

## FORENSIC ANALYSIS OF NSEL SCAM: A BLACK SPOT FOR INDIAN ECONOMY

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Abhishek Sharma\*  
Dr. Prakash Sharma\*\*

### ABSTRACT

*In previous some decades we have witnessed various large scale corporate frauds which lead to economic downfall of the nation like Commonwealth Games Scam, Satyam Scam, 2G Spectrum Scam, Bihar Fodder Scam, Harshad Mehta and Ketan Parekh Stock Market Scam, Hawala Scandal etc. In this list one name have also been added with National Spot Exchange Limited Scam which came under public domain in year 2013 in the month of July and as per the research work done and on the basis of various reports available the size of the scam is more than Rs. 5400 crore.*

**Keywords:** *Hawala Scandal, Stock Market Scam, NSEL, NAFED.*

### Introduction



This Scam came in to the notice when a payment default took place after a commodities market regulator, the Forward Markets Commission (FMC), directed NSEL to stop launching contracts and this step results to the closure of the Exchange in July 2013.

It is worthwhile to mention that this Exchange was promoted by National Agricultural Cooperative Marketing Federation of India (NAFED). In August 2011, FMC was appointed as the 'designated agency' to fill the regulatory vacuum in the commodities market and a series of bizarre actions by the FMC spooked the market and as a result NSEL had to suspend the trading of all contracts on July 31, 2013.

### Role and application of Forensic Audit

Forensic accounting & Audit is defined as the practice of rigorous data collection and analysis in the areas of litigation support consulting, expert witnessing, and fraud examination.

The objective of forensic audit is to relate the findings of audit by gathering legally tenable evidence and in doing so the corporate veil may be lifted (in case of corporate entities) to identify the fraud and the persons responsible for it (a criminal offence). While conducting forensic audit regularity and propriety of off balance-sheet items (like contracts, etc.) are examined. Forensic auditing aims at legal determination of whether fraud has actually occurred. In the process, it also aims at naming the person(s) involved (with a view to take legal action).

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\* Research Scholar, Department of ABST, University of Rajasthan, Jaipur, Rajasthan, India.  
\*\* Associate Professor, Department of ABST, University of Rajasthan, Jaipur, Rajasthan, India.

Forensic auditing is focused on the identification, interpretation, and communication of the evidence of underlying strategic economic and reporting events. It not single-event based, like a fraud examination, and a forensic audit is not used to render an audit opinion. As such, forensic audits are easily adapted to a principles-based accounting environment with broad guidelines applied to a variety of accounting investigations without using rule-based audit approaches or more narrowly-focused fraud practices. As far as NSEL Scam is concerned there were certain problems which lead to such a huge scam. While applying the Principles of Forensic audit and doing further investigations related to NSEL Scam major outcomes can be categorized following:

- One of the Critical & most identified factor which might have caused such a huge scam was the issuing of false warehouse receipts by the brokers to the investors and on the basis of these receipts fictitious limits have been set for the Investors and accordingly they have executed transactions of more than their actual limits resulting failure at the time of delivery and execution of the contract.
- Another potential area of this fraud which came across during the course of research & forensic audit was that there was lack of proper documentation in National Spot Exchange Limited with regards to brokers and Investors and even no proper KYC were being done which allowed the entry of dummy investors.
- Tampering with Email servers of the Stock exchange and issuing of falls emails to Investor were also being identified during the course of forensic audit.
- Violation of the provisions of the Prevention of Money Laundering Act (PMLA) were also probably identified and it was found that money laundering have been executed in different transactions.
- Again the Important cause of fraud which have been find out during the research & was to provide false assurance to existing & positional investors who have invested in NSEL on believing these false assurance, for which neither the exchange nor the brokers were authorise to give.
- During the scrutiny of the transactions executed at NSEL, it was also identified that Insider trading have been done by the management and internal staff of the Exchange and brokers which resultant such huge scam to happen.
- Another object of the forensic audit at NSEL was to Verify the identity of the Concept of Demutualization in National Spot Exchange and during the research it was found that such concept does not exists and it was found that the National Spot Exchange Limited (NSEL) was the fully owned subsidiary of Financial Technologies (India) Limited (FTIL) Promoted mainly by Jignesh Shah.
- Another finding & question was to identify the reasons why the Regulators have acted so late to control the actions of the exchange as the same is being operation since 2008 and accordingly it came into the notice that Govt have authorized FMC so late to monitor and control the operations of National spot exchange.
- It was also found during research that proper margins were not maintained by the brokers and Investors while executing the transactions and buying and selling of commodities done beyond the capacity of the brokers and Investor.
- Another observation was value of stocks which were traded at the exchange was not proper and justify and the stock which were not available physically.
- It also alleged that these brokers had manipulated client code modifications. They engaged in trades without the permission of clients. They also allowed clients to execute trades despite debit balances in their accounts. The regulator said they had also not segregated funds between client accounts and their own, thus violating rules.

The main object of the research was to identify whether in this NSEL Scam sufficient evidences persists which leads to the Potential Forensic Audit of National Spot Exchange Limited of the activities done in the various years. Considering the above views, it seems that forensic accounting & auditing plays a significant role in preventing and detecting possibilities of fraudulent financial reporting. It can be seen as an attainable effort to improve quality financial reporting through education and provide other alternative research in accounting. In NSEL Scam also by applying techniques of Forensic audit, many evidences about the fraud detected and if forensic audit could have been applied at some early stage than this scam will not reach to the extent of Rs. 5400 crore and would have been detected much earlier.

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