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Prescription for Fraud: NMC Health Group

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I. Synopsis

The following case details the scandal that occurred at NMC Health, an international medical company and the UAE's largest healthcare provider, which was implicated in a vast fraud scandal in 2019. NMC Health had been traded on the London Stock Exchange since 2012, where it was a component of the FTSE 100 Index. An investigation of the company was triggered by a report issued by the renowned short seller, Carson Block of the Muddy Waters equity research firm, who detected evidence suggesting that the company had overpaid for acquisitions, understated the amount of debt it used, and overstated profitability.

This case asks students to evaluate accounting fraud and failures in governance that had occurred with the largest healthcare provider in the UAE. There are three main learning objectives for this case. The first is for students to understand the relationship between governance quality and fraud in the context of a company headquartered in a developing country that is subject to UK regulation because of its listing status. The second is to incorporate the procedures used by auditors and forensic accountants in fraud risk assessment. The third learning goal is for students to use financial statement data to flag suspicious transactions identify accounts affected by the fraud scheme.

Students review the description of NMC Health operations, the initial short seller's suspicions of fraud, a description of the NMC Health management, board, investors, and UAE and UK oversight entities. As students read the case, they consider how each of these governance entities failed to detect fraud at NMC, as well as the impact on NMC investors, before answering the questions at the end of the case.

II. Background

Having become one of the largest health care providers in the United Arab Emirates (UAE), the Nursing and Midwifery Council (NMC) grew from a mere clinic in the deserts of Abu Dhabi to a large health care entity operating in various parts of the world. By helping people to lead wholesome and healthy lives, the health care organization, owned by Bavaguthu Raghuram (B.R.) Shetty, NMC Health, has undoubtedly transformed the health care system in the UAE during the past five decades. The financial and strategic success that the health care organization initially had can be attributed to the motivation of its founder in starting the company and its mission, vision, and management. However, in 2020, Emirati residents and global capital markets were surprised to hear that the United Arab Emirates (UAE) had begun an investigation into the financial position of NMC Health Group which resulted in the largest corporate fraud scheme in the country's history.

B.R. Shetty, a pharmacist, established NMC health as a small clinic and pharmacy in the capital of the United Arab Emirates, Abu Dhabi in 1974. Mr. Shetty was motivated by the need to change the global health care system and address important health challenges, especially those pertaining to fertility (NMC—About Us, 2020). After the establishment of NMC, the health care organization faced operational challenges associated with growth and a weak regulatory environment until 1981, when it launched a new marketing and distribution division, NMC Trading (NMC Hospitals, 2020). This trading division became responsible for the distribution of medical equipment and supplies that later led to the rapid growth of NMC Health. The company also exhibited significant growth over the following two decades as it transformed from a small clinic to a hospital, and began operations in other emirates, including Sharjah in 1996 and Dubai in 1999. In 2016, the company expanded into Saudi Arabia, and by 2018, it had entered the Omani market and began conducting acquisitions in

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Saudi. Over the past few years, NMC also established regional centers or operations in Slovakia, Denmark, Sweden, Spain, Egypt, Jordan, and Kenya. For a better understanding of NMC's operations from the time it listed on the London Stock Exchange in 2012 until 2020, data regarding NMC revenues by product market and geographic market are shown in Table 1. [See Table 1, pg. 543]

NMC Health has primarily focused on achieving its healthcare mission and vision. The company's mission is being the trusted health care provider in the globe that is driven by excellence in innovation, health quality and teamwork, advanced medical technologies, patient safety and customized care (NMC Healthcare, 2020). Furthermore, the organization's vision of being committed to better patient outcomes by achieving desired medical outcomes that exceeds patients' expectation has enabled it to attract a significant market share during the past few years. The company also adapted quickly to advances in medical technology in segments of the healthcare market that have high demand and expanded rapidly in these areas, such as fertility treatment.

Effective management, a void in the healthcare market in the UAE, and an understanding of the local market are some of the factors that has enabled NMC Health to attain a competitive advantage to a greater extent before its fallout following its financial fraud scandal. Despite the challenges that the organization experienced when it was established during the 20th century, the company stuck by its mission and vision which led to its strategic and financial dominance within the health care system globally.

Both financial statement profitability measures such as return on assets, return on equity, and market value performance appeared strong over the 2012–2019 time period, with no apparent concerns exhibited by the company's external auditors, the London Stock Exchange, or regulators in the UAE or UK. The financial markets were in for a surprise at the end of 2019 when a short seller, Carson Block, affiliated with reputed equity research analysis firm Muddy Watters, released a report indicating suspicions of fraud at NMC Health.

The Investigation and Nature of the Fraud

Suspicions of fraud at NMC did not occur due to whistleblowing or because the external auditor announced problems with financial statements. Rather, it was a short seller at a reputed equity research company, Muddy Watters Research, which evaluated the financial statements and identified anomalies inconsistent with the company's performance as a listed company.

Short sellers are often viewed negatively, because they tend to notice issues that management would prefer to not be uncovered; management and other investors often assert that short sellers profiteer by attacking decently run companies and triggering stock price declines. However, the role of short sellers is to conduct independent research, identify problematic areas of operations, governance, or accounting, and then make their findings public, usually accompanied by an announcement that they are short selling the stock. Shorting refers to the process of borrowing the shares from a broker, selling them on the market without owning them, and then, if their conjectures are correct and the price of the company falls, buying back the shares at the new, lower price and returning them to the broker at a profit. The information conveyed by short sellers is important because they have a risky position, and their losses are unlimited if they are incorrect about the company they shorted, and the stock price rises instead of falls. The shorts need to be solidly convinced about a short position to take the position; however, convincing the market that they are right is another story. If their intuition were right, they would be able to make a large profit from their short position.

On December 14 of 2019, Carson Block, the founder of Muddy Watters, released a report questioning whether NMC was understating its debt position by sneaking debt off balance sheet, and announced that it would take a short position on NMC equity (Muddy Waters Research, 2019). Muddy Watters also stated that it suspected improper asset valuation related to the redevelopment of NMC Royal Women's Hospital in Abu Dhabi and Brightpoint Hospital in Dubai. They also noted that goodwill as a proportion of total assets was high because of an acquisition rampage and (potentially reflecting significant overpayment for the acquisitions, a result of poor managerial decision making).

