

The Commission noted that different regulatory obligations can apply to private unlisted companies, private companies that are listed on a stock exchange, and government-owned businesses.

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 are similar to 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).

In its final report for the stage 1 advice, the Commission stated that 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.

4. Pricing principle 1: full cost recovery

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.

As explained in chapter 3, 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. This is because a private operator in a similar position would have to recover its full costs, both direct costs attributable to the crematorium as well as an appropriate share of any shared costs (where the private operator is providing other services in addition to its crematorium services).

The Commission has found that the costing model used by Canberra Cemeteries identifies all the costs of supplying services by the public crematorium facility. These costs include capital costs, operating costs, and overheads. A full list of costs and associated procurement methods is in Table 4.1.

Table 4.1 Crematorium-related costs identified by Canberra Cemeteries with the procurement method

Cost input	Procurement Method
Overheads	
Mobile phone and its usage	Shared Services Agreement
Software licences	Shared Services Agreement
Mail management	Shared Services Agreement
Reliability and maintainability services (e.g. fire protection and testing)	Shared Services Agreement
ACTGOV network charges	Shared Services Agreement
Accounting services	Shared Services Agreement
External audit fees	Shared Services Agreement
Internal audit fees	Procured directly from the market
Workers compensation insurance	Shared Services Agreement
Other insurance	Shared Services Agreement
Remote access equipment and services	Shared Services Agreement
Board remuneration and expenses	Shared Services Agreement

Capital Costs	
Crematorium and viewing room building and associated works	Procured as part of the construction of the crematorium through a competitive tender process.
Cremator and associated equipment	Procured through a competitive tender process as per the requirement set out in the ACT Government procurement policy.
ICRC costs	Cost determined by ICRC.
Professional advisory services	Competitive tender process
General office equipment	Competitive tender process
Toilets and administration building	Competitive tender process
Carports	Competitive tender process
Solar panels	Competitive tender process
Existing fencing	Competitive tender process
Existing roads	Competitive tender process
Existing landscaping	Competitive tender process
Operating costs	
Water and sewerage	Procured directly from the market
Cleaning	Procured directly from the market
Security services	Procured directly from the market
Waste services	Procured directly from the market
Banking services	Procured directly from the market
Electricity	Procured directly from the market
Major and minor rebricking	Procured through a competitive tender process as per the requirement set out in the ACT Government procurement policy.
Annual maintenance of furnace and equipment	Procured through a competitive tender process as per the requirement set out in the ACT Government procurement policy.
Gas and gas cylinder	Procured directly from the market
Box for ashes	Procured directly from the market

The Commission has confirmed that Canberra Cemeteries has identified the full costs of providing crematorium services. In its stage 1 advice, the Commission identified a list of potential costs of operating the crematorium. The Commission has confirmed that Canberra Cemeteries has identified all the applicable costs listed in the stage 1 advice. Confidential information provided by Canberra Cemeteries related to cost items is in appendix 2. In identifying the full costs of providing crematorium services, Canberra Cemeteries

has identified both the direct costs associated with the crematorium and a portion of relevant costs that are shared between the crematorium and cemetery.

Canberra Cemeteries has quantified the costs of these inputs using actual, expected and historical expenditure. Fees paid for professional services, ICRC charges for developing its stage 1 and stage 2 advice, costs for solar panels, and gas costs were quantified using actual expenditure. Capital expenditure listed in the project plan, costs related to minor and major rebricking, annual maintenance of furnace and equipment costs, and costs for boxes for ashes were quantified based on expected costs. All other costs were quantified based on historical expenditure.

Canberra Cemeteries has calculated expected variable costs based on the expected number of cremations per year, which have been estimated based on a range of data sources and assumptions. These data sources and assumptions are presented in Table 4.2.

