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Society of Certified Management Accountants of Sri Lanka

Professional II Stage March 2009 Examination

Examination Date : 5th April 2009
Examination Time: 9.30 a. m.- 12.30 p.m.

Number of Pages : 18
Number of Questions: 01

Instructions to candidates:

1. Time allowed is **three (3) hours**.
2. Attached to the question are **Scenario I** given in advance and **Scenario II**
3. Answers should be entirely in **English language**.

<u>Subject</u>	<u>Subject Code</u>
Case Study	(CaS / 804)

Question (100 Marks)

Ferto

You have been appointed as the Management Consultant to Ferto to advise the board.

Prepare a report that prioritizes analyses and evaluates the key issues facing Ferto and makes appropriate recommendations.

In your report you have to discuss the offer made by SAHG, acquisition of SILVAS and funding options

Scenario I

A Research Study Infertility

The problem with infertility or childlessness is one of the most stressful experiences that a married couple wanting a child may experience. Research shows that approximately 40% of infertility is related to the female reproductive system and 40% to the male reproductive system, while the remaining 20% falls into the category of *unexplained* infertility.

Infertility treatments

The majority of infertile couples use common infertility treatments such as assisted reproductive technologies, drug therapies and surgery. There are no guarantees with advanced infertility treatment. However reported success rates are encouraging. Defined in the broadest sense, the term Assisted Reproductive Technologies (ART) may be applied to any therapy used to improve the chances of conception.

In the current vernacular, ART is reserved to describe those interventions related to *in vitro fertilization* (IVF) and embryo transfer. In vitro fertilization (IVF) is the most common procedure and has grown in demand since the first child was conceived by IVF in 1978. IVF is a multi-step process in which eggs (oocytes) are extracted from the woman's ovary (where the eggs are produced), fertilized by sperm in a laboratory, cultured into early embryos and then transferred into the woman's uterus. **Intracytoplasmic sperm injection** (ICSI) is done in combination with IVF to increase the chances of fertilization. In brief, this procedure involves injecting a single sperm, into an egg, using a microscope and specialized instruments. ICSI is the treatment of choice for severe male infertility and may also be used to treat unexplained infertility.

Fertilization rates for ICSI are reported to be at around 70% and higher. **Gamete intrafallopian transfer** (GIFT) was developed a few years after IVF and is sometimes used on young women who have unexplained infertility. This is not often recommended since a woman must have at least one unblocked fallopian tube in order to qualify for GIFT. In GIFT, eggs are retrieved from the woman's ovaries and placed with the male sperm, obtained prior to the procedure, into a small catheter. The catheter, a flexible tube, is used to immediately deliver the eggs and sperm into the woman's fallopian tubes where nature takes over. Unlike IVF where fertilization occurs in the laboratory, in GIFT the fertilization takes place inside the woman's body.

Zygote intrafallopian transfer (ZIFT) is essentially a blend of both GIFT and IVF. Fertilization of the eggs occurs in the laboratory and the newly fertilized eggs (zygotes) are placed into the fallopian tubes rather than into the uterus as they would be in IVF. ZIFT procedures are appropriate in cases of mild to moderate male infertility where there might be a question about the fertilization capacity of the sperm and where there might be antisperm antibody production.

Intrauterine insemination (IUI) is used for women with unexplained infertility, inadequate cervical mucus; for antisperm antibodies and in men with mild to moderate sperm abnormalities. The procedure is fairly simple and can be done in a healthcare provider's office around the time of ovulation. It increases the likelihood of pregnancy regardless of the infertility treatment prescribed. IUI is performed when a woman is releasing eggs (ovulation). Sperm is collected from the man prior to the procedure and washed with a special solution in the laboratory. It is then injected into the uterus using a thin tube (catheter) attached to a plastic syringe. IUI is also used if sperm shows poor motility (swimming ability) or if there is an ejaculatory problem. However the effectiveness of IUI is naturally higher if sperm parameters are within the normal limits. Success depends on the age of the female partner, diagnosis and treatment given in conjunction with IUI.

For women who dream of having a family one day, recent high-tech medical advancements in fertility treatment will enable them to delay pregnancy and have children according to their own calendar, not their biological clock. **Egg freezing** is an evolving technology that preserves a woman's fertility by literally keeping her eggs on ice until she decides to get pregnant. The procedure, which is still being refined, will be beneficial for women who suffer from diseases and medical conditions that may impair their future fertility. Egg freezing is also an option for professional, career-minded women or women without a partner who wish to become mothers some time in the future.

