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The Auditor Caught Between Two Standards: Reconciling Sections 3 and 12 of the Prevention of Money Laundering Act, 2002

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Received 31 July 2026; Accepted 02 September 2026; Published 07 September 2026

*An auditor who agrees to sign an engagement letter on today's date is fulfilling two responsibilities which were never intended to be merged together. The first of these is of a professional character: it involves maintaining the client's confidence, examining the client's books and forming an opinion. The second is a statutory obligation: it requires the auditor to keep an eye on the same client for the state and to submit a report as soon as a transaction seems to be improper. This article argues that the Prevention of Money Laundering Act, 2002 ("PMLA") has gradually placed Indian auditors, chartered accountants, company secretaries and cost accountants in this difficult position without advising them as to how they should deal with it. Section 3 of the PMLA only imposes penalties for money laundering where the person accused had actual knowledge that the funds in question were tainted. In contrast, Section 12 requires reporting entities, a category which has included these professionals since a 2023 notification, to file a suspicious transaction report based on reasonable suspicion, without having to satisfy any similar standard of knowledge. An auditor, therefore, can easily avoid the consequences of Section 3 with a large margin of safety and yet still be liable to a penalty under Section 13 for the same transaction. By referring to the official interpretation of the PMLA, the 2023 notification that brought these professionals within the scope of reporting entities, the Reserve Bank of India's KYC/AML framework for banks, the Financial Intelligence Unit's 2023 guidelines, and the Bombay High Court's 2025 judgment in *Shyam Radhakrishna Malpani v State of Maharashtra*,¹ this article shows exactly*

¹ *Shyam Radhakrishna Malpani v State of Maharashtra* (2025) SCC OnLine Bom 2404

where these two standards come into conflict. It proposes three practical measures to narrow the gap: red flags specific to audits, similar to those issued by the RBI for banks; a standard form of documentation to record the auditor's reasons before either deciding to file or refusing to file a report; and good-faith protection from regulatory action under Section 12. None of these suggestions tackles the reasonable-suspicion reporting threshold itself, for which there is a strong justification in keeping it low. What is missing is not a lower standard for reporting; what is missing is an operational floor for the individual professional working under that threshold.

Keywords: PMLA, auditors, reporting entity, suspicious transaction report.

INTRODUCTION

In every engagement, an auditor has two roles: the first is to win the client's trust so that the client will hand over its books honestly; the second is to remain independent of that trust so that, if necessary, he or she will be in a position to say that something in the books doesn't add up. The anti-money-laundering law does not give rise to this dilemma but does make it much more severe. When a professional is involved in the system set up for detecting illegal finance, he or she is required to hold the client's confidence in one hand while at the same time keeping an eye on the client on the government's behalf.

Most of the PMLA's reporting system was intended for banks and other financial institutions and organisations which deal with a very large volume of transactions and, as is no surprise, have compliance departments in place exactly for that purpose. When the methods used for money laundering moved from the banking sector to corporate structuring, share transfers, and professional services, the law was also amended.² According to Section 2(1)(sa) of the PMLA, a notification issued in June 2023 brought chartered accountants, company secretaries, and cost accountants within the legal definition of a 'reporting entity' in relation to several specific activities: managing clients' money, securities, or other assets; managing bank, savings, or securities accounts; organising contributions for the creation, operation, or management of companies; and acting as, or arranging for someone else to act as, a formation agent, director, partner, or nominee shareholder.³ Suddenly, a group of professionals who

² 'Notification No SO 2036(E)' (Ministry of Finance, 03 May 2023) <<https://trackwizz.com/knowledge-hub/wp-content/uploads/2023/06/MINISTRY-OF-FINANCE-circular.pdf>> accessed 28 July 2026

³ 'Notification No SO 2135(E)' (Ministry of Finance, 09 May 2023) <<https://uncomplycate.com/wp-content/uploads/2023/11/Prevention-of-Money-Laundering-Amendment-to-Notification-9th-May-2023.pdf>> accessed 28 July 2026

had never before made a suspicious transaction report in their careers found themselves required to meet the same reporting obligations as banks have done over the past twenty years by setting up the necessary institutional arrangements.

