
REVISITING THE RESPONSIBILITY OF AUDITORS IN IDENTIFYING CORPORATE FRAUD UNDER THE INDIAN CORPORATE GOVERNANCE FRAMEWORK

Shraddha Jain, LL.M., Chanakya National Law University, Patna

ABSTRACT

Corporate fraud has become a persistent and structural challenge in the Indian corporate landscape, exposing weaknesses in prevailing systems of governance and corporate accountability. Auditors, as independent professionals responsible for scrutinising corporate financial disclosures, occupy a vital position in the identification and reporting of fraudulent practices. This paper analyses the statutory and regulatory framework defining auditors' duties in relation to fraud detection in India, with particular emphasis on the Companies Act, 2013, auditing standards, as well as the role of regulatory and supervisory authorities. It analyses statutory reporting obligations, disciplinary controls, and the evolving role of auditors in the evolving corporate frauds, like Satyam scam, IL&FS, and DHFL. The study highlights the gap between regulatory expectations and audit practice, demonstrating that audit failures often stem from deficiencies in professional scepticism and judgment rather than the absence of legal provisions. The paper concludes by emphasising the need for strengthened audit quality, effective enforcement, and enhanced governance mechanisms to reinforce the role of auditors in fraud deterrence and corporate accountability.

Keywords: Corporate Fraud, Auditors' Responsibility, Corporate Governance, Fraud Detection, Companies Act 2013, CARO 2020, Audit Expectation Gap, NFRA

I. Introduction

Corporate fraud poses a serious challenge to corporate governance, financial transparency, and investor confidence in India. Repeated corporate scandals have highlighted deficiencies in internal control systems, board-level supervision, and financial reporting practices, thereby intensifying scrutiny of the auditor's role. Auditors are supposed to enhance accountability and detect material misstatements arising from fraud.

The Companies Act, 2013, significantly expanded auditors' duties by strengthening independence requirements and introducing mandatory fraud reporting obligations, supported by detailed auditing standards and regulatory oversight by the National Financial Reporting Authority. However, auditing standards clarify that auditors provide only reasonable assurance, leading to an expectation gap between public perception and professional responsibility. In this context, this paper examines the legal framework governing auditors' role in fraud detection in India and evaluates its effectiveness in addressing complex corporate frauds.

II. Corporate Fraud: Conceptual and Theoretical Framework

A. Meaning and Scope of Corporate Fraud

Corporate fraud refers to deliberate, deceptive, and dishonest practices carried out by a company, its directors, officers, employees, or associated third parties with the intent to secure unlawful financial gain or to cause wrongful loss to shareholders, creditors, investors, the government, or the public at large. It involves abuse of corporate structures, positions of trust, and information asymmetry to misrepresent financial position, manipulate transactions, conceal liabilities, siphon funds, or evade regulatory and statutory obligations. Indian law approaches corporate fraud as a composite concept, derived not from one exhaustive definition but from multiple statutory provisions, evolving judicial interpretations, and regulatory standards.

A comprehensive statutory articulation of corporate fraud is provided under Section 447 of the Companies Act, 2013, that characterises fraud as *“encompassing any act, omission, concealment of material facts, or misuse of position by any individual, carried out with the intention to deceive, obtain an undue advantage, or cause harm to the interests of the company, its shareholders, creditors, or any other person, regardless of the existence of actual wrongful*

gain or loss.” This provision demonstrates the legislature’s intention to adopt a broad and purposive approach to the concept of fraud within the corporate domain.¹

B. Typologies of Corporate Fraud

Corporate fraud takes varied forms based on the nature of the wrongful conduct, the participants involved, and the organisational level at which deceptive practices arise. In broad terms, such fraud may be categorised into three primary types: financial statement fraud, misappropriation of assets, and fraud occurring at the level of corporate governance.²

Asset Misappropriation

Asset misappropriation is the unlawful taking or inappropriate utilisation of a company’s assets by employees, officers, or agents for their own personal benefit. This form of corporate fraud includes embezzlement of cash, fraudulent disbursements, payroll fraud, inventory theft, misuse of company property, and unauthorised use of corporate funds. Asset misappropriation is the predominant category of fraud in a company and is often enabled by weak segregation of responsibilities, insufficient supervisory controls, and ineffective internal audit systems.³

Financial Statement Fraud

Financial statement fraud includes the deliberate manipulation, falsification, or concealment of financial details in a company’s reports with the objective of misleading stakeholders regarding its true financial condition, operational results, or cash flow position. Such fraud typically involves manipulation of accounting records, premature or fictitious recognition of revenue, understatement of expenses or liabilities, overvaluation of assets, or improper disclosures. Financial statement fraud is typically carried out by top-level executives, since they have the power to bypass internal control systems and significantly influence compilation and reporting of financial statements.⁴ The Association of Certified Fraud Examiners has consistently noted that financial statement fraud causes the highest median losses among occupational fraud

¹ Companies Act, No. 18 of 2013, § 447 (India).