Pre-implantation genetic diagnosis (PGD), a reproductive technology, offers couples peace of mind by breaking the cycle of inherited genetic defects so that they can enjoy the prospect of parenthood without fear of passing on a devastating disease to their offspring. PGD is used to diagnose chromosome disorders in embryos. Couples who have lost pregnancies due to genetic disorders, who already have a child with a genetic problem or who are carriers of a genetic disorder, can use PGD testing to ensure that babies born after the procedure do not carry the genetic disease. Additionally, because they are free from PGD-screened chromosomal disorders, these embryos have a higher chance of resulting in successful pregnancy.

Surrogacy is a variation of egg donation, where the "egg donor" is the patient herself, while the "recipient" is the surrogate, (gestational carrier) who will provide the embryos with a uterus to develop in. The resulting baby is born to the surrogate, and will be returned to the patient and her partner. These procedures enable women with severely diminished ovarian function or severe genetic diseases to carry a child conceived with their husband's sperm, and for women without a uterus to have a child related to them and their partner.

Child's sex selection allows determination of the sex of the child to be born. Couples may be interested in selecting the sex of the child because of a specific genetic mutation is known to be present in one of the parents, which can manifest itself with disease in male or female offspring. Sex selection may also allow couples to balance the number of male and female offspring in their family. A variety of conventional and non-conventional methods exist for sex selection, all with limited success. Although not 100% accurate, the most accurate method available is PGD, with accuracy of nearing 100%. PGD has now been established as a safe and effective method for sex selection of an offspring.

Problems in IVF technology

Although IVF technology is one of advancements in the medical industry, there is a dark side to it as well. All the media hype about IVF has created a lot of pressure on infertile couples. Most family members and friends perceive IVF as a sure success method, and cannot understand why infertile couples balk at going through IVF treatment. Since the media generally highlights only the success stories, patients themselves often have unrealistic expectations from IVF treatment. Unscrupulous clinics which quote highly exaggerated and misleading pregnancy rates simply add to the confusion.

Media coverage about infertility has also given birth to a new medical condition called “pre-infertility”. Preinfertile couples are relatively young couples who suffer from nothing other than an enhanced sensitivity to the ticking of their biological clocks! Even though they have no medical problems and would conceive naturally, given adequate time, they panic and rush to seek medical assistance. Unfortunately, many doctors are more than happy to provide what is not needed, because such patients boost the clinic’s successful fertility rates and give the doctor an undeserved reputation of being a good fertility specialist!

As the treatment is expensive, many doctors feel IVF is a lucrative business proposition. Many IVF clinics are opened with the sole purpose of making money. Couples who might get pregnant with simpler treatment options are pressured into using expensive IVF treatment. Since such over treatment is generally suggested to young couples with minimal medical problems. The resulting success rate is high, boosting the clinic’s success rate as well as its reputation.

Unethical doctors have further ruined the image of IVF clinics. In order to boost fertilization success rates, doctors have taken it upon themselves to ‘donate’ eggs and embryos from one patient to another – without the consent of either party. Some ART clinics have made the exaggerating of pregnancy rates into a fine art. There are also doctors who deliberately give their female patients repeated ‘HCG’ injections after embryo transfer, and then measure the blood level of beta ‘HCG’ a few days later to ‘prove’ to the patient that she has conceived. Since the beta ‘HCG’ level is positive, the patient – who does not know that the positive test result is a result of the hormone injections - believes she did get pregnant. When the ‘HCG’ levels eventually turn out negative, the doctor explains that the patient ‘miscarried’.

Using a sperm or egg donor is a viable option when a man doesn’t have sperm and/or when a woman is unable to produce good quality eggs. Donors are recommended when one or both partners have a genetic disease which can be passed on to their offspring. The decision to use donor sperm and/or egg is one of the most difficult a couple will ever have to make. Couples may struggle with the knowledge that a child born through donation is not genetically related to one or both of them.

Ferto

Ferto PLC was incorporated in year 2000 by a team of gynecologists, embryologists and fertility treatment specialists in an Asian country. At Ferto all treatment plans are individually designed to optimize a patient's chances of achieving a successful pregnancy. The scope of services include intrauterine insemination, fertility medications and advance procedures such as in vitro fertilization (IVF), preimplantation genetic diagnosis (PGD) and a donor egg program. Ferto also aims to provide innovative and progressive fertility treatment at reasonable cost.

