies the Government's Competitive Neutrality Policy.¹¹⁶

Second, it could borrow (if approved by the Treasurer under section 42 of the *Financial Management Act 1996*) through its commercial banking arrangements. In this case, Canberra Cemeteries would face market borrowing rates.

The Commission notes that the ACT Government can provide a guarantee for a commercial loan under section 60 of the *Financial Management Act 1996*. As this arrangement is not available for private businesses, it could provide Canberra Cemeteries with a competitive advantage purely because of its public ownership. If the ACT Government were to provide a guarantee for a commercial loan by Canberra Cemeteries, Canberra Cemeteries would need to develop a costing methodology for calculating the value of the guarantee. In developing its prices, Canberra Cemeteries would need to use the calculated value to make an adjustment to its borrowing rate, consistent with pricing principle 3.2.

If a commercial lender were to provide a loan at a rate that included an implicit government guarantee, the same process as described above would need to be followed. That is, Canberra Cemeteries would need to develop a costing methodology for calculating the value of the guarantee and use the calculated value to make an adjustment to its borrowing rate, consistent with pricing principle 3.2, in developing its prices.

Similarly, if the ACT Government were, at some time in the future, to give Canberra Cemeteries an equity injection to fund its crematorium facility investments, Canberra Cemeteries would have to demonstrate that its prices allowed for an appropriate rate of return on the equity provided, consistent with pricing principle 3.3. If an equity injection was given to Canberra Cemeteries, the costing methodology would have to identify whether the equity was used to fund cemetery or crematorium investments and ensure that an appropriate rate of return could be earned on that part of the equity used for crematorium investments.

¹¹⁶ ACT Government 2010, p.10

6.5 Allocating shared costs

The public crematorium facility will be operated by Canberra Cemeteries, which already operates three cemeteries and provides associated services and products, some of which are also supplied by crematoria (see chapter 3). The Commission expects that some activities, such as corporate functions and the purchase and sale of memorialisation products, are likely to be undertaken by Canberra Cemeteries for both its cemeteries operations and its public crematorium operations.

In addition, some assets, such as roads and fences, are likely to be shared due to the location of the public crematorium facility within the grounds of the Gungahlin Cemetery. The costs relating to shared assets are called shared costs.

In the issues paper, the Commission considered that the costing methodology to be developed by Canberra Cemeteries should ensure that shared costs and overheads that are jointly provided across cemetery and crematorium operations should be allocated in a manner that ensures competitive neutrality.

It is important to note that this does not mean that any efficiencies that arise from operating both a cemetery and a crematorium facility, such as from economies of scale or scope, should not be passed onto consumers by being reflected in prices charged by the public crematorium facility. Allowing consumers to benefit from lower prices resulting from such efficiencies is not a breach of competitive neutrality principles.

Economic theory states that the efficient costs of operating a crematorium will fall between the costs of stand-alone operation and the marginal (or incremental) costs incurred in operating a crematorium as part of a joint operation (that is, in conjunction with a cemetery). Any allocation methodology that results in prices that fall within this range will be economically efficient and will, in the Commission's view, meet the competitive neutrality requirements.

In its issues paper and draft report, the Commission identified several costing methodologies for attributing shared costs and overheads that are both economically efficient and satisfy the competitive neutrality requirements.

The Commission stated that the choice of an appropriate costing methodology for allocating shared costs and overheads is a commercial decision for Canberra Cemeteries, provided it satisfies competitive neutrality requirements. The Commission considered that a practical and pragmatic allocation methodology that recognises commercial realities and is based on measurable data would assist Canberra Cemeteries in demonstrating that its approach is competitively neutral.

6.5.1 Submissions

Issues paper

The Commission received four submissions that discussed allocation of shared costs. Each supported the principle that shared costs and overheads should be appropriately attributed to the crematorium to achieve competitive neutrality.