Further, Muddy Waters found evidence of insufficient disclosure of related party transactions, and extensive asset misappropriation (Bloomberg, 2020). Muddy Waters also indicated that there had been falsification of invoices and forged documents which covered millions of dollars of medicine sales (Shankar, 2020). It suspected that entries on the company's balance sheet were inconsistent with its purchase and sales invoices (ODwyer, 2020). In addition, Muddy Waters indicated that NMC was engaged in supply chain financing arrangement involving NMC and other companies owned by Shetty in a highly unusual practice called "reverse factoring", a transaction where a company (through a series of special purpose entities) effectively borrows while not recording debt on the balance sheet by agreeing to pay suppliers at an accelerated rate in exchange for a discount on the merchandise. The company not only failed to disclose this activity properly under related party transactions, on the balance sheet, or on the income statement, they denied it outright (Arabian Business, 2020). In sum, the report stated: “We are unsure how deep the rot at NMC goes, but we do not believe that its insiders or financials can be trusted” (Bloomberg, 2020).

The reaction within the UAE to the Muddy Watters report was defensive, which is not unusual given the animosity towards short sellers and their tactics. Two of the NMC management and CEO of another Emirati company responded harshly to the research report, calling it “ignorant” and sought to discredit Carson Block in turn responded:

> With every single company, including the six that have been delisted by regulators, we’ve had pushback from people whose first instinct was to trust management. We come from a perspective of, if we detect certain patterns that we feel are patterns of deception then we’re not going to trust what management says, we’re going to look to validate what the company claims and discloses and what management says and when we come out from that perspective, then we find a lot of issues with NMC’s financials and disclosures. But frankly, most investors don’t come at it from that perspective and don’t have the ability because they haven’t focused on this, aren’t good at recognizing patterns of deception and are therefore much more credulous of management (Arabian Business, 2020).

On February 27, 2020, an official investigation of the financial fraud was launched by the Financial Conduct Authority (FCA) in the UK (Ralph, 2020). The Company put former U.S. Federal Bureau of Investigation Director Louis Freeh in charge of a review and Shetty resigned from the board of directors immediately. The launch of the investigation led to the stock of NMC being suspended on the London Stock Exchange. The CEO, Prasanth Manghat was removed from his position by the FCA for obstructing the investigation, and he announced that he would sue NMC’s board and NMC for lack of due process. The CFO, Prashanth Shenoy, was granted “extended sick leave” from the firm at the same time.

The 2018 financial statements for NMC reported that its total indebtedness was \$2.1 billion (Shankar, 2020). However, NMC Health initially appeared to have understated its total debt by over \$4 billion by early March of, 2020 (Kerr, 2020a). On 23rd March 2020, the FCA reported that the actual debt value of the organization was \$6.6 billion and not \$2 billion as earlier reported (Ralph, 2020). On 25th March 2020, the ADCB (UAE based bank) stated that the organization owed it \$1 billion (Kane, 2020a). Freeh also discovered that businesses owned by Shetty and former Vice Chairman Khaleefa Bin Butti borrowed money from NMC’s supply-chain lender (Fahy, 2020). NMC guaranteed repayment of those \$335 million of borrowings, which the board also was unaware of, and which was not disclosed in the financial statements. (Arabian Business, 2020). The investigation revealed a number of other pieces of evidence regarding the deliberate nature of the financial statement fraud, including the destruction of substantial amounts of documents that could have been used as evidence (Fahy, 2020a). In addition, Shetty has filed suit against the Manghats, claiming that they had obtained fraudulent power of attorney to authorize payments from Shetty’s private companies to their personal accounts, set up companies on his behalf without his approval, and provided him with falsified financial statements for NMC (Kane, 2020a).

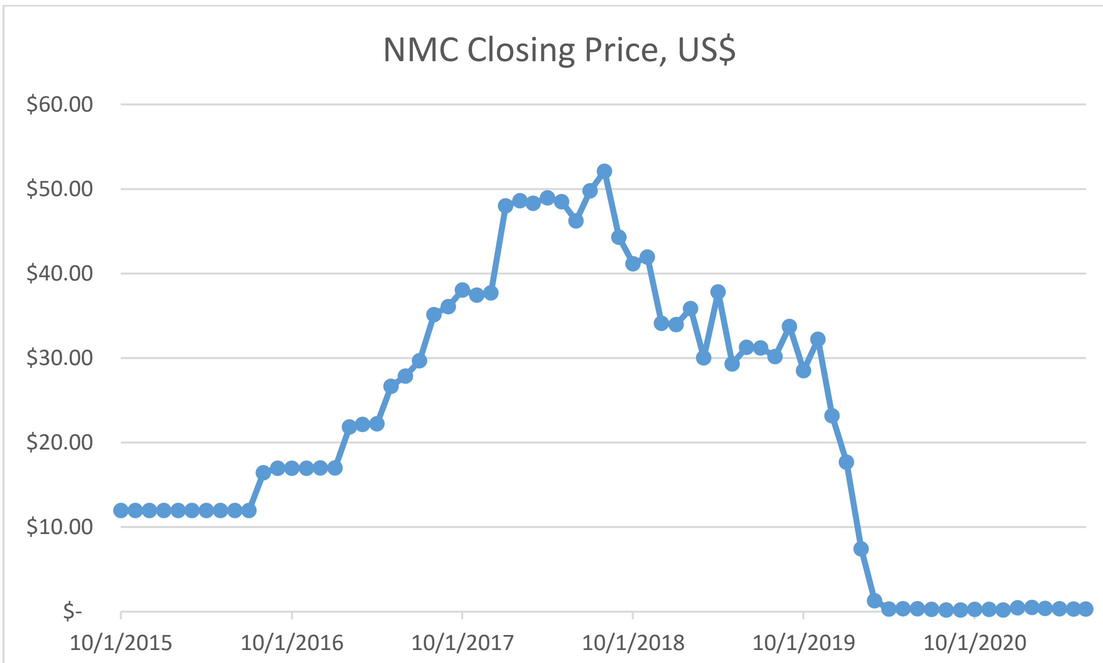
The formal investigations in the UK and UAE to date have uncovered an enormous fraud scheme described as “systematic looting”—going back as far as 2012—by management far beyond the concerns raised in the Muddy Waters report, and the shares of NMC were delisted from the LSE because of fraud (Parasie, 2020). The actual value of NMC debt was \$6.6 billion, \$4.6 billion above what NMC recorded on its balance sheet. The business owned by Shetty and the former Vice Chairman Khaleefa Bin Butti borrowed over \$300 million from NMC’s supply chain lender for which NMC guaranteed repayment (which the board claims it was unaware of, and which was not disclosed in the financial statements). Further, the investigations revealed a number of other pieces of evidence regarding the deliberate nature of the financial statement fraud, including the destruction of substantial amounts of documents that could have been used as evidence.