² Association of Certified Fraud Examiners, *Report to the Nations: Occupational Fraud and Abuse* (2024), <https://www.acfe-mexico.com.mx/inicio/sitepad-data/uploads/2024/03/2024-Report-to-the-Nations.pdf>.

³ Misappropriation of Assets, *Auditing Accounting* (Jan. 20, 2025), <https://auditingaccounting.com/misappropriation-of-assets>.

⁴ Arjan Reurink, *Financial Fraud: A Literature Review*, 30 *J. Econ. Surv.* 1 (2016).

schemes.⁵

Governance-Level Fraud

Governance-level fraud occurs at the highest levels of corporate decision-making and involves abuse of fiduciary duties by directors, promoters, or key managerial personnel. This typology includes acts such as diversion of corporate funds, related party transactions conducted without disclosure or at unfair values, manipulation of board decisions, suppression of material information from shareholders, and collusive arrangements with auditors or advisors. Governance-level fraud strikes at the core principles of transparency, accountability, and fairness that underpin the governance of a company.⁶ In our country, corporate fraud is regulated through an extensive statutory framework under the Companies Act, 2013. The statute imposes fiduciary duties and disclosure responsibilities on directors,⁷ obligates auditors to apply professional diligence and to notify the Central Government of any detected fraud in accordance with Section 143(12),⁸ empowers the Serious Fraud Investigation Office to conduct investigations as per Section 212,⁹ and provides for severe penalties for fraudulent conduct under Section 447.

C. Technology-Driven Fraud Detection: Role of data analytics and AI

In the contemporary corporate and financial audit environment, technology-driven fraud detection refers to the deployment of advanced analytical approaches for data, along with Machine Learning (ML) and Artificial Intelligence (AI) technologies, big data tools to identify anomalous trends, irregular transactions, and potential indicators of fraud that traditional audit techniques may fail to detect. These technologies enable auditors to analyse extremely large and complex datasets at high speed, allowing for more comprehensive, timely, and continuous fraud detection. AI and ML models can be trained to understand normal transaction behaviour and automatically flag deviations, detect concealed relationships across multiple data sources,

⁵ Association of Certified Fraud Examiners, *Occupational Fraud 2024: A Report to the Nations* 10 (2024), <https://www.acfe-mexico.com.mx/inicio/sitepad-data/uploads/2024/03/2024-Report-to-the-Nations.pdf>.

⁶ Satyam Goyal & Nikita Singh, *The Anatomy of Corporate Fraud: Governance to Accountability—Insights from India*, 166 Indian J.L. & Legal Rsch. (2023), <https://www.ijlra.com>.

⁷ Companies Act, No. 18 of 2013, § 166 (India).

⁸ Companies Act, No. 18 of 2013, § 143(12) (India).

⁹ Companies Act, No. 18 of 2013, § 212 (India).

and improve accuracy over time through learning from new data.¹⁰

Illustrative applications include continuous real-time surveillance of financial transactions, identification of irregular patterns within financial statements, predictive risk assessment based on historical datasets, and the use of natural language processing to examine unstructured information such as emails and contractual documents for potential indicators of fraud. The predictive capabilities of AI enable auditors and compliance professionals to detect emerging risks at an early stage, thereby enhancing both the precision and effectiveness of fraud detection mechanisms.

Despite these advantages, the incorporation of data analytics and Artificial Intelligence in fraud detection is subject to notable limitations and risks. The accuracy of AI systems is heavily dependent on data quality, and biased or imbalanced datasets may generate false positives or false negatives. The “black-box” the opaque and complex structure of many AI models gives rise to concerns relating to transparency, auditability, and regulatory acceptance. Additionally, the processing of sensitive financial and personal data creates privacy and compliance challenges under data protection regimes. Overreliance on automated systems, evolving fraud techniques, and high implementation costs further necessitate continuous human oversight and robust governance frameworks.¹¹

III. Auditors as Corporate Governance Gatekeepers

A. The Audit Function as an Integral Component of Corporate Governance

1. Conceptual Position of the Audit Function in Corporate Governance

Within the wider corporate governance framework, the audit function serves a critical role, acting as a central mechanism to uphold accountability, transparency, and ethical integrity in corporate operations. Modern governance systems recognise auditing as an essential control device that mitigates agency problems by minimising information asymmetry between management and stakeholder. Through independent examination and verification of financial

¹⁰ Oluwatosin Ilori et al., *Advanced Data Analytics in Internal Audits: A Conceptual Framework for Comprehensive Risk Assessment and Fraud Detection*, 6 *Fin. & Acct. Rsch. J.* 931 (2024), <https://www.fepbl.com/index.php/farj/article/view/1213>.

