

Mayah Group of Hospitals – Unseen material provided on examination day  
Read this information before you answer the question

---

**Note: a reminder of the abbreviations used, for your reference:**

DH = the district hospital

MH = the mental hospital

MCWC = the maternity and child welfare clinic

**Results of investigation**

The senior health executive from a neighbouring region sent in to investigate the allegations made by a Non-Executive Director (Carlos Cluntz) of misconduct in the awarding of the redevelopment contract (the "Investigating Executive") has completed his investigation and delivered three main conclusions:

1. There were a number of irregularities in the process of selecting the contractor.
2. Carlos Cluntz's contention that there were serious managerial weaknesses in the MGH Board was upheld. In particular, the investigating executive discovered that John Asta, the Chief Executive, was a shareholder in Romstat Properties. Although there was no evidence that he had attempted to influence the purchase terms of the Romstat land, he was required by his contract of service to declare such interests. The investigation also revealed that a Non-Executive Director, John Vance, undertakes freelance consulting work for MGH which he has not declared at Board meetings when contracts for the provision of such services have been discussed and awarded.
3. Although there were documents detailing MGH's corporate governance policy and procedures and the Chief Executive had ultimate responsibility, there was no supporting managerial or administrative framework to ensure the policy was followed and monitored.

The main recommendation from the Investigating Executive is that MGH needs to strengthen and improve its management structure.

A second recommendation was made that strategies for MGH achieving its objectives must recognise a wide range of issues, including ethical considerations.

As a result of the Investigating Executive's critical report, the Chairman, Chief Executive, Finance Director and John Vance have resigned. The Vice Chairman, who has recovered from her period of ill health, has been appointed Acting Chairman. Temporary appointments have also been made to the positions of Chief Executive and Director of Finance. The Acting Chairman, with the approval of her Board, has invited Carlos Cluntz back onto the Board as Non-Executive Director. He has accepted. This still leaves a vacancy for a Non-Executive Director. No one has yet been appointed.

The Investigating Executive criticised ArkFin for "inappropriate" discussions with some of the outgoing MGH Directors during the original bidding process but stopped short of claiming that ArkFin had done anything illegal or unethical. Its selection as "preferred building contractor" was therefore allowed to stand, subject to the following criteria:

- acceptance of its detailed cost estimates;
- that the *financing* of the contract be re-opened to limited competitive tender by at least one other company.

TURN OVER

## **Appointment of advisers**

As a result of this investigation, the new Board has appointed a firm of professional advisers, Ross, Jackson and Broomes, to assist with re-evaluating the choice of lead contractor and evaluating the restructuring Proposals. This advisory firm specialises in public sector consultancy work of this kind and is very experienced, if expensive. Ross, Jackson and Broomes will lead a Project Evaluation Team that will include representatives from managerial, administrative and clinical departments in MGH. Its terms of reference are:

- to evaluate and prioritise the strategic issues facing MGH at the present time;
- to evaluate the three redevelopment Proposals;
- to recommend actions for addressing the strategic issues, including the most appropriate redevelopment Proposal.

## **Projected overspend**

ArkFin has now submitted detailed cost estimates for building and financing the three redevelopment Proposals. The totals are shown in *Table 1* (below) along with other forecast information prepared by the Project Evaluation Team. The costs of the project if Proposal 1 or 2 is chosen are likely to be much higher than originally expected and the project would take much longer to complete. The main reasons for these changes have been identified as:

- Land prices have increased since the outline bid was submitted and Romstat Properties believes that new planning laws mean the company might now be able to obtain permission for the site to be developed for limited commercial use. The Romstat land now has an estimated market value of €25 million. However, the estimated sale value of the land and buildings on the existing sites has also increased.
- Surveys of the proposed Romstat Properties' site have discovered geological faults that were not evident at the time of the initial bid. This will make the building work more difficult and more expensive.
- The environmental study has resulted in requirements for a number of costly changes to the original building design. The local authority has indicated this work will be required as a condition of planning permission being given. This also will introduce a delay into the timescale for completion.

<b>Table 1</b>		<b>Proposal 1</b>	<b>Proposal 2</b>	<b>Proposal 3</b>
	<i>Note</i>			
Cost of Romstat land ( <i>€ million</i> )		25·00	25·00	0
Building costs ( <i>€ million</i> )		145·00	115·00	35·00
Less: estimated sale proceeds of old land and buildings ( <i>€ million</i> )	1	(30·00)	(24·00)	0
Net capital costs ( <i>€ million</i> )	2	140·00	116·00	35·00
ArkFin's annual lease charge ( <i>€ million</i> )		13·12	10·87	4·87
Duration of lease		25 years	25 years	15 years
Estimated completion date (months from date of signing contract)		+40 months	+36 months	+32 months
Forecast increase in activity	3	13·6%	21·4%	4·20%
Required income per annum ( <i>€ million</i> )	4	266·25	246·00	253·31
Efficiency adjusted annual cost saving ( <i>€ million</i> )	5	7·76	8·32	2·51

#### Notes

1. The Project Evaluation Team commissioned an independent valuer to value the land and buildings. With Proposal 1 the land and buildings of all three sites would be sold, although the value is almost exclusively for the land, as the buildings have virtually no alternative use other than as hospitals. With Proposal 2, only the MH and MCWC land and buildings would be sold.  
  