Table 4.2 Assumptions and data sources used to undertake financial forecasting

	2018 Value	Data Source
Total deaths in the ACT	2127	Australian Bureau of Statistics
Death rate	2.9%	Based on the ACT Government forecast of deaths
Percentage of deaths where remains are cremated	75%	ACT Government Transport Canberra and City Services 2019 Annual Report
Canberra Cemeteries market share	Confidential	Provided to Canberra Cemeteries by an industry expert
Cremations of adults (%)	98.24%	This distribution is assumed to follow burials in FY 2019. It is based on internal data from Canberra Cemeteries.
Cremations of child 6 to 17 years (%)	0.18%	
Cremations of child 1 to 5 years (%)	0.30%	
Cremations of stillborn to 1 year (%)	1.27%	

Details on how an appropriate portion of the costs shared between the crematorium and cemetery have been estimated are in chapter 5.

The Commission is satisfied that Canberra Cemeteries has identified and quantified all the costs related to providing crematorium services and that its costing methodology is therefore compliant with pricing principle 1.1.

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.

In its stage 1 advice (as noted in chapter 3 of this report), the Commission stated that a key factor for competitive neutrality is how goods and services used for the crematorium are sourced. Goods and services that are sourced via a competitive tender process or via an open marketplace will reflect commercial costs and therefore meet the conditions for competitive neutrality. If goods and services are not sourced this

way, the Commission highlighted in its stage 1 advice that Canberra Cemeteries should demonstrate that the costs of these goods and services reflect market rates so that they meet this pricing principle.

Canberra Cemeteries has provided information on how it has sourced the inputs needed to supply crematorium goods and services. The methods used to source inputs are shown in Table 4.1 above.

Canberra Cemeteries purchases utility services like gas, electricity, and water and sewerage under market contracts. It also purchases cleaning, waste management, security, and banking services from the market, either under contract or at fees that are available to private and public sector businesses (such as bank fees). It purchases boxes for ashes directly from the market.

Canberra Cemeteries used competitive tender processes to procure all new capital items, such as buildings for the crematorium and viewing room, cremator and associated equipment, and professional services. It provided information that existing buildings, roads and fencing, and other infrastructure that will be shared with the Gungahlin cemetery operations had also been procured through competitive tender processes. Some services, such as landscaping and annual maintenance of the furnace and other equipment, have also been procured through competitive tender processes.

Canberra Cemeteries obtains information and communication technology services and equipment, accounting and audit services, insurance services, and fire protection and testing services from ACT Government Shared Services under supply agreements. Where annual charges paid under these supply agreements are more than \$5000, Canberra Cemeteries has benchmarked the charges for those services and equipment against market rates. Where Canberra Cemeteries found that the charges it pays are less than market rates, it has made an adjustment in its costing model to ensure the costs used in setting prices reflect the benchmarked market rates. Specifically:

- Software licence fees have been benchmarked against the prices listed on vendor websites. Canberra Cemeteries has used the benchmark price in its costing model to ensure that its costing model uses market rates.
- Canberra Cemeteries benchmarked the cost of accounting services against the salary of management accountants found in Page Personnel and Hays 2020 Salary Benchmark reports. Canberra Cemeteries has used the benchmarked cost in its costing model. Canberra Cemeteries did not benchmark the cost of audit services. It did not benchmark the costs of internal audit services because these are procured commercially. It did not benchmark the costs of external audit services because due to the size of the business, a similar privately owned entity would not be subject to external financial audits.
- Canberra Cemeteries obtains workers compensation insurance through the Public Sector Workers Compensation Fund which outsources its functions to a commercial entity through a public procurement process. The insurance premium therefore reflects market premiums.

Canberra Cemeteries decided not to benchmark the costs for services and equipment that are less than \$5000 a year. These include, for example, the mobile phone used by the Chief Executive Officer and mobile usage charges. There were two reasons for this decision. First, any differences between actual and benchmarked costs are expected to be immaterial. Second, the administrative costs of benchmarking the charges for these items would be greater than the expected cost adjustment.

Confidential information on cost benchmarks provided by Canberra Cemeteries is in appendix 2.

The Commission is satisfied that Canberra Cemeteries has provided sufficient evidence on how it has sourced the inputs required to provide crematorium services and on the benchmarking approaches used to

adjust input costs to reflect commercial rates. The Commission considers Canberra Cemeteries' benchmarking approaches, and its decision not to benchmark a small number of low-cost services and equipment obtained through ACT Government Shared Services, are reasonable. The Commission has found that Canberra Cemeteries has complied with pricing principle 1.2.