Ferto's pregnancy success rates are excellent, averaging 50%. For those who are over 35 years of age, the success rate is around 30% - 40%, while for those below 35 years; it is in the region of 50% to 60%. In the year 2004, Ferto built a state-of-the-art embryology/andrology laboratory. The 'embryo culture environment' has been uniquely designed to combat the presence of environmental contaminants found in the air of every IVF lab, which have a significant negative effect on embryo cleavage and pregnancies. IVF and PGD done at the facility now make it possible to biopsy the embryo, complete the genetic analysis, and replace the embryo in the same day or by the next morning. Ferto also provides psychological counseling, egg aspiration under local anesthesia, a sperm storage facility and advanced stimulation protocol.

Shareholding & Management

50% of the shares are held by Dr. Suresh Ameresekere and his family. Dr. Ameresekere graduated from a leading university in USA and is one of the world's leading embryologists. He is a regular contributor to many medical journals and is a popular speaker in the international medical conference circuit. Dr. Ameresekere is the Chairman of the company and his wife, a member of a well-known and very wealthy business family, is on the Board of Directors. Equity Venture Ltd, a leading international venture capitalist, holds 40% of the shares of Ferto. The balance 10% of the shares are held by employees.

Dr. Ravi Herath is also one of the directors of Ferto. He is one of the Asia's foremost gynecologists and is a consultant at a number of leading hospitals. He is in his late 60s and is planning for retirement next year.

Dr. Ameresekere is currently based in Boston, USA and Ferto is managed by the newly appointed CEO, Mr. Sanjay Kaza. Sanjay, aged 45, has an MBA from one of the premier Asian business schools. Prior to joining Ferto, he was the CEO of another South Asian hospital. Sanjay brings an immense enthusiasm and many aggressive plans for growth to the business. He is confident of achieving 20% growth per annum during the next five years. He was recruited in year 2008 with the understanding that he would generate a minimum return of 15% on investments made.

Mr. John David is the Financial Director of the company and heads the Finance, Accounting, Procurement and IT areas. He is in less early 50s and worked at a local Commercial bank for 20 years prior to joining Ferto. He is a close friend of Dr. Ameresekere.

Mr. Saliya Carvalho, aged 35, is the new Sales & Marketing Director, appointed in year 2008. Before moving to Ferto, he worked in a similar capacity in the local IT and Financial Services sector.

Mr. Kanishka Ekanayake, Director, Human Resources, overlooks the HR, Administration and Legal areas. Prior to joining Ferto, he was employed in the Army for 25 years.

New venture

Saliya proposed to the board that Ferto offer maternity services - one of biggest segments in the medical services sector. As per his initial estimates, the incremental investment would not be more than L\$ 250,000 and there are many skilled gynecologists in the country who could easily be recruited. This is a highly competitive area and there are already 30 hospitals in the country which provide such services. Saliya suggested focusing on a particular segment to gain a competitive advantage over the others. There are currently over 200,000 births a year and on average, a hospital could earn a net L\$ 400 per birth. This segment is growing at 2% per annum. At the moment, Ferto is obliged to send patients to other hospitals which offer maternity services. By offering maternity services, Ferto will be able to generate an additional income from its existing patients.

Government Subsidy

In the recent budget, the Government offered a 10 year tax free holiday for new investments in the medical industry. If existing companies invest more than L\$ 500,000, they will be permitted to import equipment on a duty free basis and the income tax rate will be reduced from the current 35% to 20%.

There are at least two companies from a neighboring country which have expressed interest in setting up operations in Ferto's home country. One of these companies plans to establish a joint venture with an existing private hospital to specialize in IVF treatment.

Expatriates

Ferto employed 10 expatriates in specialized areas. However, the Government is now very strict about granting work permits to foreigners in view of the availability of skilled local staff, high levels of local unemployment and the necessity of reducing the outward remittance. This situation has affected the operations of Ferto, because two of the critical staff's visas were not extended and the company couldn't find suitable and skilled local replacement. As per the revised Government regulations, a company is permitted to employ a maximum of 3 expatriates. One of the expatriates, whose visa was not extended by the Government subsequently sued Ferto for terminating his employment prior to the expiry of his contract period. The compensation sought is considerable.