¹¹ Luiz Moura, André Barcaui & Renan Payer, *AI and Financial Fraud Prevention: Mapping the Trends and Challenges Through a Bibliometric Lens*, 18 *J. Risk & Fin. Mgmt.* 323 (2025), <https://doi.org/10.3390/jrfm18060323>.

and operational information, the audit function strengthens confidence in corporate disclosures and supports informed decision-making by shareholders, creditors, regulators, and the market at large.¹²

2. Audit Pathway and Institutional Roles

Corporate governance structures establish a systematic audit architecture that incorporates both internal and external audit functions, each assigned distinct but mutually reinforcing responsibilities. The internal audit function provides continuous and impartial assurance on the effectiveness of internal controls, risk management processes, and compliance with regulations, typically reporting directly to the audit committee or board of directors to safeguard its independence and maintain effectiveness.¹³ External, or statutory, auditors act as independent assurance providers by examining a company's financial statements in accordance with relevant auditing standards and offering an opinion on whether the statements present a true and fair view of the entity's financial position and performance.¹⁴ This multi-layered audit pathway enables a systematic flow of information from management to auditors, from auditors to those entrusted with governance responsibilities, and ultimately to external stakeholders, thereby reinforcing checks and balances that are fundamental to effective corporate governance.

3. Stages of the Audit Process Relevant to Fraud Detection

Fraud detection constitutes a fundamental element of the audit process and is incorporated throughout its different phases. In the planning phase, auditors gain an in-depth knowledge of the organisation, identify areas susceptible to fraudulent activity, and evaluate the likelihood of material misstatements due to such risks.¹⁵ At the risk assessment stage, auditors analyse particular indicators of fraud risk, such as managerial incentives or pressures, vulnerabilities arising from deficient internal controls, and the possibility of management override. Based on

¹² Samer Alhababsah, *Corporate Governance and Audit Quality: Further Recommendations Beyond the Code*, 15 Corp. Ownership & Control 8 (2018), <https://dx.doi.org/10.22495/cocv15i2art1>.

¹³ Fadhilah Rahma Anwar, *Analysis of the Role of Internal Audit in Enhancing Company's Internal Control*, 2 Golden Ratio Auditing Rsch. 33 (2022), <https://doi.org/10.52970/grar.v2i1.370>.

¹⁴ External Auditor, ScienceDirect Topics, <https://www.sciencedirect.com/topics/computer-science/external-auditor>.

¹⁵ Int'l Auditing & Assurance Standards Bd., *International Standard on Auditing 240: The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* (Revised), <https://www.iaasb.org/publications/isa-240-revised-auditor-s-responsibilities-relating-fraud-audit-financial-statements>.

this evaluation, they tailor and implement audit procedures that specifically address the identified risks.¹⁶

The audit execution stage involves the application of substantive procedures, analytical reviews, and tests of controls aimed at detecting unusual transactions, inconsistencies, or patterns indicative of fraud. Finally, at the reporting and communication stage, auditors evaluate the adequacy and relevance of the audit evidence gathered and communicate significant findings, including detected frauds or material red flags, to those charged with governance. Where mandated by law or professional standards, such matters are also reported to regulatory authorities, thereby linking the audit function with broader enforcement and governance mechanisms.¹⁷

B. Audit Expectation Gap and Associated Challenges

The concept of the audit expectation gap highlights the disparity between what stakeholders expect from auditors and the obligations auditors are legally and professionally bound to fulfil, and the obligations that are in fact imposed on auditors by law and professional auditing standards. Investors, creditors, and other stakeholders often assume that auditors are expected to recognise and prevent every instance of fraud, error, or wrongdoing.¹⁸ By contrast, auditing standards obligate auditors to receive only rational, not absolute proof that the financial statements do not contain significant misstatements, caused by either fraudulent conduct or error. The resulting gap is largely attributable to an inadequate public understanding of the scope, purpose, and inherent constraints of the audit role, coupled with the professional terminology of audit reports, which are frequently misinterpreted as certifying the overall financial health or viability of a company.¹⁹

The persistence of this expectation gap poses significant obstacles for the audit profession and for the proper functioning of corporate governance mechanisms. When corporate failures or large-scale frauds emerge after the issuance of unqualified audit opinions, auditors are frequently subjected to reputational damage, regulatory sanctions, and increased litigation

¹⁶ Id.

¹⁷ Am. Inst. of Certified Pub. Accountants, *Statement on Auditing Standards No. 99: Consideration of Fraud in a Financial Statement Audit*.

¹⁸ Abdullahi D. Ahmed, *The Role of Auditors in Fraud Detection and Prevention*, Int'l J. Auditing (2019), <https://doaj.org/article/1c0f025e72a84fb4bcee49de6ee60e58>.