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

The public crematorium was built on existing land at the Gungahlin Cemetery. For competitive neutrality, the prices charged by the public crematorium should recover the full cost of the land as this is what a private operator in the same position would be required to do.

The full cost of land includes the market value of the land and land holding costs. In its final report on the stage 1 advice, the Commission explained that the holding cost is the cost to the crematorium operator of financing the purchase, or acquisition, of land before it is used to provide crematorium or related services, such as land that will in future be used for memorialisation.

Canberra Cemeteries has provided evidence to the Commission that it has included the full cost of land in its costing model, including the market value and the holding costs.

Canberra Cemeteries estimated the market value of the land for the crematorium facility as the foregone revenue from using the land as gravestock. This represents the value of the land in its next best use (known in economics as the opportunity cost of the land). Canberra Cemeteries calculated the land value in this way because there was no benchmark value of land zoned for use as a cemetery or crematorium. Canberra Cemeteries calculated that the land used for the crematorium would otherwise have been used for 92 graves, based on the area of one gravestock (5 square meters) and the total land area of the crematorium (460 square meters). Canberra Cemeteries estimated the foregone revenue for 92 graves, based on the price of a plaque beam burial,¹³ at \$805,000 for the market value of the land used for the crematorium facility.

Canberra Cemeteries did not account for the cost of developing the gravestock when estimating the opportunity cost. Canberra Cemeteries calculated the opportunity cost as foregone revenue rather than the foregone net value of land which represents foregone revenue less the cost of developing the land for gravestock. Canberra Cemeteries stated that the cost of developing the gravestock, if it were included, would be spread over the expected life of the crematorium and would be immaterial. Confidential information on land costs provided by Canberra Cemeteries is in appendix 2.

Canberra Cemeteries has also included in its costing model the cost of holding the land for the period from when the crematorium services business case was approved by the Government to when the crematorium building was completed. To calculate the land holding cost, Canberra Cemeteries applied the annual rate of return on its capital investments (the WACC discussed in chapter 6) to the unimproved value of the land for this period. Canberra Cemeteries estimated the unimproved land cost by deriving an average value per square meter of nearby unimproved land. These values were sourced from the ACT Revenue Office, which

¹³ A plaque beam burial is burial in a lawn grave. Memorialisation is by a large plaque installed flush on the exposed aggregate (concrete) beam at the head of the grave. Gungahlin Cemetery information sheet at <http://cpc-web-prd-01.cloudapp.net/docs/default-source/information-sheets/information-sheet---plaque-beam-allotment.pdf>

reviews unimproved land value on yearly basis.¹⁴ Confidential information on land holding costs provided by Canberra Cemeteries is in appendix 2.

The Commission considers that the method Canberra Cemeteries has used to calculate total land costs will result in prices charged by the public crematorium that recover the costs of land, including land holding costs. The Commission has therefore found that Canberra Cemeteries is compliant with this pricing principle.

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.

In the final report for the stage 1 advice (and noted in chapter 3 of this report), the Commission stated that 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. The direct costs are the costs that would be avoided if the product or service was not supplied. For memorialisation products, this means that prices should at least cover the costs of the products themselves.

The Commission also said that the pricing proposal would have to explain whether the prices for memorialisation products and services contribute to Canberra Cemeteries' profit margin and to relevant shared costs. The proposal should explain how Canberra Cemeteries decided whether the prices would contribute to the profit margin and relevant shared costs.

Canberra Cemeteries intends to continue its current method of pricing memorialisation goods and services. It sets prices to recover the costs of supply and other directly attributable costs including shared expenses as follows.

- First, it calculates the cost of the merchandise by adding the purchase price of the item, estimated direct and associated labour costs, and an allowance for overheads to cover other expenses and depreciation.
- Second, it applies a profit margin to the cost of merchandise to arrive at selling prices. Commercially sensitive information on this calculation is in appendix 2.

The Commission considers that the approach used by Canberra Cemeteries to determine the prices of memorialisation products and services complies with pricing principle 1.4.