Canberra Cemeteries stated that the crematorium will operate as a separate business unit¹¹⁷ and that it intends to use a measure of full time equivalent staffing for the crematorium to identify and allocate overheads accordingly.¹¹⁸ Canberra Cemeteries also noted that ‘roads, buildings, paths and fences may warrant inclusion in operational costs calculations, however only insofar as they relate to the crematorium, with caution as to not spread the net over the whole’.¹¹⁹ Canberra Cemeteries stated that it ‘has taken an activities-based approach to inform our business and operational model for the crematorium.’¹²⁰

Norwood Park supported an appropriate allocation of shared costs but disagreed with the Commission’s statement that: ‘Any allocation methodology that falls within this range will be economically efficient and will ... meet the competitive neutrality requirements.’ Norwood Park considered that:

Multiple methods may fall within this range, providing different values; they cannot all be efficient. Any methodology needs to be practically and appropriately applied to simulate an efficient outcome and be a competitively neutral outcome.¹²¹

Norwood Park stated that it may not be practical to use Ramsey pricing or marginal cost pricing methods to allocate common costs. It stated that:

[Ramsey Pricing would] be problematic to apply transparently and consistently. This approach would require the Commission to identify crematorium services (or baskets of services) that have similar elasticities, setting prices above marginal cost according to each service’s (or baskets of services’) price elasticity of demand. We do not consider this a practical approach, particularly given the relevant market is already competitive (i.e. across the ACT and into NSW).¹²²

[Marginal cost pricing would] be inefficient to compensate the operator because of the existence of scale economies and fixed costs associated with running a crematorium. Canberra Cemeteries pricing crematorium services on a marginal cost basis would unfairly disadvantage the incumbents by allowing Canberra Cemeteries to price in a manner that

¹¹⁷ Canberra Cemeteries issues paper submission, p. 3

¹¹⁸ Canberra Cemeteries issues paper submission, p. 3

¹¹⁹ Canberra Cemeteries issues paper submission, p. 3

¹²⁰ Canberra Cemeteries issues paper submission, p. 2

¹²¹ Norwood Park, p. 2

¹²² Norwood Park, p. 4

would not adequately cover the fixed costs of its operations, a luxury not afforded to the incumbents.¹²³

Norwood Park supported the use of activity-based costing (ABC), which is a method of allocating overheads based on a measure of use. It stated that: ‘If the Commission considers that an ABC exercise is practical, then this should be employed.’¹²⁴ However, Norwood Park also submitted that a simplified version of activity-based costing, known as ‘fully distributed costs’ (FDC), would be a pragmatic compromise.¹²⁵

Norwood Park stated that there were a range of cost drivers that could be used when employing an FDC approach. This includes:

- staff involved in the activity as a percentage of total staff
- the direct resource use of the activity as a percentage of total resource use
- the budget for the activity as a percentage of the total business budget.¹²⁶

Draft report

Canberra Cemeteries outlined the approaches it intends to use to allocate share costs, stating that it intends to adopt an ‘activity-based costing methodology designed to capture both the full direct costs, and the relevant portion of shared costs attributable to the Crematorium’.¹²⁷

Canberra Cemeteries submitted that its approach to allocating shared costs will balance ‘developing and maintaining a more precise, but more complex and hence more expensive costing model compared with developing a simpler and less expensive, but less precise costing model’.¹²⁸

6.5.2 Commission’s findings

The Commission identified a range of shared costs in section 6.1 (operating costs) and section 6.2 (capital costs). In terms of the allocation methodology, the Commission considers that it may be difficult to use Ramsey pricing or marginal cost pricing to allocate overheads. For example, as highlighted by Norwood Park, there would be difficulties in estimating the price elasticities required to implement Ramsey pricing. Similarly, it may be difficult to implement marginal cost pricing in a competitively neutral way because it may not allow for relevant fixed costs to be recovered.

¹²³ Norwood Park, p. 4

¹²⁴ Norwood Park, p. 3

¹²⁵ Norwood Park, p. 3

¹²⁶ Norwood Park, p. 3

¹²⁷ Canberra Cemeteries draft report submission, pp. 2-3

¹²⁸ Canberra Cemeteries draft report submission, p. 7

The Commission considers that the ABC and FDC approaches proposed by Norwood Park are two practical and pragmatic methods for allocating shared costs.