¹⁹ Int'l Auditing & Assurance Standards Bd., *International Standard on Auditing 200: Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*.

risk.²⁰ The gap also weakens stakeholder trust in audited financial statements and may result in misplaced reliance on audit opinions in economic decision-making. Furthermore, unrealistic expectations regarding auditors' roles strain relationships between auditors, management, and stakeholders, complicating the exercise of professional judgment. Addressing these challenges requires clearer articulation of audit responsibilities, enhanced transparency in auditor reporting, and continuous stakeholder education to align public expectations with the legally defined role of auditors.²¹

C. Auditors' Governance Roles

1. Auditors as Watchdogs of Corporate Governance

Auditors have traditionally been conceptualised as “watchdogs” rather than “bloodhounds,” tasked with exercising independent oversight over corporate financial reporting rather than actively investigating all wrongdoing.²² This watchdog role is central to corporate governance, as auditors act as external monitors who reduce agency costs by scrutinising management representations and validating financial disclosures. By independently examining accounting records, internal controls, and financial statements, auditors provide assurance that management has discharged its fiduciary duties honestly and competently.²³ The effectiveness of this watchdog function lies not in guaranteeing fraud detection, but in maintaining professional scepticism, resisting management pressure, and ensuring that significant misstatements, whether arising from fraud or error, are identified and reported. In this sense, auditors operate as governance gatekeepers who reinforce transparency and discipline within corporate structures.

2. Auditors as Whistleblowers and Early Warning Mechanisms

Beyond their traditional watchdog role, auditors increasingly function as institutional whistleblowers within the corporate governance framework.²⁴ Auditing standards and statutory

²⁰ Paul Olojede, Emmanuel Erin & Sunday Asiriwa, *Audit Expectation Gap: An Empirical Analysis*, 6 *Future Bus. J.* 1 (2020).

²¹ Taslima Akther & Fengju Xu, *Existence of the Audit Expectation Gap and Its Impact on Stakeholder Confidence*, 8 *J. Risk & Fin. Mgmt.* 4 (2020).

²² Pieter Conradie & Karin Barac, *Rational Purpose Requirement and Sustainability Reporting Assurance*, 16 *Sustainability Acct. Mgmt. & Pol'y J.* 156 (2025), <https://www.researchgate.net/publication/391639317>.

²³ Yee Shih & Linda Wang, *The Role of the Audit Oversight Board: Watching the “Watchdog”*, 9 *J. Acct. & Pub. Pol'y* 1 (2014), <https://www.researchgate.net/publication/259827776>.

²⁴ India Envisages Auditors as Whistleblowers, *Int'l Acct. Bull.* (Apr. 2014), <https://www.internationalaccountingbulletin.com>.

regimes require auditors to report material frauds, illegal acts, or serious control deficiencies to individuals entrusted with governance responsibilities, and in specified circumstances, to regulatory or enforcement authorities. In the Indian context, this responsibility is further strengthened by the Companies Act, 2013, which obligates auditors to disclose instances of fraud to the Central Government, and where applicable, facilitates investigation by the Serious Fraud Investigation Office once the prescribed monetary thresholds are satisfied.²⁵ Auditors thus serve as early warning mechanisms, capable of triggering regulatory intervention before corporate misconduct escalates into systemic failure. This whistleblowing dimension strengthens governance by ensuring that serious irregularities are not confined within managerial hierarchies and are brought to the attention of independent oversight bodies.

3. Auditors as Accountability and Enforcement Mechanisms

Auditors also perform a critical accountability function by linking corporate management to shareholders, regulators, and the broader market.²⁶ Through audit reports, qualified opinions, and emphasis-of-matter disclosures, auditors publicly signal concerns regarding financial integrity, internal controls, or governance failures. These signals influence investor confidence, regulatory scrutiny, and market discipline, thereby imposing indirect sanctions on errant management. High-quality auditing constrains earnings management, enhances financial reporting credibility, and strengthens enforcement of corporate governance norms. In this manner, auditors operate not merely as technical verifiers of accounts, but as accountability mechanisms that contribute to the enforcement architecture of corporate law and governance.

D. Audit Quality and Ethical Obligations

1. Audit Quality as a Pillar of Corporate Governance

Audit quality plays a crucial role in assessing the quality of the audit function within corporate governance. Audits of high quality enhance the credibility of financial reporting, reduce information gaps between management and stakeholders, and strengthen market confidence. Audit quality is typically defined as the probability that an auditor will detect a significant error

²⁵ Companies Act, No. 18 of 2013, §§ 143(12)-(15) (India).

