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Governance framework - cemeteries

Independent Pricing and Regulatory Tribunal (IPART)

July 2020

Deloitte Access Economics

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Glossary

Acronym	**Full name**
AASB	Australian Accounting Standards Board
AFFA	Amended Final Funding Agreement
AICF	Asbestos Injuries Compensation Fund
APRA	Australian Prudential Regulation Authority
CCNSW	Cemeteries & Crematoria NSW
DPIE	NSW Department of Planning, Industry and Environment
etc	Etcetera
GPS	General insurance Prudential Standards
ICAAP	Internal Capital Adequacy Assessment Process
IPART	Independent Pricing and Regulatory Tribunal
LPS	Life insurance Prudential Standards
NSW	New South Wales
PDS	Product Disclosure Statement
PG	Professional Guidance issued by Actuaries Institute in Australia
PS	Professional Standard issued by Actuaries Institute in Australia
RSE	Registrable Superannuation Entity (i.e. a superannuation fund)
SA NSW	Subsidence Advisory NSW
SPS	Superannuation Prudential Standard
VIC	Victoria

Executive summary

Introduction

IPART engaged Deloitte Access Economics to comment on options for IPART to consider in relation to an appropriate governance and prudential framework for ensuring cemeteries' perpetual maintenance responsibilities for interment plots are adequately and equitably funded in future.

In making the observations in this report Deloitte Access Economics has considered:

- **current existing framework and observed practices** – there is an existing legislative act in NSW which governs the operations of cemeteries and crematoria, with allowance for regulations to be created relating to perpetual care (although no such regulations are currently in place). Industry practice varies, therefore, especially between different type of operators (Crown, council and private)
- **comparable frameworks** applying to defined benefit superannuation funds and long tailed insurance liabilities, as well as selected case studies of frameworks applying to cemetery operators in Victoria and overseas (Ontario, Canada, and Illinois, USA) and for funding other long-tailed liabilities such as mine subsidence and asbestos provisions
- **relevant differences applicable to cemeteries** that may be required depending on type of cemetery operator, cemetery size or structure

Deloitte Access Economics has identified options for an appropriate governance and prudential framework for ensuring cemeteries' perpetual maintenance responsibilities are adequately and equitably funded in future. Section 6 of this report provides suggested options that we believe will most readily meet your stated objectives and how this could operate. However, any decision and recommended framework will be up to IPART based on its overarching criteria.

In addition, Deloitte Access Economics considered the potential issues associated with transition to an enhanced governance framework where cemetery operators may not hold (and possibly cannot fully finance) sufficient reserves to cover perpetual maintenance costs in respect of previously sold interments (legacy obligations), and as a result a deficiency may persist into the foreseeable future. Accordingly, for the purposes of developing options for an appropriate governance framework, we have focused on the establishment of a robust framework in respect of future sales, which will therefore limit the compounding of existing issues, and separately commented on transition issues for legacy obligations.

Cemetery operators can be considered to have an obligation to provide maintenance to sold interment plots in perpetuity (or for the renewable term if such recently introduced rights are sold). Although the standard of such perpetual maintenance is not commonly specified in interment right contracts, customers and communities may have implicit expectations on the level of care cemetery operators will provide. Delivering a standard of maintenance that meets these customer expectations affects the maintenance cost of cemetery operators, which can be influenced by a number of factors, such as the level of maintenance standard, difficulty of maintenance, business mix, outsourcing arrangements, age of cemetery, and number of visitations.

Current structure in NSW

Cemeteries in NSW are currently governed by the Cemeteries and Crematoria Act 2013, and Cemeteries and Crematoria Regulation 2014. These contain existing requirements for cemetery pricing, provisioning and disclosure, but currently there are not any specific, enforceable requirements addressing the estimation or funding of long-term perpetual care obligation.

Current practice, particularly regarding the level to which perpetual maintenance costs have been estimated and are reflected either in the pricing of interments or through the establishment of a perpetual maintenance fund, differs from operator to operator and particularly between the different types of operators:

- Crown operators - We understand from discussions with the Department of Planning, Environment, and Infrastructure that all of the Crown operators have produced estimates of their perpetual maintenance liabilities. In some cases, these estimates have been produced internally, while in other cases external actuarial analysis has been obtained in this regard. There are also different approaches to the ongoing governance of these liabilities, such as ongoing monitoring and plans to meet any existing funding shortfall.
- Council operators - A select number of councils have established a perpetual maintenance fund or trust so that a portion of revenue is set aside to meet future maintenance requirements. However, the rules established for these funds are not consistent between these councils, with different rules and restrictions around how assets are invested, and how the funds can be used.
- Private operators – Our analysis of publicly available information for a number of private operators has not identified any explicit liabilities or funds to recognise perpetual maintenance costs. Unlike the council and Crown operators where the government is the ultimate sponsor of the cemeteries, private operators may have fewer options for recourse if perpetual maintenance liabilities are unable to be met.

From a financial statements and public reporting perspective, based on our review of operators in NSW, they do not appear to report any liability in relation to perpetual maintenance obligations on their balance sheets. We understand this is for one or both of the following reasons:

- they consider that no liability has crystallised for future maintenance at the reporting date, as such obligation is considered by them as a future event; and/or
- they consider there to be considerable uncertainty as to the reliability of any estimation of costs given the time frame involved

Comparable governance frameworks

To inform thinking around options for an appropriate governance and prudential framework for ensuring cemeteries' perpetual maintenance responsibilities are adequately and equitably funded in future, the report considers comparable governance frameworks for management of similar patterns of obligations (i.e. long-tailed liabilities into the future) and the applicability of similar requirements for perpetual maintenance obligations of cemeteries.

The report explores governance frameworks in relation to the following:

- defined benefit superannuation, where employers need to make contributions over the service period of employees in order to fund a defined final benefit ultimately payable on ceasing service and where for some funds the final benefit is payable as a lifetime income stream
- long-tailed insurance liabilities, where upfront premiums are received by an insurer but claims are paid as a stream of payments over many years (in some cases for the remaining lifetime of individuals)
- cemeteries in other regions, specifically in Victoria, Ontario (Canada) and Illinois (United States)
- other provision schemes (such as mine subsidence in NSW and asbestos-related liabilities)

To the extent possible, the report then considers each of the following key areas of governance across each comparable framework, which then ultimately inform our suggestion of a potential recommended framework for cemetery perpetual care governance:

(a) Liability measurement and reporting
(b) Board (or trustee or elected Council, as applicable) obligations
(c) Independent advice
(d) Asset restrictions, such as limitations in relation to use of assets or the investment strategy
(e) Transition aspects upon introduction of new requirements
(f) Funding of future new business (i.e. liabilities or claims arising in relation to future events, dependent on future activity)
(g) Prudential proportionality

Options for perpetual maintenance governance for cemeteries

The report sets out options for a future governance framework that IPART may consider in relation to management of perpetual maintenance obligations.

The following aspects of a governance framework have been explored in the report:

- the different **measurement of perpetual maintenance obligations** as being either "hard" (i.e. in balance sheet liabilities) or "soft" (i.e. not on balance sheet)
- a **recommendation that Boards (or equivalents)** of cemetery operators **obtain external independent advice** on their potential perpetual maintenance obligations on a regular basis including advice on how to manage/contribute to a fund to provide for these future costs, and a potential requirement to make copies of these reports available to the regulator
- the various items which should be included at a minimum in independent advice on perpetual maintenance obligations to Boards (or equivalents)
- the considerations for **"ring fencing" assets** set aside for meeting perpetual maintenance costs in future so that they are used solely for that purpose
- consideration of **prudential proportionality** such that the enhanced governance requirements only be enforced for operators of a minimum size
- **possible transition arrangements** to deal with the management of "legacy" perpetual maintenance obligations owed at the time a new governance framework is implemented
- consideration of an **alternative option where a centralised perpetual maintenance fund** is established which applies across multiple cemetery operators

The "regulator" referenced in recommendations may be Cemeteries & Crematoria NSW ("CCNSW") or may be a new regulator set up specifically for this purpose.

Section 31 of the Cemeteries and Crematoria Act 2013 allows regulations to establish an interment industry scheme which may require a cemetery operator to ensure adequate provision is made for perpetual care of interment sites and the cemetery, but there are no such requirements in the current regulations. Also, there is no requirement to consider future maintenance in setting fees and charges, except in respect of Crown cemeteries[1].

It is the Board's (or equivalent's) responsibility to determine what maintenance care should be provided for its operations, both while new interments are being performed and after burial land is exhausted. The Board (or equivalent) needs to form its own view as to what is its obligation in respect of the provision of perpetual maintenance for interment rights, both in relation to past sales as well as for future sales. This requires the Board (or equivalent) to determine its methodology for designating the maintenance levels to be provided, with input from external advisers as appropriate. It is expected that Boards (or equivalents) would consider what are the expectations of interment rights holders in this regard, whether that be contractual or based on reasonable expectations of rightsholders.

Ground maintenance is an essential part of cemetery operators' activities after selling an interment right to clients, and cemetery operators can be considered to have an obligation to provide maintenance to sold plots in perpetuity. That is, the obligation to provide ongoing maintenance can be viewed as being incurred when the interment right is sold, not when the cemetery is fully utilised. When a cemetery approaches the point of its burial land being exhausted in terms of sales of new plots, the potential revenue sources available to fund ongoing maintenance dry up, and accordingly the most preferable position is that the cemetery operator has set aside sufficient assets to support its perpetual maintenance commitment into the future. Ideally, a provision would be brought into the balance sheet to recognise that obligation to be offset against the assets of the cemetery operator, so that the net assets reported by the operator are not inadvertently inflated. We recommend that the NSW regulator (and potentially in conjunction with other state and territory counterparts) should engage with the Australian Accounting Standards Board to consider whether perpetual maintenance care obligations presently required in connection with past sold

[1] Cemeteries & Crematoria Act 2013, Section 107 (3)

interments can be reliably estimated such that they can be treated as a provision under AASB 137, rather than as a contingent liability which is unquantifiable.

An interim methodology for transition to an enhanced governance framework would be to require that, in lieu of estimating the value of perpetual maintenance care obligations themselves, cemetery operators be required to disclose what proportion of their retained earnings relates to supporting the maintenance obligations, and/or the amount physically set aside in a dedicated perpetual maintenance care fund.

Areas to be covered as part of regular independent advice to Boards (or equivalents) would be expected to cover topics such as:

- best estimate of existing perpetual maintenance cost obligations
- prudent margin on obligations
- advice on the investment strategy and asset allocation of assets held to support the perpetual maintenance obligations
- adequacy of pricing of interments and interment rights, and the factors that the independent adviser may take into account in determining recommended contribution levels
- short-term lending
- restrictions and permitted uses of assets supporting perpetual maintenance obligations

One approach to ensuring that future perpetual maintenance costs are adequately provided for would be to set aside assets which are designated for that purpose only. In a complicated business like cemeteries, with long term maintenance obligations, cemeteries could divert fees from perpetual maintenance funds towards covering day-to-day operating activities if the assets are not "ring fenced". The report describes various advantages and disadvantages to requiring the establishment and maintenance of an explicit perpetual maintenance care fund, with ring-fenced assets. It is more likely that larger operators would be expected to hold discrete perpetual maintenance care funds than smaller operators which may only have small burial areas.

Proportionality is a key obligation for all regulators across different industries. An objective is to ensure that prudential supervision is proportionate to the expected outcomes of that supervision. However, proportionality is an inherently subjective concept. Proportionality means adapting the nature and intensity of supervision to the specifics of the entity – its risk profile, its business model and its size. To achieve proportionality, the regulatory model should be balanced so that the governance is enhanced at an industry level, but at the same time the model does not impose excessive burdens on particular operators or classes of cemetery operators.

It is prudent to consider transition to a new governance framework in the context of two parts:

(i) Past sold interments ("legacy" obligations) when new requirements are introduced
(ii) Interments sold on or after the date of introduction

It may be unreasonable to apply the burden of imposing the more stringent governance requirements in relation to past sold interments (also called "legacy" maintenance cost obligations) with immediate effect. One approach to managing this would be to consider splitting obligations in respect of existing (legacy) sold interments and any existing supporting assets into a separate "fund", ring fenced as above. As part of this approach, the Board (or equivalent) would be required to specifically develop a "medium term" transition plan of how any legacy shortfall positions will be managed (e.g. some cross-subsidy from future sales, additional contributions from other operations like cremations, capital injections from owners etc). We do not specifically define what "medium term" may represent as it should vary based on the position of each operator, however we suggest it should not be longer than 7 years.

In relation to new interment rights sales, it is feasible to require that the funding be at least 100% of perpetual maintenance cost obligations plus any prudency buffer set by the Board (or equivalent). These should be ring-fenced separate to the legacy obligations (i.e. related to pre-implementation obligations).