The home country's migration rate is high. Approximately 200 qualified local medical staff migrates overseas every year, a number higher than that of the new University-pass outs. Ferto is faced with a major problem vis a vis retaining their local skilled staff. The current global recession, however, is expected to reverse the migration phenomenon.

There has been an acute shortage of nursing staff in the country for the last five years. At Ferto, 10 nurses resigned during the last quarter. Ferto managed to find replacements for only five. Kanishka proposes to recruit a few trainees, trained but uncertified from the Nursing college, to meet most urgent requirements. Ravi proposes 'headhunting' some of the competitors' staff at salaries 25% higher than their current earnings. Kanishka was not comfortable with Ravi's suggestion, feeling that this could demotivate Ferto's existing nursing staff, who are paid a lower salary.

Court Case

A couple whose IVF operation was unsuccessful, sued Ferto for L\$ 100,000 claiming the failure was due to negligence of Ferto's staff, who failed to do a critical test prior to the IVF operation. This case has created bad publicity for Ferto.

The Director, HR, Kanishka suggested that the Doctor who performed the operation be terminated from employment and the case settled out of court, with Ferto undertaking to perform the surgery again - with a different doctor - free of charge.

However, Ferto's CEO is of the view that failure is a possibility within the normal process and that the probability of success was clearly communicated to the couple prior to the commencement of the treatment. Tests are determined by the doctors on a case by case basis depending on the condition of the patient. The CEO also pointed out that if Ferto agreed to settle this case by offering a second operation free of charge, there is a strong likelihood of other unsuccessful patients also instituting action against Ferto.

Drug

Recently one of Ferto's drug suppliers supplied the hospital with a duplicate drug manufactured by an unlicensed company. This was pointed out in the periodic internal audit done on suppliers. The supplier is one of regular ones that supplies a range of products. The owner of the company is the brother of the local Minister of Health. This supplier has threatened that if Ferto divulges information or takes action on this matter, the supplier will have the hospital's medical license cancelled by the Health Ministry.

The drug in question has many side effects and there is risk of its use creating chronic illness. Ferto currently has a large stock of this drug in the stores.

Inventory

Ferto maintains a large stock of drugs and medical items. Every year Ferto writes-off L\$ 100,000 worth of drugs. John is very concerned about this matter and has lodged an official complaint to the board. In his point of view, the write-off is due to the excessive stocking of drugs and medical items, incorrect procurement planning and the LIFO stock issue system practiced by the stores. The Stores & Purchasing Managers have denied these allegations. According to the Purchasing Manager, most of these items have to be imported from other countries, through local agents with a lead time of 60 to 90 days and Ferto is compelled to maintain adequate stocks to meet any contingency.

Complaint

A patient has made a formal complaint to the CEO that in an invoice issued by Ferto there are several mistakes and some items have been duplicated. He says he has been charged for services and drugs which have not been provided to him. He has informed the hospital that he is in consultation with his lawyers and intends reporting the matter to the relevant authorities.

Disputes

In most of the recent management meetings there have been a few disputes between John and Saliya. The last meeting ended with major arguments between them and John walked out while the meeting was still on. John told the Chairman that he would resign if Saliya continued to work for the company. Saliya and John are from rival schools and have had disputes since their school days.

Marketing Campaign

At the last meeting Saliya proposed an L\$ 200,000 marketing campaign to promote Ferto and its services. He also informed the board that if it did not approve this expenditure, there would be the possibility of a 40% reduction in turnover next year, which would lead to substantial losses. Saliya proposes to place advertisements in the local newspapers, host a dinner and offer gifts to all major gynecologists in the country. He feels that the best way to promote Ferto's services would be to develop close relationships with the gynecologists, convince them of Ferto's success rate and use them to promote Ferto to their patients.

Multiple Births

In IVF operations over the last 25 years, the incidence of twin births has risen more than 50 percent and the incidence of triplets and multiple births in general have increased. This has both positive and negative impacts. Saliya informed the board that a few patients complained to him that full disclosure of all risks involved in the IVF operation was not made, prior to treatment.