The problem that results is basic and not merely coincidental. Even though Section 3 of the PMLA makes it a criminal offence only in the case where a person actually knows that the property in question is the proceeds of crime or has knowingly assisted in making it appear clean,⁴ Section 12 says nothing of the kind; it simply requires a reporting body to file a report as soon as it considers that a transaction is 'suspicious' in accordance with Rule 2(1)(g) of the 2005 Rules a definition which is based entirely on reasonable suspicion, unusual complexity, and the absence of an obvious economic purpose, without referring to what the professional knew.⁵ It follows that an auditor can be entirely free from any accusation of having committed money laundering under Section 3 and yet still be subject to a financial penalty under Section 13 for having, in hindsight, wrongly judged whether the transaction had gone beyond the threshold established in Section 12. The same set of facts is subject to two different standards and is judged twice, there being no part of the statute which shows where one standard ends and the other begins.

The central point of this article is that it is the professionals who are most unable to cope with the gap between the two standards applicable to individual auditors and small firms. If a large bank encounters a doubtful transaction, it can pass the problem on through its compliance department, via a named Principal Officer, and by using a documented risk-assessment procedure which has been established for that purpose.⁶ In contrast, a sole-practice chartered accountant operating in a mid-sized city has no such facilities; she has to make the decision entirely on her own by relying on her professional judgment, her name must appear on the engagement letter, and she will be personally liable if that judgment is later challenged. The remainder of the article examines the different ways in which Sections 3 and 12 have been interpreted, notes that the single ruling on the matter, Malpani, addresses the aspect of the difference relating to Section 3 but leaves the Section 12 aspect entirely untested, and proposes three specific measures for eliminating the gap in this way without

⁴ Prevention of Money Laundering Act 2002, s 3

⁵ Prevention of Money-Laundering (Maintenance of Records) Rules 2005, r 2(1)(g)

⁶ 'Master Direction - Know Your Customer (KYC) Direction, 2016 (Updated as on August 14, 2025)' (*Reserve Bank of India*) <<https://www.rbi.org.in/commonman/english/scripts/notification.aspx?id=2607>> accessed 28 July 2026

lowering the reporting threshold, a threshold which both the FATF and India's own Mutual Evaluation Report support the idea of maintaining.⁷

SCOPE AND METHODOLOGY

This is a doctrinal article which examines the text of the PMLA, the rules and notifications made under that Act, the Financial Intelligence Unit's 2023 guidelines, and the one judicial decision that pertains to an auditor's liability under Section 3, with a view to showing a deficiency in the way the framework deals with individual professionals. The article does not make use of survey data, interviews with auditors who are in practice, or enforcement statistics from FIU-IND regarding how often Section 13 penalties are actually imposed on individual professionals as compared to banks and large intermediaries. Even though these questions are important and a study based on empirical evidence that answers them would reinforce the argument made in this article, they lie outside the scope of what this article aims to achieve.

The study is concerned with auditors, chartered accountants, company secretaries, and cost accountants those professionals who have fallen within the scope of the reporting entity as a result of the 2023 notification. Banks are included merely for the sake of comparison and are not subject to separate analysis since their organisational structure, featuring a dedicated compliance team, well-established monitoring systems, and an internal escalation procedure all the way up to senior management, is precisely the type of arrangement that individual professionals do not possess. The comparison made in this article is with the Reserve Bank of India's Master Direction on Know Your Customer, since this shows what operational guidance looks like when a regulator has actually prepared it for a group of reporting entities and as there is still no similar guidance available for auditors under Section 12.

The example given here deliberately concentrates on the regulatory systems in India and does not include a similar system from abroad. This is so since the regulators, the professional bodies, and the FIU all operate within a single statutory and institutional framework; it therefore seems more reasonable to refer to an example from within the country when suggesting reforms rather than to apply a standard which was drawn up for a different legal

⁷ *Anti-Money Laundering and Counter-Terrorist Financing Measures – India: Mutual Evaluation Report* (Financial Action Task Force 2026)

system and a different system of enforcement. Although this results in the article's scope being narrowed, it does ensure that the recommendations are based on measures which the Indian regulatory system could plausibly put into effect without having to amend the legislation. Moreover, the article does not take into account entities that are not CAs, such as real estate agents, dealers in precious metals and stones, and virtual digital asset service providers, who are covered by the same Section 3/Section 12 arrangement but under different practical conditions and would therefore need to be treated separately.