²⁶ Nurhayati et al., *The Role of Internal Audit in Maintaining Financial Accountability and Transparency in Government Agencies: A Literature Review*, J. Public Sector Acct. (2024), <https://www.researchgate.net/publication/386387346>.

in a client's financial statements and report it correctly and appropriately.²⁷ This dual requirement competence in detection and integrity in reporting makes ethical obligations central to audit quality, especially in reference to fraud risk and governance failures.

2. Auditor Independence

Independence forms the foundation of audit quality and represents a core ethical duty of auditors. Without independence, the audit opinion loses its credibility and governance value. Regulatory frameworks and professional standards impose strict requirements relating to auditor appointment, rotation, prohibition of non-audit services, and disclosure of relationships that may impair objectivity.²⁸ Impaired independence is associated with lower audit quality, increased earnings management, and reduced likelihood of fraud detection, underscoring the governance risks arising from compromised auditor autonomy.²⁹

3. Professional Scepticism

Professional scepticism is a vital ethical and methodological quality in high-standard auditing. It compels auditors to exercise professional scepticism, maintain a sceptical and analytical approach, and stay vigilant for circumstances that could suggest potential misstatements arising from fraud or error. Auditing standards explicitly highlight scepticism as a continuous obligation throughout the audit process, particularly in areas involving significant management judgment or estimates.³⁰ Failure to exercise adequate scepticism has been identified as a recurring factor in major audit failures, where auditors placed undue reliance on management's assertions or did not sufficiently question assertive accounting approaches.

4. Ethical Compliance and Professional Conduct

Ethical compliance extends beyond technical adherence to auditing standards and encompasses conformity with professional codes of ethics governing integrity, objectivity, confidentiality, and professional conduct. Codes issued by professional bodies require auditors to act in the public interest, even where such duties conflict with client preferences or commercial

²⁷ S. K. Dopuch, *The Demand for and Supply of External Auditing Services*, 19 *J. Acct. Rsch.* 170 (1981), <https://www.sciencedirect.com/science/article/abs/pii/0165410181900021>.

²⁸ Int'l Ethics Standards Bd. for Accts., *International Code of Ethics for Professional Accountants* (2023).

²⁹ Mark L. DeFond & Jieying Zhang, *A Review of Archival Auditing Research*, 58 *J. Acct. & Econ.* 275 (2014), <https://www.sciencedirect.com/science/article/pii/S0165410114000536>.

³⁰ Int'l Auditing & Assurance Standards Bd., *International Standard on Auditing 200 & 240* (IAASB).

considerations.³¹ Ethical lapses such as acquiescence to management pressure, failure to report known irregularities, or participation in aggressive accounting schemes undermine audit quality and erode the appropriateness of the audit function as a governance mechanism. In this sense, ethical compliance operates as both a preventive and corrective tool, reinforcing auditors' role as guardians of financial integrity and corporate accountability.

IV. Legal Framework Governing Auditors' Role in Fraud Detection in India

The Function and Responsibility of Auditors in Detecting Fraud in India is governed by a multi-layered legal framework comprising statutory provisions under the Companies Act, 2013, delegated legislation, mandatory auditing standards, and disciplinary mechanisms under professional regulatory laws. While auditors are not expected to act as investigators, the law imposes upon them significant duties to exercise professional scepticism, detect material misstatements arising from fraud, and report specified frauds to regulatory authorities. This framework signifies a transition from a purely compliance-driven audit approach to a broader model centred on governance and institutional accountability.

A. Position of Auditors under the Companies Act, 2013

Appointment and Tenure of Statutory Auditors

The selection and tenure of statutory auditors are primarily governed by Sections 139 and 140 of the Companies Act, 2013. For listed companies and certain specified categories of companies, the law requires compulsory rotation of auditors. *"An individual auditor can hold office for a single term of five consecutive years, while an audit firm may serve for two consecutive terms of five years each,"* after which rotation is mandatory. This framework is designed to minimise familiarity threats and reduce the potential for collusion between auditors and management, which has historically led to undetected corporate fraud in India.³²

Independence and Eligibility Requirements of Auditors

Auditor independence is reinforced through a combination of eligibility restrictions and disqualifications under Section 141. Auditors are prohibited from having direct or indirect financial interests in the auditee company, from rendering certain non-audit services, and from

³¹ Int'l Ethics Standards Bd. for Accts., *International Code of Ethics for Professional Accountants* (IESBA).