South Asian Hospital Group

South Asian Hospital Group (SAHG) is a leading hospital chain operating in Asia. They are most impressed with the services provided by Ferto. SAHG doesn't provide IVF treatment facilities. They have expressed their interest in buying Ferto and are currently in the process of making an offer to the board and have had preliminary discussions with Ferto's Chairman. SAHG is also interested in investing in Ferto with a view to expanding its operations to other countries. The SAHG group maintains 20 hospitals and has a proven track record for the last 25 years. They don't currently operate in the country in which Ferto operates. However they do have collaboration with certain local hospitals, who direct patients to SAHG for major surgeries and complex treatments such as renal transplant. SAHG is the pioneer in providing new innovative services. They were the first to provide heart transplant services in Asia. SAHG's shares are quoted in two of Asia's stock exchanges. They have a PE ratio of 14 and expect a 15% return on all of their investments. They expect to reduce the fixed cost of Ferto by 10% through synergies, if they acquire Ferto. The weighted average cost of capital of SAHG is 10%.

Waste Disposal

In view of the delay in the collection of waste by the Government Municipal Council and the limited waste storage capacity, Ferto has been disposing of its waste through a private waste disposal company. Recently there was a media report that this particular waste disposal company dumps the medical waste collected from Ferto in an unauthorized location. Residents in that location lodged a formal complaint against Ferto with the Environmental Authority, against Ferto. Ferto CEO was summoned by the Chief of Environmental Authority.

ISO 9001:2000 Certification

Ferto is in the process of obtaining the ISO certification and have appointed a local consultant to assist in preparing the relevant documentation and recommending improvements. There are many non-conformities reported by the Consultant in his preliminary survey. Also expressed is a concern that certain staff do not cooperate with the consultant, as they 'didn't see any benefit in getting ISO certifications'. This has delayed the application for certification.

Private practice

It was observed that a few Ferto doctors have their own private medical practices and they divert a few Ferto patients to their private clinics. One of the doctors complained that the salary they get from Ferto is not adequate to maintain a decent life style and if they don't run private practice, they have no option but to obtain employment overseas. Some of the doctors obtain 60% to 70% of their income from private practice. The board is most concerned about this issue and is seriously looking at how best to address this problem.

Information System

The current IT package used by Ferto is outdated and the CEO has received a proposal from a local IT company on an advanced and integrated IT package. This package costs L\$ 400,000 and could record, store and report all patients' data, maintain a large database of medical information, an electronic checklist of each activity, cost tracking system, management reports etc. This system could also facilitate e-prescribing and electronic appointment scheduling. Each patient will be given a unique patient reference number and doctors would be able to access previous medical history of the patient from the database.

Customers would also be able to check the status and database of their medical records by logging into the relevant web page of the Hospital. All medical records including X-rays and ECGs would be stored in the database. This would be a web-based system and would assist Ferto to exercise more controls. Doctors would be able to monitor the reports and treatment prescribed remotely. It is also intended to support integrated care pathways and make billing more efficient. The system would eliminate duplication and administrative inefficiencies and provide substantial cost saving. Further, it will enable Ferto to absorb its fixed cost to its patients, based on cost drivers and usage of resources. Instead of moving patients amongst doctors and departments, this system would facilitate movement of information between doctors and departments. This system could facilitate electronic ordering of drugs from stores and the obtaining consultations from experts in other countries.

Media report

There was a documentary on one of the local TV stations inferring that Ferto is buying female eggs from college students without the consent of their parents. The students sell their eggs to finance their education and meet their personal expenses. The report alleged that a minor employee of Ferto was acting as the broker for these transactions.

As per this media report, egg donors need to take a series of fertility drugs, some of which must be injected, to stimulate the ovaries to produce many eggs at one time. While using the drugs, they have frequent medical tests. Removing the eggs from the ovaries involves a minor surgical procedure. The medications can cause hot flashes, fatigue, sleep problems, body aches, mood swings, breast tenderness, enlarged ovaries, mild fluid retention, headache, and / or vision problems. Donors may also develop soreness, redness or mild bruising around the injection site. Although rare, it is possible to damage or puncture the bowel, bladder or nearby blood vessels. In the unlikely possibility of severe internal bleeding or serious damage to the pelvic organs, major abdominal surgery may be needed.

Fraud

One of Ferto's cash counter staff was caught in a major fraud. Some of the cash payments made for medical consultations were taken by him and not receipted or recorded in the books. When receiving payments, he generated the receipt through the IT system, issued it to the patient, accepted cash and subsequently cancelled the receipt in the system. The fraud was detected when a patient made a request for a refund of a consultation fee from another member of the counter staff, as the doctor concerned had cancelled all appointments due to a personal commitment.