THE DOCTRINAL FRAMEWORK

Section 3: Knowledge as a Threshold: Section 3 of the PMLA defines the offence of money laundering; it covers anyone who directly or indirectly attempts to carry out such an offence, who knowingly gives assistance, who knowingly takes part in it, or who is actually involved in an operation or activity concerning the proceeds of crime and then represents or claims those proceeds as though they were untainted.⁸ The provision is not restricted to the person who first acquired the illegal funds; anyone who later hides, keeps or uses those proceeds, knowing what they are, is also within its scope. If a person obtains money as a result of fraud and disguises it as payment for a service which had never been provided, then anyone who knowingly arranges or directs that payment can be held liable under Section 3, even if they were not involved in the fraud.

The fact that a professional mistake is not a criminal offence under Section 3 should be noted. An accountant who fails to detect an irregular entry or conducts a defective audit is not therefore liable for it. As the Supreme Court understood the terms 'knowingly assists' and 'knowingly is a party to' in *Directorate of Enforcement v Padmanabhan Kishore*,⁹ Section 3 applies to cases involving conscious participation in the laundering process and not to situations where a person is merely accidentally or negligently involved. The section does not call for negligence; instead, it demands either actual knowledge that the money in question was dirty or active participation in hiding that fact.

Section 12: Suspicions as the Criterion: Section 12 is based on a wholly different set of principles: it places on certain professionals an ongoing duty to keep a lookout for red flags

⁸ Prevention of Money Laundering Act 2002, s 3

⁹ *Directorate of Enforcement v Padmanabhan Kishore* (2022) SCC OnLine SC 1490

and to report them each time they are carrying out particular kinds of work for a client, and it terms these professionals a 'reporting entity'.¹⁰ A reporting entity must verify the client's identity, keep the transaction records for the prescribed period and pass on to the Financial Intelligence Unit any transactions which appear suspicious, this organisation being responsible for receiving and analysing such reports.

Above all, this duty only applies in the case of a 'designated business or profession', a designation which the Central Government has set by means of a notification, since such activities carry a higher risk of money laundering.¹¹ Chartered accountants, company secretaries, and cost accountants are covered by this category, but only when they are managing money belonging to clients, helping with the formation of a company or its restructuring, or acting on the client's behalf in connection with the sale or purchase of a business. A statutory audit alone is not enough to make an accountant into a reporting entity; instead, the status is obtained under the Companies Act and the applicable auditing standards, not under the PMLA. But if the same accountant is also assisting that client in incorporating an entity or in managing funds linked to a transaction, then the obligations under Section 12 apply to that particular engagement and remain in force separately and in addition to the audit work.

Once they have been set off, these obligations conflict with the confidentiality that an auditor ordinarily owes to her client. The same professional, within the same relationship, is required both to protect the client's information and to keep an eye on the client for the sake of the state duties which not only exist in an unsatisfactory way but can, according to the particular circumstances, work in opposite directions.

THE APPLICATION OF THE GAP IN A HYPOTHETICAL SITUATION IN PUNE

Picture a chartered accountant who runs a small accounting practice in Pune and has been hired by a medium-sized manufacturing company for two reasons: in one role she serves as the company's statutory auditor, examining its financial statements and giving an independent opinion as to whether they present a true and fair view; the same client has also

¹⁰ Prevention of Money Laundering Act 2002, s 12

¹¹ *Ibid* s 2(1)(sa); Notification No SO 2036(E) (n 2)

asked her to help in establishing a new subsidiary and to look after the funds transferred to it.

The fact that she is taking part in the audit does not imply that she is a reporting entity; rather, that status is set out in the Companies Act and the applicable auditing standards, not under the PMLA. Moreover, if she fails to spot a red flag or makes an error during the audit, she is not automatically liable under Section 3 criminal liability. Malpani makes this point clear: liability under Section 3 hinges on actual knowledge or active assistance, and negligence in carrying out the audit does not amount to that level.¹²

The case is entirely different when it comes to the subsidiary's involvement. Activities such as assisting with the incorporation of the company and managing the funds are mentioned in the 2023 notification. Once she starts carrying out these tasks, she too becomes a reporting entity and is therefore obliged to verify the client's identity, assess and record any risks, and report anything suspicious to the FIU even if it is never established that any wrongdoing has occurred.