Additionally, Shetty claimed that individuals within the firm had obtained fraudulent power of attorney to authorize payments from Shetty’s private companies to their personal accounts, set up companies on his behalf without his approval, and provided him with falsified financial statements for NMC (Ohri, 2020). A “round-tripping” scheme involving buying and selling shares of the same security to manipulate the value by indicating greater demand for the securities also may have occurred (O’Dwyer and O’Murchu, 2021).

The evidence of fraud led UAE regulators to place NMC into administrative receivership through the Abu Dhabi Global Market Courts, so that creditor claims could be stalled as the company raised \$300 million in additional capital to keep its UAE operations open (Fahy, 2020b). The stock price performance of NMC Health from October 2015 to December 2020 is shown in Figure 1.

As shown in Figure 1, the stock reached a high of $52.11 per share in August of 2018. Upon the release of the Muddy Water research report, the stock dropped dramatically, and the company lost approximately $200 million in market value on the day the report was released, the largest one-day decline in the value of a single company in the history of the LSE. By January 1, 2020, the price had fallen to $17.69 per share and by the time that the fraud investigation was launched, it was under $2 per share. Until its delisting, the stock continued to decline as the details of the investigation unfold. As of September 4, 2022, NMC Health shares trade on the OTCBB and are hovering in the range of $0.0020 per share, as investors gamble on a potential residual claim in or a premium arising from an eventual sale of the company.

Figure 1: NMC Stock Performance, 2012 to 2020 (Stock price data from Bloomberg)



The carnage did not stop with the employees of NMC not being paid during the scandal or the shareholders of the company; because Shetty was also the chairperson of the board at a related company, Finablr, which owns a large network of currency exchanges in the UAE (Banker Middle East, 2020), also observed a significant decline in its stock price. To date, the investigation of the NMC fraud scandal has uncovered $4 billion in losses experienced because of misappropriation going back as far as December 31, 2012 (Nair, 2020).

The question naturally arose regarding why, over the seven years that NMC was a publicly traded firm meeting its listing and disclosure requirements in London, the fraud scheme was not detected, who was responsible, and what had gone wrong with corporate governance at NMC. We next describe the key governance stakeholders in the NMC Health fraud case: management, the board of directors, the UK regulators, the London Stock Exchange, the UAE regulatory environment, and NMC's external auditor, Ernst & Young.

III. The Governance Framework

IIIa. Governance Stakeholders Internal to NMC

The Management Team

Due to the financial scandal that was experienced at NMC health, there is no doubt that the organization's key stakeholders demonstrated certain poor leadership personalities. The founder of the firm, BR Shetty, was the CEO of the company from its founding to 2017, when he resigned from the position and took over as the co-chairman of the board. Whether Shetty is guilty of fraud against NMC shareholders and creditors—a judicial determination which requires proof beyond a reasonable doubt (in a criminal trial) or based on the preponderance of the evidence (in civil court) of knowingly misleading investors—has not yet been determined, as court cases are still proceeding.

Upon the resignation of Shetty, Prasanth Manghat took over as CEO. Manghat is the key stakeholder facing the probe related to the financial fraud for demonstrating lack of integrity (Kerr, 2020a). Mr. Manghat is alleged to have made several payment transactions using the personal account of Mr. BR Shetty, the organization's founder without his authority (Kane, 2020b). The organization's CFO, Suresh Krishnamoorthy also is facing a probe for his lack of accountability and transparency by falsifying the organization's financial statements and transactions for his personal gain (Kerr, 2020b). The organization's vice chairperson, Khalifa Al Muhairi, also resigned and is facing a probe for his lack of adaptability and irresponsibility that led him to cover up the actions of the CEO and CFO from the organization's chairperson and board.

The Board of Directors

Data regarding the board of directors are shown in Table 2 for the 2014–2018 period. [See Table 2, pg. 545]

The board of directors of NMC was comprised of ten members in 2018, of which three are executive directors and seven are non-executive directors. Of the seven non-executive directors, two are not independent: Shetty, the founder of NMC and non-executive joint Chairman and Abdulrahman Basiddiq. Therefore, five NMC directors were independent and five were not (NMC, 2019). Shetty shared the role of non-executive joint Chairman with HJ Mark Tompkins, also a non-executive director. The board was comprised of members with Emirati, Kenyan, Indian, and British nationality; two non-executive board members, Abdulrahman Basaddiq and Jonathan Bomford, each had been partners with Ernst and Young, the company's auditor, for over 20 years. The audit committee consisted of four members at the beginning of 2018, but one member left in March of that year. Bomford was the audit committee financial expert and had been the chairperson of the audit committee until March of 2018, when Lord Clomwilliam, who had no accounting experience, took over. The internal audit function within NMC as of 2018 was "outsourced" (NMC 2018 annual report), with controls within the company being "self-assessed;" no external audit of internal controls was requested of the auditor, as none were required under UAE or UK law.

While the board of directors of NMC was not considered problematic on its face as of 2018 given that outsiders dominated the board, looking back, it nevertheless had substantial conflicts of interest and an outdated governance style that did not provide for sufficient oversight of managerial decisions. As stated by AQ&P analyst Fahim al Qasimi:

> … if you read through the corporate governance reports of NMC, it infers a lot that the board basically receives a bunch of information from management, the whistleblowing policy doesn't work, there's no objectivity on behalf of the board, and even in the language they use about what they do, it's not what the board should do … It's very 1980s corporate governance: 'we approve the strategy, we approve this, we approve that' rather than setting a mandate and steering and that's where the corporate governance failure is … (Arabian Business, 2020).