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

Ashes are interred at a cemetery or crematorium in the ACT in perpetuity (forever). Usually, fees paid at the time of interment are set to recover the costs of the interment and contribute to the perpetual care trust and perpetual care trust reserve that fund the ongoing maintenance of the cemetery or crematorium. The Commission's stage 1 advice highlighted that an appropriate share of the perpetuity maintenance cost should be included in Canberra Cemeteries' prices.

¹⁴ ACT Revenue Office Land Valuation <https://www.revenue.act.gov.au/rates/land-valuations>

Canberra Cemeteries' proposal states that it intends to provide interment services at its crematorium facility at prices that recover the associated perpetuity maintenance costs. It also plans to undertake regular reviews to ensure perpetuity maintenance costs will continue to be recovered into the future.

In developing its stage 1 advice, the Commission found that, under section 11 of the ACT's *Cemeteries and Crematoria Act (2003)*, the Minister determines (usually every five years) the percentage of revenue that interment providers must put aside in the perpetual care trust and perpetual care trust reserve. The Minister's determination applies equally to both public and private sector interment providers, which is consistent with competitive neutrality.

The Commission considers that this process results in Canberra Cemeteries' prices recovering the perpetuity maintenance costs associated with interring cremated remains. The Commission therefore considers that the proposed prices are compliant with this pricing principle.

5. Pricing principle 2: allocation of shared costs and overheads

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

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.

The Commission has found that Canberra Cemeteries' costing methodology and proposed prices are compliant with this pricing principle. Canberra Cemeteries has used an activity-based costing method to allocate shared costs and overheads. The Commission considers that the method has been implemented appropriately for two reasons.

First, the Commission considers that Canberra Cemeteries has identified all relevant shared capital costs, operating costs and corporate overheads. Table 5.1 lists the relevant shared costs.

Table 5.1 Cost items shared between cemetery and crematorium operations

Shared capital costs	Shared overheads
General office equipment	Executive mobile phone and its usage
Toilets and administration building	Software licenses
Carports	Reliability and maintainability services (e.g. fire protection and testing)
Solar panels	ACTGOV network charges
Existing fencing	Mail management
Existing roads	Accounting services
Existing landscaping	External audit fees
Shared operating costs	Internal audit fees
Water and sewerage	Workers compensation insurance
Cleaning	Other insurance
Security services	Remote access equipment and services
Waste services	
Bank fees	
Electricity	

Second, the Commission considers that Canberra Cemeteries has adopted cost drivers that are appropriate for estimating the relevant portion of shared costs attributable to the crematorium.

In its stage 1 advice, the Commission noted that there are several approaches that can be used to allocate shared costs and overheads. The Commission considered that the decision on the allocation methodology is a commercial matter for Canberra Cemeteries and suggested using a method that is practical and pragmatic, such as a measure of use.

Canberra Cemeteries has used activity-based cost drivers, with the specific measure used depending on the type of cost. Canberra Cemeteries has justified the selection of cost driver for each cost type by providing reasons why those cost drivers are more appropriate than other cost drivers. The cost drivers are:

- The cost driver for corporate overheads is the percentage of fulltime equivalent (FTE) staff involved in crematorium operations over the year compared to the total FTE staff number for the cemetery and crematorium. Canberra Cemeteries has estimated a total of FTE staff of 18, with the FTE staff for the crematorium calculated based on the activities required to deliver services related to the crematorium facility. This method resulted in 3.23 FTE staff being allocated to the crematorium facility. Canberra Cemeteries used FTE staff as the cost driver because corporate overhead costs primarily relate to supporting Canberra Cemeteries' operations and its service staff.
- The cost driver for allocating shared operating costs is the volume of cremations compared to the total volume of burials and cremations, calculated annually. Canberra Cemeteries considers operational costs are driven by volumes of services.
- The cost driver for capital costs is the square meter footprint of the crematorium facility relative to the total footprint of the cemetery and crematorium combined.

Canberra Cemeteries stated that the cost allocation based on these cost drivers would most likely capture the relevant portion of shared costs attributable to the crematorium. For example, Canberra Cemeteries noted that an allocation of shared capital costs between the cemetery and crematorium based on square meter footprint resulted in approximately 99 per cent of the costs being allocated to the cemetery. In Canberra Cemeteries opinion, the square meter footprint measure is the most appropriate method to allocate shared capital costs as the shared capital costs include existing roads, fencing and landscaping, which are primarily used for its cemetery operations.