At the time of the incorporation, she noticed that the original funding of the subsidiary had been channelled through a multi-stage transaction via an intermediary company with which she had never previously dealt. The client explained that this had been only a restructuring arrangement and that it had been given orally without any written documentation to support the business rationale for it. On the surface, this conforms with the Rule 2(1)(g) definition of a suspicious transaction, namely a transaction which is unusually complex and has no apparent economic purpose.¹³

She has to decide, and there is no straightforward solution regardless of which way she goes. If she does file a report, it might damage a valuable client relationship which has developed over a long period of time in the event that the transaction turns out to be entirely innocent and in a small firm that relationship might make up a large portion of her income. Conversely, if she does not file, it could lead to enforcement action under Section 12 should the transaction later be examined and found to be one that should be reported. At this stage she has to come to a decision; she has no reliable way of knowing whether the transaction

¹² *Shyam Radhakrishna Malpani v State of Maharashtra* (2025) SCC OnLine Bom 2404

¹³ Prevention of Money-Laundering (Maintenance of Records) Rules 2005, r 2(1)(g)

meets the knowledge criterion established in Section 3 and that exact uncertainty is the problem that this article deals with.

The same accountant, the same client, and the same fundamental facts are covered by two legal standards which are both in force: one requires that knowledge must be proven before liability can be established, while the other is satisfied by reasonable suspicion alone, since the statute or the rules do not indicate as to where one standard ends and the other begins.

THE DIFFERENCE IN MEANING BETWEEN SECTION 3 AND SECTION 12

The uncertainty referred to in the hypothetical is not the result of any error on the part of the accountant; instead, it stems from a gap in the definition which is built into the system. Under Rule 2(1)(g) of the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005, a 'suspicious transaction' gives rise to reasonable suspicion that it involves the proceeds of crime, or is marked by unusual or unjustifiable complexity, or appears to have no economic justification or legitimate purpose. The rule does not make a distinction between a transaction which is only unusual, meaning the kind that regularly happens in ordinary business activity, and one which is genuinely suspicious in the sense in which the regulator actually cares. Each reporting entity, whether it is an individual practitioner or a large firm having a compliance department, must decide on a case-by-case basis what the difference is.

Large banks are able to reach a reasonably consistent judgment on this matter by means of their specialist compliance teams, transaction-monitoring software, and a long record of previous internal decisions, while individual chartered accountants and small firms are generally not in a position to do so. This puts them in a difficult spot with no safe course of action: if they report too readily, then the professional runs the risk of harming the client's trust and may even compromise the confidentiality which the relationship depends on; if, on the other hand, they delay reporting or fail to report at all, the professional is liable to face regulatory fines under Section 12 and, in more serious cases, could end up with the type of criminal exposure that had been considered though was ultimately dismissed on the facts in the Malpani case. Since the person who signs the engagement letter has to make this decision themselves and could be personally held liable should the decision later be challenged, the absence of clear guidance is not merely a minor inconvenience at the fringe of practice; it

means that every judgment an individual auditor makes under Section 12 has to be made from first principles.

THE COURTS' RULINGS: WHAT HAS BEEN ESTABLISHED AND WHAT HAS NOT BEEN ESTABLISHED

Padmanabhan Kishore says that Knowledge should come before Action: In *Directorate of Enforcement v Padmanabhan Kishore*,¹⁴ the Supreme Court considered whether a person who delivers cash with the intention that it be treated as a bribe can be prosecuted under the PMLA even if, strictly speaking, the money remains untainted while it is still in his possession. The respondent argued that the cash could not be considered as 'proceeds of crime' until it had actually been received by the public servant and therefore could not in any way be connected with such proceeds. The Court dismissed this contention and held that it must be intended at the time of handing over the money that it is to be given as a bribe, and that a person who has formed such an intention is already part of the process concerning the proceeds of crime even before the money has in fact been transferred. The significance of this judgment for the present article is not due to its facts, which concern a straightforward bribery case, but rather to the way in which the Court has interpreted the terms 'knowingly assists' and 'knowingly is a party to' in Section 3. The Court interpreted these expressions as requiring conscious and intentional participation, a standard which does not allow liability to be based merely on carelessness or on failing to spot a red flag.