³² Companies Act, No. 18 of 2013, §§ 139-140 (India).

having close business or employment relationships with the company or its key managerial personnel. These safeguards are critical to ensuring that auditors can exercise unbiased judgment while assessing fraud risks. Limiting the provision of certain non-audit services—such as internal auditing, management consulting, and bookkeeping further supports auditor independence and objectivity, enhancing their capacity to detect and report cases of fraudulent financial reporting.³³

Statutory Powers and Duties of Auditors in Relation to Fraud Detection

Section 143(1) empowers auditors with broad authority *“to inspect a company’s books of account, supporting documents, and any additional information or explanations necessary for the proper performance of their duties.”* Complementing this, Section 143(2) imposes a statutory responsibility on auditors *“to express an opinion on whether the financial statements present a true and fair view of the company’s financial position and adhere to the relevant accounting standards.”*³⁴

B. Statutory Duty of Auditors to Report Fraud

Mandatory Reporting of Fraud by Auditor

One of the notable innovations of the Companies Act, 2013 is the compulsory reporting of fraud under Section 143(12). Under this provision, *“if an auditor has reason to believe that an offence involving fraud is being committed or has been committed against the company by its officers or employees, the auditor is statutorily obligated to report the matter to the Central Government in the prescribed form and manner.”*³⁵

Procedural Mechanism for Reporting Fraud under the Companies (Audit and Auditors) Rules, 2014

Rule 13 of the Companies (Audit and Auditors) Rules, 2014 prescribes the procedure to be followed by auditors while reporting fraud. In terms of Rule 13(1), *“where an auditor has reason to believe that an offence involving fraud is being committed or has been committed against the company by its officers or employees, and the amount involved meets or exceeds*

³³ Companies Act, No. 18 of 2013, § 141 (India).

³⁴ Companies Act, No. 18 of 2013, § 143 (India).

³⁵ Companies Act, No. 18 of 2013, § 143(12) (India).

*the threshold specified under Section 143(12) of the Companies Act, 2013, the auditor is obligated to report the matter to the Central Government in the prescribed manner and format.*³⁶ This provision represents a departure from the traditional confidentiality-centric audit model and positions auditors as statutory whistle-blowers.

Disclosure and Reporting of Fraud under the Companies (Auditor's Report) Order, 2020

The Companies (Auditor's Report) Order, 2020 (CARO 2020), issued pursuant to Section 143(11) of the Companies Act, 2013, significantly enhances the disclosure responsibilities of auditors in matters relating to fraud by requiring detailed and specific reporting in the statutory audit report. Clause 3(xi) of CARO 2020 mandates *“that auditors disclose whether any fraud by the company or on the company has been identified or reported during the financial year, thereby broadening the scope beyond frauds committed solely by officers or employees, as was envisaged under earlier CARO frameworks.”*³⁷ Additionally, CARO 2020 requires auditors to take into account complaints lodged by whistleblowers during the reporting period and to reflect their consideration of such complaints in the audit report.

C. Penal and Disciplinary Framework Governing Auditors

Penal Consequences for Auditors under the Companies Act, 2013

Non-compliance with statutory obligations prescribed under the Companies Act, including fraud reporting obligations, attracts penal consequences under Section 147. Auditors may be subjected to monetary penalties, and in cases involving wilful misconduct or intent to deceive, may also face criminal liability. Where an auditor is found to have acted fraudulently, liability may extend jointly and severally with officers of the company, underscoring the seriousness with which the law treats audit failures in fraud contexts.³⁸

Disciplinary Control under the Chartered Accountants Act, 1949

Disciplinary oversight of auditors is regulated under the Chartered Accountants Act, 1949, especially Section 21, which authorises the Institute of Chartered Accountants of India (ICAI)

³⁶ Companies (Audit and Auditors) Rules, 2014, r. 13 (India).

³⁷ Companies (Auditor's Report) Order, 2020, cl. 3(xi) (India).

³⁸ Companies Act, No. 18 of 2013, § 147 (India).

to investigate allegations of professional misconduct against its members.³⁹ Professional misconduct is delineated in the First and Second Schedules to the Act and encompasses acts such as gross negligence, lack of due diligence, and failure to obtain adequate audit evidence which frequently arise in matters involving fraud. Depending on the gravity of misconduct, disciplinary action may range from reprimand and monetary penalties to removal of the auditor's name from the register of members, thereby reinforcing professional accountability alongside statutory liabilities.⁴⁰

Regulatory and Enforcement Role of the National Financial Reporting Authority

The National Financial Reporting Authority (NFRA), constituted under Section 132 of the Companies Act, 2013, serves as the principal regulator overseeing auditors of listed companies and certain large unlisted entities. It is vested with wide-ranging investigative and disciplinary powers, including the authority to conduct inquiries into professional misconduct, levy substantial monetary penalties, and suspend or debar auditors and audit firms from practice.⁴¹ Its intervention in high-profile audit failures has reinforced expectations regarding auditors' responsibility to identify and appropriately address fraud-related risks.