Canberra Cemeteries has acknowledged that its proposed cost allocation method will not capture the precise or exact amount of shared costs attributable to the crematorium facility. Due to data limitations and the costs of trying to devise a more precise allocation method, the proposed method will approximate the costs attributable to the crematorium. This approach is consistent with the Commission's stage 1 advice that Canberra Cemeteries should consider adopting a pragmatic cost allocation method, such as an activity-based allocation method or method based on appropriate cost drivers. The Commission noted that a private business would also be likely to take a pragmatic approach to allocating shared costs.

In its stage 1 advice, the Commission stated 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). The Commission stated that any allocation methodology that results in prices that fall within this range will be economically efficient and will meet the competitive neutrality requirements. The Commission considers that the allocation methodology used by Canberra Cemeteries results in shared costs that are close to the marginal costs of providing crematorium services for some cost inputs. For example, Canberra Cemeteries has allocated 99 per cent of its shared capital costs to the cemetery. The Commission considers that this is consistent with competitive neutrality.

Canberra Cemeteries considered other drivers for shared capital costs but found them to be inappropriate. They included:

- Volumes of cremations and burials – Canberra Cemeteries noted that while volumes may be an appropriate method to allocate shared operation costs between the crematorium and viewing room, it was deemed inappropriate to use for shared capital assets. According to Canberra Cemeteries, using volume as a cost driver for capital costs would result in approximately 60 per cent of the costs being allocated to the crematorium, despite these costs being predominantly associated with the cemetery operations. For example, shared roads are mostly used to attend burials and visit graves.
- FTE staff numbers – Canberra Cemeteries noted that while FTE staff numbers may be an appropriate cost driver for allocating overhead and capital costs associated with the administration building, there is no strong relationship between FTE staff numbers and other shared capital assets.

Canberra Cemeteries intends to review the drivers of costs in its costing model after 12 months of operation. Canberra Cemeteries indicated that it may change cost drivers if more appropriate drivers are identified.

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

Ring fencing requires Canberra Cemeteries to maintain financial accounts for the crematorium facility and for its cemetery operations that are sufficiently separated to:

- allow for easy identification of costs relating to the crematorium operations
- give transparency about how costs are attributed between the crematorium facility and Canberra Cemeteries' other business activities
- allow for verification that the cost allocation method has been applied as described in Canberra Cemeteries' documentation of its costing methodology.

Canberra Cemeteries has proposed that the accounts of the crematorium and the cemetery will be 'ring-fenced' by using separate cost centres in its financial management system.

Canberra Cemeteries currently identifies six business units as separate cost centres (Woden, Gungahlin, Hall, Woden Mausoleum, Crematorium and Administration). Canberra Cemeteries' business manager ensures the cost codes are applied appropriately. Each cost centre has an assigned purchase order book and costs are allocated to the appropriate cost centre. This ensures that costs attributable to the crematorium operations and costs attributable to the Gungahlin cemetery operations are allocated different cost codes and are therefore separately accounted for.

The Commission analysed Canberra Cemeteries' costing model and found sufficient documentation in the model to separately identify costs related to cemetery and the crematorium.

The Commission has therefore found that the crematorium facility's accounts are ring fenced from the accounts of the cemetery operations and that Canberra Cemeteries' costing methodology and proposed prices are compliant with this pricing principle.

6. Pricing principle 3: financing costs

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.

In its stage 1 advice, the Commission recognised that there are several ways to determine an appropriate commercial rate of return. The Commission noted that it would assess whether Canberra Cemeteries' pricing proposal explained the method it had used for determining the rate of return, the reasons why its method is appropriate, and the evidence and reasons given for its choice of inputs used in estimating the rate of return.

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 used existing retained earnings to fund the construction of the crematorium. These earnings were accumulated from profits on its cemetery operations. For Canberra Cemeteries' crematorium facility not to have a competitive advantage from access to these retained earnings, it must pay an appropriate rate of return on these funds, equivalent to what it would pay on commercial borrowings or equity raised from shareholders (including an appropriate risk allowance).