Malpani: The Shield Provided for by Section 3 of the Auditors' Act: The principle in question is directly applied to an auditor in the case of *Shyam Radhakrishna Malpani v State of Maharashtra*, and it is this ruling which forms the main point of reference for the present article. The applicant, who is a chartered accountant, acted as a statutory auditor for companies connected with the former Maharashtra minister Chhagan Bhujbal in the Maharashtra Sadan land allotment case from 2012 to 2015. The Enforcement Directorate maintained that his failure to detect suspicious cash deposits, accommodation entries, and transactions involving shell companies amounted to knowingly assisting in the concealment of the proceeds of crime in accordance with Section 3. In its judgment, delivered by Laddha J on 16 June 2025, the Bombay High Court completely dismissed this contention, holding that

¹⁴ *Directorate of Enforcement v Padmanabhan Kishore* (2022) SCC OnLine SC 1490

a mere lack of due diligence, even if, for the sake of argument, such a failure had in fact occurred, does not constitute either the commission or omission of an offence under Section 3. The Court also noted that the role of an auditor is fundamentally different from that of an investigating authority: it would be unreasonable to expect a statutory auditor, merely because of her position, to independently verify the truth of every document supplied to her by the company's authorised personnel. Moreover, the Court observed that the alleged criminal origin of the fund's dates back to 2007–08, a period which was many years before the applicant began his term as auditor in 2012, a chronological gap which on its own undermined any conclusion that there was a connection between his actions and the alleged offence.

The view expressed by Malpani, when considered together with that of Padmanabhan Kishore, protects auditors from criminal liability under Section 3 provided that they act honestly and rely in good faith on the information furnished by their clients. However, neither of these judgments touches on Section 12. While both of them deal with criminal liability in cases of money laundering, neither of them examines whether an auditor's failure to file a suspicious transaction report leads to regulatory consequences in accordance with the reporting-entity provisions. At the moment, there is no court decision that has looked at the Section 12 standard as it applies to auditors. The judicial gap which this article highlights is, at this stage, not only unresolved but, in fact, has never been considered by the Indian courts.

THE BOUNDARIES OF REGULATORY GUIDANCE

As there has been no judicial interpretation of Section 12, the only guidance that current content auditors have is that provided by the regulator. The anti-money-laundering and counter-fraud guidelines issued by the Financial Intelligence Unit on 19 June 2023 for professionals who hold practice certificates from ICAI, ICSI, and ICMAI stipulate that such professionals must have internal AML policies, carry out client identity verification, conduct periodic risk assessments, maintain recordkeeping, and establish internal reporting systems.¹⁵ The guidelines contain one clear and specific requirement, namely that a suspicious transaction must be reported within seven working days of the reporting entity

¹⁵ *AML & CFT Guidelines for Professionals with Certificates of Practice from ICAI, ICSI and ICMAI* (Financial Intelligence Unit-India 2023)

suspecting it.¹⁶ They also give examples of warning signs, for instance, unusual complexity, unusually high transaction values, and the absence of an apparent economic explanation, which are essentially the same as the language used in Rule 2(1)(g).

What is clear is that this guidance merely delays rather than resolves the more complicated question. While it asks ICAI, ICSI, and ICMAI to decide in practice how suspicious transactions should be identified, monitored, and reported, the ambiguity surrounding the term 'suspicious' is a separate issue. Rather than dealing with the matter as a whole, the FIU has set up a general procedural framework and has left the actual, transaction-by-transaction judgment to the professional bodies.

A good example to compare with this is the situation concerning banks. The Reserve Bank of India's Master Direction on KYC, which was first issued in 2016 and has since been amended, requires banks to take a risk-based approach, to appoint a Principal Officer, to set up transaction- monitoring systems, and to establish an internal escalation procedure that reaches senior management.¹⁷ An earlier circular from 2008 had pointed out certain red flags in banking transactions, for instance, cash deposits that are unexplained and do not correspond with the customer's stated business, the reactivation of dormant accounts just before a large transaction, and unusual patterns in foreign remittances. When Section 12 was extended in 2023 to cover individual auditors, company secretaries, and cost accountants, these professionals were given the same reporting obligation as banks have had for twenty years, even though they have not been given any of the operational support that goes with it. The compliance officer in a bank works within a system that is specifically designed to spot red flags before they reach a human decision-maker. By contrast, an individual chartered accountant is expected to identify the same kind of transaction on his own during a single client relationship and has essentially nothing to rely on.