An alternative governance approach to that described above would be to establish a centralised perpetual maintenance fund which applies across multiple cemetery operators. The funding of this

centralised fund could be financed by imposing a proportional levy on all cemetery operators to be contributed towards the central fund. It is expected that the regulator could be given the legislative power to set (and revise) the required rate of contributions (or levy) across operators in the sector which must be contributed to the fund in respect of new sales of interment rights. The levy rate and how this should be fairly and equitably applied across operators would need careful consideration. It could be appropriate for the regulator to periodically seek independent professional advice to support it in assessing the recommended levy rates to ensure that they remain adequate for the purpose. The report also discusses some potential difficulties which would need to be resolved in order to implement a centralised perpetual maintenance fund approach.

Summary of Key Recommendations

In summary, from our analysis, this report recommends the following as a potential framework for IPART to consider in respect to a perpetual maintenance governance framework:

- Introduce a regulatory requirement to have cemetery operators which are **over a certain size** (e.g. 50 bodily remains interments per annum or total sold bodily interment plots of greater than 10,000 across the operator) to **prepare an estimate of the perpetual care maintenance liability** and to **establish/build a dedicated perpetual maintenance fund** for this purpose. This is across Crown, council and private operators.
- That in doing so, the Board (or equivalent) of the operator is to **engage an independent external adviser** to either perform such calculation or review the operator's own calculation. Such advice should also cover the required level of contribution to be made from interment right sales and/or operating surplus to be allocated to a perpetual maintenance fund on an annual basis. This should be done at least every three to five years, or more frequently if material changes are proposed to the pricing or contribution rates. A copy of the independent report is to be provided to the regulator.
- That the Board (or equivalent) **articulate a risk appetite statement** in regard to the perpetual maintenance fund and its tolerance for funding levels and appropriate investment strategy. This should take into account the operator's available sources of capital for future support.
- The perpetual maintenance fund so established should be "ring fenced" such that the **assets can only be used for the purpose of providing for perpetual maintenance obligations** (with explicit definition of what activities these comprise), and that no other use of the funds is permitted. However, should such funds grow to be more than sufficient given the Board's (or equivalent's) risk appetite, then distributions may be made to general retained earnings.

While the above recommendations introduce a regulatory requirement for operators of a certain size to comply with an enhanced governance framework, smaller operators could still be encouraged to opt-in to the enhanced governance framework to the extent that is reasonably achievable in the context of their business overall.

This report also suggests that the regulator (CCNSW) engage with the accounting body (AASB) to seek guidance on whether or when such perpetual maintenance obligations would be triggered as a quantifiable liability on the balance sheet of operators. In the meantime, the report recommends that operators disclose in their notes to the accounts, or by separate split of the retained earnings, what component of the net assets relates to the perpetual maintenance fund.

In respect to past sales, or legacy obligations, the report suggests that the above framework could equally apply but recognise that a **transition plan will need to be developed by each operator** and approved by the regulator. This transition plan for legacy obligations should consider what the current available assets are based on historical retained surpluses and what the potential future perpetual maintenance costs may be for such past sales, and should this result in an existing funding shortfall position, determine what options are available to improve this situation over a period of time. This would need to be done on an operator by operator basis, in conjunction with the regulator, and consider what is an acceptable ultimate funding position that may be possible (or alternatively what level of maintenance care can be supported), and over what time period would this position be targeted.

1. Introduction

1.1. Background

The Independent Pricing and Regulatory Tribunal (IPART) has a responsibility to investigate and report on the costs and pricing of interment rights in NSW under section 145 of the *Cemeteries and Crematoria Act 2013 (NSW)* (the Act). As part of this review, IPART is to consider:

- the relativity of costs and pricing factors for perpetual and renewable interment rights
- full-cost pricing of perpetual interment rights, including provision for the perpetual care of interment sites and cemeteries.[2]

In undertaking this review, IPART has identified a specific issue with respect to full cost pricing for perpetual interment being the operational life cycle of a cemetery: while interments are taking place, a cemetery has income from which to pay its costs, including costs of maintenance; but once burial land is exhausted for the sale of new plots, it has ongoing costs of maintenance into perpetuity, but no revenue from interments.

Ground maintenance is an essential part of cemetery operators' activity after selling an interment right to clients. The Cemeteries and Crematoria Code of Practice 2018[3] states that the operator of a cemetery or crematorium must maintain the grounds of the cemetery or crematorium in a safe, clean and orderly condition. However, we note that this Code of Practice is not mandatory.

IPART released an Interim Report[4] in December 2019. The IPART interim report recommended that, for future interment right sales, cemeteries charge a price that includes a component to recover costs of maintenance attributable to that right into perpetuity, and that cemeteries be required to reserve funds from current sales to fund future maintenance of the sold sites.

However, there remains the issue of "legacy costs". Most cemeteries commenced operations many years ago. While perpetual maintenance considerations for cemeteries have been known for a long time, historic interment right prices charged by cemetery operators may not have fully included future maintenance costs, and even if they did, such loadings may have been used for other purposes over time. In addition, many current cemetery operators are not the historic operators of their cemeteries and may have been handed control of cemeteries containing many existing interments but with no accumulated funding to cover their maintenance. For example, The Local Government (Control of Cemeteries) Amendment Act 1966 resulted in the control of many cemeteries previously operated by religious and other trusts passing over to the local council. As such, operators may not have made adequate provision for the funding of perpetual maintenance of their cemeteries and there may be "legacy costs" from past interments.

As per its Interim Report, IPART is considering making recommendations in the following areas:

- Introducing a legal obligation on all cemetery operators to make adequate financial provision for perpetual maintenance of interment sites and cemeteries
- Implementing an independently managed perpetual maintenance reserve fund to provide for long-term cemetery maintenance, to be managed by Treasury Corporation or an independent body approved by CCNSW, for cemetery operators that conduct more than 50 bodily interments in new perpetual interment sites per year
- CCNSW to develop guidelines on when and how a cemetery operator can use perpetual maintenance funds
- Clear disclosures of terms and conditions for interment rights at a cemetery, including the obligations of each of the interment right holder and the cemetery operator for the nature and level of maintenance of the interment site and the cemetery.

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[2] IPART, *Review of the costs and pricing of interment in NSW: Interim Report* (December 2019).
[3] CCNSW, *Cemeteries and Crematoria Code of Practice* (November 2018)
[4] IPART, *Review of the costs and pricing of interment in NSW: Interim Report* (December 2019).

IPART has outlined four main steps that it will undertake in its review – namely:

1. establishing pricing principles.
2. assessing the structure of the interment services market and decide on the form of recommendations.
3. assessing efficient costs of delivering interment services and recommending measures where necessary to encourage more efficient costs in the future.
4. recommending measures to ensure prices meet the pricing principles.[5]

In this context, IPART engaged Deloitte Access Economics to assess and report on options for the implementation of a governance framework applying to cemetery operators in the provision for perpetual maintenance care obligations. This will contribute to step 4 in IPART's review.

1.2. Scope of this report

Deloitte Access Economics has been engaged to comment on options for IPART to consider in relation to an **appropriate governance and prudential framework for ensuring cemeteries' perpetual maintenance responsibilities for future interments are adequately and equitably funded in future**.

Our observations in this report have considered:

- current existing framework and observed practices – there is an existing legislative act in NSW which governs the operations of cemeteries and crematoria, with allowance for regulations to be created relating to perpetual care (although no such regulations are currently in place). Industry practice varies, therefore, especially between different type of operators (Crown, council and private)
- comparable frameworks applying to defined benefit superannuation funds and long tailed insurance liabilities, as well as selected case studies of frameworks applying to cemetery operators in Victoria and overseas (Ontario, Canada, and Illinois, USA) and for funding other long-tailed liabilities such as mine subsidence and asbestos provisions
- relevant differences that may be required depending on type of cemetery operator, cemetery size or structure

We have identified options for an appropriate governance and prudential framework for ensuring cemeteries' perpetual maintenance responsibilities are adequately and equitably funded in future. Section 6 of this report provides suggested options that we believe will most readily meet your stated objectives and how this could operate. However, any decision and recommended framework will be up to IPART based on its overarching criteria.

In addition, we have considered potential issues associated with transition to an enhanced governance framework where cemetery operators may not hold (or cannot finance) sufficient funds to cover perpetual maintenance costs in respect of previously sold interments (legacy obligations), and as a result a deficiency may persist into the foreseeable future. Accordingly, for the purposes of developing options for an appropriate governance framework, we have focused on the establishment of a robust framework for future sales, which will limit the compounding of existing issues, and separately comment on transition issues for legacy obligations.

1.3. The concept of perpetual maintenance costs

Cemetery operators can be considered to have an obligation to provide a level of ongoing maintenance to sold plots in perpetuity (or for the term of the renewable right). This ongoing maintenance can include a range of activities[6] including but not limited to:

- mowing, weeding, edging, and irrigation of the grass areas
- maintenance and irrigation of plants and garden
- litter control
- cleaning and maintenance of roadways, walks and buildings

[5] IPART, *Review of the costs and pricing of interment in NSW: Interim Report* (December 2019).
[6] The activities listed here are examples only and are not intended to be a comprehensive list. Depending on the specific characteristics of the cemetery, these activities may be different.

- repairs
- ad-hoc maintenance work to prepare for visits / events
- associated administration and management, including finance, IT and corporate aspects

Ground maintenance costs generally decline when an open cemetery becomes fully utilised, i.e. most interment rights are sold and enters the perpetual care state for all its burial sites. This reduction is mainly driven by two factors:

- Increased adoption of outsourcing arrangements for ground maintenance when cemetery is fully utilised allowing the operator to focus on providing remaining services (e.g. cremation, chapel).
- The number of visitations decreases over time reducing the level of required maintenance.[7]

Although the standard of such perpetual maintenance is not commonly specified in interment right contracts, customers and communities may have implicit expectations on the level of care cemetery operators will provide. Delivering a standard of maintenance that meets these customer expectations affects the maintenance cost of cemetery operators, which can be influenced by a number of factors, such as:

- The level of maintenance standard: clearly the higher the standard required (e.g. more frequent, higher quality, more thorough), the more the cost.
- Faith and community standards: certain religious groups may have particular expectations in relation to perpetual maintenance which can affect costs. The greater use of memorials by certain cultures can also affect maintenance costs.
- Difficulty of maintenance: some cemeteries have large areas of manicured turf and gardens, which requires more time, resources and skills to maintain. Some cemeteries’ land is hilly, which makes it difficult to move equipment / machineries. Generally, the harder it is to maintain, the higher the maintenance cost.
- Business mix: different burial types involve different maintenance costs. Burial plots with monuments and headstones are more expensive to maintain compared to basic lawn graves. A cemetery with a large number of monumental burial plots would generally incur higher maintenance costs compared to those that mainly have basic lawn burials.
- Outsourcing arrangements: operators may choose to outsource the ground maintenance work for a significant proportion of or the entire cemeteries to external contractors which can impact maintenance costs.
- Age of cemetery: older cemeteries (and older sections of a cemetery) may require more significant maintenance and repairs, leading to higher cost.
- Number of visitations: Within one cemetery, areas / sections that receive more visitations would generally require a higher standard of maintenance and more maintenance for adjacent roads/pathways/infrastructures.

1.4. Structure of this report

The remainder of this report is structured as follows:

- **Chapter 2** summarises the current governance requirements applying to cemeteries in NSW.
- **Chapters 3 to 5** discuss comparable governance frameworks covering:
  - **Chapter 3:** defined benefit superannuation
  - **Chapter 4:** insurance long-tailed liabilities
  - **Chapter 5:** cemetery requirements in other jurisdictions (Victoria, Ontario and Illinois), plus selected other long tail provisions for risks such as mine subsidence and asbestos liabilities
- **Chapter 6** sets out our recommendations for a future governance framework that IPART may consider in relation to management of perpetual maintenance obligations.

[7] It is worth noting that the family is responsible for maintaining monumental and mausoleum fittings, while perpetual maintenance is only that which the cemetery operator has to cover.

2. Current structure in NSW

Cemeteries in NSW are currently governed by the Cemeteries and Crematoria Act 2013 (the Act), and Cemeteries and Crematoria Regulation 2014. These contain existing requirements for cemetery pricing, provisioning and disclosure, although as we will discuss in the following sections there are not currently any specific, enforceable requirements addressing the estimation or funding of long-term perpetual care liabilities.

Crown operators are also governed by the Crown Land Management Act 2016.

The primary regulator is Cemeteries and Crematoria NSW (CCNSW).

2.1. Current requirements

Section 31 of the Act allows for regulations to establish an interment industry scheme which may require "an operator of a cemetery to ensure adequate provision is made for perpetual care of interment sites and the cemetery". An interment industry scheme may also include requiring compliance with a code of practice, as well as requiring licensing in relation to the provision of interment services and the imposition of conditions on licenses.

To date however, an interment industry scheme has not been developed and as a result there are no such requirements in the current regulations.

Section 107 of the Act includes a requirement for Crown cemeteries to consider "future maintenance" in setting fees and charges. However, this requirement does not extend to council or private cemeteries and the regulator does not have the power to review their pricing.