The Internal Audit Function

The purpose of internal auditors is to function as a first line of defense against fraud. Internal auditors engage in independent, objective evaluation of the company's financial and operational activities and controls, ensure information security, examine whether the company is applying policies and procedures correctly, and verify that the company follows regulations. Internal auditors also are responsible for advising management on how to manage the company's risks.

Little has been officially released regarding the failures of the internal audit function at NMC that may have led to the scandal, but it failed in assessing the quality of internal controls or in verifying critical information, such as bank balances. Senior management probably were able to override controls or intimidate internal auditors.

IIIb. National Level Oversight Entities

UK Governance Requirements

The UK Corporate Governance Code sets different standards for companies on the premium segment versus the standard segment of the exchange; any company that is listed in the FTSE 100 index is required to follow the standards for premium segment companies. Since principles based, the standards are not requirements, and the Code involves a "comply or explain" requirement with regards to corporate governance standards; shareholders and boards of directors must ensure that they are satisfied with the governance quality of the companies they invest in. Companies that do not adopt Code standards are required to explain why. The European Union Commission also has standards that applied to UK listed firms; the audit committee is required to be "independent and competent in both finance and accounting", although competency is not clearly defined beyond "it is desirable that (the financial expert) has a qualification from one of the professional accountancy bodies" and "relevant and recent financial experience"), and is responsible for assessing internal controls. To date, they are merely tasked with having effective internal controls. Like the UK Code, the Commission requires firms to explain what standards they are not compliant with and explain why in their annual reports (LSE, 2021).

Unlike U.S. listed firms under the Sarbanes-Oxley Act, firms are not required to assess internal controls annually and publish the results of this assessment. A new regulatory body and new requirements that firms assess and report internal control quality have been proposed, but to date, this has not been implemented in the UK (PWC Ireland, 2021). UK listing requirements only require an external audit of internal controls at the time of initial listing, but not on a continual basis.

To be specific, the external auditor of UK listed firms under the UK code is required to assess:

> … specific parts of the annual report, outside the audited financial statements, including various directors' statements. Reporting requirements based on the UK Code, company law, and FRC and other guidance. These require auditors to variously audit, read, review, or perform other procedures, many relating to internal consistency and consistency with the auditors' knowledge of the business, based on the audit. ICAEW (2021).

In addition, there is no rule in the UK comparable to SOX requirements that CEOs and CFOs certify that the financial statements are correct and that they understand them. This is, in part, how Shetty was able to claim that he was "misled" regarding the financial statements.

The London Stock Exchange

In April 2012, NMC completed an Initial Public Offering (IPO) and listed its shares on the premium segment of the London Stock Exchange (LSE) as "NMC Health PLC," and in 2017, they were added to the FTSE 100 index due to its high market capitalization. When the investigation by Abu Dhabi Commercial Bank (ADCB), one of NMC's creditors, revealed that the actual amount that NMC health owed was $1 billion in February 2019, the London Stock Exchange suspended the organization from Financial Times Stock Exchange (FTSE) 100 listing (Kerr, 2020a). However, when the organization announced on 23 March 2020 that its evidence of financial fraud, its FTSE 100 listing was permanently revoked (CGLytics, 2020). Consequently, the fact that the organization's profits did not match with its total debt values was a significant indication of a financial fraud.

The UAE

The United Arab Emirates is a small Middle Eastern state bordering Saudi Arabia, which consists of seven Emirates (Abu Dhabi, which is the capital, Dubai, Sharjah, Ajman, Fujairah, and Umm Al Quwain). Since the modern state was founded by Sheikh Zayed in 1971, the country of ten million residents (with one million Emirati citizens) has undergone a rapid and dramatic transformation supported by strong social and political cohesion. The primary economy of the UAE in 1971, prior to the development of the oil sector, was fishing. Given the stereotypes in the West of sand dunes and Arab oil barons, it is a surprise to many outside of the country that a FTSE 100 health company was headquartered in the UAE.

The UAE government's "Soft Power Council" released a "Soft Power Strategy" in 2017 that codifies its policy objectives. The Strategy "aims to increase the country's global reputation abroad by highlighting its identity, heritage, culture and contributions of the UAE to the world," and includes economic and scientific diplomacy as important political objectives (UAE Federal Government, 2020). Establishing trust in institutions and reputational capital of its financial system is part of the Soft Power Strategy and is critical for a developing country like the UAE to attract foreign capital. To achieve these goals, the country's leadership has made enormous investments in human capital and technology, and in 2020, as activity in the rest of the world halted due to COVID-19, the UAE Hope Mission became the first Arab space mission and the third mission in the world successfully send a rover to Mars. In part, this was possible due to not only the wealth of the country, but also its reputation for financial secrecy, the absence of corporate and individual income taxes, high economic freedom, and low levels of corruption (its Transparency International Corruption Perception Index ranking for 2020 was 21st from the top, and three positions better than the United States.)

Further, contrary to common perception, UAE economy has experienced significant diversification away from the oil sector in recent decades and into services, including higher education, medicine, science, media, technology, and engineering. Today, although it is still reliant on oil, the UAE is a regional and international center for trade and a global leader in port management.

Alongside its social and economic development, to establish leadership in economic diplomacy as per the Soft Power Strategy, the country has worked to create a modern financial system, and while the financial sector is still developing, it is now a regional diversified financial services center. Thus far, the equity markets consist of three stock exchanges and several derivatives markets. The Dubai Financial Markets (DFM) in Dubai is an onshore exchange listing over sixty equities and sukuks (Islamic Bonds) (Oxford Business Group, 2022). NASDAQ Dubai is an offshore exchange located in the Dubai International Financial Center (DIFC); a free zone established in 2002. NASDAQ Dubai established to permit remote access to trading by foreign investors, and primarily lists fixed income securities, exchange traded funds, futures and other derivatives, and real estate investment trusts. The third exchange, the Abu Dhabi Securities Exchange (ADZ) is in Abu Dhabi. Dubai also hosts the Dubai Multi Commodities Exchange (for trading of derivatives on four regionally significant commodities, gold, pearls, diamonds, and tea), the Dubai Gold and Commodities Exchange (which facilitates trading of metals, hydrocarbons, currencies, and equities, and the Dubai Mercantile Exchange (listing commodities and energy futures contracts) (UAE Federal Government "Financial Markets," 2022).