Canberra Cemeteries has calculated a weighted average cost of capital (WACC) as a pragmatic approach to estimating an appropriate rate of return. It has applied the WACC to the total amount of retained earnings used to fund the construction of the crematorium and procurement of other capital assets.

Canberra Cemeteries has used long term-term parameter estimates to calculate the WACC. Canberra Cemeteries considered the variability in current economic conditions due to the effects of COVID-19 means that short term parameter estimates would potentially result in an inappropriate estimate of the commercial rate of return required to recover the financing costs of its long-term investments in the crematorium facility.

Canberra Cemeteries has used parameter estimates that reflect the specific operating environment and risks faced by cemetery and crematorium businesses, including private crematorium operators. These parameters were obtained from the IPART report on its Review of Costing and Pricing of Interment Services¹⁵ and are shown in table 6.1. The WACC used by Canberra Cemeteries is 4.2 per cent.

¹⁵ IPART 2019b

Table 6.1 Parameter values used by Canberra Cemeteries to calculate its proposed WACC

Nominal risk free rate	2.5%
Inflation	2.4%
Implied debt margin	2.2%
Market risk premium	8.8%
Gearing ratio	45
Tax rate	30.0%
Beta	0.45
Gamma	0.25

The above parameters were developed by IPART for cemetery businesses. 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 slowly over time, and a shift over time to a preference for cremation over burial. Therefore, the Commission considers that the above parameters are appropriate for calculating a WACC for a crematorium and the WACC of 4.2 per cent is therefore an appropriate rate of return on the retained earnings used to fund the construction of the crematorium.

The Commission has confirmed that Canberra Cemeteries has applied this rate of return to the retained earnings used to fund the construction of the crematorium in its costing model, which is used to estimate prices. The Commission has therefore found that the costing methodology complies with this pricing principle.

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 public ownership, prices must include an allowance to offset the financial savings from any such concessions.

Canberra Cemeteries' proposal stated that it has not borrowed money for the crematorium facility.

However, Canberra Cemeteries has received an interest free loan from the Environment, Planning and Sustainability Development Directorate (EPSDD) to finance the installation of solar panels. As private sector operators are not entitled to this interest rate concession, Canberra Cemeteries' prices include an adjustment to offset the financial savings from the concessional interest rate to ensure compliance with pricing principle 3.2. In making the adjustment, Canberra Cemeteries calculated the annual interest rate payments that would be paid by a comparable private business for an equivalent loan. Canberra Cemeteries used 4.82 per cent as the commercial interest rate, as it was the interest rate for small business loans in April 2020 according to the Reserve Bank of Australia. Canberra Cemeteries has assumed the loan will be repaid in 8 years. Confidential information on this adjustment is in appendix 2.

The Commission considers this adjustment is appropriate and has confirmed that it has been applied in Canberra Cemeteries' costing model. The Commission has therefore found that the costing methodology complies with this pricing principle.

Canberra Cemeteries stated that if it borrows money in future, the borrowings will be through the ACT Treasury. Canberra Cemeteries would recover a commercial rate of interest on the borrowings by including an adjustment to reflect market rates to offset any interest rate concession or debt guarantee received. Typically, this adjustment would be made through the debt guarantee fee which is calculated by the ACT Treasury to offset the interest rate discount received as a result of borrowing through whole-of-government arrangements and is designed to ensure that the borrowing satisfies the Government's Competitive Neutrality Policy. The Commission considers that such an approach would be compliant with the pricing principle 3.2.

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.

Canberra Cemeteries' proposal indicated that it has not received any equity from the ACT Government to develop the public crematorium. It does not expect to receive equity from the ACT Government in the future. The Commission's analysis of the costing model confirmed that no equity had been provided by the ACT Government to Canberra Cemeteries to establish the crematorium.

The Commission has therefore found that Canberra Cemeteries has complied with this pricing principle.

Canberra Cemeteries stated that, should it receive equity from the ACT Government, it will recover a commercial rate of return on any equity received.

Pricing principle 3.4: 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.