2.2. Current practices

Current practice, particularly regarding the level to which perpetual maintenance costs have been estimated and are reflected either in the pricing of interments or through the establishment of a perpetual maintenance fund, differs from operator to operator and particularly between the different types of operators.

2.2.1. Crown operators

In NSW, there are five Crown cemetery operators as at 30 June 2019. These are operators which are effectively owned (and funded) by the NSW State government and are incorporated under the Act. They are:

- Northern Metropolitan Cemeteries Land Manager
- Rookwood General Cemeteries Reserve Land Manager
- Catholic Metropolitan Cemeteries Trust
- Southern Metropolitan Cemeteries Land Manager; and
- Rookwood Necropolis Land Manager

We understand from discussions with the Department of Planning, Industry, and Environment (DPIE) that all of the Crown operators have produced estimates of their current perpetual maintenance liabilities. In some cases, these estimates have been produced internally, while for others external actuarial advisers have been engaged to perform this analysis on a periodic basis.

None of these analyses or reports are made publicly available. The value of the perpetual obligations calculated are not recorded on the balance sheet as a liability, and limited disclosure is otherwise provided in the financial statements of the Crown operators. Where some disclosure is provided, it is generally an acknowledgement that the net assets are being built up in order to support future perpetual maintenance obligations, however it does not state whether the amount funded to date is adequate or not. It also states that such net assets can be used for other purposes such as land acquisition or funding other revenue generating services of the operators.

From our discussions with DPIE, we understand that when such calculations are performed there is no set methodology used and that it is up to the interpretation of each operator and their actuarial adviser. We also note that there is no guidance from the Actuaries Institute to its members over how such valuations should be performed. As a result, there is variation on key aspects such as:

- Whether liabilities are calculated on an accrued basis (e.g. only for interment rights currently sold) or allowing for future sales of interment rights also
- How perpetual maintenance costs are determined
  - "bottom up" based on estimates of the maintenance that will be required once burial land is exhausted; or
  - "top down" by adjusting current total maintenance expenses for expected changes when the cemetery reaches the point of entering into perpetual maintenance mode
- The level of maintenance that it is assumed will be provided
- How maintenance costs will change over time (e.g. with changes to visitation etc)
- Discount rates used to calculate liabilities
  - "risk-free", which assumes no investment risk premia is taken into account when setting the liabilities. This can result in a more prudent estimate of the liability to the extent that actual investment returns likely to be earned on the assets funding the liability can be set with a long term horizon and will earn premia above the risk-free rate.
  - "asset mix" approach, where the discount rate is tied to the expected investment earnings rate on the actual assets in which the funds are invested
- There is limited articulation of a risk appetite that supports the setting of the investment strategy and associated liability discount rate, taking into account available sources of future capital or funding support from the ultimate sponsor (i.e. NSW state government)

There are also different approaches to the ongoing governance of these liabilities, such as ongoing monitoring and plans to meet any existing funding shortfall.

2.2.2. Council operators

In our analysis undertaken, we reviewed information provided to us by 15 councils that manage cemeteries, including having consultations with such groups. This ranged from large metropolitan cemeteries to regional cemeteries across NSW.

We noted that a select number of councils indicated to us that they have established a perpetual maintenance fund or trust so that a portion of revenue is set aside to meet future maintenance requirements. However, the rules established for these funds were not consistent between such councils, with different rules and restrictions around how assets are invested, and how the funds can be used. Of those who had established a fund, none of those indicated that they have conducted a detailed assessment of the potential perpetual maintenance liabilities, or of the adequacy of the perpetual maintenance funds that they have established, but rather they were using internal estimates of what they considered would be required.

For many of the councils, they stated that current records are not able to identify the costs related to perpetual maintenance and separate them from other cemetery costs (e.g. costs of interment) or other council costs (where a single maintenance team is also responsible for other council land).

Many of the council operators spoken to indicated that they do not believe they are collecting enough in fees to fully fund their perpetual maintenance costs. In some cases, they would like to collect more but feel that they are not able to raise their fees due to community expectations and comparisons to the fees in surrounding council areas, while in some cases they do not believe fees should be increased as maintenance costs will be met by other sources of ongoing revenue (e.g. from cremations) or because there is a view that the perpetual maintenance of cemeteries will be managed as per other council land (e.g. through a Parks Management budget).

While meeting these costs from other operations is possible, it will mean that fees for these operations will need to be higher than they would otherwise be. This may in turn create its own problems, for example residents may choose to have their cremations carried out at a neighbouring council which is able to charge cheaper fees if it does not also need to use these to meet perpetual maintenance costs from previous interments.

2.2.3. Private operators

Our analysis of publicly available information (e.g. Annual Reports, investor information) from a number of private operators has not identified any explicit liabilities or funds to recognise perpetual maintenance costs. Also, our analysis did not identify any disclosure or transparency in investor reporting packs or other information from such operators about any perpetual maintenance fund or reserving having been allowed for.

It could be that private operators consider they can continue in operations for the foreseeable future and therefore can fund any maintenance expenses with future revenues, such as from not only future sales of interment rights but also margins from other parts of their business (e.g. crematoria, funeral services, chapels etc). We consider this a particular risk for the cemetery sector as in a competitive environment it cannot be assumed that cross-subsidies can always be available.

Unlike the Crown and council operators where the state or local government is the ultimate sponsor of such cemeteries, private operators may have fewer options for recourse if perpetual maintenance liabilities are unable to be met. Indeed, if any of these private operators cease business for whatever reason, the only way to continue to provide for perpetual maintenance will be the accumulated funds (in the absence of existing owners providing funds via equity contributions to "make good" any shortfall).

2.3. Accounting requirements

AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* issued by the Australian Accounting Standards Board distinguishes "between:

- (a) provisions – which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations; and
- (b) contingent liabilities – which are not recognised as liabilities because they are either:
  - (i) possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits; or
  - (ii) present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made)."

Paragraph 14 of AASB 137 further states:

"A provision shall be recognised when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

The majority of (if not all) operators hold the view that there is no requirement to recognise a liability in the balance sheet under current accounting requirements in relation to perpetual maintenance care obligations in relation to past sold interments. We understand that this is generally due to one or both of the following reasons:

- no liability has crystallised for future maintenance at the reporting date, as this is a future event
- the reliability of the estimation of costs given the time frame involved

As a result, operators have generally treated perpetual maintenance cost as a non-current contingent liability and one which cannot be reliably estimated. Where relevant, entities have disclosed that they have obligations in relation to the perpetual maintenance of each cemetery, and the amount of retained earnings allocated for this purpose, but do not quantify the value of the maintenance obligations themselves.

3. Comparable governance frameworks: Defined benefit superannuation

Compulsory superannuation was introduced in Australia in 1992 and is regulated by the Australian Prudential Regulation Authority (APRA) under Superannuation Industry (Supervision) Act 1993 and Superannuation Industry (Supervision) Regulations 1994. Superannuation operates under a trust structure, whereby the trustee controls the fund's assets and operates them solely for the benefit of its members and beneficiaries.

Governance is particularly important in the superannuation sector because people typically rely on trustees of superannuation funds to manage their retirement savings, and also frequently rely on the advice of other key agents to make choices about their superannuation options. Robust governance practices that support sound decision-making are therefore essential for ensuring the business operations of trustees remain sustainable into the future and will continue to meet the best interests of their members.

The operations of superannuation funds are subject to requirements imposed by:

- Australian Prudential Regulation Authority (APRA) which establishes and enforces prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by APRA-regulated entities are met within a stable, efficient and competitive financial system
- Australian Accounting Standards Board (AASB) through accounting standards to set a consistent method for the recognition, measurement and disclosure of superannuation benefit liabilities (for superannuation fund financial statements) and of employee benefits (for employers in relation to their obligations with respect to superannuation and other employee benefits).
- Actuaries Institute in Australia through promotion of a high standard of actuarial practice by establishing and maintaining professional and ethical standards and guidance

Together, these requirements, standards, and guidance cover not only trustees' and employers' financial responsibilities, but also other aspects of governance such as risk management, conflicts of interest, investment governance, and fit and proper rules. In addition, specific prudential and professional standards apply in relation to defined benefit superannuation.

3.1. Defined benefit arrangements

In Australia, two broad categories of superannuation arrangements can apply. These are:

- Defined contribution (or accumulation) arrangements – whereby amounts are paid by an employer into their employee's nominated superannuation account in accordance with the government stipulated percentage of salary as per Superannuation Guarantee Charge (SGC) legislation. In addition, the individual employee can choose to make voluntary contributions, subject to maximum annual contribution limits. All contributions, less fees and taxes, are accumulated with investment earnings, based on the investment option(s) chosen by the employee (or MySuper default set by the Trustee) based on those available in the fund, and the total accumulated amount at retirement represents the superannuation benefit to that employee.
- Defined benefit arrangements - these arrangements provide for benefits to fund members which are typically defined as an accrued multiple based on number of years of membership applied to final average salary (such as average defined benefit salary over

the latest three years of membership). The sponsoring employer is responsible for the funding of the vested benefits and accrued obligations over the lifetime of the fund, makes regular contributions as recommended by the fund actuary and generally bears the investment and other risks of the fund.

In Australia, superannuation arrangements for most employees are now accumulation in nature. The majority of Australian defined benefit superannuation funds have been closed to new members for many years. However, they remain common in some other countries.

While many defined benefit funds provide lump-sum only benefits to members, some funds provide lifetime pension benefits for members, often with a reversion to the spouse and/or dependants upon the death of the member pensioner. This introduces added complexity in relation to the adequacy of fund assets to provide a defined income stream for the remaining lifetime of members and other beneficiaries, given uncertainties around how long individuals will live.

Defined benefit superannuation, while less common in Australia, provide a relevant comparison of how a funding approach may be taken to meeting "long tail" obligations, similar to the perpetual maintenance requirements of cemeteries (particularly in the case of defined benefit lifetime pensions), and so these arrangements are our focus in this section.

3.2. Liability measurement and reporting

Defined benefit liabilities are calculated for both funding and accounting purposes.

Liabilities for funding purposes are determined in accordance with Superannuation Prudential Standard (SPS) 160 issued by APRA and Professional Standard (PS) 400 issued by the Actuaries Institute. These liabilities are calculated on a best estimate basis, which means that all assumptions used to calculate the liabilities, and subsequently the liabilities themselves, are intended to be just as likely to overestimate or underestimate the ultimate value of the benefit obligations.

Accounting liabilities are determined under different requirements for fund accounting (i.e. the financial statements of the superannuation fund itself) versus employer (or defined benefit fund sponsor) accounting:

- Fund accounting: based on the requirements of AASB 1056 *Superannuation Entities* issued by the AASB, and in accordance with Practice Guideline (PG) 499.06 issued by the Actuaries Institute. This is generally aligned with the measurement of liabilities for funding purposes as described above, and accordingly represents a best estimate liability value.
- Employer accounting: based on the requirements of AASB 119 *Employee Benefits* issued by the AASB, and in accordance with PG 3 issued by the Actuaries Institute.

One of the key differences between benefit liabilities under fund accounting compared to employer accounting relates to the discount rate used to determine the present value of benefits expected to be paid in future.

For defined benefits, liabilities are based on the benefit definitions set out in Product Disclosure Statements (PDSs) issued to members, which depend on the final salary levels of members in the years immediately prior to the benefit becoming payable. This is somewhat different for cemeteries where expectations or obligations for ongoing maintenance are not clearly defined and where the level of maintenance may be changed over time. While it is possible to vary the future levels of defined benefit superannuation benefits arising in relation to future service, it is typically not permitted to retrospectively reduce the benefits already accrued by members in relation to past service.

In all cases, liabilities are generally calculated using a discounted cash flow approach. The funds engage actuaries to consider historical experience, as well as future trends and external impacts (including expectations of future salary increase rates) when determining the assumptions.

AASB 1056 applying to fund accounting sets out the measurement of defined benefit liabilities using a discount rate reflective of an expected investment return for "a portfolio of investments that would be needed as at the reporting date to yield future net cash inflows that would be

sufficient to meet accrued benefits as at that date when they are expected to fall due". In many cases, this will be the same discount rate as the expected return on the assets held in the fund to support the defined benefit member liabilities.

By contrast, AASB 119 applying to employer accounting requires that employers recognise the net defined benefit asset/liability on their balance sheet, using a discount rate based on high-quality corporate bond yields (or government bond yields for public-sector entities). Therefore, this tends to result in a more conservative liability being recognised for the employer than the best estimate liability recorded by the fund. In practice, it means that investment risk premia gains flow through retained earnings of the employer as they are released each year if actual experience (including investment returns earned on assets) is in line with best estimate expectations.

3.3. Board obligations

SPS 160 *Defined Benefit Matters* sets out APRA's requirements in relation to the management of defined benefit superannuation funds (and sub-funds) with the objective of enabling the trustee to meet, out of the fund assets, "the liabilities of the fund as they fall due".