Both the DFM and ADX are regulated by the Emirates Securities and Commodities Authority (SCA), a politically independent authority established in 2000, and the NASDAQ Dubai (as well as other DIFC registered entities) is regulated by the Dubai Financial Services Authority (DFSA). The goal of the SCA is to "provide the opportunity to invest savings and funds in Securities and Commodities in a manner that serves the interest of the national economy, secures the integrity and accuracy of transactions, ensures interaction of the forces of supply and demand in order to determine prices and protection of investors by establishing the bases for sound and just dealings between the various investors". Its role is in creating and enforcing listing and disclosure requirements, setting and monitoring compliance with rules for market makers, brokers, and traders to prevent market manipulation, and providing oversight over trading activities of the entities it regulates (UAE Federal Government "Financial Markets," 2022).

To solidify its status as a regional financial market and enhance its reputation for integrity and transparency, the UAE also has created a number of anti-fraud organizations related to oversight and the audit function: the Supreme Audit Institution, Financial Audit Authority, The UAE Internal Auditors Association, and the Central Bank of the UAE. The Supreme Audit Institution (SAI) is the supreme audit authority in the United Arab Emirates and is an independent body under the Federal National Council of the UAE. Its role is to promote excellence in the audit functions and supporting improvements in corporate governance and accountability as well as capacity building of the national workforce. The role of the State Audit Institution is to audit federal government entities and enforce laws regarding fraud and corruption. The Financial Audit Authority (FAA) is an independent public authority established to audit public funds and promote accountability, transparency, and integrity in the use of the government resources. It provides a verification function through financial and compliance audits. The FAA conducts performance audits of entities' activities to verify their efficiency and effectiveness, tax audits (to ensure compliance with the UAE Value Added Tax system) and investigates financial and administrative violations.

The UAE Internal Auditors Association (UAE IAA) is a non-profit organization which interfaces with a number of large companies and organizations in the UAE (including the Emirates Group, Dubai Aluminum Company, Emirates Bank, the Dubai Chamber of Commerce, and the UAE Ministry of Economics Department. It promotes the quality of internal audits by providing professional internal audit services to its stakeholders, conducting training and studies related to the audit function, and providing opportunities for networking among those in the audit function. Finally, the Central Bank of the UAE promotes financial and monetary stability, financial system efficiency, and consumer protection (including anti-money laundering supervision and financial crime investigation) through its supervisory role. While these institutions of governance pertaining to audit in the UAE are still developing, the country has taken the initiative to create an environment of accountability, setting a public sector "tone at the top" that it hopes will discourage fraud.

Financial statement fraud is clearly prohibited by law in the UAE, in particular, Article 399 of UAE Federal Law No. 3 of 1987. The law requires proof in court of an intent to deceive and of the deception resulting in the victim handing over financial assets or property. The UAE regulatory authorities have refined the corporate governance requirements for publicly traded firms to facilitate investor confidence and attract foreign investment. Accordingly, the country takes scandals such as NMC Health very seriously, as it perceives that its reputational capital could be harmed if investment is not sufficiently protected by regulation combatting fraud and other financial crimes.

To strengthen investor confidence in the financial system, Dubai Law No. 4 on Financial Crimes was passed in 2016, containing provisions in its Article 19 for "protection for the reporter" of financial statement fraud. Specifically, Dubai Law No. 4 states that (so long as the report of fraud is true), no legal or disciplinary consequences will occur as a resort of reporting financial crime. The regard for its reputational capital is an important reason that the media focused heavily on the case and why the UAE launched an aggressive investigation into fraudulent practices at NMC, rather than attempting to cover up the fraud as other countries have in the past.

Firms publicly traded in the UAE are subject to another layer of monitoring from UAE banks that extend credit, shareholders in the UAE, and external auditors. However, NMC was never listed in the UAE, and accordingly, was not subject to the listing and disclosure requirements of UAE listed firms. In addition, managers of firms in the UAE are not required to assess and publish reports on internal controls annually, nor are firms listed in the UAE are not subject to any requirement for an external audit of internal controls, as under the Sarbanes-Oxley Act in the U. S. Although NMC operates in the UAE and throughout the Middle East, the company is listed on the London Stock Exchange and, thus, must comply with the U.K. financial regulations, International Financial Reporting Standards (IFRS), and International Standards on Auditing (ISA). The UAE follows IFRS and IAS as it does not have its own standards. ISA 240 recommends that auditors “approach audit engagements with an enhanced sense of professional skepticism.” (IAASB, 2009).

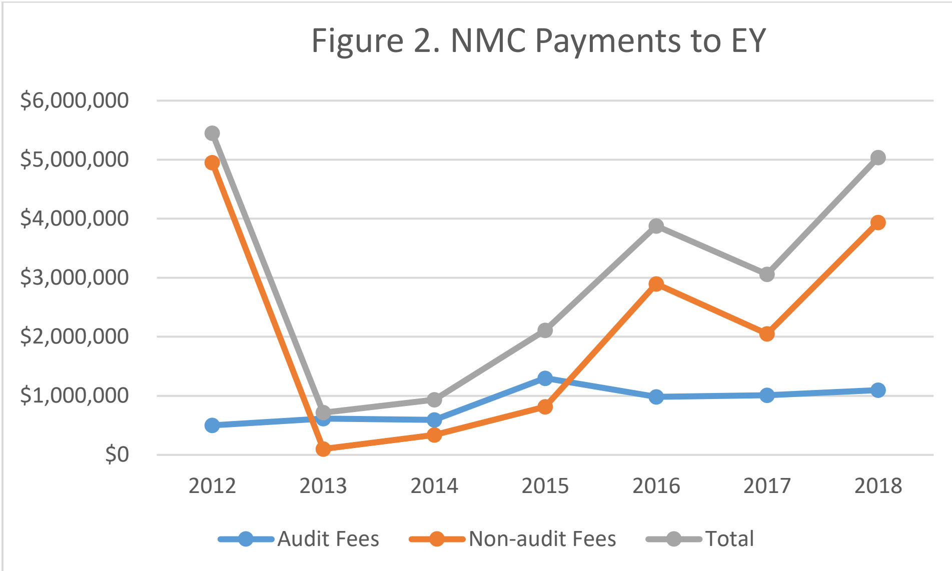
The Auditor

EY had served as the auditors for NMC since its IPO in 2012. From 2012 to 2015, the senior statutory auditor for EY for NMC was Cameron Cartmell, who was replaced by Victor Vagas from 2016 to 2018. The administrators for NMC (Averz & Marsal) are suing EY for negligence when they signed off the group’s accounts during the supposed multi-billion-dollar fraud (Abdulah, 2020).