Canberra Cemeteries' costing methodology allows for depreciation of capital assets over time so that the cost of the investments is recovered over the lives of the assets.

It is important that appropriate asset lives are used to calculate the rate of depreciation. To identify appropriate asset lives, Canberra Cemeteries referred to the accounting standard AASB 116 Plant Property and Equipment, which applies equally to public sector and private sector businesses. This standard requires the useful life of an asset to be defined in terms of the asset's expected utility to the entity, that is, how long the asset is expected to be in productive use by the business to produce services and/or products. The standard recognises that estimating the useful life of an asset requires some judgement based on the business' experience with similar assets.

To assist it in identifying appropriate assets lives, Canberra Cemeteries has used the asset lives recommended by the Transport Canberra and City Services (TCCS). TCCS has determined recommended asset lives in accordance with accounting standard AASB 116. The asset lives used by Canberra Cemeteries are in Table 6.2.

Table 6.2 Useful lives of capital assets

Capital Item	Useful Life (Years)
Crematorium and viewing room building and associated works	40
Cremator and associated equipment	20
Additional Southern Civil works - roads and carparks	90
ICRC costs	20
Contractor costs	20
General office equipment	3
Office reception	23
Toilets and administration building	23
Carports	10
Gungahlin office	49
Solar panels	15
New roads total (sealed roads, drainage, kerb structures)	24
Existing fencing	16
Existing roads	24
Existing landscaping	64

Canberra Cemeteries' pricing model assumes that the costs and prices are in a 'steady state' where the crematorium has reached its target market share. That is, the costing model calculates the costs and prices for a 'standard' or 'expected' year once the target market share has been reached. There are two methods for calculating the capital financing cost in such a steady state and both have implications for how depreciation and the return on capital (discussed above) are treated.

The method adopted by Canberra Cemeteries is to calculate the return on capital in each year using the real (inflation adjusted) value of the initial asset base; that is, the return on capital is calculated assuming that the asset base that has not been depreciated (which is consistent with the 'steady state' assumption, where assets are effectively replaced as they depreciate). Depreciation is calculated using the straight-line method which means that depreciation costs are the same each year. Because the return on capital is calculated on the initial asset base rather than the depreciated asset base, the return on capital is overstated compared to what is required by investors and lenders. Therefore, under this method, an adjustment needs to be made to the return on capital. The adjustment is that depreciation is deducted from the return on capital to avoid double-counting of the depreciation allowance.

This approach differs from the method typically used in regulatory pricing, which involves calculating the return on capital using the real depreciated asset base in each year. Depreciation is calculated using the straight-line method as above. Under this method, the value of the asset base depreciates over time and there is new investment to replace assets at the end of their useful lives.

The Commission has confirmed that the two methods result in the same total capital financing cost over the lives of the assets but the timing of cash flows differs. The approach adopted by Canberra Cemeteries results in a profile of cash flows that is smoother compared to the alternative approach.

The straight-line depreciation method used by Canberra Cemeteries is one of the two methods allowed by the Australian Taxation Office for calculating depreciation for both public and private entities.

The Commission considers that Canberra Cemeteries' costing methodology appropriately accounts for depreciation costs because:

- it allows for the recovery in Canberra Cemeteries' prices of the full costs of depreciation of its capital assets
- depreciation allowances are consistent with generally accepted accounting principles and based on appropriate asset lives.

Therefore, the Commission has found that Canberra Cemeteries' approach is compliant with pricing principle 3.4.

7. Pricing principle 4: taxation

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.

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.

As explained in the Commission's stage 1 advice (and noted in chapter 3 of this report), an important element of competitive neutrality is that the public crematorium facility should face the same tax obligations as private crematorium operators. A public entity would obtain a competitive advantage if it was not subject to the same tax obligations as its private competitors.