These requirements are shown in Table 3.1 below.

Table 3.1 : Trustee requirements under SPS 160

	Trustee requirement
Regular actuarial investigations	Trustee must appoint a Registrable Superannuation Entity (RSE) actuary to undertake, and report on, regular actuarial investigations into the financial position of a defined benefit fund (at least triennially)
Shortfalls	Trustee must arrange for an interim actuarial investigation in circumstances where the financial position of a defined benefit fund deteriorates below a shortfall limit set by the trustee (i.e. where assets fall below % of vested benefits coverage) Factors which may be considered in setting the shortfall limit include asset mix, impact of fluctuations in market value of fund assets, whether the defined benefit fund pays pensions, membership profile, whether the fund is open or closed to new members, accrued benefits, the weighted average term of projected defined benefit liabilities and any assurance (or concerns) of support provided by the employer-sponsor(s)
Restoration plan	Where there is a deficiency, Trustee must implement a program to restore a defined benefit fund to a satisfactory financial position (i.e. assets fully covering vested benefits*), and submit the program to, and report to, APRA
Monitoring	Trustee must determine and implement a monitoring process designed to detect, on a timely basis, when the fund has, or may have, fallen into an unsatisfactory financial position and/or breached the shortfall limit
Sub-funds	Determined at sub-fund level, i.e. where separately identifiable assets, separately identifiable beneficiaries and entitlements determined wholly or partly by reference to the conditions governing the sub-fund
Approach to financial management	SPG 160 notes relevant factors, particularly where a fund's financial position is unsatisfactory, would include the Trustee's approach to governance and risk management, the size of the fund (considering both assets and number of members), the ratio of members in draw-down phase to members in the accumulation stage (which may impact on fund liquidity), the financial strength and willingness of the employer-sponsor(s) to meet the shortfall, and also any contractual guarantee by the employer sponsor(s) to pay benefits or to meet a shortfall in the amount needed to pay the pensions.

Source: Deloitte Access Economics

SPS 510 *Governance* and associated guidance set out APRA's requirements for the minimum foundations for good governance of a superannuation trustee. Its objective is to ensure the

trustee's business operations are managed soundly and prudently by the trustee board, which should make business decisions in the "best interests of beneficiaries". These requirements include:

- Trustee must have a sound governance framework and conduct its affairs with a high degree of integrity
- Take account of the size, business mix and complexity of trustee's business operations
- Minimum governance framework includes Board charter and policies and processes that achieve appropriate skills, structure and composition of Board and senior management
- Principles of a sound and effective governance framework for a trustee: Responsibility, Independence, Expertise, Diligence, Prudence, Transparency, Oversight, Renewal

3.4. Independent advice

3.4.1. RSE Actuary

The Trustee must appoint an RSE Actuary which is a statutory position responsible for actuarial management of a defined benefit superannuation plan.

An RSE Actuary provides advice to the Trustee on the following matters:

- Actuarial investigations and advice in accordance with SPS 160 requirements
- Accounting advice for both fund and employer financial statements
- Actuarial certificates in relation to Superannuation Guarantee compliance - Benefit Certificates and Funding and Solvency Certificates
- Actuarial certificates for taxation purposes – various tax exemptions, Notional Taxed Contribution certificates for reporting of notional contributions to the ATO for each individual member
- Ad-hoc advice in relation to:
    - funding and solvency
    - investment strategy
    - insurance
    - contribution reviews
    - payments from super funds to employers
    - transfers from defined benefit to accumulation basis
    - pension commutations
    - benefit projections and illustrations
    - individual member calculations

3.5. Asset restrictions

3.5.1. Use of assets

As mentioned earlier, the trustee controls the superannuation fund's assets and operates them solely for the benefit of its members and beneficiaries.

Payments to the sponsoring employer, such as for repatriation of surplus assets, is only allowed in limited circumstances as set out in section 117 of the Superannuation Industry (Supervision) Act, and require the actuary to provide a written certificate to the trustee stating that, if the amount were paid, the fund would remain in a satisfactory financial position. In practice, it is more common for employers to seek a "contribution holiday" and/or to use any surplus defined benefit fund assets to assist in funding contributions for accumulation members or fund expenses, as it is tax inefficient to remove monies from superannuation.

3.5.2. Investment strategy

Superannuation Industry (Supervision) Act and Regulations include covenants to formulate, review regularly and give effect to an investment strategy for the whole of the entity, and for each investment option offered by the trustee in the entity, having regard to:

- the risk involved, and the likely return from, the investments
- the composition of the investments, including diversification
- the liquidity of the investments, having regard to the expected cash flow requirements

- reliability of available valuation information
- the ability of the entity to discharge its existing and prospective liabilities
- expected tax consequences and costs incurred

Under SPS 530 *Investment Governance* requires that the investment strategy reflect the Trustee's duties to beneficiaries – for the whole fund and for each investment option. Fund members typically have the ability to direct the trustee to allocate their voluntary account balances to an investment option of the member's choice. The investment strategy for each investment option is disclosed in Product Disclosure Statements and other information available to employers and members.

While the trustee is responsible for setting investment strategy for defined benefit assets, they will typically consult with the employer-sponsor in relation to their risk appetite and tolerance for variability in returns and the resulting impact on contribution requirements. The RSE Actuary comments on the suitability of the investment strategy in their actuarial investigations, having consideration of the nature of liabilities, employer support, and funding shortfalls.

3.6. Transition and funding

Defined benefit funds are pre-funded, not pay-as-you-go like social security. Employers fund the promised defined benefits through periodic contributions to the superannuation fund. An actuary periodically reviews the contribution rate and the extent to which assets held in the superannuation fund are adequate to meet the obligation to pay benefits. If the fund is in deficit because, for example, returns on assets held in the superannuation fund are lower than expected, the employer has an obligation to make good the shortfall by making additional contributions to the fund; thus, employers sponsoring defined benefit funds bear the investment and other risks.

Generally defined benefit superannuation funds in Australia operate with net surplus positions, i.e. assets at least fully covering benefit obligations, although there may be periods where a fund is underfunded.

Underfunding can be explicit and/or implicit. Implicit underfunding happens when the actual experience is worse than the best estimate actuarial assumptions used to value benefits and determine recommended employer contributions. For example, this can arise due to volatility in investment markets causing sudden shifts in the market value of defined benefit plan assets.

Explicit underfunding happens when a public sector employer – such as a state agency or government department – does not contribute the full actuarially determined amount of costs to fund benefits accruing to members. In such cases, the public sector entity would fund the shortfall in relation to benefits as they fall due.

3.7. Prudential proportionality

The same requirements are applicable to all defined benefit superannuation funds regulated by APRA. Similar requirements also apply for self-managed superannuation funds (which must have less than five members and which are regulated by the Australian Taxation Office) where they provide lifetime pension benefits and therefore experience the risk of a mismatch between assets and member liabilities.

APRA is frequently reviewing the requirements to ensure that the level of regulation strikes the right balance between meeting its objectives and the compliance cost to superannuation funds. Introductions of increased requirements over time has led to merger and consolidation activity across the superannuation industry reducing the numbers of superannuation funds.

4. Comparable governance frameworks: Insurance long-tailed liabilities

Insurance in Australia is categorised as life, health, or general insurance. Each of these types of insurance are governed by different Acts of parliament, but all have a consistent set of goals and principles. The key Acts for each type of insurance are the Life Insurance Act 1995, Private Health Insurance Act 2007, and Insurance Act 1973 ("the Acts").

In each of these Acts, powers to regulate the industry are given to APRA, whose goal is to ensure that under all reasonable circumstances financial promises made by these supervised institutions are met within a stable, efficient and competitive financial system.

In addition to the requirements of the Acts and the regulations produced by APRA, governance of the insurance industry is also assisted by:

- Australian Accounting Standards Board - through accounting standards to set a consistent method for the recognition, measurement and disclosure of insurance contracts
- Actuaries Institute in Australia **-** through promotion of a high standard of actuarial practice, including relevant professional standards around the approach to valuation of liabilities and financial advice to insurance companies

Together, these requirements, standards, and guidance cover not only insurers' financial responsibilities, but also other aspects of governance such as risk management and accountability, and disclosure and transparency.

4.1. Long Tail Liability products

Life and general insurance both have exposure to "long tail" products, where the benefits may be payable for many years after the insured event has been incurred or where the liability may not be known for several years after the event. Examples of long tail insurance products are:

- Annuities (Life Insurance) - A single premium is received up front, in exchange for a stream of payments payable to the policyholder (often for their remaining lifetime)
- Disability Income (Life Insurance) - Premiums are received until a claim is made. At this stage premiums will typically cease, and a stream of payments is payable to the policyholder until they recover or until a pre-specified benefit period is reached (either over a short term of 2-5 years or long term such as benefit payable to "age 65")
- Workers Compensation (General Insurance) - Benefits are typically paid for an average of 7–10 years, but some medical benefits can extend until death
- Other Liability Classes (General Insurance) - Such as Public and Product Liability, and Professional Indemnity, where claims may not be known for 3-5 years after an insurable event occurs

It is considered that such long tail insurance products, and the approach to their liability estimation and management, may have characteristics relevant to the perpetual maintenance requirements of cemeteries, and so these types of insurance are our focus in the section.

4.2. Liability measurement and reporting

4.2.1. Contract liabilities

Insurance contract liabilities, both short and long term, are calculated for both prudential and accounting purposes. Such liabilities are reported on the balance sheet of insurance companies and hence impact the profit/loss statement of insurers.

The Acts give APRA the power to determine how these liabilities are determined for prudential reporting, and APRA does this through its prudential standards LPS340 (Life) and GPS340 (General), while accounting liability requirements are set out by the AASB in AASB1038 (Life) and AASB1023 (General). Generally, the insurance liabilities calculated for these two different purposes are aligned, though there are some slight differences for General Insurance.

The Actuaries Institute has issued professional standards for actuaries to follow for the valuation of insurance contract liabilities.

For insurance, liabilities are based on clearly defined contractual obligations as outlined in their Product Disclosure Statements ("PDSs"). In insurance, an obligation is considered as having been generated and subject to potential liability estimation once a premium is received and a contract has been entered into by the policyholder, regardless of when that liability may fall due.

The specific calculation of policy/insurance liabilities for Life and General Insurance differs, but the overarching principles are the same.

Life Insurance:

- Liabilities are calculated on a Best Estimate basis
- This means that all assumptions used to calculate the liabilities, and subsequently the liabilities themselves, are intended to be just as likely to overestimate or underestimate the true extent on future costs associated with a company's insurance obligations
- In addition, Life Insurance liabilities include a profit recognition mechanism which means that profit earned on insurance policies sold cannot be recognised in full as soon as premiums are received, but is instead gradually released as it is earned throughout the subsequent life of the policy as the insurance obligations are met
- If experience is worse than expected, the amount of future profits to be released will be reduced accordingly

General Insurance:

- Liabilities are calculated at a 75% Level of Sufficiency
- Assumptions are set on a Best Estimate basis, and an additional explicit Risk Margin is applied to the resulting Best Estimate Liability to raise it to the required level of sufficiency
- If experience is in line with expectations, this additional level of conservatism in the liabilities will be released as profit over time

In both cases, liabilities are typically calculated using a discounted cash flow approach. The company must consider historic experience, as well as future trends and external impacts (including community expectations) when selecting assumptions. Regulatory requirements, professional standards and industry practice have resulted in a range of checks and controls on the valuation process.

Australian standards require that insurance liabilities and capital for most insurance products are calculated using a risk-free discount rate. This is typically calculated with reference to yields on government bonds and so actual returns on invested assets, which are not entirely risk-free, are therefore likely to exceed the discount rates used. This results in a level of conservatism in insurance liabilities, and the excess of investment returns earned over the discount rate will emerge as profit over time.

An illiquidity premium may be applied for some products such as annuities, in cases where cash flows are seen to be more predictable and so assets held to support them have a greater likelihood of being held to maturity. This is an amount that is added to the risk-free rates when determining the discount rates to be applied

4.2.2. Capital requirements

Insurers are required by APRA to hold capital additional to their contract policy liabilities, to ensure their obligations can be met in more adverse and extreme circumstances.

Minimum capital requirements are determined as the level of assets needed to withstand a 1 in 200 year event (i.e. a 99.5% level of sufficiency) over a 12 month period, and cover different types of risk:

- Insurance Risk – the possibility that claim experience is worse than expected
- Asset Risk – the possibility that asset values are adversely impacted due to market movements (e.g. interest rates, equity values, exchange rates) or counterparty default
- Operational Risk – the possibility that losses result from human, system, or process error

Allowance is also made for concentration of insurance and asset risks, and correlations between each individual risk type. These, together with the above specific insurance, asset and operational risks for the Prescribed Capital Requirement ("PCR"). APRA may further apply a Supervisory Adjustment if it considers the risk profile is not otherwise accurately captured by the requirements.