Recruitment

It was noticed that three staff recruited to the laboratories and pharmacy, submitted forged certificates. Recently a university staff member was arrested for issuing fraudulent certificates for the payment of a fee. Kanishka suggested that disciplinary action should exclude dismissal, since the three people are very competent in their jobs and it would be extremely difficult to find suitable replacements.

Trade Union

Some of the staff plan to establish a Trade Union and join the *Joint Hospital Industry Trade Unions Association (JHITUA)*, which has over 2000 employees. A team of five employees are the 'drivers' of the movement. They are demanding a 30% salary increase and three months bonus for all staff. If the management declines their requests, they may form a Union and forward their demands formally through JHITUA.

Waste

According to research, wasteful spending within the health system amounts to more than half of all health spending. Defensive medicine, such as redundant, inappropriate or unnecessary tests and procedures, was identified as the biggest area of excess, followed by inefficient healthcare administration. Suresh has asked Saliya to search and exploit all possible avenues of reducing waste at Ferto.

State University

One of the leading state universities in the country submitted a proposal to Ferto for a grant to fund research. They requested funding of L\$ 25,000 per annum to partially finance their research work on Genetic Engineering in the University. In return, they agreed to provide ten of their graduate students to work on placements at Ferto for at least 20 hours per week per student free of charge.

Global Opportunities

In view of the commencement of many budget airlines in the region and reduction in fuel prices, air travel from neighboring countries has become cheaper. This has created opportunities for Ferto to attract patients from neighboring countries. Saliya suggested having agents in four neighboring countries, who would provide information on Ferto and direct patients to Ferto. These agents could be gynecologists working for other hospitals or staff placed by Ferto fulltime in other hospitals. Retired government servants could also be appointed as agents. The remuneration would be a nominal fixed sum with an attractive commission percentage on the income received from patients referred by the agents.

Increase in Diagnosis

One of the senior doctors proposed to increase the diagnostic tests which may increase the success rate. This will increase the overall costs, take a longer time and increase the prices charged by Ferto. While this could affect the overall competitiveness of pricing offered by Ferto, higher success rates could be a worthwhile differentiator.

Appendices

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Appendix 1:

Ferto PLC

Profit and Loss Accounts for the financial years ended 30th September 2008

	2006/2007 (in L\$ 000)	2007/2008 (in L\$ 000)
Sales Revenue	12,078	11,055
Personnel Cost	7,078	7,200
Drugs	2,400	2,300
General Administration Expenses	500	525
Depreciation	200	205
Marketing Expenses	57	65
Total Operation Cost	10,235	10,295
Profit before Interest & Tax	1,843	760
Interest	200	225
Profit Before Tax	1,643	535
Tax	575	187
Profit After Tax	1,068	348

Appendix 2:

Ferto PLC

Statement of Changes in Reserves

	Share Premium L\$ 000	Retained Earnings L\$ 000	Total L\$ 000
Balance as at 30 th September 2007	300	500	800
Profit for the period		348	348
Dividends paid		400	400
Balance as at 30th September 2008	300	448	748

Appendix 3:

Ferto PLC

Balance sheets as at 30th September 2008

	30th September 2007 (in LS 000)		30th September 2008 (in LS 000)	
Fixed Assets		2,470		2,287
Current Assets				
Inventory	200		225	
Cash	<u>5</u>		<u>4</u>	
		<u>205</u>		<u>229</u>
Total Assets		<u>2,670</u>		<u>2,516</u>
Current Liabilities				
Account payables & accruals		170		168
Share capital & Reserves				
Share capital	700		700	
Share premium	300		300	
Retained earnings	<u>500</u>	1,500	448	1,448
Long term liabilities				
Bank Loans		<u>1,000</u>		<u>900</u>
Total equity & Liabilities		<u>2,670</u>		<u>2,516</u>

End of Scenario I

Scenario II – Continuation of Scenario I

SILVAS

SILVAS is a local hospital established in 1965, operating a 100-room hospital in the capital city of the country. They provide a wide range of medical services. The hospital, however is in serious financial difficulties and has appointed a consultant to find a suitable buyer. Subsequent to the death of the founder of the hospital, this year, all the children migrated to the USA and plan to divest themselves their shares of Silvas Hospital.