The actual problem mentioned in this article is not the reporting threshold in question. As both FATF Recommendation 20 and India's Mutual Evaluation Report point out, the threshold based on suspicion should remain low since raising it would allow sophisticated

¹⁶ 'Frequently Asked Questions (FAQs) on Notification dated 3rd May, 2023 under the Prevention of Money Laundering Act, 2002' (*Institute of Chartered Accountants of India*)

<<https://resource.cdn.icai.org/76877cecleanpo61946.pdf>> accessed 28 July 2026

¹⁷ 'Master Direction - Know Your Customer (KYC) Direction, 2016' (*Reserve Bank of India*)

<<https://www.rbi.org.in/commonman/Upload/English/Notification/PDFs/MD18KYCF6E92C82E1E1419D87323E3869BC9F13.pdf>> accessed 28 July 2026

money launderers to escape detection by means of nominees, layered ownership structures, or transactions that are deliberately kept below any specific numerical limit.¹⁸ The remedy therefore is not to narrow the legal definition of what constitutes a suspicious case; instead, it should be to give individual auditors what banks currently possess, that is, audit-specific red flags, a written procedure for escalating concerns, and legal protection for reports which are made honestly and on reasonable grounds.

The Penalty System Provided for in Sections 12A, 12AA and 13: In this section, the emphasis changes from the duties imposed on auditors to the situation in which a judgment made under Section 12 is later found to be defective. The appropriate provision is Section 13, which grants the Director of FIU-IND the power to investigate whether a reporting entity is complying with the obligations specified in Chapter IV and, where a failure is identified, to issue a warning, prescribe specific measures to ensure compliance, require the entity to submit periodic reports, or impose a financial penalty ranging from not less than ten thousand rupees to not more than one lakh rupees for each failure.¹⁹ The provisions of Sections 12A and 12AA are directly connected to this investigation. Section 12A allows the Director to ask for records including those maintained under Sections 12 and 12AA and for any other information which may be regarded as necessary, and it obligates the reporting entities to furnish this information.²⁰ Section 12AA sets out enhanced due diligence requirements in relation to certain high-risk client transactions and provides that the information thus obtained shall be retained for a period of 5 years.²¹

The key point is that the exposure provided under Section 13 is regulatory and not criminal. The Director's investigation and any penalties that arise out of it have nothing at all to do with the knowledge requirement set out in Section 3; an auditor can still be given a Section 13 order even in situations where it would be impossible to plausibly bring a criminal money-laundering charge, since there is no evidence of actual knowledge or intent in the records. This is the real-world advantage of the legal distinction described in this article: the Pune hypothetical accountant who mistakenly concludes that a transaction is 'suspicious' may escape all liability under Section 3 as Malpani suggests and yet still face a Section 13 penalty

¹⁸ *International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations* (Financial Action Task Force 2026)

¹⁹ Prevention of Money Laundering Act 2002, s 13

²⁰ *Ibid* s 12A

²¹ *Ibid* s 12AA

for not meeting the record-keeping, reporting, or enhanced due diligence obligations imposed by Section 12 and Section 12AA, irrespective of whether there is any issue of guilt.

THE RESPONSE OF THE PROFESSION ITSELF

The kind of exposure referred to in this article is not just something that can be discussed in an academic context; the same concerns have been expressed by practitioners and professional organisations in their own publications, thereby giving independent support to the doctrinal gap which this article points out.

As stated by CS Bharti Kashyap in an article published in *Chartered Secretary*, the official journal of the Institute of Company Secretaries of India, the 2023 notification made it the responsibility of practising chartered accountants, company secretaries, and cost management accountants to carry out KYC procedures, keep records, conduct enhanced due diligence, and to report any suspicious transactions connected with particular client activities. She notes that many of the notification's key terms such as 'formation agent' and 'arranging for another person to act as' a director or nominee shareholder remain poorly defined in practice and suggests that members should be given structured training as well as more detailed operational guidance. The fact that the professional body's own journal treats this as an operational rather than a theoretical issue offers independent confirmation of the definitional gap previously identified in this article.

In the article he writes for *LawStreet India*, Arvind addresses the practical implications and states that the notification does not cover all the activities carried out by a chartered accountant, a company secretary, or a cost accountant for a client, only those specific activities which are carried out on the client's behalf and fall within the designated categories. Where a professional's engagement is within the scope, Sections 12, 12A, 12AA and 13 come into full force, and financial and regulatory consequences will result in the event of non-compliance. This shows, from the practitioner's point of view, what has already been established doctrinally in the earlier parts of the article: the exposure mentioned here is not just hypothetical, and a professional who incorrectly decides whether a transaction should be reported or who fails to maintain the records required by the framework will in fact have to face real consequences under a standard that is separate from Section 3.