The ABC approach involves allocating overheads according to relevant cost drivers. As such, it allows shared cost allocation to vary with relevant activities that drive overhead costs. ABC is often regarded as a sophisticated method of allocating costs because it requires that all overhead cost drivers be identified and taken into account.¹²⁹

A simplified form of ABC is FDC. Under the FDC method, each shared cost is allocated based on one cost driver. For example, corporate overhead costs may be allocated as a proportion of staff hours or in proportion to the relative budget for a particular activity.

The Commission considers that the decision on the allocation methodology is a commercial matter for Canberra Cemeteries. The Commission has noted Canberra Cemeteries' submission that it intends to allocate direct and shared cost using an ABC approach, based on cost drivers such as full-time equivalent staff or facility size.¹³⁰

In setting prices for crematorium services, Canberra Cemeteries will need to demonstrate that its costing methodology allocates shared costs and overheads appropriately across its cemeteries and crematorium operations, consistent with pricing principle 2.1.

Pricing principle 2.2 requires that Canberra Cemeteries should ring fence the crematorium facility's accounts from the accounts for its cemetery operations. This will promote transparency about how costs are attributed between the crematorium facility and Canberra Cemeteries' other business activities and facilitate verification that the allocation methodology has been applied correctly.

The Commission considers that Canberra Cemeteries' proposed approach to allocating shared (operational or capital) costs through an ABC methodology is a reasonable approach and appears consistent with meeting pricing principle 2.1. Nonetheless the Commission will need to assess in greater detail Canberra Cemeteries' approach to allocating shared costs as part of stage two of the Government's request for advice.

6.6 Tax and tax equivalent payments

An important element of competitive neutrality is that competing businesses, whether public or private, face the same tax obligations. If a government business was subject to lower tax obligations than competing private businesses, as a result of government ownership, it would gain a competitive advantage.

The ACT Government agreed in 1995 to a tax equivalent regime (known as the national tax equivalent regime, or NTER) by which it sought to establish a tax burden for its wholly owned businesses that would be equivalent to the tax regime imposed on

¹²⁹ The Chartered Institute of Management Accountants, p. 3

¹³⁰ Canberra Cemeteries draft report submission, pp. 6-7

privately owned businesses. The tax equivalent regime aims to ensure that even if an ACT government business is not required to pay certain taxes due to its government ownership, an equivalent payment must be made to the ACT Government for the taxes that would be paid by a comparable private business.

6.6.1 Submissions

Issues paper

Canberra Cemeteries and InvoCare supported the Commission's proposal that the crematorium should be subject to all equivalent taxes and charges faced by private sector competitors.¹³¹ InvoCare stated it 'does not believe private operators should pay a tax/levy and or other financial imposition to which a government enterprise is not subject'.¹³² Norwood Park submitted that it expects that Canberra Cemeteries faces all the same direct and indirect tax obligations as a private enterprise.¹³³

Draft Report

Canberra Cemeteries stated that intends to include an allowance that is equivalent to the taxes that would be paid by a private operator and is seeking ACT Treasury advice on how best to apply the NTER to the crematorium facility's operations.¹³⁴

6.6.2 Commission's findings

The Commission has found that private crematorium operators pay the following taxes and charges: GST, company tax, capital gains tax, fringe benefits tax, payroll tax, workcover premiums and ACT Government rates.

Canberra Cemeteries is subject to the same ACT Government taxes, fees and charges as private businesses. Canberra Cemeteries is a 'prescribed entity'¹³⁵ under section 9 of the *Taxation (Government Business Enterprise) Act 2003* (ACT) (the *Taxation Act*). The *Taxation Act* requires that prescribed ACT Government entities are not exempted from any ACT Government tax, fee or charge.