The proceeds from the sale of the surplus Romstat Properties' land that would be available with Proposal 2 has now been estimated at €8 million. This estimate assumes planning permission for housing is received. This amount is excluded from the figures above, as it is so uncertain.
2. The Zamorna government has told MGH it can expect no financial assistance with capital expenditure for the investment required for redevelopment, which must now all be raised from private sector funding.
3. Increase in activity is, broadly, an increase in the number of patients treated for comparable health complaints. The required annual income reflects this increase in activity.
4. The government has indicated it will provide additional annual income required as a consequence of the redevelopment provided there is a "substantial" improvement in MGH's performance on patient-related performance measures. To date, it has not been more specific about the level of improvements required and has not seen the figures in *Table 1* or any supporting documents. The Project Evaluation Team has incorporated forecast lease charges into the required annual income.
5. Government targets require efficiency-adjusted cost improvements to be a minimum of 3% of annual income on major redevelopment projects and 1% on rebuild or refurbishment projects. These efficiency gains are reflected in the required annual income.

## Competitive tender for the provision of finance

As required by the independent investigator, the MGH Board approached two companies for a competitive tender for financing the project. One was LinMel, which had bid for the original contract. The other was a subsidiary of an international bank. LinMel informed the Board they did not wish to tender. The bank submitted the following lease terms:

	<i>Proposal 1</i>	<i>Proposal 2</i>	<i>Proposal 3</i>
Annual lease charge (€ million)	15.42	12.78	4.60
Duration of lease	25 years	25 years	15 years

## Methods of appraisal and evaluation of Proposals

The decision process in choosing the most favourable Proposal will involve expressing MGH's requirements in output terms. In other words, what outcomes would it be getting for the money invested. The following key variables will be considered as part of the appraisal and evaluation process. Each of the variables has been ranked on a scale of 1 to 3 (where 1 = best and 3 = worst) and weighted according to its relative importance. The resulting weighted scores have been determined by the project evaluation team but are in line with the government's guidelines.

<i>Variable</i>	<i>Weighting</i>	<i>Proposal 1</i>		<i>Proposal 2</i>		<i>Proposal 3</i>	
		<i>Rank</i>	<i>Weighted score</i>	<i>Rank</i>	<i>Weighted score</i>	<i>Rank</i>	<i>Weighted score</i>
Capital cost	0.10	3	0.30	2	0.20	1	0.10
Annual funding requirement	0.20	3	0.60	2	0.40	1	0.20
Reduction in cost per treatment	0.22	2	0.44	1	0.22	3	0.66
Increase in activity	0.25	2	0.50	1	0.25	3	0.75
Reduction in complaints received and investigated	0.05	2	0.10	1	0.05	3	0.15
Improvement in quality of patient care, as measured by reduced waiting times for treatment	0.18	2	0.36	1	0.18	3	0.54
Totals	1.00		2.30		1.30		2.40

These are not the only variables that will be considered in the evaluation process, but they are the ones most easily quantifiable. Also to be considered is how each Proposal will contribute to the achievement of MGH's four aims and how they will help address the strategic issues facing MGH at the present time.

Public sector organisations in Zamorna are required to show a 5% return on investment (that is, they use a discount rate of 5% to evaluate cash flows).

## Operating and financing the project

In addition to the construction of the new buildings, ArkFin will provide building and equipment maintenance and replacement services as required by the terms of bidding. The costs of these services are included in the lease charge. Discussions are taking place with ArkFin about the consortium also providing ancillary services such as catering, laundry and cleaning services. If ArkFin is given the contract for these services, it will have a favourable effect on the terms of finance for the land and construction. The annual lease charge for Proposals 1 and 2 would reduce to €12.57 and €10.40 respectively. The charge for Proposal 3 would be unaffected.

The required annual income from government, shown above, has included an estimate of costs for ancillary services. The difference in costs between ArkFin providing the services and MGH continuing to provide them in-house is minimal. The possible differences in the quality of the services are difficult to quantify, although there are strong and differing views about this issue among the management and staff of MGH. At present MGH uses local suppliers for most of its consumables. It would probably lose this business if ArkFin took over the ancillary services. The main benefit of using ArkFin is in the favourable lease finance terms.

## Demographic changes

A new demographic forecast has just been produced which is likely to have an impact on the future requirements of hospital services. This forecast shows a likely increase in the average age of the local population, and declining birth rate, due to its popularity as a retirement area. Many younger people are moving to other districts or regions. The revised forecast is shown below. These effects have not as yet been quantified or the effect on the hospitals in the group assessed.

	<i>Actual as at 2003</i>	<i>Original demographic forecast for 2013</i>	<i>Revised demographic forecast for 2013</i>
Population total	518,000	534,000	519,000
Percentage:	%	%	%
aged under 4	5.2	4.8	4.7
aged 5 - 16	12.5	11.7	11.4
aged 17 - 25	10.6	9.7	9.7
aged 26 - 45	26.3	24.3	22.5
aged 46 - 60	17.4	18.5	18.6
aged 61 - 80	20.3	22.5	24.3
aged over 80	7.7	8.5	8.8

*The above information was provided in the pre-seen material*