Insurers are not meant to breach this minimum requirement, and the closer the insurer is to breaching it the greater the level of regulatory scrutiny and intervention they would face. The actual amount of capital targeted (the "target capital") by any insurer is sufficiently above this amount to make such as breach unlikely, and below target capital there would typically be a series of triggers for insurers to take action before breaching PCR.

LPS110 and GPS110 also require insurers to have an Internal Capital Adequacy Assessment Process ("ICAAP)", which includes requirements on:

- Activities and policies to identify, measure, monitor and manage risks and capital held against them continuously
- A strategy for ensuring adequate capital is maintained
- Reporting ICAAP outcomes to Board and Senior Management to use in decision making
- Regular independent review (at least every 3 years)
- Projected capital position for at least next 3 years

We note that there is no accounting equivalent to the prudential capital requirements, however AASB1023 and AASB1038 require that the capital position (as per the Acts) is disclosed in a note to insurers' financial statements

4.3. Board obligations

The board has ultimate responsibility for oversight of the sound and prudent management of the insurer, and making reasonable and impartial business judgments in the best interest of the insurer whilst considering the impact of its decisions on policyholders. They are therefore also ultimately responsible for the valuation of policy liabilities, prudential management and capital adequacy, and risk management.

4.4. Independent advice

4.4.1. Appointed Actuary

The Appointed Actuary is a statutory defined position, whose role is to ensure that the Board and senior management have unfettered access to expert and impartial actuarial advice and review, and assist with the sound and prudent management of the insurer and ensure that the insurer gives appropriate consideration to the protection of policyholder interests.

This role is key in providing effective challenge to activities that materially affect the insurer's financial condition and policyholder interests. It includes:

- Advice on provisioning for insurance liabilities (Actuarial Valuation Report "AVR")
- Financial Condition Report – a summary of the policy liability and capital requirements as calculated by the Appointed Actuary in the AVR, together with an assessment of all operations including claims, pricing, risk management, investments, reinsurance and capital. This must be provided to the Board and to APRA. In particular, if the Board does not adopt the policy liabilities and capital figures advised by the Appointed Actuary they must notify APRA and justify it to APRA.
- Provision of advice under the Actuarial Advice Framework (e.g. must provide advice on product pricing, investment strategy)

4.4.2. Appointed Auditor

The Appointed Auditor is another statutory defined role. The Appointed Auditor is responsible for providing impartial advice on the operations, financial condition and internal controls of the insurer.

4.5. Asset restrictions

4.5.1. Use of assets

For Life Insurance, the assets backing contract liabilities and capital requirements must be held in special statutory funds. This "ring-fences" these assets from those held for other purposes and ensures that they are kept available to meet the insurance obligations.

Separate statutory funds must be put in place for investment linked and non-investment linked policies (i.e. insurance) contracts, and companies may also create separate statutory funds for different products or classes of product (e.g. to separate superannuation and non-superannuation policies where different taxation rules apply to investment returns on the assets backing those policies).

Strict restrictions apply to transferring money between statutory funds and the shareholder fund, including a requirement for Appointed Actuary approval of the transfer and confirmation that capital requirements will continue to be met.

4.5.2. Investment strategy

The assets invested in by an insurer will depend on their investment strategy and risk appetite. In general, for shorter term policies assets backing insurance liabilities would be invested in short term securities and cash. For longer term liabilities with a more predictable cash flow profile, such as annuities and claim reserves for income protection policies, longer term fixed interest securities are invested in to duration match the liabilities.

Investment strategies are typically prudent as investment risk is borne fully by the insurer, and capital associated with asset risks will need to be held for any significant asset risks being taken.

When measuring an insurer's capital adequacy, restrictions are applied to the types of assets that can be included in the capital base. This ensures that all amounts counted as capital are adequately unrestricted, available to absorb losses, and rank behind the claims of shareholders in the event of winding up of the insurer.

4.6. Transition

When APRA does consider the introduction of new or revised prudential standards, there is a transition period between the finalising of the new requirements and the period in which they become active. This allows APRA and the insurers to engage in consultation, and to ensure the changes operate as intended and for insurers to be able to take any necessary actions, before the change is implemented. As part of this, APRA may also undertake a quantitative impact study with the industry to assess the likely financial impacts and any process challenges for the sector.

Should it result in a need for the Actuaries Institute to make revisions to its professional standards for actuaries performing such calculations or giving such advice, it will also involve the professional body.

4.7. Prudential proportionality

The same regulatory requirements are applicable to all insurers.

A potential new entrant seeking to obtain an insurance licence must demonstrate a comprehensive operational capability and risk management framework, as well as financial capital and funding, before a licence would be considered. As such, APRA seeks to ensure the new operators can meet the same level of competency of governance as an existing operator.

APRA is frequently reviewing the requirements to ensure that the level of regulation strikes the right balance between meeting its objectives and the cost to insurers of compliance.

5. Comparable governance frameworks: Other

In this section, we explore some other examples of comparable governance frameworks. These are necessarily limited and focus on those which were agreed with IPART as being potentially useful to consider from the perspective of cemetery governance and, in particular, funding of perpetual or long dated obligations.

Cemetery requirements in other jurisdictions:

It was considered important to look at other Australian and overseas examples of where cemeteries had either had a review into governance practices or had in place specific governance requirements:

- In **Victoria** a review of major public cemeteries in Victoria was conducted by the Auditor General in 2006, which made a number of recommendations on financial management and governance. These recommendations, and the subsequent amendments adopted to the Act, include considerations for the governance of cemeteries and the funding of future perpetual maintenance costs, and so are useful to consider in relation to NSW cemeteries.
- In both **Ontario** and **Illinois** cemeteries have existing legislated requirements to set aside a percentage of sales revenue into a fund for the costs of perpetual maintenance. The rules around contributions to, the investment of, and uses of these funds provide examples of the types of arrangements that might be considered by IPART for NSW cemeteries.

Mine subsidence:

This was chosen due to it representing a state government issue of providing compensation for past and current mine rectification or remediation issues that can arise and how these are funded:

- Mine subsidence is the movement of the ground that can occur after underground coal mining. Subsidence impacts to buildings and other structures vary depending on the depth of the mining, the geology of the land, and how the coal was extracted. Buildings damaged by mine subsidence can remain safe and can be used until they are repaired.
- If someone's property is damaged by subsidence as a result of coal mining in NSW, their rights are protected under the Coal Mine Subsidence Compensation Act 2017 and they can claim compensation through Subsidence Advisory NSW (SA NSW).

James Hardie asbestos claims:

This represented an emerging, significant liability of deep concern to the government which required consideration with the industry, in particular the key provider being James Hardie, about how to set up appropriate funding and a govern the process for payment of compensation:

- James Hardie dominated the market for asbestos products during the decades following the Second World War. However, the boom years of the 1960s-1970s were overtaken by warnings about the danger of asbestos to human health, and links to lung disease. James Hardie quit its manufacture of asbestos products in the early 1980s. The first negligence verdict against James Hardie came in 1991.
- James Hardie set up the Medical Research and Compensation Foundation (MRCF) in 2001 to meet all the future asbestos claims, but this was found to have a significant shortfall.
- After great public and government pressure, the company was forced to finalise a new compensation deal, known as the Amended Final Funding Agreement (AFFA). The Asbestos Injuries Compensation Fund (AICF) was formed in 2006.

The information in this section has been compiled from publicly available sources.

5.1. Cemeteries in Victoria

In Victoria the Cemeteries and Crematoria Act 2003 places specific responsibility on cemetery management to maintain their cemeteries in perpetuity:

- In exercising their functions, trusts must have regard to their obligations in relation to the funding of the perpetual maintenance of the cemetery they are responsible for[8]
- In setting fees and charges trusts must have regard to the need to provide for the maintenance of the cemetery in perpetuity[9]

A review conducted by the Auditor General in 2006 recommended that cemeteries, in consultation with the Department of Human Services which oversees the industry:

- develop standards for the maintenance of cemetery property;
- establish systems and procedures which enable them to determine the direct costs associated with maintaining cemetery property;
- undertake a detailed assessment of the level of funds required to meet future maintenance obligations; and
- develop strategies to ensure adequate funds are set aside for future preservation needs.

Public cemeteries are operated by trusts which are responsible for oversight of cemetery operations. Prior to 2009, these were all unremunerated volunteers, but following a 2009 amendment to the Act trusts were split into Class A and Class B Trusts. The majority of cemeteries are governed by Class B Trusts for which the existing statutory framework was largely unchanged.

Class A Trusts, which apply for the larger cemeteries which are subject to the Financial Management Act 1994, comprise members selected for their skills and expertise and appointed by the Governor in Council. They must:

- Have a statutory role to provide assistance and guidance to Class B Trusts
- Establish a finance committee, an audit and risk committee and community advisory committees
- Employ a person as the Chief Executive Officer of the trust
- Prepare and submit annual plans to the Secretary of the Department
- Pay a levy of 3% of gross annual earnings to provide a sustainable source of funds to enable improvements in cemetery administration and governance, and to assist small trusts to maintain their cemeteries

The Secretary of the Department of Human Services may commission audits of cemetery trusts. Class A cemetery trusts must produce annual financial statements in line with the Financial Management Act 1994, and have them audited under the Audit Act 1994.

The Auditor General’s 2006 review also recommended that cemeteries should consider engaging specialist investment advisors to provide the cemetery with ongoing investment advice.

The Act requires prices to be set with regard to the need to provide for the maintenance of the cemetery in perpetuity (the Department has recommended 15-20% of total costs should contribute to these obligations)[10].

The Auditor General’s 2006 review additionally recommended that controls are established so that investments set aside for perpetual maintenance cannot be used for other purposes unless expressly authorised by the cemetery trust.

The separation of trusts into Class A (the larger trusts) and Class B (the smaller ones) means that the level of compliance required is proportional to the size of each trust so that requirements for the smaller trusts are not too onerous.

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[8] Cemeteries and Crematoria Act 2003, Sections 12 (2) and 12A (2)
[9] Cemeteries and Crematoria Act 2003, Section 39 (2)
[10] https://www2.health.vic.gov.au/public-health/cemeteries-and-crematoria/governance-and-finance/finance/financial-management

5.2. Cemeteries in Ontario

In Ontario, the Funeral, Burial and Cremation Services Act 2002 requires that cemetery grounds, including all lots, structures and markers, are maintained to ensure the safety of the public and to preserve the dignity of the cemetery[11].

Operators must establish a Care and Maintenance Fund when opening a Cemetery[12]. An initial deposit of $100,000 must be made to this trust, which is held separately from other funds, and ongoing contributions are prescribed for each sale of rights (e.g. 40% for in-ground graves, floored at $150/$250 depending on size). Because an explicit portion of each sale price goes to fund the perpetual maintenance of interments, operators cannot charge any additional maintenance costs. Cemeteries operated by municipalities are exempt from the initial $100,000 requirement.

Cemeteries' Care and Maintenance Accounts must be audited by an independent public accountant. For funds greater than $500,000, an audit report must be submitted alongside the statement of account and trust fund statement that are filed with the registrar annually.

A trustee is appointed for the Care and Maintenance Fund. A municipality may be a trustee (e.g. where it is the cemetery owner).

Rules regarding use of the Care and Maintenance Fund are:

- Interest earned on the fund must be used for maintenance of the cemetery only (or maintenance of other cemeteries operated by the same operator if the maintenance requirements of the cemetery have already been met)
- No use of the capital portion of the fund is permitted (the one exception is where the capital may be used to purchase additional land, where doing so to enlarge the cemetery will "promote its economic viability and strengthen the fund", but this amount must then be repaid from the sale of rights on the purchased lands (in addition to the standard contribution required on these sales))
- Money must be invested in an interest-bearing account, or a guaranteed investment certificate, deposit receipt, deposit note, certificate of deposit, term deposit or other similar instrument that is issued by an eligible depositary

5.3. Cemeteries in Illinois

In Illinois, the Cemetery Care Act defines "Care" as the maintenance of a cemetery and of the lots, graves, crypts, niches, family mausoleums, memorials, and markers therein; including:

- the cutting and trimming of lawn, shrubs, and trees at reasonable intervals;
- keeping in repair the drains, water lines, roads, buildings, fences, and other structures, in keeping with a well maintained cemetery;
- maintenance of machinery, tools, and equipment for such care;
- compensation of employees, payment of insurance premiums, and reasonable payments for employees' pension and other benefits plans; and
- to the extent surplus income from the care fund is available, the payment of overhead expenses necessary for such purposes and for maintaining necessary records of lot ownership, transfers, and burials.

Wherever a cemetery operator accepts care funds, they must set aside amounts in trust subject to legislative minimums (10%-15% of sales price). On this basis, they provide a document to the purchaser setting out the nature and extent of care to be furnished, and that such care is only furnished in so far as the net income permits.

Cemetery operators may act as the trustee of up to $500,000 of care funds that have been deposited into the trust fund, but must retain an independent trustee for any amount of care funds held in trust which are in excess of $500,000.