In respect of federal taxes and charges, the Commission has been advised that Canberra Cemeteries is subject to the GST regime (that is, it pays GST on goods and services purchased and collects GST on fees and charges) and is subject to the fringe benefits tax regime.

However, Canberra Cemeteries is not subject to the same Commonwealth Government taxes as a private sector competitor, due to an exemption from the NTER by regulation

¹³¹ Canberra Cemeteries issues paper submission, p. 4; InvoCare, p. 3

¹³² InvoCare, p. 3

¹³³ Norwood Park, p. 4

¹³⁴ Canberra Cemeteries draft report submission, pp. 8-9

¹³⁵ Section 4 *Taxation (Government Business Enterprises) Regulation 2003*

under Section 6 of the *Taxation Act*.¹³⁶ This exemption means that Canberra Cemeteries is not required to pay the equivalent company tax under the Commonwealth *Income Tax Assessment Act 1936*¹³⁷ to the ACT Government.

The ACT Competitive Neutrality Policy requires that all Territory-owned corporations are liable to pay all taxes and charges that their competitors are required to pay. For consistency with this Policy, the ACT Government may decide that Canberra Cemeteries' NTER exemption will not apply to its crematorium facility. If this was the Government's decision, the public crematorium facility would be required to make a tax equivalent payment that is equal to the income tax that it would be liable to pay under the Commonwealth *Income Tax Assessment Act 1936*.

Ring-fencing consistent with pricing principle 2.2 will facilitate any ACT Government decision on limiting the application of Canberra Cemeteries' NTER exemption to the cemetery.

If Canberra Cemeteries' NTER exemption applies to its crematorium facility, Canberra Cemeteries would, in setting prices for crematorium services, have to make an adjustment to its tax payments, consistent with pricing principle 4.1.

The Commission considers that Canberra Cemeteries' proposed approach of including an allowance that is equivalent to tax that would be paid by a private operator is reasonable. Canberra Cemeteries will need to explain how it has calculated (and included in setting prices) an appropriate tax allowance in its pricing proposal for stage two.

6.7 Regulatory equivalence

Any differences in regulations applying to public and private operators would have implications for competitive neutrality. The Commission has assessed whether there is regulatory equivalence between public and private crematorium operators in the ACT.

The Commission has also considered broader obligations imposed by legislation or regulation on government-owned businesses. As noted in chapter 3, Cemeteries Canberra is, as a result of its government ownership, subject to the *Financial Management Act 1996* and the *Public Sector Management Act 1994*. It is also subject to other obligations imposed on ACT Government agencies, which may confer either an advantage or a disadvantage compared to comparable private businesses (refer to Table 6.3). For example, there may be differences in the reporting obligations for government businesses and private businesses.

¹³⁶ Section 3 *Taxation (Government Business Enterprises) Regulation 2003*

¹³⁷ Part III, Division 1AB

6.7.1 Submissions

Issues paper

Canberra Cemeteries supported the Commission's proposal that competitive neutrality should be applied to regulatory obligations and did not identify any particular regulatory obligations that were specific to it.¹³⁸

Norwood Park's submission sought to clarify that a public operator would face the same regulations as a private operator in relation to environmental risks, traffic, fire risk and compliance with all relevant laws (including industrial relation laws).¹³⁹

Harris McDonald stated that the ACT Government planning regulations have prevented the development of a new private crematorium in the ACT.¹⁴⁰

Draft report

Canberra Cemeteries agreed with the Commission's draft finding that there are: a range of common regulations that apply to both Canberra Cemeteries and private sector operators; regulations that apply specifically to Canberra Cemeteries as a public sector entity; and regulations that apply specifically to private operators.¹⁴¹ Canberra Cemeteries stated that it was:

of the view that public-sector regulatory obligations are more onerous and therefore costly to comply with than those placed on its private-sector counterparts and therefore suggests that no additional demonstration of compliance with regulatory obligations placed on its private sector counterparts is required. However, for due diligence, estimates of pricing comparisons will be undertaken in tandem with the costing methodology process.¹⁴²