D. Auditing Standards Governing Fraud Detection

Professional Scepticism and Risk Assessment under SA 240

Standard on Auditing (SA) 240, titled "*The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*," constitutes a central element of the fraud detection framework. The standard requires auditors "*to maintain a questioning mindset throughout the audit, carry out thorough assessments of potential fraud risks, evaluate the risk of management overriding internal controls, and develop audit procedures specifically aimed at addressing the identified risks.*" While SA 240 acknowledges that management bears the primary responsibility for preventing and detecting fraud, it also establishes an obligation for auditors "*to provide reasonable assurance that the financial statements do not contain material misstatements resulting from fraudulent activities.*"⁴²

³⁹ Chartered Accountants Act, No. 38 of 1949, § 21 (India).

⁴⁰ Chartered Accountants Act, No. 38 of 1949, First & Second Schs. (India).

⁴¹ Companies Act, No. 18 of 2013, § 132 (India).

⁴² Int'l Auditing & Assurance Standards Bd., *International Standard on Auditing 240: The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* (IAASB).

Interaction of SA 240 with Other Relevant Auditing Standards

Other auditing standards complement SA 240 in strengthening fraud detection. SA 315 mandates the recognition and evaluation of risks of significant errors, including those arising from fraud,⁴³ while SA 330 mandates that auditors formulate and execute suitable audit process to manage the risks that have been assessed.⁴⁴ SA 250 addresses consideration of laws and regulations, which is particularly relevant where fraud involves statutory non-compliance.⁴⁵ Together, these standards operationalise statutory duties and translate legal expectations into practical audit methodologies.

V. Lessons from Corporate Fraud Cases

Corporate fraud cases in India have significantly influenced the evolution of audit regulation, corporate governance norms, and enforcement mechanisms. An examination of prominent fraud cases reveals recurring deficiencies in audit processes, professional scepticism, and governance oversight, while also demonstrating how regulatory responses have sought to address these failures.

Satyam Computer Services Limited Case

The scam of Satyam Computer Services Limited identified the intentional alteration of accounting records by B. Ramalinga Raju, the founder and chairman of the company. As revealed in subsequent investigations, the company had inflated its assets by nearly USD 1.47 billion through the creation of fictitious cash and bank balances, overstated revenues, fabricated interest income, and concealed liabilities over an extended period. The fraud was sustained through the creation of fake invoices, bogus customer accounts, and false employee records, with the objective of projecting consistent growth and maintaining investor confidence. A critical aspect of the scandal was the failure of the statutory auditors to independently verify bank balances and critically evaluate management representations, despite clear red flags such as unusually high cash reserves. The Satyam scam revealed significant and systemic shortcomings in audit scepticism and corporate governance and became a turning point for

⁴³ Int'l Auditing & Assurance Standards Bd., *International Standard on Auditing 315: Identifying and Assessing the Risks of Material Misstatement* (IAASB).

⁴⁴ Int'l Auditing & Assurance Standards Bd., *International Standard on Auditing 330: The Auditor's Responses to Assessed Risks* (IAASB).

⁴⁵ Int'l Auditing & Assurance Standards Bd., *International Standard on Auditing 250: Consideration of Laws and Regulations in an Audit of Financial Statements* (IAASB).

regulatory reforms in India, directly influencing stricter auditor accountability, enhanced disclosure norms, and the strengthening of fraud reporting obligations under company law.⁴⁶

Infrastructure Leasing and Financial Services (IL&FS) Case

The downfall of Infrastructure Leasing and Financial Services (IL&FS) showcased profound shortcomings in corporate governance, risk management practices, and audit supervision, demonstrating that it was not simply a case of commercial failure but a systemic breakdown in oversight and accountability. The group suffered from severe asset–liability mismatches, excessive leverage, and concealment of liquidity stress, which were not adequately reflected in its financial statements. Auditors failed to highlight persistent warning signs such as deteriorating financial ratios, inadequate provisioning, regulatory non-compliance, and the unsustainability of the going concern assumption. Despite mounting defaults, audit reports continued to present a stable financial position, revealing a lack of professional scepticism and effective risk assessment. The IL&FS case ultimately led to government intervention, regulatory investigations, and reinforced the need for stronger audit scrutiny and corporate governance reforms in systemically important financial entities.⁴⁷

Dewan Housing Finance Corporation Limited (DHFL) Case

The DHFL scam revealed extensive financial irregularities and significant audit lapses within one of India's leading housing finance institutions. Investigations revealed diversion of loan funds through shell entities, manipulation of loan portfolios, and misrepresentation of asset quality to conceal mounting defaults. Auditors failed to adequately verify loan disbursements, identify related-party transactions, and assess credit risk despite persistent red flags. Regulatory action, including investigations by enforcement agencies and disciplinary proceedings against auditors, highlighted deficiencies in professional scepticism and audit diligence. The DHFL case underscores the need for heightened scrutiny in audits of financial institutions and stronger accountability mechanisms to prevent systemic financial fraud.⁴⁸

⁴⁶ Corporate Accounting Fraud: A Case Study of Satyam Computers Limited, ResearchGate (year not specified), https://www.researchgate.net/publication/271133698_Corporate_Accounting_Fraud_A_Case_Study_of_Satyam_Computers_Limited.

