



The ACT Public Cemeteries Authority (Canberra Cemeteries)

**Submission to the Independent Competition and Regulatory
Commission's Public Crematorium Services: Competitive Neutrality
Report 3 - Draft Report, March 2020**

20 April 2020

The ACT Public Cemeteries Authority (Canberra Cemeteries) Submission to the Independent Competition and Regulatory Commission's: Public Crematorium Services: Competitive Neutrality Report 3 - Draft Report, March 2020

Summary

This submission outlines the Canberra Cemeteries' approach to addressing the proposed pricing principles, and addresses any specific areas raised by the Independent Competition and Regulatory Commission (the Commission) in its draft report.

Canberra Cemeteries is committed to meeting the draft pricing principles, supports competitive neutrality and welcomes the opportunity to provide this submission in response to the Commission's draft report.

Canberra Cemeteries notes that in developing its approach to addressing each draft pricing principle from a competitive neutrality perspective, it has also considered how its approach would align with the ACT government's Fees and Charges Policy and Guidelines in the setting of prices for crematorium goods and services.

Response to Draft Report

1. Current and planned approach to addressing pricing principles

Canberra Cemeteries notes that the public Crematorium was originally planned to be operational by December 2020. Due to the COVID-19 Public Health Emergency, the delivery of the project will now be in two stages, with the Crematorium anticipated to be operational in August 2020 ahead of the completion of the Commission's pricing process.

Following completion of the Commission's pricing process, Canberra Cemeteries will review its pricing structure to ensure continued alignment with the pricing principles and any additional outcomes of the Commission's competitive neutrality review.

A pricing structure would be implemented from the commencement of the Crematorium's operation that sets prices based on a comparative analysis of crematorium goods and services provided by certain comparable crematorium providers in the ACT and surrounding regions. This proposed approach would price Canberra Cemeteries' crematorium goods and services in line with market rates and thus promote the principles of competitive neutrality. This approach

was designed with the intention that the pricing structure set on commencement will be as consistent with the pricing principles as possible and is therefore likely to also be consistent with any future pricing structure. This is referred to as the 'interim pricing structure' for ease of reference.

Canberra Cemeteries intends to undertake further analysis and benchmarking of cost inputs to confirm its interim pricing structure while continuing to ensure that prices are compliant with the pricing principles and competitive neutrality requirements. Any revised pricing structure as a result of further work would be implemented following completion of the Commission's competitive neutrality process, stage two. Canberra Cemeteries will work collaboratively with the Commission to ensure a fit-for-purpose pricing structure that adequately demonstrates all relevant pricing principles in a way that is commensurate with the operations of the Crematorium. It is noted that the Commission will provide their Stage One Final Report in May 2020. The proposed future pricing is anticipated to be provided to the Commission in July 2020 for their review during Stage Two of the Competitive Neutrality Analysis. This is referred to as the 'future pricing structure' for ease of reference.

2. Specific areas raised by the Commission in its draft report

Draft pricing principles

Canberra Cemeteries is broadly supportive of the draft pricing principles, and the requirement to maintain competitive neutrality in the provision of public crematorium services in the Australian Capital Territory (ACT). Canberra Cemeteries' responses to each of draft pricing principles are set out below.

Draft 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.

Draft 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.

Canberra Cemeteries' proposes adopting an activity-based costing methodology that is designed to capture both the full direct costs, and the relevant portion of shared costs attributable to the Crematorium. These include operating and capital costs covering the following areas as outlined by the Commission in its draft report:

- Activities and resources required to deliver crematorium services

- Any goods or services provided by the ACT Government to Canberra Cemeteries
- Activities undertaken by Canberra Cemeteries in relation to its provision of cemetery and ashes interment services
- Any differences in regulatory obligations resulting from the facility being publicly owned and operated.

Canberra Cemeteries has identified relevant costs and quantified these based on historical costs (where the same or similar costs are currently incurred) and has identified costs unique to the Crematorium through financial forecasting and modelling. The setting of its interim pricing structure is based on an initial comparative analysis of comparable crematorium providers as mentioned above.