[11] Funeral, Burial and Cremation Services Act 2002, Section 5 (3) (b)
[12] Funeral, Burial and Cremation Services Act 2002, Section 53; O. Reg. 30/11 GENERAL, Division G

The government Comptroller annually examines every cemetery licensee who holds at least $250,000 in care funds, and may examine any licensee at any time. Cemeteries must prepare annual report to Comptroller showing the amount of the principal of care funds, investments and cash holdings, income and expenditure over the year, and number of interments made in the year. Alongside this, they must provide a certificate from the independent trustee (where applicable) on the truthfulness of statements.

There are no restrictions on investment of care funds in trust (unless attached to specific grant or payment). Trustees must exercise due care and prudence – considering probable income and probable safety of capital. There are restrictions on loans to private cemeteries.

5.4. Mine subsidence

The Mine Subsidence Compensation Fund is used to compensate homeowners whose properties are damaged by subsidence from inactive mine workings.

Compensation is based on an assessment of damage to property. Assessment may involve independent engineering investigations, quantity surveys, and expert valuations. Compensation claims are lodged through an ePortal with Subsidence Advisory NSW (SA NSW), a government agency, which replaced the Mine Subsidence Board.

SA NSW may borrow monies where there are insufficient funds to meet payments. Any moneys in the Fund which are not immediately required for the purposes of the Fund may be invested by the Board/Minister in any manner in which trustees are authorised to invest trust funds.

Legislative changes from 2018 sought to address cross-subsidisation issues whereby the vast majority of claim costs related to damage from a small number of active longwall mining operations, but were being funded through an industry-wide levy paid into the Mine Subsidence Compensation Fund. The changes were designed to provide a more equitable model for mining operators.

Following the legislative changes to the mine subsidence system, compensation for subsidence damage to properties from non-active coal mines is paid using a central fund managed by SA NSW, but compensation for subsidence damage arising from an active coal mine is payable by the relevant mine proprietor.

The new legislation included five year transitional arrangements to support the three mine operators deemed worse off under the reforms. As a result, they may be reimbursed wholly or in part from the Mine Subsidence Compensation Fund for compensation payments made under the new legislation in relation to subsidence damage from active mine sites.

5.5. James Hardie

An actuarial valuation of the potential asbestos-related disease liabilities of the Liable Entities which are to be met by the AICF Trust is conducted annually. The Liable Entities in this context are the former James Hardie entities which are covered by the Amended Final Funding Agreement. This provides for the long-term funding for compensation arrangements for certain victims of asbestos-related diseases in Australia.

The valuation methodology involves assessing the liabilities in two separate components:

(i) Cost of reported but not yet been settled claims - case estimates used
(ii) Cost of incurred but not reported (IBNR) claims - average cost per claim method used

Actuarial calculations use Commonwealth Government bond yield curve to discount liabilities, in accordance with PS302 issued by the Actuaries Institute and with accounting standards.

In AICF financial statements, the provision for outstanding claims comprises the central estimate (being the present value of expected future payments) plus an appropriate risk margin in accordance with Australian accounting requirements to recognise the inherent uncertainty in the central estimate, and a provision for the estimated future claims handling costs.

The trustee of the AICF Trust performs the functions set out within the AICF Amended and Restated Trust Deed dated 14 December 2006. The funds in the Trust are maintained and applied by the Trustee for the principal purpose of receiving and providing funding for the payment of asbestos-related compensation claims, and for additional purposes including investment of trust assets.

The AFFA requires the completion of an Annual Actuarial Report evaluating the potential asbestos-related disease liabilities of the Liable Entities to be met by the AICF Trust. Under the AFFA, the actuary must calculate (amongst other requirements) the discounted central estimate as well as the period actuarial estimate of compensation payments for each of the next three years.

6. Options for perpetual maintenance governance for cemeteries

This section summarises our recommendations for a future governance framework that IPART may consider in relation to management of perpetual maintenance obligations.

The discussion in this section draws upon the insights gained from analysis of other governance frameworks as described earlier in this report. We have also taken into account information gained from consultations with various local councils in relation to their perpetual maintenance costs in relation to sold internments at local government cemeteries, as well as consultations with stakeholders at private cemeteries in relation to management of perpetual maintenance obligations. In addition, we have incorporated our understanding of the approach by Crown operators, gained through correspondence (both written and verbal) with the DPIE Statutory Review team which has been explicitly reviewing the Crown sector.

We have considered a governance framework, covering the following items:

- Section 6.1 considers the different measurement of perpetual maintenance obligations as being either "hard" (i.e. in balance sheet liabilities) or "soft" (i.e. not on balance sheet)
- Section 6.2 recommends that the Boards (or equivalents) of cemetery operators obtain external independent advice on their potential perpetual maintenance obligations on a regular basis including advice on how to manage/contribute to a fund to provide for these future costs, including a potential requirement to make copies of these reports available to the regulator
- Section 6.3 considers the various items which should be included at a minimum in independent advice on perpetual maintenance obligations to Boards (or equivalents)
- Section 6.4 sets out the considerations for "ring fencing" assets set aside for meeting perpetual maintenance costs in future so that they are used solely for that purpose
- Section 6.5 recommends that prudential proportionality be considered such that the enhanced governance requirements only be enforced for operators of a minimum size (measured across all cemeteries operated by the operator)
- Section 6.6 discusses the role of the regulator in an enhanced governance framework
- Section 6.7 sets out possible transition arrangements to deal with the management of perpetual maintenance obligations owed at the time a new governance framework is implemented
- Section 6.8 describes an alternative option where a centralised perpetual maintenance fund is established which applies across multiple cemetery operators

We note that for local government operators, the references above and throughout the rest of Section 6 to a "Board (or equivalent)" instead relate to the elected Council which is the responsible decision maker with respect to these cemeteries.

The "regulator" referenced in recommendations may be Cemeteries & Crematoria NSW ("CCNSW") or may be a new regulator set up specifically for this purpose.

6.1. Recognising perpetual maintenance obligations

As described in section 1 of this report, ongoing maintenance (including grounds and administration) are an essential part of cemetery operators' activities after selling an interment right to clients. As such, **cemetery operators can be considered to have an obligation to provide maintenance to sold plots in perpetuity.**

Further, it can be considered that this obligation to maintain the plot into perpetuity is incurred once the plot is sold, as opposed to when the cemetery reaches exhaustion point in terms of availability of burial space. This is due to the need to provide for perpetual maintenance of an existing sold plot regardless of whether future sales are made or not by the operator.

As noted in section 2.3 of this report, cemetery operators appear to interpret the accounting standards as not requiring the recognition of a liability in the balance sheet in relation to perpetual maintenance care obligations of sold interment rights, for one or both of the following reasons:

- They consider that no liability has crystallised for future perpetual maintenance at the reporting date, as they interpret it as a future event
- They consider the costs are too uncertain to be reliably estimated given the time frame involved

As a result, operators have generally treated perpetual maintenance cost as a non-current contingent liability and one which cannot be reliably estimated. Where relevant, some entities have disclosed that they have obligations in relation to the perpetual maintenance of each cemetery, and the amount of retained earnings allocated for this purpose, but do not quantify the value of the maintenance obligations themselves.

In relation to the reliability of estimates, paragraph 25 of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* states:

> "The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other items in the statement of financial position. Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision."

Given the stability of maintenance costs in cemeteries, it is arguable in our opinion that, particularly as a cemetery approaches maximum capacity, the future maintenance costs associated with sold interments can be reasonably estimated, which would therefore mean that the perpetual maintenance obligations should be recognised as a provision, rather than a contingent liability. As a cemetery gets closer to the point of burial land being exhausted, it is anticipated that there is a greater potential for the operator to confidently estimate the expected future maintenance costs.

When a cemetery approaches the point of burial land being exhausted, the potential revenue sources available to fund ongoing maintenance will dry up, and accordingly the most preferable position is that the cemetery operator has set aside sufficient assets to support that perpetual maintenance commitment into the future. Ideally, a provision would be brought into the balance sheet to recognise that obligation to be offset against the assets of the cemetery operator, so that the net assets reported by the operator are not inadvertently inflated whereby there is no corresponding offset against entity assets to recognise the ongoing responsibility to finance maintenance costs for the cemetery.

This then raises the question of at what point should a cemetery operator recognise such a liability, as only recognising it when a cemetery's burial land is exhausted will result in a sudden decline in reported net assets which is undesirable. Instead, it would be appropriate to recognise this gradually over time, starting from when the interment right is sold, particularly if (notionally or physically) segregated assets are set aside in a perpetual maintenance care fund (which is discussed further below).

We recommend that CCNSW should engage with the Australian Accounting Standards Board to consider whether perpetual maintenance care obligations presently required in connection with past sold interments can be reliably estimated such that they can be treated as a provision under AASB 137, rather than as a contingent liability which is unquantifiable. It may be appropriate for CCNSW to seek cooperation of its counterparts in other Australian states and territories in order to get a holistic national approach, particularly in relation to the treatment of perpetual maintenance obligations (as opposed to renewable rights). If Boards (or equivalents) obtain independent advice

in relation to their perpetual maintenance obligations on a regular basis, this could potentially provide greater confidence in being able to reliably estimate perpetual obligations at any point in time, with the ability to update the value from time to time based on any new advice and/or taking into account latest experience of perpetual maintenance costs.

However, we acknowledge that cemetery operators in NSW have typically not shown a liability in their balance sheet in respect of perpetual maintenance costs. As a result, we expect that it would be an onerous burden on cemetery operators to immediately recognise a balance sheet liability in relation to past sold interments. Also, if a liability was put on the balance sheet, then at transition it could result in some operators, who issue public financial accounts, potentially showing as being under-funded, which is not necessarily a beneficial outcome for such operators or the consumers (as it could drive concern).

Therefore, we consider a more practical approach in the short term (while such accounting interpretation is being sought by the regulator) would be to require cemetery operators to note in their financial statements that component of their net equity which relates explicitly to the setting aside of funds for perpetual maintenance care purposes. While it may not necessarily represent the full amount of the obligations they may require (at least initially), it will aid users of the financial statements in order to understand the importance of such net assets being segregated and set aside for the purpose of maintenance cost obligations and not for other business uses.

Such an alternative could be considered a “soft” disclosure of the perpetual maintenance obligations, managed at Board (or equivalent) level and requiring active monitoring and planning (see below).

6.2. Board (or equivalent) obligations

As noted in section 2 above, Section 31 of the Cemeteries and Crematoria Act 2013 allows regulations to establish an interment industry scheme which may require a cemetery operator to ensure adequate provision is made for perpetual care of interment sites and the cemetery, but there are no such requirements in the current regulations. Also, there is no requirement to consider future maintenance in setting fees and charges, except in respect of Crown cemeteries.

Based on existing requirements and practices it is likely that Boards (or equivalents) have only been receiving limited (if any) information on the obligations in relation to perpetual maintenance of existing plots. This is probably due to the lengthy timeframes over which these obligations extend and the perceived time frame until they may be crystallised, coupled with the competing demands in managing the cemetery business as a whole, particularly where there are significant other activities such as new interments or cremations and development of new cemeteries/crematoria.

In order to enable Boards (or equivalents) to meet the expectations of the Act in respect to the financial management of the perpetual care obligations, we recommend that Boards (or equivalents) of cemetery operators be required to receive external independent advice on the financial value of their perpetual maintenance obligations and advice on how to manage/contribute to a fund to cover such obligations. It may also be appropriate to require that such reports be made available to the regulator, either upon request or as part of regular reporting by the operator to the regulator.

Introducing such a requirement for the Board (or equivalent) to obtain independent advice will therefore serve to actively engage and support Boards (or equivalents) in order to improve their understanding and equip them to make more informed decisions about the management of the business considering both short-term and long-term issues, which will ultimately result in better governance across the cemetery sector.

It is the Board’s (or equivalent’s) responsibility to determine what level of maintenance care should be provided by its operations. The Board (or equivalent) needs to form its own view as to its obligation in respect of the provision of perpetual maintenance for interment rights, in relation to past sales as well as for future sales. This requires the Board (or equivalent) to determine its

methodology for designating the maintenance levels to be provided, and it may use input from external advisers to assist it in developing this. It is expected that Boards (or equivalents) would consider what are the expectations of interment rights holders in this regard, whether that be formally documented in contracts or otherwise based on reasonable expectations of rightsholders such as by reference to current maintenance levels applied in the cemetery.

6.2.1. Seeking independent advice

The choice of external adviser would be suitably qualified professionals, which we suggest the regulator should give guidance to operators as to what professions may be appropriate. At a minimum we would suggest specific consideration for an actuary given they are already involved with many operators and have a professional body to help to set standards of practice, and which applies a code of conduct for their members. Other professionals that the regulator could consider may also include accountants, certified financial analysts or other financially qualified professions where relevant experience in valuation of long tail exposures and valuations can be proven.