Canberra Cemeteries stated that it faces a number of additional regulatory requirements as a public sector entity that are not imposed on private operators such as 'transparency in the use of public funds and to meet government policies or obligations'.¹⁴³

6.7.2 Commission's findings

Based on submissions and its own research, the Commission has found that many regulatory obligations would apply equally to unlisted private crematorium operators, private crematorium operators listed on the stock exchange, and government-owned crematorium operators in the ACT. Common regulatory obligations include compliance with: Australian Accounting Standards; the *Cemeteries and Crematoria Act 2003*

¹³⁸ Canberra Cemeteries issues paper submission, p. 4

¹³⁹ Norwood Park, p. 4

¹⁴⁰ Harris McDonald, p. 2

¹⁴¹ Canberra Cemeteries draft report submission, p. 9

¹⁴² Canberra Cemeteries draft report submission, p. 9

¹⁴³ Canberra Cemeteries draft report submission, p. 9

(ACT); the *Fair Work Act 2009* (Cwth); and the *Information Privacy Act 2014* (ACT). However, there are also regulatory obligations that apply differently or apply only to private businesses or only to government-owned businesses.

Table 6.4 lists legislation and regulations that apply only to government-owned businesses or only to private businesses. Different regulations aim to achieve similar objectives in many instances. For example, financial reporting and annual report regulations applying to ACT Government agencies are similar to reporting and disclosure requirements for private sector listed companies imposed by the Australian Securities and Investment Commission and the ASX (in the case of ASX-listed companies).

Differences in regulatory obligations may result in different costs and operating conditions between government-owned and private crematorium operators. The Commission recognises that it may be difficult to quantify the costs associated with the various regulations.

For competitive neutrality, Canberra Cemeteries must demonstrate that it has complied with the same regulations that apply to its private sector counterparts, consistent with pricing principle 5.

Canberra Cemeteries proposed approach to demonstrating that it has complied with the same regulations that apply to its private sector counterparts appears appropriate. The Commission will assess Canberra Cemeteries' evidence that it has complied with the same or equivalent regulations as its private sector counterparts in stage two.

The Commission has found no evidence that the development of a private crematorium in appropriately zoned land in the ACT is prevented under the *Planning and Development Act 2007* (ACT) or subordinate instruments made under the *Planning and Development Act 2007*.

Table 6.4: Regulatory obligations on crematorium operators

ACT Government specific regulatory obligations		Private company specific regulatory obligations
- Whole of Government and General Government Sector Financial Reporting	- <i>Auditor-General Act 1996</i> (ACT) and subordinate instruments	- <i>Corporations Act 2001</i> (Cwth)
- <i>Financial Management Act 1996</i> (ACT) and subordinate instruments	- <i>Territory Records Act 2002</i> (ACT) and subordinate instruments	- Australian Securities Exchange reporting obligations (e.g. half year reporting and continuous disclosure)
- <i>Public Sector Management Act 1994</i> (ACT) and subordinate instruments	- <i>Public Interest Disclosure Act 2012</i> (ACT) and subordinate instruments	- Australian Securities and Investment Commission reporting obligations
- Aboriginal and Torres Strait Islander Procurement Policy	- <i>Ombudsman Act 1989</i> (ACT) and subordinate instruments	
- Secure Local Jobs Code	- <i>Integrity Commission Act 2018</i> (ACT) and subordinate instruments	
- Labour Relations, Training and Workplace Equity Plan	- <i>Legislation Act 2011</i> (ACT) and subordinate instruments	
- <i>Government Procurement Act 2001</i> (ACT) and subordinate instruments	- <i>Annual Reports (Government Agencies) Act 2004</i> (ACT)	
- Canberra Region Local Industry Participation Policy	- <i>Cemeteries and Crematoria Act 2003</i> (ACT) and subordinate instruments	
- Technical and Other Professional Enterprise Agreement 2018-2021	- Administrative and Related Classifications Enterprise Agreement 2018-2021	

6.8 Community service obligations

Government owned businesses may be directed to provide services that in the usual course of commercial activity would not be provided, or would be provided at a higher price, usually to meet government social objectives. These services are referred to as community service obligations (CSOs). If a government business, but not a private business in the same industry, was required to meet CSOs without an offsetting CSO payment, this could increase the government-owned business' costs and prices, resulting in a competitive disadvantage.