In a progress report to creditors, the administrators said that they had “interviewed and selected leading counsel” to advise them in relation to possible actions and that it has issued EY a preliminary notice informing the auditor of their intention to file a legal claim. “The investigation is complex, given the well-organized and long-term nature of the fraud, coupled with the number of jurisdictions involved,” Alvarez and Marsal said.

The NMC case yields new reputational penalties for EY, which is already facing large-scale legal suits and regulatory scrutiny over its audits in several recent high-profile scandals including three “unicorn” IPOs Wirecard, WeWork, and Luckin Coffee. EY also has faced concerns recently regarding their professional conduct in their Dubai offices; a former partner, Amjad Rihan, claims he was forced to flee the UAE after telling authorities that EY pressured him to cover up a client’s (a Dubai gold refinery) drug gang related money laundering activities, for which he was awarded $10.8 million in damages (Booth, 2020). Questions are being increasingly raised regarding potential conflicts of interest with auditors and their clients and concerns regarding auditor independence; Kowsmann, Mauer, and Yang (2020) argue that it may be the case that in seeking consulting contracts, which are higher margin activities than auditing, auditors such as EY are failing to employ the necessary professional skepticism. The Financial Reporting Council (FRC) also has opened an investigation into EY’s audit of NMC Health’s 2018 financial statements. The UAE’s laws are mostly silent on auditors’ professional negligence, and it is uncommon to sue auditors when a company fails; this may have led EY to assume it would not be attached in court.

Audit fees, non-audit fees, and total fees to EY from NMC are shown in Figure 2.



Source: NMC Health Annual Reports

IV. Impact on NMC Investors

The impact on NMC investors has been substantial. We next describe stakeholders in the capital markets and how they have been affected by the fraud scheme.

The Creditors

Creditors do not like the risk of a company to go up once they have lent money to the company, because they will get the same return on the stock (the cost of debt) regardless of whether the company takes on additional risk. The creditor can protect their position with ex ante (preemptive) measures and ex post (after the fact) measures. The ex-ante measures creditors use to limit exposure to risk caused by management takes the form of restrictive covenants, which often preclude managers from borrowing more, taking actions such as increasing dividends, or conducting acquisitions (negative covenants), or require companies to maintain certain solvency standards (positive covenants). Creditors also act as monitors of the firm, because they need to assess whether the return they will get for investing in debt and lending money to a company is commensurate with the risk of the investment, and they watch the management carefully to ensure that they are not finding new ways of taking risk that were not precluded by the covenants and to monitor the proximity to a covenant violation (known as technical default).

No one really wants to end up in a situation requiring an ex-post solution. The ex-post settling takes place through the courts through either a renegotiation of the debt (yielding a "haircut" to the creditor) or through the bankruptcy process, where vultures from the legal sector swoop in and gobble up 30 percent of the value of the firm in liquidation. The creditors would prefer a restructuring that respects their contractual claims, such as a restructuring followed by an acquisition, so that they are able to be repaid the full amount in accordance with the terms of the loan.

Two of NMC's creditors, the New York and UAE branches of Bank of Baroda and Credit Europe Bank (of the Netherlands), not only failed to perform their monitoring role but acted as enablers of the fraud at best. Credit Europe Bank reported during the litigation proceedings against it filed by Shetty that it was aware of, but did not report, fraudulent invoices because it obtained a fee of 5 percent on its loans to NMC; the bank also continued lending to NMC (Roy, 2021). At best, Bank of Baroda's internal controls failed to detect fraudulent loan documents made in Shetty's name by the Manghats. Allegations against Bank of Baroda arising from a forensic audit of bank records indicates a failure to enact proper anti-money laundering controls, including inconsistencies in account opening forms, which would have detected the questionable transactions (Fahy, 2021). Further, Bank of Baroda is accused of failing separate accounts personally held by Shetty from those held by NMC Health, potentially due to the close ties Shetty had with Vadodara (O'Dwyer, 2020).

Abu Dhabi Commercial Bank (ADCB) was the largest creditor of NMC Health at the time that the fraud was exposed and was the first creditor to ask UAE regulators to put NMC into receivership. ADCB and other creditors—which consist primarily of 10 large banks—are currently parties to the insolvency process being resolved through the ABGM courts. Their approval is, as of the end of May 2021, sought for the creditors to take over the restoration of 35 out of 36 NMC entities to continue as going concerns following the restructuring of NMC. This idea would allow the healthcare operations to generate the funds to repay the creditors' debt. The creditors could then exit through a sale of the business. If the creditors are unwilling to accept the restructuring of the business, the assets would be sold to investors (such as large Abu Dhabi investment companies) in a "fire sale" to recover the funds to pay the creditors, but it is likely that this process would generate significant losses for the creditors (Nair, 2021).

Also related to the status of creditors in the MENA region environment is the cultural environment in which lending decisions are made. A phenomenon referred to as "name lending"—loans made because of the public profile of the borrower rather than a traditional solvency assessment based on cash flows or collateral, which would have benefitted a well-known billionaire such as Shetty (Eastern Eye, 2020).

The Shareholders

In the Fourth quarter of 2019, the largest shareholders of NMC equity were BR Shetty, the founder, BRS International LTD, Ithmar Capital Partners, Capital Group Companies, Infinity Investments, Federated Hermes Inc, and Saeed and Yousef Khalifa Bin Butti. BlackRock, Vanguard Group, and Wellington Management also held significant shares. Insiders Bin Butti, Al Qubaisi and Al Muhairi sold the sizeable stake of NMC stock they owned upon the release of the Muddy Waters report.