Independent advice to Boards (or equivalents) could be a three to five yearly process, either based on a regulatory requirement or promoted as best practice guidance for cemetery operators. The rationale for suggesting a three to five yearly frequency is that the underlying drivers of the perpetual care obligation (being estimates of maintenance expenses, discount rates and long term asset strategy) may not vary materially on an annual basis (except for investment returns). It would be appropriate to allow for ad-hoc external advice to be required/recommended at other times, such as if a material event occurs or if the Board (or equivalent) is seeking to revise the strategy for management of the supporting assets (e.g. change to the investment strategy).

In the following section, we discuss the aspects that the external independent advice to the Board (or equivalent) would be expected to cover, at a minimum.

6.2.2. Expanded obligations

This could be coupled with an expanded set of Board (or equivalent) obligations, such as:

- fit and proper requirements – requiring Board directors (or equivalent) and senior management to meet fit and proper criteria in order to ensure that the persons responsible for the governance, oversight and management of the cemetery operator, have the appropriate knowledge, skills and experience and act with honesty and integrity in the performance of their duties. This is similar to the requirements imposed by ASIC and APRA in relation to various financial services businesses. Assessment of fit and proper persons also focuses on persons having the attributes of good character, diligence, honesty, integrity and judgement; having no conflict of interest or any conflicts that exists will not create a material risk that the person will fail to properly perform their role in the business; and not being disqualified by law from performing that role.
- regulator power – providing the regulator with the power to remove/replace/show notice on the Boards (or equivalents) and/or individual directors or senior management in relation to following the advice of the independent expert in relation to managing perpetual maintenance obligations including recommendations for progressively strengthening coverage of those obligations over time.

6.3. Independent advice

As noted above, we recommend that Boards (or equivalents) obtain external independent advice on the management of perpetual maintenance obligations, including supporting assets (where applicable). There should be minimum requirements on what must be covered as part of such independent advice, to ensure that this meets minimum acceptable standards of practice.

We believe that a reasonable frequency of independent advice would be every three to five years (as discussed in 6.2.1 above). Where the independent advice covers situations where there is a current underfunding in relation to legacy perpetual maintenance costs in respect of past sales, we recommend that independent advice be required to be obtained every three years so that the process of progressively funding these obligations is monitored more often and so that recommended contributions can be revised earlier if deemed necessary.

Areas to be covered as part of the independent advice process would generally include:

- **Best estimate of existing maintenance cost obligations**, i.e. those obligations in relation to interment sales at the valuation date. This value would be determined using the best estimate of expected future investment returns on supporting assets.
- **Prudent margin on obligations**. Advice on an appropriate margin above the best estimate value which should be held, to recognise risks associated in valuing the perpetual maintenance obligations. This is likely to take into account the liquidity risk of underlying assets and hence ability to pay future maintenance costs as they fall due, and risk appetite in relation to investment risk and operational risk.
- **Investment strategy/mix**. Advice on the investment strategy and asset allocation of assets held to support the perpetual maintenance obligations. Considerations in relation to investment strategy may include:
  - risks involved in making, holding and realising, and the likely return from the investments compared to the cemetery operator's objectives and cash flow requirements
  - composition of investments including the extent to which they are diverse (such as investing in a range of assets and asset classes) and the risks of inadequate diversification
  - liquidity of the assets (how easily they can be converted to cash to meet current year maintenance expenses)
  - policy in relation to short-term loans and borrowings to manage any gaps between investment income and maintenance expenses in the short-term, and any limits on the maximum amount of borrowings permitted at any one time.
- **Adequacy of pricing of interments and interment rights and contribution levels**. The independent adviser would be required to comment on the proposed future pricing of interments and interment rights, relative to current pricing levels and making adequate allowance for the amount required to fund maintenance costs in perpetuity. It would be expected that the cemetery operator's Board (or equivalent) would take the independent advice into account in setting their pricing levels, but it would be possible for the Board (or equivalent) to also consider other factors in ultimately determining their final pricing, such as competitive aspects and community expectations.

  The independent adviser would also recommend the amounts to be contributed into a perpetual maintenance fund from future interment sales (or from other income sources, where relevant) in order to appropriately fund expected maintenance costs into the future. Typically the independent adviser would be expected to recommend contribution levels for the next 3 to 5 years, aligned to the frequency of the formal independent advice.

  Factors that the independent adviser may take into account include adequacy of historical funding (i.e. any surplus or deficiency of current assets compared to maintenance costs for past sold interments), time period for rectifying any funding shortfalls, forecasts of operating surpluses (and potential available surplus to be released back to operators), access to other income sources to meet any maintenance cost shortfalls on an ongoing basis, cross-subsidies in pricing of different services offered by the operator and the equity and sustainability (having due consideration of competitive pricing pressures) of those cross-subsidies over time, expected timeframes until burial land is exhausted and proceeds of sales of interment rights dry up, standards of maintenance to be upheld and the extent that these may vary over time, balance between stability of contribution rates/levels over time and acceptance of volatility in funding position in the short-term, etc.

  It is important to include pricing review (and consideration of future business expenses and capex) to mitigate the risk that an operator which is currently appropriately funded could erode this position over the coming years by not appropriately pricing future

services/rights. A core fundamental will be that future sales of interments must include an adequate allowance for associated maintenance costs. The regular pricing review by the independent adviser will embed the need for the Board (or equivalent) to understand costs and cost allocation and recovery through pricing.

Should a levy instead be prescribed in legislation as the minimum rate (e.g. as a percentage of the sale price for new interment rights) required to be contributed to the perpetual maintenance fund on an ongoing basis for the purposes of funding ongoing perpetual maintenance costs, then the independent adviser would be expected to take these regulatory requirements into account when providing their advice.

- **Short-term lending.** To the extent that there may be short-term shortfalls in the amount of investment income available in a single year to cover perpetual maintenance costs in that year, the independent expert may be required to comment on the appropriateness of short-term lending to meet such temporary shortfalls in cashflows, subject to commentary on the proposed plan for eventual repayment of that loan arrangement involving timeframe for extinguishing the loan and sources of surplus income flows to finance the loan repayments in future.

- **Use of capital value.** The independent adviser may comment on whether the capital value of assets must be preserved to protect the earnings base on which income can continue to be earned into the future in order to safeguard the ability to fund maintenance costs in perpetuity, or what may be permitted uses of capital in the context of expanding the cemetery operator's business in such a way that would promote the economic viability and strengthen the assets held for perpetual maintenance care purposes.

Boards (or equivalents) may choose to obtain independent advice on a more frequent basis, e.g. annually to align with any disclosures in financial statement notes or for annual reviews by the Board (or equivalent) of coverage of perpetual maintenance obligations, but we would not expect this to be a requirement in all cases.

6.4. "Ring-fencing" of perpetual maintenance fund

To provide some initial context, one approach to ensuring that future perpetual maintenance costs are adequately provided for would be to set aside assets which are designated for that purpose only. That is, a pool of assets is set aside which is "ring fenced" so that those monies can only be used for meeting perpetual maintenance costs of the cemetery and are protected from the potential of being used for non-approved purposes which would diminish the assets available and hence could endanger the operator's capacity to meet its ongoing maintenance obligations. In a complicated business like cemeteries, with long term maintenance obligations, cemeteries could divert fees from perpetual maintenance funds towards covering day-to-day operating activities if the assets are not "ring fenced".

There are advantages and disadvantages to requiring the establishment and maintenance of an explicit perpetual maintenance care fund, with assets ring-fenced for use for specific purposes only. It is more likely that larger operators (being those with large numbers of total potential interments, being sold interments to date plus interments expected to be sold in future years) would be expected to hold discrete perpetual maintenance care funds than smaller operators which may only have small burial areas (possibly in conjunction with larger cremation businesses).

We discuss in section 6.7 below the challenge for Boards (or equivalents) in transitioning to a framework where assets must be set aside in a perpetual maintenance care fund, given that cemetery operators will not generally be in a position to immediately set aside amounts in relation to past sold interments at the point of implementation of the new framework. As a result, it would be appropriate for Boards (or equivalents) to separately consider establishment and management of perpetual maintenance funds in relation to future interment sales from the date of implementation versus funds in relation to past sold interments at that date. The remainder of this section therefore concentrates on the design of a designated maintenance fund, setting aside such transition issues.

It would be expected that the uses of monies held in the perpetual maintenance care fund would be restricted to being used for the purposes for which they are held. However, it may be appropriate to have a small number of exceptions such as managing excessive levels of surplus if they were to accumulate over time. The exercise of certain restrictions may potentially be subject to sign-off by the regulator or by the independent adviser.

Advantages of holding a perpetual maintenance fund:

- Security of holding designated monies in order to fund maintenance costs in perpetuity
- Knowledge that future maintenance costs have been adequately reserved for in the event that a cemetery operator "walks away" (which could be a particular risk in relation to private operators if their business model does not meet their initial expectations)
- More robust financial position (and better re-sale values) for cemeteries in the event of transfer of ownership or change in operators

Disadvantages of holding a perpetual maintenance fund

- The burden of accumulating assets in a perpetual maintenance fund in relation to significant historical interments, where assets have not been set aside to date
- Having to manage a sizeable pool of assets and make relevant investment decisions (although this could be mitigated through use of investment consultants and/or appointing a trustee or similar to manage the perpetual maintenance fund operations)

A perpetual maintenance care fund, comprising the accumulation of amounts of retained earnings allocated to maintenance obligations, plus appropriate proportions of the sale prices for future interments, together with investment earnings, must only be used for future maintenance and not for other business uses (such as for land acquisition), subject to meeting an appropriate level of sufficiency. A Board (or equivalent) should undertake an ICAAP style process to set its own level of sufficiency for the prudent levels it should maintain, considering its risk appetite, capital funding positions and availability to other sources of funding from sponsors.

Any surplus above the prudent value of future maintenance cost obligations can then be released back to the operator subject to the advice of the external expert. This means that any growth aspirations of the cemetery operator should be funded by the underlying business case itself supporting commercial return for capital/funding, rather than using ring-fenced assets which are to support perpetual maintenance obligations accrued in relation to past interment sales to date.

Where there is the ability for surplus assets to be released back to the cemetery operator, this will need to balance the risk that future maintenance costs may be higher than current best or prudent estimates with the opportunity cost that the excess monies could be better spent within the business, e.g. for future development or business expansion.

Similarly, it is expected that there would be restrictions on the Board's (or equivalent's) ability to use the perpetual maintenance care fund as security for any loans obtained for the general operations of the cemetery operator.

If an operator feels they lack sufficient investment expertise to manage such a fund themselves, especially given the long time horizon for such assets, they should consider obtaining independent investment consulting advice and consider an external investment manager. Furthermore, for certain operators such as councils, TCorp (the financial markets partner for the NSW public sector) presently offers an investment management service and general financial advisory assistance to New South Wales local councils, and such an option could be practical for such council operators in relation to investment management of their perpetual maintenance funds.

6.5. Prudential proportionality

Proportionality is a key obligation for all regulators across different industries. An objective is to ensure that prudential supervision is proportionate to the expected outcomes of that supervision. However, proportionality is an inherently subjective concept.

Proportionality means adapting the nature and intensity of supervision to the specifics of the entity – its risk profile, its business model and its size. In deciding how best to adapt their approach, regulators must be guided by the other primary objectives of supervision. Proportionality strategies used to tailor regulatory requirements vary markedly across jurisdictions, including the criteria used to differentiate institutions, the scope of application, and the methods used to apply proportionality.

Care is needed to ensure that the costs and benefits of prudential regulatory activities are balanced across entities of different sizes and with different business models. Applying the same supervisory approach to small operators as that applied to the very largest operators is unlikely to be proportionate. Complex supervisory approaches and demanding information requests tend to be disproportionately costly for smaller operators. As smaller operators tend to pose a smaller risk to the systemic functioning of the sector, the benefits of such intensive supervision are also likely to be smaller.

To achieve proportionality, the regulatory model must be balanced so that the governance over perpetual maintenance obligations is enhanced at an industry level, but at the same time the model does not impose excessive burdens on particular operators or classes of cemetery operators.

Accordingly, a reasonable methodology would be to enforce the framework only for operators (including across all of their cemeteries, and covering Crown, council and private models) that are greater than a certain size (by net assets or number of sold or total plots (sold and unsold), or annual numbers of interments). This allows it to not be overly burdensome for small operators, as well as appropriately manage the more material risks to the public from the larger operators. Notwithstanding this, smaller operators could still be encouraged to follow (or even to more actively opt-in to) the enhanced governance framework to the extent that is reasonably achievable in the context of their business overall.

We suggest that a suitable minimum size of operation could be:

- 50 bodily interments performed per year (or interment right sales per year); or
- 10,000 bodily interment plots sold to date across all of the operator's cemeteries

The rationale for at least 50 is based upon being able to appropriately cover all the Crown operators, the major metropolitan and regional council based operators and the major private sector operators. Assuming a population mortality rate of around 1.7% and a burial rate of around 30% (noting this can vary based on location, faith and other factors) this would imply a catchment zone population of around 10,000 people. This would cover many regional centres but not capture smaller locations or those with limited burials.