In developing its stage 1 advice, the Commission 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.¹⁶

Canberra Cemeteries has included in its costing model an allowance for the company tax that would be paid by a private crematorium operator in the same position. In calculating the tax adjustment, Canberra Cemeteries assumed that the applicable company tax rate is 26 per cent for a 'base rate entity'. According to the Australian Taxation Office, the tax rate for base rate entities in 2020-21 is 26 per cent.¹⁷

Canberra Cemeteries advised that it meets the Australian Taxation Office definition of a base rate entity as a company that both:

- has an aggregated turnover less than the aggregated turnover threshold, which is \$25 million for the 2017-18 income year and \$50 million from the 2018-19 income year
- 80 per cent or less of its assessable income is base rate entity passive income, where base rate entity passive income is:
 - corporate distributions and franking credits on these distributions
 - royalties and rent
 - interest income (some exceptions apply)
 - gains on qualifying securities
 - a net capital gain
 - an amount included in the assessable income of a partner in a partnership or a beneficiary of a trust, to the extent it is traceable (either directly or indirectly) to an amount that is otherwise base rate entity passive income.

¹⁶ Under the NTER, the ACT Government agreed to establish a tax burden for its wholly owned businesses that would be equivalent to the tax regime imposed on 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.

¹⁷ https://www.ato.gov.au/Rates/Changes-to-company-tax-rates/?page=1#Base_rate_entity_company_tax_rate

Canberra Cemeteries' tax allowance uses a forecast of profit from the crematorium's operations. Table 4.2 in chapter 4 shows the assumptions and data sources used in Canberra Cemeteries' calculation of forecast profits. The Commission considers that the forecast is based on reasonable assumptions and reliable data sources. Confidential information related to the assumptions and data is in appendix 2.

Canberra Cemeteries will adjust its costing model for instances where its actual profits are different from forecast results. It intends to review the costing model in 12 months and revise the inputs to the model based on actual operating experience if necessary.

The Commission's analysis has confirmed that Canberra Cemeteries has included an appropriate tax allowance in the costing model and the tax is recovered from the prices charged. Therefore, the Commission has found that Canberra Cemeteries' costing methodology complies with pricing principle 4.1.

8. Pricing principle 5: regulations

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

In developing its stage 1 advice, the Commission found that many regulatory obligations apply equally to unlisted private crematorium operators, private crematorium operators listed on the stock exchange, and government-owned crematorium operators in the ACT. The Commission also found that some regulatory obligations apply differently or apply only to private businesses or only to government-owned businesses but in many instances the different regulations aim to achieve similar objectives.

Canberra Cemeteries' proposal stated that while there are regulatory obligations on the private sector that do not apply to it, there are other legislative and regulatory requirements placed on public sector entities like Canberra Cemeteries that do not apply to private sector counterparts. Canberra Cemeteries considered these public sector specific regulations may be more onerous and therefore costly to comply with than the private sector obligations. For example, Canberra Cemeteries cited rules around transparency in the use of public funds and requirements to meet government policies or obligations, where no equivalent regulatory burden is placed on private-sector operators. Canberra Cemeteries concluded that no adjustment to its costing model or prices was needed to comply with this pricing principle.

The Commission has considered Canberra Cemeteries' explanation and the available evidence on regulations applying to public and private crematorium operators. The Commission recognises the difficulties both in quantifying the cost impacts of complying with regulations with any degree of precision and in comparing the cost impacts of different regulations across private and public sector businesses. The Commission considers that Canberra Cemeteries is required to comply with the same or equivalent regulations as a private crematorium operator and would therefore be expected to incur similar compliance costs. For this reason, the Commission has concluded that Canberra Cemeteries' costing model and prices comply with this pricing principle.

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
Minister for Racing

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

Dear Mr Dimasi

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

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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.

Sch 2.2(a)(xi), Sch 2.2(a)(xiii)

Sch 2.2(a)(xi), Sch 2.2(a)(xiii)

Sch 2.2(a)(xi), Sch 2.2(a)(xiii)

Abbreviations and acronyms

ACT	Australian Capital Territory
COAG	Council of Australian Governments
Commission	Independent Competition and Regulatory Commission
ICRC	Independent Competition and Regulatory Commission
ICRC Act	Independent Competition and Regulatory Commission Act 1997
IPART	Independent Pricing and Regulatory Tribunal
TCCS	Transport Canberra and City Services Directorate
WACC	Weighted average cost of capital

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ICRC

independent competition and regulatory commission

www.icrc.act.gov.au