The Commission understands that the only CSOs related to death services are obligations on, and payments to, funeral directors to assist low-income households.¹⁴⁴

¹⁴⁴ ACT Government 2020b

6.8.1 Submissions

The Commission received no submissions indicating that Canberra Cemeteries or a private crematorium operator had any CSO obligations imposed on them by the ACT Government.

6.8.2 Commission's findings

Based on submissions and investigations undertaken by the Commission, there are no current CSOs imposed on Canberra Cemeteries or private crematorium operators. On this basis, there would be competitive neutrality between Canberra Cemeteries and a private operator in relation to CSO obligations.

Appendix 1 Scope of Work



Andrew Barr MLA

Chief Minister
Treasurer
Minister for Social Inclusion and Equality
Minister for Tertiary Education
Minister for Tourism and Special Events
Minister for Trade, Industry and Investment
Member for Kurrajong

Mr Joe Dimasi
Senior Commissioner
Independent Competition and Regulatory Commission
PO Box 161
CIVIC SQUARE ACT 2608

Dear Mr Dimasi ^{Joe}

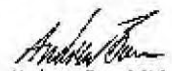
I am writing to you about the recently announced public crematorium facility at Gungahlin, which will be built and operated by the ACT Cemeteries Authority (the Authority).

In approving the proposal, the Government decided to engage the Commission to help ensure that the new facility operates in a manner consistent with competitive neutrality. In particular, the Government wishes to use the Commission's expertise to develop an appropriate costing methodology and prices to apply to goods and services at the facility, which will be provided in direct competition with private sector operators already present in the market.

Please find enclosed a scope of works for the project, which I provide under section 12 of the *Independent Competition and Regulatory Act 1997*. The Commission will be required to undertake two main tasks, an initial process to develop pricing principles to guide the development of the costing methodology and prices for the facility, and a subsequent process to review and assess the Authority's pricing proposal for its compliance with the pricing principles and competitive neutrality policy more broadly.

I thank the Commission in advance for providing assistance to the Government on this matter, and I look forward to the outcomes of your work in due course.

Yours sincerely


Andrew Barr MLA
Treasurer

20 DEC 2019

ACT Legislative Assembly

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Scope of Work: ICRC process to assist the determination of prices for the ACT Public Crematorium

In September 2019, the Government agreed to proceed with a proposal by the ACT Public Cemeteries Authority (the Authority) to build and operate a public crematorium facility at the Gungahlin Cemetery. As part of that approval, to ensure the facility is operated in line with competitive neutrality principles, the Government agreed to engage the Independent Competition and Regulatory Commission (ICRC) to:

- develop a set of pricing principles to guide the development of a costing methodology and prices for the public crematorium facility; and
- formally review the Authority’s proposed costing methodology and prices to ensure compliance with the pricing principles and the ACT Competitive Neutrality Policy.

This work is to be undertaken under section 12 of the *Independent Competition and Regulation Commission Act 1997*, which allows the ICRC to assist any agency, body or person by “providing services within the Commission’s field of expertise and relevant to its functions.”

The following documents provide the policy framework for the work to be undertaken:

- the *Competition Principles Agreement 1995* (as amended 13 April 2007);
- the *ACT Competitive Neutrality Policy*; and
- the ICRC’s *Competitive Neutrality Complaints: Guidelines*.

Stage 1: Development of pricing principles

The first stage of this work will require the ICRC to develop detailed pricing principles for the ACT public crematorium, to guide the setting of prices for the goods and services, in a manner consistent with ACT Competitive Neutrality Policy. The issues identified below are considered to be relevant to the development of the pricing principles for the facility.