V. Epilogue

Criminal charges for fraud and forgery were brought against BR Shetty and four other executives in April of 2020 (John, 2020). Mr. Shetty attempted to return to the UAE in November of 2020, was initially stopped at the airport by the Indian authorities from due to claims filed against him by several Indian banks including Bank of Baroda (Moneycontrol News, 2020) He has since agreed to cooperate fully with the fraud investigation of NMC. Mr. Shetty's other company Finalbr which owns and operates UAE Exchanges was sold for $1 to an Israeli investor (Gulf News, 17 December 2020). As of February 14, 2021, the worldwide assets of BR Shetty, former CEO Prasanth Manghat, and two Emirati investors, Khalifa al-Muhairi and Saeed al-Qebaisi, have been ordered frozen by London courts due to claims by Abu Dhabi Commercial Bank. The restructuring process has continued with the sale of core operations in Oman and the UAE (Gulf Business, 2021).

A restructuring consultancy firm, Alvarez and Marsal, was appointed in September 2020 to resolve claims against NMC and facilitate asset sales and reorganization to maintain the quality of healthcare in the UAE as the COVID-19 pandemic drags along. Consistent with the saga of NMC, rumors regarding fees and conflicts of interest have arisen with the interim management and the Alvarez and Marsal (Ralph, 2021). Fees are expected to rise going forward, as Alvaraz and Marsal have filed for an extension of the restructuring and resolution process.

Litigation remains underway on behalf of various NMC stakeholders. The creditors of NMC will continue to fight for precedence over cash flows generated by NMC in its continued operations and assets that had been used to secure the loans. On May 25, 2021, Dubai Islamic Bank won a legal battle over rights to NMC loans collateralized by insurance receivables in the Abu Dhabi UAE courts, overturning a verdict from the DIFC court (Barbuscia, 2021). In July of 2021, Shetty sued Ernst & Young, several NMC creditors, the current management team of NMC Health, and the UAE Exchange Centre for $7 billion in New York Courts, accusing them of operating a Ponzi scheme to misappropriate assets and obtain bank loans (Nair, 2021). In December 2021, Abu Dhabi Commercial Bank sued Shetty and five other NMC directors for damages in London courts (Peachey, 2021).

VI. Case Questions (for Forensic Accounting)

1. NMC allegedly omitted about $4 billion of its debt. Why would NMC management resort to such act? What would NMC management gain from omitting its liabilities? Elaborate.
2. What accounting maneuver did NMC management do in hiding its liabilities? Be as specific as possible including stating the accounts that could have been used to hide the liabilities?
3. As mentioned above, Muddy Waters discovered that there had been falsification of invoices and forged documents which covered millions of dollars of medicine sales. How would forging sales documents help MNC appear to have lower levels of debt? Why would they do this falsification?

4. Why do you think NMC's management is so corrupt? What lead to that for individuals who are well intended, well-educated and well trained in healthcare and business management?

5. (a)What are the responsibilities of NMC's board of directors?
   (b) Could the board of directors at NMC—especially the audit committee—have prevented the fraud?
   (c) Do you believe the composition of NMC's board of directors is adequate and truthfully independent?
   (d) If NMC had listed on the Abu Dhabi Global Market rather than or in addition to the London Stock Exchange, do you think it would have gotten away with fraud for so long?

6. Why do you think EY failed to uncover the fraud at NMC for many years? It always gave clean audit opinions for the firm from 2012–2019.

7. Do you see anything in the NMC financial statements that would have led you to believe that the company was embroiled in a massive fraud scheme?

VII. Case Questions (for Auditing)

1. As reported in the case above, NMC allegedly omitted about $4 billion of its debt. Why would NMC management resort to such act? What would NMC management gain from omitting its liabilities? What was driving them to manipulate their liability disclosures? How could extensive acquisition activity and overpayment for acquisitions potentially relate to fraud? Elaborate in detail.

2. What accounting maneuver did NMC management do in hiding its liabilities? Be as specific as possible including stating the accounts that could have been used to hide the liabilities?

3. Who audited NMC from 2012–2020? What opinions did the auditors issue to the firm from 2012–2020? Did the auditors provide an opinion over the quality of internal controls? If yes, what opinions were given? If no, why not?

4. Short-seller Carson Block released a report questioning whether NMC was understating its debt position by sneaking debt off balance sheet and announced that it would take a short position on NMC equity (Muddy Waters Research, 2019). What does take a short position mean? Explain this process. Elaborate on the findings of the Muddy Waters Research and the reasons for them to take a short position.

5. What is "reverse factoring?" Explain this process in more detail and explain why it is considered fraudulent.

6. The investigation uncovered an enormous fraud scheme described as "systematic looting"—going back as far as 2012—by management far beyond the concerns raised in the Muddy Waters report. Explain this fraud scheme.

For the next two questions, access the UK Corporate Governance Code at: https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code

Also, obtain the 2018 Annual Report of NMC Health at: https://cf-cdn.nmc.ae/Uploads/InvestorRelations/annual-report-2018-nmc-health-plc-20-may-2019-904148b8-58c9-4487-b7f4-875c613667b8.pdf

7. Using the UK Corporate Governance Code, summarize the FTSE requirements on listed firms' BOD. Identify the board members of NMC as of end of 2018 and look through their qualifications. Classify these executives as executives and non-executives. Did NMC meet FTSE requirements on independence BOD members?

8. Using the UK Corporate Governance Code, summarize the FTSE requirements on listed firms' audit committees. Identify the audit committee members of NMC in 2018 and any changes to the committee members. Identify which audit committee members had financial expertise. Did NMC audit committee meet these requirements? Explain.

9. Mr. Shetty was able to claim that he was "misled" regarding the adequacy of the company's financial statements. Had NMC been listed on a U.S. stock exchange, why would this argument not hold?

For additional insights into the NMC Health fraud scandal, access the sources in the following reference section.

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Table 1: This table provides data from Bloomberg regarding the revenue breakdown of NMC by segment and by geographic area.