Canberra Cemeteries also intends 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. Canberra Cemeteries intends to review its pricing structure and cost base on a regular basis (annually) to ensure alignment to the pricing principles, in line with its existing fee review processes.

Draft 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.

Canberra Cemeteries intends to source inputs for crematorium goods and services at a price comparable to market rates in accordance with the ACT Government's procurement policies and procedures.

Canberra Cemeteries also notes that it intends to procure any additional inputs and services in relation to the Crematorium facility including equipment and materials in accordance with the ACT Government's procurement policy.

Canberra Cemeteries accesses some services via Shared Services Agreements, provided by the ACT Government. Canberra Cemeteries pays a rate determined by Transport Canberra and City Services Directorate (TCCS) and The Chief Minister, Treasury and Economic Development Directorate (CMTED), as the providers of Shared Services. Canberra Cemeteries understands that these rates are benchmarked periodically.

Canberra Cemeteries notes that there are a number of challenges in determining an appropriate rate to adjust for Shared Service costs, if any. 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.

Canberra Cemeteries intends to undertake additional analysis to confirm the market rate for Shared Services. Should there be evidence to suggest that Canberra Cemeteries accesses shared service arrangements provided by the ACT Government at a rate that is not aligned with market rates, Canberra Cemeteries will factor in an appropriate adjustment to align the cost of shared services to reflect commercial rates.

Major Projects Canberra (MPC) is an ACT Government entity which is engaged for the purposes of the Crematorium Project, to perform certain project administration functions such as oversight, procurement and such. MPC charge a levy of 4% of the project's capital cost. Canberra Cemeteries notes that it has also procured the services of a project management firm at market rates for the Crematorium Project.

A majority of the services provided by MPC are focused around ensuring a transparent and sustainable process that is aligned to government policies and processes, these include:

- Assisting the business case development and government decision-making process.
- Preparing project delivery plans and establishing project governance.
- Leading all stages of the procurement process.
- Undertaking contract administration and management.

Canberra Cemeteries suggests that a majority of the services provided by MPC have additional components or requirements that are public-sector centric and are often more onerous than any similar processes undertaken by its private sector counterparts. For example, activities to support the undertaking of a transparent procurement process; and preparation of briefing, submissions and reporting to support government decision-making and processes.

Canberra Cemeteries notes 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. 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.

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

Canberra Cemeteries intends to recover the cost of land, including land holding costs occupied by the Crematorium facility at an equivalent market rate. Canberra Cemeteries intends to undertake additional research to identify and benchmark these equivalent costs and will provide further detailed evidence through its future pricing structure as outlined above.

In addition to the cost of land and any land holding costs, there is the further consideration of the opportunity cost of utilising the crematorium land for gravestock. Canberra Cemeteries acknowledges that although over the longer term there is a net gain from establishing the crematorium facility, the revenue foregone from utilising that same land for gravestock is not insignificant.

Canberra Cemeteries also highlights that not acknowledging this opportunity cost could place it at a competitive disadvantage compared to its competitors that operate crematorium only facilities under arrangements that would not incur the same opportunity cost.

Further, Canberra Cemeteries acknowledges that reflecting this opportunity cost through its crematorium pricing structure could create inequity across user groups.

Canberra Cemeteries intends to undertake further analysis of the potential impacts of including or excluding this opportunity cost in its cost base and will work closely with the Commission and ACT Treasury on its treatment in the final pricing structure.

Draft 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.

Canberra Cemeteries notes that it currently provides memorialisation goods and services which are priced to recover the costs of supply and other directly attributable costs (including shared costs) such as the cost of relevant staff and associated overheads. These are adjusted to include a commercial profit margin.

Canberra Cemeteries intends to continue to recover the cost of memorialisation goods and services associated with direct referrals from its new Crematorium facility in line with its current memorialisation business whilst ensuring that it continues to adhere to the pricing principles.

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

Canberra Cemeteries notes that it currently provides interment services and that these are currently priced to recover the associated perpetuity maintenance costs.