The hospital owns a property located on a 10-acre plot of land in the central part of the city. They are expecting a price of L\$D 12 Million for the total business. As per the valuation done by a leading local valuer, the land & building are together worth over L\$ 8 Mio. Equipment is valued at L\$ 1 Mio. The hospital currently generates a monthly profit of L\$ 80,000 per month. This has been declining at 10% per annum during the last 5 years. Silvas Hospital has a very good reputation in the country and regular clientele.

Business Times

This is a leading local newspaper and has the largest circulation in the country. Recently the BT reported that even when some patients could conceive without IVF treatment. Ferto doctors pushed for IVF treatment for most of their patients in order to increase Ferto's revenue. The editor of the newspaper requested a meeting with the Ferto CEO to discuss issues pertaining to the investigations. The CEO proposes to sue the newspaper on the grounds of defamation. He recommended the Board to consult a lawyer to handle this issue.

SAHG

SAHG has approached the equity venture and offered them L\$ 1.7 Million to buy the entire stock of shares held by them in Ferto. They plan to make an offer to Ferto within a week. If Ferto rejects the offer, SAHG is plans to start their own hospital providing IVF treatment services in Ferto's country. A few of Ferto's senior specialists have expressed their interest in joining SAHG.

Growth plan

Suresh called for an urgent board meeting and informed the Board and senior management that the current decline in revenue and profits is unsatisfactory and that a plan is urgently needed to improve Ferto's profitability. Suresh wants Ferto to generate a minimum annual profit of L\$ 1.5 Million and requires a clear road map on how Ferto could achieve such a profit target. He has requested all Senior Managers to aggressively focus on cost reduction. All managers are given the task of reporting their cost reduction initiatives within two weeks. Suresh also indicated that if Ferto were not in a position to achieve the set profit target, there is a possibility of shareholders selling their shares to SAHG.

Cost Reduction

John proposed making consumers more personally responsible for the cost of seeking medical care and put prices on the menu; disclosing charges to reduce cost. Saliya was of the view that rather than reducing costs and services, Ferto should look into the possibility of providing additional value in its services at a higher rate. He said ‘The move from cost containment to value is a profound and genuine change. The relentless pursuit of lower costs as the single goal of healthcare management is not tenable in the long run as it was rejected by professionals, patients and the public at large. Buying value means being willing to expedite payment for worthy innovations while simultaneously saying no to those innovations that do not drive quality and efficiency’.

DC Bank

DC bank is one of the joint financiers of the project since its inception. Ferto banks with them exclusively and all its assets are mortgaged to the DC bank. There are no defaults in the loan repayments. The regional manager of the bank has called the CEO, expressed his concern on Ferto’s declining profitability and called for a formal meeting to discuss future cash flows and loan repayments.

In view of the current global financial crisis, DC bank has announced an increase in interest rates by 2%, with immediate effect. They have also indicated their inability to further increase their exposure. If the situation gets worse, there is a risk of the bank requesting Ferto to repay loans before the agreed due dates and may not roll over some of the long term loans.

Inflation

In view of the financial/ liquidity crisis in the country, inflation has increased to 25%. All major suppliers are looking at the option of increasing their prices. The Government has reduced fuel prices only nominally and the global reduction in fuel prices has not been fully passed on to the fuel users. The local currency (L\$) has significantly depreciated against USD and other major currencies. This has increased the cost of imported drugs. According to an international survey, costs in the health care sector are forecast to increase by 10% during 2009.

Cleaning company

The cleaning of linen is outsourced to a laundry in the vicinity of the hospital. The contractor has requested an increase of 25% in the rates. If refused, he intends to terminate his contract within three days. There are no reliable laundries in the city and the second best laundry has also increased its rates, which will be 15% higher than the rates currently paid to the existing laundry company. There are a few concerns regarding the quality of the cleaning services provided by other launderers.

Tax

Some of the medical consultants requested that Management not to declare their full incomes to the tax authorities as they would be subject to taxation. They also advised that if the Management refused their request, they might increase their consultation rates by 30% to cover their tax expenses. During the last two years, payments to a few of the medical consultants were classified under 'reimbursements of staff expenses' and 'staff entertainment expenses', not taxed and not reported to the Inland Revenue.

Forex exposure

Ferto has a forex outstanding of USD 5,000 on payments due to an overseas drug supplier and the Finance controller is in the process of hedging the forex risks. During the last year local currency has depreciated by 15% against the USD. The DC bank has quoted a premium of 1.5% on the USD rate for a 30 Days forward contract.