An examination of the 2023 notification by the SCC Online Blog shows that the reporting-entity framework is not confined to financial transactions in the strict sense; it also covers acting as a formation agent, arranging for directors or company secretaries, providing a registered office or correspondence address, and serving as a trustee or nominee shareholder on behalf of another person in relation to a trust arrangement.²² Although there are exemptions for certain routine activities, the framework as a whole goes well beyond what many professionals appear to believe. A chartered accountant who had thought her responsibilities to be limited to audit and tax work might discover that a separate corporate-services engagement, for example, helping a client to set up a subsidiary, places her directly within the reporting duties under the PMLA, even if no aspect of her audit relationship with that client gives rise to such obligations.

When the three accounts are looked at together, they reinforce one another: Kashyap highlights the definitional ambiguity in the terms of the notification itself; Arvind confirms the penalty exposure referred to above under Sections 12A, 12AA, and 13; and the analysis on the SCC Online Blog shows how easily the framework's scope can include a professional who had not anticipated being covered by it.²³ The problem that this article deals with has already been recognised within the profession, not merely stated here.

THE LITERATURE GAP

There is a great deal of existing commentary on the PMLA's reporting-entity framework, but this is mostly descriptive in character: articles prepared by practitioners and compliance manuals describe what Sections 12, 12A, and 12AA require of a reporting entity, and the judicial observations in the cases of Malpani and Padmanabhan Kishore accurately state the requirement under Section 3 for criminal liability to arise. Nevertheless, very little of this literature examines the relationship between these two standards, one being a criminal standard based on knowledge and the other a regulatory one based on suspicion, as a separate and distinct problem for the professionals who currently find themselves in this

²² 'Practising professionals as reporting entities under PMLA' (Vinod Kothari Consultants, 05 May 2023) <<https://vinodkothari.com/2023/05/practicing-professionals-as-reporting-entities-under-pmla/>> accessed 28 July 2026

²³ Kriti, 'MoF widens ambit of "Person carrying on designated business or profession" under PMLA' (SCC OnLine, 12 May 2023) <<https://www.sconline.com/blog/post/2023/05/12/activities-included-in-definition-of-person-carrying-on-designated-business-or-profession-under-pmla-legal-news/>> accessed 28 July 2026

position. This failure to analyse the issue is especially noticeable in the case of individual auditors and small firms, since these organisations do not have the institutional guidance available to banks and are, rarely, the subject of commentary that makes a distinction between their level of exposure and that of larger reporting entities which have a dedicated compliance system in place. The present article does not intend to give a comprehensive survey of the Indian legal scholarship on the PMLA; instead, it notes, based on the sources considered here, that the particular tension it has identified has not been regarded as a separate issue in the existing literature, and that it is worth pointing out this omission in light of the practical implications discussed in this article.

LIMITATIONS

The article is entirely concerned with a doctrinal analysis and makes no use of any empirical evidence, for example, interviews with auditors in practice, structured surveys, or FIU-IND enforcement statistics, to demonstrate how auditors in actual situations handle the conflict between Sections 3 and 12, or how frequently Section 13 penalties are in fact imposed on individual auditors as compared to banks and large intermediaries. Its comparative element is limited to the regulatory systems in India, particularly the RBI's KYC/AML framework; it does not examine how other jurisdictions organise the relationship between a criminal knowledge standard and a regulatory suspicion-based reporting standard for auditors, a line of inquiry which might uncover alternative models other than the one shown in the RBI example here. The article also fails to take into account the non-CA reporting entities brought within the same framework, such as real estate agents, dealers in precious metals and stones, and virtual digital asset service providers, who face a situation under Sections 3 and 12 that is structurally similar but whose practical circumstances differ enough from those of audit professionals to warrant separate treatment. Finally, since no court decision has so far considered the Section 12 standard as it applies to an auditor, the analysis of that aspect of the issue must rely on the statutory text and the FIU's regulatory guidance rather than on judicial interpretation. At the present time, how a court would settle a real Section 12 dispute involving an individual auditor is still a matter of informed prediction and not of settled law.