Key issues to be considered by the ICRC

- Identification of core activities and resources required to deliver crematorium services at an ACT public crematorium;
- Detailed analysis of the estimated costs of supplying crematorium services, to ensure all costs are identified and accounted for;
- Identification of shared activities and resources that will be used by the Authority to deliver burial and cremation related services, and the development of a methodology for appropriate allocation of these costs between the two areas;

- Identification of services related to the operation of the crematorium that are provided by, or could be provided, by the ACT Government;
- Identification of any unique circumstances/requirements arising because the facility will be publicly owned and operated that would not apply to a private sector provider; and
- Consideration of the most appropriate approach to ensuring prices for goods and services provided at the crematorium that could alternatively be provided by private entities, but are not necessarily directly related to core crematorium services (for example memorialisation goods and services), are consistent with competitive neutrality policy.

Process

To understand the activities, resources and costs of delivering public crematorium goods and services, and to identify any synergies and/or shared costs in supplying goods and services resulting from the Authority providing both crematorium and burial services, the process to develop the pricing principles should include:

- consultation with the Authority;
- where appropriate, consultation with private crematorium operators within and outside of the ACT;
- consultation with relevant cemetery/crematorium authorities in other jurisdictions;
- the release of a public Issues Paper to explain the process and key issues, and to seek input from stakeholders;
- the release of a draft report including the proposed pricing principles for consultation with stakeholders; and
- the provision of a final report incorporating the pricing principles to the Treasurer, the Minister for City Services and the Authority.

Deadline for provision of final report for Stage 1: 31 May 2020

Stage 2: Competitive neutrality analysis of pricing schedule developed by ACT Public Cemeteries Authority

The second stage will require the Authority to submit a proposed costing methodology and pricing schedule to the ICRC and demonstrate that these are consistent with the pricing principles developed in Stage 1, and ACT Competitive Neutrality Policy more generally. The ICRC will review the cost methodology and pricing schedule to ensure they are consistent with the principles.

In its submission, the Authority may include explanatory material and describe any issues, or unexpected outcomes identified by the Authority in developing its proposed cost methodology and prices.

The key outcome of this work will be to ensure that prices have been appropriately developed, that all relevant costs have been accounted for and the crematorium does not receive a net competitive advantage solely arising from its public ownership.

Process

The process to review the proposed costing methodology and prices should be undertaken in consultation with the Authority, and should include:

- the verification of the validity of proposed costs, and their allocation between the cemetery and crematorium operations;
- a review of the proposed prices and costing methodology for compliance with the pricing principles determined in Stage 1 and ACT competitive neutrality policy;
- development of draft findings from the initial analysis;
- an opportunity for the Authority to respond to the draft findings, and to provide detail of any proposed revisions to address any identified issues; and
- the provision of the final report, including any findings and recommendations, to the Treasurer, the Minister for City Services and the Authority on a confidential basis, with a summary of the final report suitable for public release also prepared.

Appendix 2 Competition principles agreement

[competition principles agreement cl 3 (1) & (4)-(7)]

3 (1) The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities.

(4) Subject to subclause (6), for significant Government business enterprises which are classified as “Public Trading Enterprises” and “Public Financial Enterprises” under the Government Financial Statistics Classification:

(a) the Parties† will, where appropriate, adopt a corporatisation model for these Government business enterprises (noting that a possible approach to corporatisation is the model developed by the intergovernmental committee responsible for GTE National Performance Monitoring); and

(b) the Parties† will impose on the Government business enterprise:

(i) full Commonwealth, State and Territory taxes or tax equivalent systems;

(ii) debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees; and

(iii) those regulations to which private sector businesses are normally subject, such as those relating to the protection of the environment, and planning and approval processes, on an equivalent basis to private sector competitors.

(5) Subject to subclause (6), where an agency (other than an agency covered by subclause (4)) undertakes significant business activities as part of a broader range of functions, the Parties† will, in respect of the business activities:

(a) where appropriate, implement the principles outlined in subclause (4); or