Increase in stocking of drugs

One of the main drug suppliers to Ferto has requested that the next six months' requirement be ordered in one lot within the next week, as they expect the price to go up by 25% within the month. These drugs have an expiry of 12 months and are very critical for IVF operations. This will affect the cash flows of the business, which is tight due to the restrictions in financing by the bank

Performance related pay for doctors

John has made a proposal to Saliya to provide incentives to clinicians based on profitability from patients. This will enable clinicians to reduce the costs in treating a patient. However, there are many risks involved in this system. There were complaints in the past that many clinicians don't focus on costs and profitability, which has resulted in costs being higher than the rates collected from patients. Saliya has sought Kanishka's advice on alternative performance related pay models, which could include qualitative factors as well.

New funding sources

Saliya has requested John to look for new, cheaper and sustainable sources of funding to reduce financial costs and to ensure adequate funding for future expansion. Weighted average cost of capital of Ferto is at 20%

Maternity Hospitals

There was a recent press item in the local newspapers to the effect that the number of patients to private maternity hospitals has reduced significantly, as most of them prefer to go to state hospitals due to a reduction in their income levels. The current financial crisis has affected the income levels of the people and forced the people to shift towards free medical services from Government maternity hospitals. Saliya is of the view that this trend is only for the short term and that the patients will return to private hospitals, due to the many problems in Government hospitals. Reduction in funding to Hospitals, limited resources and excessive needs, are seriously affecting the quality of services provided at Government hospitals.

Management Consultant

The board has decided to appoint a Consultant to advise on the current problems, take over bid, acquisition opportunities, financing options and future growth plans.

End of Scenario II
End of Question Paper

SCMA PROFESSIONAL II CASE STUDY – CaS (804)
March 2009- Marking Grid

Appendix 4:

	Marks	A	B	C	D	E
1. Management Accounting Sound technical knowledge in Management Accounting	20	High level of Management Accounting awareness relating to world examples 17-20	Good Management Accounting awareness relating to case study examples 11-16	Some level of Management Accounting awareness relating to few case study examples 10-14	Low level Management Accounting awareness 5-9	Lack of Management Accounting awareness 0-4
2. Application of theories Diverse knowledge clearly applied in an analytical and practical manner in solving the problems in the case study.	20	High level of application of theory in an analytical manner in solving problems in the case study 17-20	Good level of application of theory in an analytical manner solving problems in the case study. 11-16	Some level of application of theory in an analytical manner solving problems in the case study. 10-14	Low level of application of theory in solving problems in the case study 5-9	Lack of application of theory in solving problems 0-4
3. Identifying key issues Issues to be identified and prioritized in a logical manner with a clear rationale.	10	High level of recognition of key issues and these being prioritized logically with a clear rationale. 8-10	Good level of recognition of issues and these being prioritized logically 5-7	Some level of recognition of issues and these being prioritized 3-4	Low level of recognition of issues 1-2	Lack of recognition of issues 0
4. Decision making skills Ability to recognize and present appropriate alternate solutions and make effective judgement in a logical & rational manner.	20	High level of ability to recognize and present appropriate alternate solutions and make effective judgement in a logical and rational manner 17-20	Good level of ability to recognize and present alternate solutions and make effective judgement in a logical and rational manner. 11-16	Some level of ability to recognize and present alternate solutions in a logical and rational manner 10-14	Low level of ability to recognize alternate solutions 5-9	Lack of ability to recognize alternate solutions 0-4
5. Logical arguments Ability to communicate effectively with realistic recommendations in a concise and logical manner.	20	High level of ability to communicate effectively with realistic recommendations in a concise and logical manner 17-20	Good level of ability to communicate effectively with realistic recommendations in a concise manner 11-16	Some level of ability to communicate effectively with realistic recommendations in a concise manner 10-14	Low level of ability to communicate effectively 5-9	Lack of ability to communicate effectively 0-4
6. Communication skills Style and synthesis in evaluation of a good report to higher management.	10	High level of combining ideas and experiences in a professional manner using relevant appendixes 8-10	Good style in writing a Management Report encompassing ideas and recommendations with some appendixes 5-7	Some style in writing a Management Report encompassing ideas and recommendations 3-4	Poor style in writing a Management Report 1-2	Lack of knowledge in writing a Management Report 0
TOTAL	100					