Panel A: Revenue by product market

Bloomberg Financial Stat

Ticker: NMC LN Equity | Periodicity: Annuals | Currency: USD | Note: Years shown on the report are Fiscal Years

Filing: Most Recent

	Original:2016 A	%	Restated:2017 A	%	Original:2018 A
For the period ending	2016-12-31	2017-12-31	2017-12-31	2018-12-31	2018-12-31
Revenue	1,220.84	100.00	1,603.40	100.00	2,057.25
Healthcare	816.31	71.49	1,146.24	75.34	1,549.87
MBZC					
Sharjah Day Patient Medical Center					
Dubai General Hospital					
Al-Ain Specialty Hospital					
Dubai Specialty Hospital					
Reconciliation					
Abu Dhabi Specialty Hospital					
BR Medical Suites					
Distribution and Services	404.52	28.51	457.15	24.66	507.38
Adjustments and Elimination	0.00		0.00		
EBITDA	246.08	100.00	353.39	100.00	487.37
Healthcare	241.12	87.33	355.40	87.71	487.97
Distribution and Services	47.11	12.67	51.55	12.29	68.38
Adjustments and Elimination	-42.15		-53.56		-68.99
Net Income	132.69	100.00	185.97	100.00	248.65
Healthcare	192.93	85.70	287.83	86.25	394.37
Distribution and Services	43.57	14.30	48.02	13.75	62.90
Non-controlling interests	-18.71		-23.21		-3.26
Adjustments and Elimination	-85.10		-126.66		-205.35
Assets	2,316.99	100.00	2,939.01	100.00	3,872.42
Healthcare	1,454.77	88.45	2,270.56	88.93	3,070.98
Adjustments and Elimination	597.03		372.00		419.18
Distribution and Services	265.19	11.55	296.44	11.07	382.25
Liabilities	1,368.12	100.00	1,794.38	100.00	2,515.65
Adjustments and Elimination	1,039.10		1,353.42		1,956.41
Healthcare	256.61	77.84	343.26	77.78	434.97
Distribution and Services	72.41	22.16	97.70	22.22	124.28
Depreciation and Amortization	56.00	100.00	70.88	100.00	100.36
Healthcare	43.32	94.28	58.14	94.60	82.95
Adjustments and Elimination	9.43		9.21		12.68
Distribution and Services	3.25	5.72	3.53	5.40	4.74
Depreciation					
Healthcare					
Adjustments and Elimination					
Distribution and Services					
Capital Expenditures	-67.41		-64.86		-164.99
Distribution and Services	-4.17	8.06	-5.11	2.56	-4.00
Adjustments and Elimination	-1.75		-1.54		-8.85
Healthcare	-61.48	91.94	-58.21	97.44	-152.13

Table 1
Panel B: Revenue by Geographic Market (From Bloomberg)

Ticker: NMC LN Equity | Periodicity: Annuals | Currency: USD | Note: Years shown on the report are Fiscal Years | Company: NMC Health PLC

Filing: Most Recent

	Original:2015 A	%	Original:2016 A	%	Restated:2017 A	%	Original:2018 A
For the period ending	2015-12-31	2016-12-31	2016-12-31	2017-12-31	2017-12-31	2018-12-31	2018-12-31
Revenue	880.87	100.00	1,220.84	100.00	1,603.40	100.00	2,057.25
United Arab Emirates	841.85	94.59	1,154.76	91.95	1,474.34	87.56	1,801.30
Others	4.03	0.88	10.72	5.14	82.37	7.24	148.89
United Kingdom					0.00	2.62	53.99
Spain	34.99	4.53	55.36	2.91	46.68	2.58	53.08
Group Eliminations							
Dubai and Other Emirates							
Long-Term Assets				100.00	1,810.50	100.00	2,480.92
United Arab Emirates				84.40	1,528.08	73.93	1,834.23
Others				4.47	80.97	15.36	381.16
Spain				11.13	201.46	8.72	216.40
United Kingdom					0.00	1.98	49.14

Table 2: NMC Board Characteristics (from Bloomberg)

Bloomberg

Financial Statement

Ticker: NMC LN Equity | Periodicity: Annuals | Currency: USD | Note: Years shown on the report are Fiscal Years | Company:

Filing: Most Recent

	Restated:2012 A	Original:2013 A	Restated:2014 A	Original:2015 A	Original:2016 A	Restated:2017 A	Original:2018 A
Audit Committee							
Size of Audit Committee	4.00	4.00	4.00	4.00	3.00	3.00	3.00
# Independent Dir on Audit Cmte	4.00	4.00	4.00	4.00	3.00	3.00	3.00
% Independent Dir on Audit Cmte	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Independent Audit Committee Chairperson	Yes	Yes	Yes	Yes	Yes	Yes	Yes
# Non Exec Dir on Audit Cmte	4.00	4.00	4.00	4.00	3.00	3.00	3.00
Audit Committee Meetings	3.00	4.00	5.00	5.00	4.00	4.00	4.00
Audit Committee Meeting Attendance Percentage	100.00	100.00	100.00	100.00	100.00	100.00	91.66
Compensation Committee							
Size of Compensation Committee	4.00	4.00	4.00	4.00	4.00	4.00	4.00
# Independent Dir on Comp Cmte	4.00	4.00	3.00	3.00	3.00	3.00	4.00
% Independent Dir on Comp Cmte	100.00	100.00	75.00	75.00	75.00	75.00	100.00
Independent Compensation Committee Chairperson	Yes	Yes	Yes	Yes	Yes	Yes	Yes
# Non Exec Dir on Comp Cmte	4.00	4.00	4.00	4.00	4.00	4.00	4.00
# Comp Committee Meetings	0.00	3.00	5.00	3.00	5.00	4.00	4.00
Compensation Committee Meeting Attendance %		100.00	100.00	100.00	100.00	100.00	100.00
Outside Compensation Advisors Appointed	No	No	No	No	No	Yes	Yes
Executive Compensation Consultant Srvcs Provided						3.00	3.00
Fees Paid to Compensation Consultants						86,000.00	75,000.00
Executive Comp Advisory Fees Pd to Comp Adv						86,000.00	75,000.00
Pct of Compensation Advisory Fees Paid to Comp Adv						100.00	100.00
Nomination Committee							
Size of Nomination Committee	4.00	4.00	5.00	3.00	3.00	3.00	3.00
# Independent Dir on Nom Cmte	4.00	4.00	4.00	2.00	2.00	2.00	2.00
Pct of Ind Directors on Nomination Committee	100.00	100.00	80.00	66.67	66.67	66.67	66.67
Independent Nomination Committee Chairperson	Yes	Yes	Yes	Yes	Yes	Yes	Yes
# Non Exec Dir on Nom Cmte	4.00	4.00	5.00	3.00	3.00	3.00	3.00
# Nom Cmte Meetings	0.00	0.00	4.00	1.00	0.00	1.00	0.00
Nomination Committee Meeting Attendance Percentage			100.00	100.00			