⁴⁷ IL&FS Fallout: Is It a Business Failure or Corporate Governance Failure?, ResearchGate (year not specified), https://www.researchgate.net/publication/339643162_ILFS_Fallout_Is_it_a_Business_Failure_or_Corporate_Governance_Failure.

⁴⁸ Nikita Agarwal & Shashwat Anand, *DHFL Scam and the Entire Rigmorole*, Int'l J.L. Mgmt. & Human. (2021), <https://www.ijlmh.com/wp-content/uploads/DHFL-Scam-and-the-Entire-Rigmorole.pdf>.

Yes Bank Case

The Yes Bank crisis illustrated how aggressive lending, evergreening of stressed assets, and suppression of non-performing assets can distort financial statements. Although not a conventional accounting fraud in its initial stages, the case revealed governance failures and audit lapses in recognising asset quality deterioration. Auditors were criticised for failing to adequately challenge management's credit assessment practices and provisioning policies. The case highlighted the importance of regulatory coordination between auditors, banking regulators, and boards, and demonstrated that failure to recognise early warning signals can culminate in systemic financial instability.⁴⁹

VI. Conclusion and Recommendations

1. Strengthening Auditor Competence and Professional Scepticism

To enhance auditors' fraud detection capabilities, focused training and ongoing professional development are indispensable. Audit quality improves fraud detection when auditors possess higher competence and professional scepticism, emphasising rigorous evaluation of audit evidence and critical thinking beyond procedural checklists. Auditors should receive regular fraud-focused education on risk assessment, behavioural red flags, and forensic techniques to better identify misstatements caused by fraud. Improving competence will empower auditors to challenge management assertions and detect sophisticated fraud schemes effectively.

2. Enhancing Audit Standards and Risk Assessment Practices

Auditing standards such as SA 240 provide a framework for assessing fraud risks, but these standards need continuous refinement to address emerging fraud patterns. Auditors should apply robust risk assessment procedures at the assertion level, particularly in areas such as revenue recognition where fraud risks are high, as highlighted by regulatory guidance from NFRA.

3. Leveraging Technology and Data Analytics

Technology-driven tools such as data analytics, AI, ML, and continuous monitoring systems

⁴⁹ R. K. Gupta & Meenakshi Sharma, *Corporate Fraud and the Role of Auditors in Detection and Prevention*, 7 Mgmt. J. 15 (2025), <https://managementjournal.in/assets/archives/2025/vol7issue2/7015.pdf>.

should be integrated into regular audit procedures. These tools improve auditors' ability to detect anomalous patterns and complex fraud signals that traditional methods might miss. For example, ML models can systematically identify irregular transactions and highlight risk areas for further investigation, while analytics platforms enable auditors to process large datasets more efficiently. However, auditors must be trained to interpret outputs and understand limitations such as data quality and model transparency.

4. Encouraging Robust Whistle-blower Protection and Reporting Channels

A reliable system for reporting concerns can uncover fraud that auditors might not detect through traditional audit procedures. Enhanced legislation and internal policies protecting whistle-blowers encourage reporting of suspected fraud without fear of retaliation. Such mechanisms provide auditors with additional information sources and reinforce corporate ethical standards, enabling timely investigations and regulatory notifications.

5. Promoting Transparency and Public Understanding of Audit Roles

Bridging the audit expectation gap requires clearer communication of auditors' responsibilities to stakeholders. Audit reports should include more transparent disclosures concerning audit scope, fraud risk assessments, and key audit matters where relevant. Educating the public, regulators, and corporate stakeholders on the *reasonable assurance* nature of audits as distinguished from absolute fraud detection will better align expectations with statutory and professional standards.

6. Enhancing Regulatory Oversight and Enforcement Consistency

Regulatory authorities such as NFRA should continue to issue guidance and clarifications on auditors' fraud detection responsibilities and enforce compliance consistently. Recent NFRA pronouncements underscore the need for stronger identification and disclosure of fraud-prone areas such as related party transactions, which auditors must scrutinise with heightened scepticism. Consistent enforcement of auditing standards and professional obligations enhances deterrence and reinforces high audit quality.

Conclusion

Corporate fraud continues to present significant challenges to effective governance and reliable

financial reporting. This study highlights the pivotal role of auditors in detecting and addressing fraudulent activities, supported by auditing standards and regulatory oversight. Historical cases such as Satyam, IL&FS, and DHFL illustrate that audit shortcomings often stem from insufficient professional scepticism and limited scrutiny rather than gaps in legislation. Although auditors cannot prevent all instances of fraud, rigorous and methodical auditing remains vital for early detection and for sustaining confidence in corporate governance and financial reporting.