RECOMMENDATIONS

There are three measures that could be adopted in order to reduce the gap which this article points out without changing the low reporting threshold, since it is suspected that both the FATF and India's Mutual Evaluation Report support maintaining it.

In the first place, it should be the FIU or the relevant professional bodies that publish audit-specific red flags which have as much detail and specificity as those currently issued by the RBI for banks. Although both Rule 2(1)(g) and the FIU's 2023 guidelines provide a general explanation of what constitutes suspicion, for example, unusual complexity or the lack of an economic purpose, they do not convert these general descriptions into specific and concrete indications that an individual practitioner can use when looking at a particular transaction. If a practical reference list were offered, one tailored to the kinds of transactions that auditors and company secretaries in fact encounter, such as related-party fund transfers when a company is being set up, transfers that are unexplained and pass-through intermediary entities, and cash components that do not match the client's stated business, then professionals would have a proper standard that is at present missing from both the Rules and the existing guidance.

Second, the professional bodies ought to introduce a standard form for recording an auditor's reasons either when they decide to file or when they choose not to file a suspicious transaction report. This type of form would provide a contemporaneous record of the professional's good-faith judgment at the time the decision was taken, rather than requiring that judgment to be inferred afterwards if a Section 13 inquiry is later initiated. This is advantageous for the auditor since she would then have a documented basis on which to demonstrate that her decision was reasonable at the time it was made. It is also beneficial for the FIU, since it would have a structured basis on which to judge whether a particular judgment call was defensible rather than having to work out the auditor's intent from an incomplete file.

Thirdly, auditors should be protected in good faith under a safe harbour clause when they have acted on reasonable suspicion, have done so in good faith and did not actually know that the transaction in question was tainted. This provision would formally establish on the regulatory side of the framework what Malpani and Padmanabhan Kishore have already

suggested on the criminal side, namely that a professional who acts honestly based on the information available to her and who does not consciously take part in any concealment should not be subject to open-ended liability for a judgment call which a regulator later assesses in the light of hindsight. At the moment, such protection is available only in the case of Section 3, and there is nothing in the statute at present which provides anything similar to the protection offered under Section 12.

Neither of these three measures involves altering the suspicion threshold which sets off the duty to report, a threshold which this article holds should stay as it is, since both the FATF and India's own Mutual Evaluation Report have already provided the reasons for this. All that each of the measures does is to provide individual auditors and small firms, who are responsible for fulfilling the reporting requirements under Section 12 yet have not developed any of the compliance facilities that banks have established over the past twenty years, with a degree of operational clarity equivalent to that which banks already routinely receive.

CONCLUSION

The article aimed to pinpoint a particular and little-studied issue concerning India's PMLA framework: that auditors who are involved in complying with anti-money-laundering regulations are subject to two standards which do not match. While Section 3 provides that criminal liability can only arise on the basis of actual knowledge, Section 12 requires reporting merely based on reasonable suspicion, with no similar knowledge requirement stated anywhere in that section. The hypothetical scenario presented in this article illustrated what this discrepancy looks like in practice: the same professional, the same client, and the same set of fundamental facts being governed by two rules which are in fact addressing completely different questions.

The decisions in the case law show that the aspect of the rule concerned under Section 3 is now fairly settled. The rulings of Padmanabhan Kishore and Malpani together prove that negligence or failing to spot a red flag by itself does not constitute criminal participation in money laundering. However, no court has so far clarified where an auditor's exposure under Section 12 actually starts, and although the FIU's 2023 guidance is helpful in many respects, it puts off the more difficult task of defining the issue onto the professional bodies rather than dealing with it directly. The implications under Section 13 make the practical consequences

clear: an auditor who completely avoids liability under Section 3, precisely as Malpani envisages, can still be subject to a regulatory penalty for incorrectly judging whether a transaction should be reported, under a standard which the profession's own comments confirm is already causing uncertainty in ordinary practice.

The three measures suggested here specific red flags for audits, a standard form for documentation, and a good-faith safe harbour would reduce that gap without affecting the low reporting threshold which ensures that the PMLA's suspicious-transaction mechanism remains effective with regard to sophisticated laundering schemes. They would not alter the sensitivity of the trigger, but would rather increase the amount of support available to the individual professional who raises it. So long as that support does not exist, the gap that this article has identified will continue to be what it currently is: a real and increasing source of professional risk, based on a distinction which the law has not yet itself established.