The selection of the measure of total plots sold historically at 10,000 is to also ensure that operators that may be close to being exhausted are also properly included. Similar analysis undertaken as part of our review of council operators shows that generally those that are doing around 50-70 interments a year also have existing cemeteries with around 10,000 sold plots.

6.6. Role of the regulator

As noted above, the role of the regulator, CCNSW, is important for enforcing the enhanced governance requirements recommended in this report. CCNSW should be provided with a copy of the independent advice reports obtained by the cemetery operators, both where this is introduced as a new requirement for larger operators and also where smaller operators choose to adopt some or all of the enhanced governance framework on an opt-in basis. To allow CCNSW to perform its duties, these reports must be provided on a timely basis, such as within three months of receipt by the operator.

Section 6.7 below discusses transition issues associated with moving to an enhanced governance framework, particularly in relation to funding for legacy maintenance cost obligations in relation to past sold interments at the date that the new governance rules comes into effect. As part of that process, cemetery operators will need to develop a plan for progressively improving the funding of

any shortfalls in coverage of expected future maintenance costs in respect of past sales. The regulator would be responsible for providing guidance (or setting standards) for the cemeteries industry in relation to the minimum items which are required to be considered in independent advice reports required by an enhanced regulatory model and in the transition plans required to be developed by operators.

It would be reasonable to require a copy of the transition plan be provided to the regulator. Possible approaches for the regulator in response to receipt of the transition plan may be:

- The regulator is required to approve the transition plan; or
- The regulator reviews the transition plan and may:
    - require the cemetery operator to report to the regulator at specified intervals or on occurrence of certain events;
    - require the cemetery operator to review the investment strategy of the perpetual maintenance fund; or
    - require or permit a variation to the period of the transition plan, or to the target level of funding in relation to legacy maintenance obligations.

It is expected that the regulator will need to provide guidance to the cemeteries industry in relation to what are minimum expectations for funding for legacy maintenance obligations, as well as requirements for setting aside monies from future interment sales for perpetual maintenance purposes. Another area of guidance which the regulator may choose to provide is the level of maintenance standards which are to be provided in perpetuity, which may take into account factors such as levels of visitation, community expectations, time since the cemetery was fully utilised, heritage status (where applicable), and absolute minimums of maintenance permissible.

Based on the increased information which the regulator will have access to in relation to the status of funding for legacy perpetual maintenance costs, and in particular the size of any unfunded shortfalls, the regulator may use this information to publish reports at a whole industry level on the progress towards resolving historical funding issues since implementation of an enhanced framework, and to report on the satisfactory coverage of maintenance obligations for new interment sales post-implementation.

Also, the regulator would be expected to consider future refinements in the perpetual maintenance governance framework over time, based on information gathered in relation to developments of other cemetery regulators in other states or territories in Australia as well as overseas.

6.7. Potential transition path/timeframe

It is prudent to consider transition to a new governance framework in the context of two parts:

(i) Past sold interments ("legacy" obligations) when new requirements are introduced
(ii) Interments sold on or after the date of introduction

6.7.1. Legacy maintenance cost obligations at introduction

As mentioned above, it is necessary to consider the burden of imposing the more stringent governance requirements in relation to past sold interments (also called "legacy" maintenance cost obligations). It may be unreasonable to apply this burden with immediate effect, and a transition plan would be needed to aim towards full (or as full as is reasonably achievable given the current status of the operator's cemeteries and proportions already sold) funding of the expected future maintenance costs in respect of past sales.

One approach to managing this would be to consider splitting obligations in respect of existing (legacy) sold interments and any existing supporting assets into a separate "fund", ring fenced as above. In some cases, there may be negligible existing assets set aside (or available to be immediately set aside) to meet these perpetual maintenance obligations for past sales. As part of this approach, it would be necessary to accept that the current coverage of legacy maintenance obligations may not currently be at 100% (and many may be well less than that), but rather than being immediately required to get to 100% funded, a more appropriate approach in practice would instead be to require the Board (or equivalent) to specifically develop a "medium term" plan of

how such legacy shortfall positions will be managed (e.g. some cross-subsidy from future sales, or additional contributions from other operations like cremations, capital injections from owners etc).

This will drive thinking about options of capex spend, how to price other operations, dividend payout policy, etc, in order to contribute to funding of the shortfall. Under this structure, the Board (or equivalent) would be required to receive advice from the external adviser on the options for building an asset pool and improving the funding ratio in relation to legacy maintenance cost obligations, and that legacy funding plan so developed would need to be reported to the regulator. The regulator would have the right to go back to the Board (or equivalent) if it did not consider the outcome as being appropriate, and to challenge the period over which the Board (or equivalent) intends to fund the legacy obligations.

A "medium term" multi-year period is proposed, to give ample time for operators and the regulator to work through the challenges that each may face. We do not specifically define what "medium term" may represent as it should vary based on the position of each operator, however we suggest it should not be longer than 7 years. This could also allow other strategic options to be explored which could assist in resolving some of the potential shortfall across the sector, such as merging of operations/cemeteries, cost efficiency programs to be implemented, reduction to a more moderate level of ongoing maintenance care, etc.

We also note that some operators could wish to consider exploring other alternatives such as a letter of credit or the like from a bank, instead of needing to find assets to be set aside or funding via equity capital. This may be considered as an interim action allowable by the regulator, provided it is comfortable with the counter party risk exposure. However, we observe that a lender giving a letter of credit will likely require some collateral to be put up by the operator, such as a right over future income, and payment for the option cost requiring future servicing from the operators.

6.7.2. Future sales of rights

For new rights sold from implementation date, it is appropriate that these should be also ring-fenced separate to the legacy obligations (i.e. related to pre-implementation obligations). In relation to new interment rights sales, it is feasible to require that perpetual maintenance care funding must be maintained at the 100% level plus a prudent buffer set by the Board (or equivalent). This therefore means future pricing and monitoring adheres to the full requirements from the start and prevents the exacerbation of any shortfalls existing in relation to previously sold (legacy) interment rights.

6.8. Alternative option – centralised perpetual maintenance fund

An alternative approach to the ring fencing by each operator as described earlier in this section, could be the establishment of a centralised perpetual maintenance fund which applies across multiple cemetery operators. The funding of this centralised fund could be financed by imposing a proportional levy on all cemetery operators to be contributed towards the central fund.

It is expected that the regulator could be given the legislative power to set (and revise) the required rate of contributions (or levy) across operators in the sector which must be contributed to the fund in respect of new sales of interment rights. The prescribed minimum levies/contributions could be set out in the cemeteries legislation itself, or in an accompanying legislative instrument which could provide more ease for regular review and resetting of the levy rates over time as required than having to update the Act itself. The levy rate and how this should be fairly and equitably applied across operators would need careful consideration. It could be appropriate for the regulator to periodically seek independent professional advice to support it in assessing the recommended levy rates to ensure that they remain adequate for the purpose.

The centralised fund could initially be operated in relation to future maintenance obligations in respect to the sale of new interment rights only, rather than being set to cover any existing "legacy cost" position of operators. This could allow a more equitable starting approach, and the percentage to be contributed to the centralised fund could be set based on type of interment right (eg lawn burial, monument, mausoleum etc) as well as be set in reference to a set maintenance level standard offered by the operator with the sale of the interment right. The assets could be

pooled and run by a central investment manager, such as TCorp, in order to gain efficiencies of scale and diversification across the sector.

It is acknowledged however that it would not be practicable to operate a centralised fund on a commingled basis in respect of legacy perpetual maintenance obligations in relation to past sales, as the levy rates would not be able to be determined on a fair and equitable basis given the differences in size of legacy maintenance obligations for different cemeteries based on their maturity and varying levels of current funding.

Another approach rather than one central pooled fund could be to operate a centralised fund but still retaining a segregation of assets in relation to each operator. This is similar to how master trusts operate in the superannuation industry, where there are separately identifiable sub-plans (and separately identifiable assets and beneficiaries) within the overall fund structure but where monies are pooled for investment purposes (i.e. multiple sub-plans can invest in the same unitised investment portfolios). Applying this approach in a cemeteries context would avoid issues of cross-subsidisation between operators, but would mean that the levy rates would also need to be set at an operator (or cemetery) level which is more complex than a single levy rate across the industry. It would be possible to apply this type of approach for either new sales only, or to cover all perpetual maintenance obligations (i.e. both legacy obligations and future sales too), as the accumulated monies in relation to a specific operator are only accessible by that operator. As an aside, we note that this should not cause any issues in relation to any transfers of responsibility for certain cemeteries from one operator to another, with the associated perpetual maintenance sub-fund for the transferred cemetery also being able to be attributed to the new operator.

Overall however, we consider it would be a significant challenge to introduce a centralised approach to an established sector. In addition to the issue noted above, some further potential difficulties we envisage which would need to be resolved include:

- Only active operators would be contributing to the fund, which raises the question of whether the levy contributions are aligned to the distribution of payments. A risk to be mitigated would be whether an operator exits the industry in order to avoid having to meet the costs of their perpetual maintenance obligations, and maybe even re-enter again as a different entity with a clean slate
- Different cemetery operators, and even individual cemeteries, will have different perpetual maintenance standards, which makes it difficult to determine what is a reasonable payment from the central fund for financing their perpetual maintenance costs. This could raise issues with inequitable treatment between contributions vs payments across different operators.
- Given that perpetual maintenance costs tend to be lower than general maintenance expenses while a cemetery is still in its active sales period, a process would need to be developed to allow for determining the amount of monies to be regularly recouped from the fund to support these ongoing perpetual maintenance costs
- The governance of the central fund would be critical to ensure that it is well-managed and that assets are available when operators need to draw upon them. This would need to consider who will manage that fund (or whether it would be managed by the NSW State government), set the investment strategy, and set the levy contribution rates/amounts as well as how levels of payments out of the fund will be determined.

A further alternative way that a centralised fund could operate would be as a means of funding perpetual maintenance obligations "as a last resort". This would effectively be akin to an insurance policy where if an operator fails, the centralised fund is able to cover the legacy maintenance obligations they would leave behind. There would need to be suitable safeguards put in place to minimise the risk of moral hazard (where an operator perceives this as an easy way to 'walk away' from their obligations). The levy amounts in this case are payable, not to finance the perpetual maintenance obligations of the operator, but to finance the potential funds needed to bail out a failed operator – i.e. those contributing to a centralised "last resort" fund would not necessarily expect to get anything back from the fund themselves.

6.9. Summary of Key Recommendations

In summary, from our analysis, this report recommends the following as a potential framework for IPART to consider in respect to a perpetual maintenance governance framework:

- Introduce a regulatory requirement to have cemetery operators which are over a certain size (e.g. 50 bodily remains interments per annum or total sold bodily interment plots of greater than 10,000 across the operator) to prepare an estimate of the perpetual care maintenance liability and to establish/build a dedicated perpetual maintenance fund for this purpose. This is across Crown, council and private operators.
- That in doing so, the Board (or equivalent) of the operator is to engage an independent external adviser to either perform such calculation or review the operator's own calculation. Such advice should also cover the required level of contribution to be made from interment right sales and/or operating surplus to be allocated to a perpetual maintenance fund on an annual basis. This should be done at least every three to five years, or more frequently if material changes are proposed to the pricing or contribution rates. A copy of the independent report is to be provided to the regulator.
- That the Board (or equivalent) articulate a risk appetite statement in regard to the perpetual maintenance fund and its tolerance for funding levels and appropriate investment strategy. This should take into account the operator's available sources of capital for future support.
- The perpetual maintenance fund so established should be "ring fenced" such that the assets can only be used for the purpose of providing for perpetual maintenance obligations (with explicit definition of what activities these comprise), and that no other use of the funds is permitted. However, should such funds grow to be more than sufficient given the Board's (or equivalent's) risk appetite, then distributions may be made to general retained earnings.

While the above recommendations introduce a regulatory requirement for operators of a certain size to comply with an enhanced governance framework, smaller operators could still be encouraged to opt-in to the enhanced governance framework to the extent that is reasonably achievable in the context of their business overall.

This report also suggests that the regulator (CCNSW) engage with the accounting body (AASB) to seek guidance on whether or when such perpetual maintenance obligations would be triggered as a quantifiable liability on the balance sheet of operators. In the meantime, the report recommends that operators disclose in their notes to the accounts, or by separate split of the retained earnings, what component of the net assets relates to the perpetual maintenance fund.

In respect to past sales, or legacy obligations, the report suggests that the above framework could equally apply but recognise that a transition plan will need to be developed by each operator and approved by the regulator. This transition plan for legacy obligations should consider what the current available assets are based on historical retained surpluses and what the potential future perpetual maintenance costs may be for such past sales, and should this result in an existing funding shortfall position, determine what options are available to improve this situation over a period of time. This would need to be done on an operator by operator basis, in conjunction with the regulator, and consider what is an acceptable ultimate funding position that may be possible (or alternatively what level of maintenance care can be supported), and over what time period would this position be targeted.

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