Canberra Cemeteries intends to continue to recover the perpetuity maintenance costs for interred cremated remains generated from its Crematorium facility.

Consideration will be given to the perpetual care obligations under the new legislation (Cemeteries and Crematoria Bill 2019) going forward.

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

Draft 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.

Canberra Cemeteries intends to adopt an activity-based cost methodology that identifies and applies appropriate cost drivers to drive direct and shared costs to appropriate cost pools. Cost pools would be driven to each price point based on relevant cost drivers. The most appropriate driver will be determined based on each shared cost. For example, corporate overheads are likely to be driven by the number of Full Time Equivalent staff identified as a relevant cost to

the Crematorium facility; while maintenance and garden costs are more likely to be driven by the size of the area occupied by the Crematorium facility.

It is Canberra Cemeteries' view that the cost allocation methodology adopted should be proportionate to the potential revenue from each price point. That is, balancing 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.

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

The Financial Governance Model under development will outline Canberra Cemeteries' proposed approach to meeting competitive neutrality requirements through a Hybrid Model. Such a model would see the Crematorium established as a separate business unit and managed accordingly within the financial management information system, without the need for separate accounts or financial reporting.

Draft 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.

Draft 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 intends to apply an appropriate risk-adjusted commercial rate of return on its retained earnings used to finance Crematorium facility investments and notes the detailed discussion in the Commission's draft report on the issue of the appropriate risk-adjusted commercial rate of return, including reference to the Weighted Average Cost of Capital (WACC) estimated by the Independent Pricing and Regulatory Tribunal New South Wales (IPART) for cemetery businesses.

Canberra Cemeteries intends to finalise its methodology in line with its future pricing structure as outlined above.

Draft 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 notes that it does not intend to borrow to finance the development of the Crematorium facility. Should Canberra Cemeteries borrow in the future, it will borrow through the ACT Treasury and recover a commercial rate of interest on these borrowings by including an adjustment to offset any interest rate concession or debt guarantee received to adjust for market rates and therefore price in line with pricing principle 3.2.

Draft 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 notes that it does not intend to receive equity from the ACT Government for the development of its Crematorium facility and is unlikely to receive equity from the ACT Government in the future. Should Canberra Cemeteries receive equity from the ACT Government in the future, it will recover a commercial rate of return on any equity invested by the ACT Government and reflect this in relevant prices accordingly.

Draft 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.

Canberra Cemeteries intends to recover the depreciation of capital assets over time. The application of depreciation allowances will be consistent with relevant accounting principles and based on appropriate asset lives.

Draft 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.

Draft 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.

Canberra Cemeteries intends to include an allowance that is equivalent to the company tax and associated costs that would be paid by a private operator in the same position.

Canberra Cemeteries intends to seek further advice from the ACT Treasury with regards to any actual application of company tax, and/or tax related matters, for the Crematorium.

Draft pricing principle 5: The public crematorium operator must comply with the same regulations that apply to its private sector counterparts.

Canberra Cemeteries notes that for competitive neutrality purposes, it must consider regulatory compliance and determine the same or equivalent regulations that apply to its private sector counterparts. There are a number of regulations that apply to both Canberra Cemeteries as a public-sector operator and its private sector counterparts as noted in the Commission's draft report. There are also a number of regulatory requirements that apply differently, but aim to achieve a similar objective, such as financial reporting and annual reporting requirements also noted in the Commission's draft report. Given these categories of regulations are either the same, or equivalent, Canberra Cemeteries suggests that no competitive neutrality adjustment is required for these regulations.

There are also a number of regulatory obligations that apply to the private sector only, or to the public sector only. These are listed in the Commission's draft report (page 61). There are a number of additional legislative and regulatory requirements placed on public-sector operators, such as those for transparency in the use of public funds and to meet government policies or obligations, where no equivalent regulatory burden is placed on private sector operators. Canberra Cemeteries acknowledges that there are also additional regulatory obligations placed on its private sector counterparts (particularly those that are listed entities) that are not also placed on public-sector operators.

Canberra Cemeteries is 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.