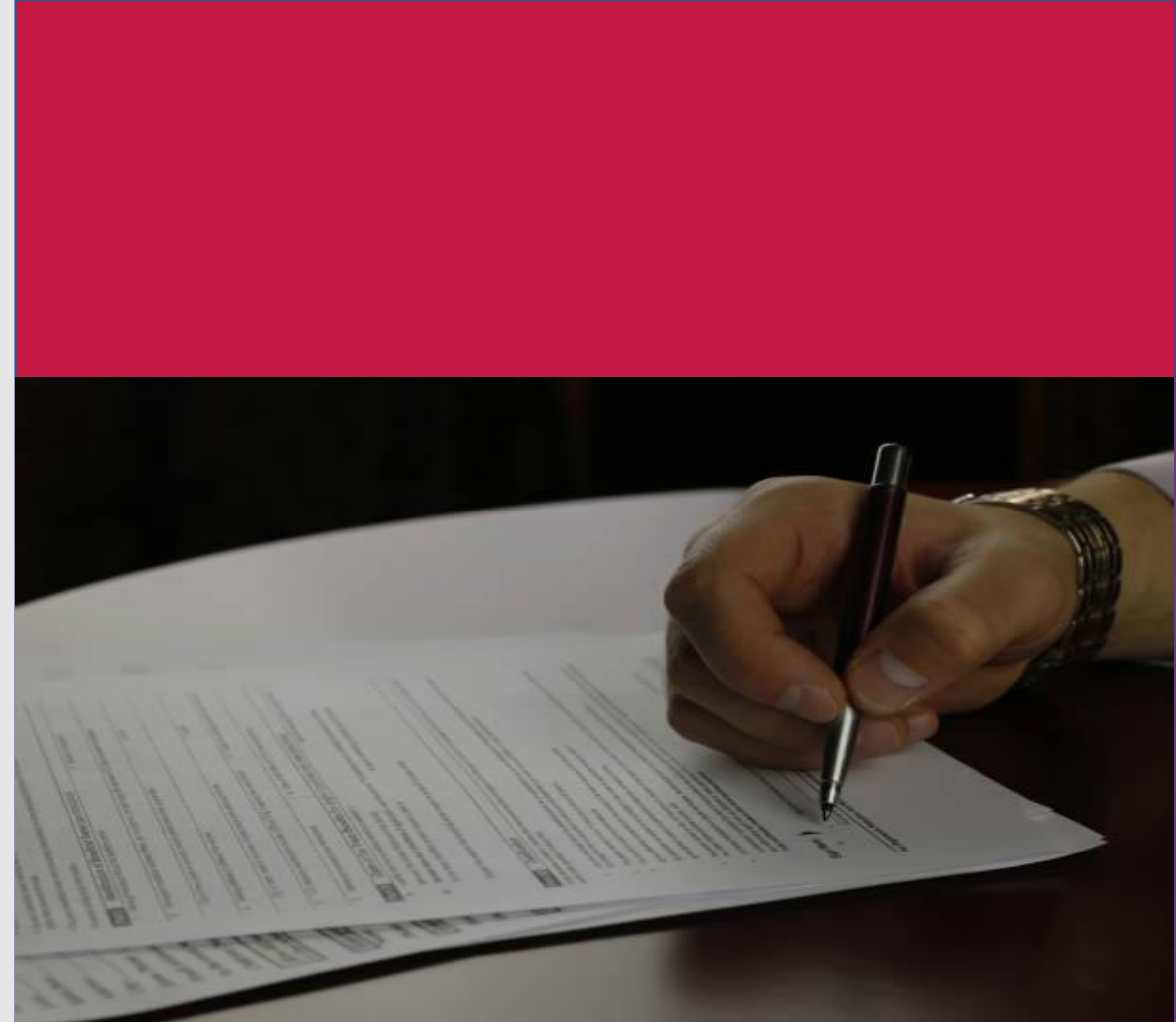


Synopsis of “Audit Trail” Implementation Guidelines issued by ICAI

Knowledge Publication by JHS

Source: ICAI [*Implementation Guide on Reporting under Rule 11(g) of the companies (Audit and Auditors) Rules, 2014*]



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- Section 143(3) of the Companies Act, 2013 provides various matters on which auditors are required to report in their auditor's report. Clause (j) of Section 143(3) states that auditor's report shall also state such other matters as may be prescribed. Rule 11 of the Companies (Audit and Auditors) Rules, 2014 specifies such other matters that are to be reported by the auditor.
- The Ministry of Corporate Affairs (MCA) vide its notification No. **GSR 206(E)** dated March 24, 2021, has issued the 'Companies (Audit and Auditors) Amendment Rules, 2021' (hereinafter referred as "the Audit Rules") read with subsection 3 of Section 143 of the Companies Act, 2013 (hereinafter referred as "the Act") introducing new Rule 11(e), new Rule 11(f) and new Rule 11(g) and deleting Rule 11(d).

Rule 11(g) is reproduced below:

"Whether the company, in respect of financial years commencing on or after the 1st April 2022, has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention."

- The requirement was initially made applicable for the financial year commencing on or after the 1st day of April 2021 vide notification **G.S.R. 206(E)** dated March 24, 2021. However, the applicability was deferred to financial year commencing on or after April 1, 2022, vide MCA notification **G.S.R. 248(E)** dated April 1, 2021.
- It may be noted that a new requirement for companies has been prescribed under the proviso to Rule **3(1)** of the Companies (Accounts) Rules, 2014 requiring companies, which use accounting software for maintaining their books of account, to use only such accounting software which has audit trail feature.
- This requirement for companies was initially made applicable for financial year commencing on or after April 1, 2021. However, its applicability has been deferred two times and this requirement is finally applicable from April 1, 2023.

<u>Text of Proviso to Rule 3(1) of Companies (Accounts) Rules, 2014</u>	<u>Text of Rule 11(g) Companies (Audit and Auditors) Rules, 2014</u>
<ul style="list-style-type: none">• Provided that for the financial year commencing on or after the 1st day of April 2023, every company which uses accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in the books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.	<ul style="list-style-type: none">• Whether the company, in respect of financial years commencing on or after the 1st April 2022, has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

Applicability

- Audit reporting will be triggered for financial years commencing on or after April 1, 2022, however, the applicability of the Account Rules will commence on or after April 1, 2023.
- Accordingly, auditors of all class of companies including section 8 companies would be required to report on these matters
- The auditor is required to comment on the above matters both in case of standalone financial statements and consolidated financial statements.

Management Responsibility

- Records an audit trail of each and every transaction, creating an edit log of each change made in the books of account along with the date when such changes were made; and
- Ensuring that audit trail is not disabled.
- Preserve the audit trial record for 8 years.

Accounting Software is a computer program or system that enables recording, maintenance and reporting of books of account and relevant ecosystem applicable to business requirements. The functionality of such accounting software differs from product to product. Every organization today employs multiple software for accounting, its operations and other requirements like consolidation, collection of data. For the purposes of this Implementation Guide, only the accounting software which is relevant for maintaining books of account should be considered for enabling of audit trail.

"Books of Account" as per Section 2(13) of the Act includes records maintained in respect of-

- i. all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
- ii. all sales and purchases of goods and services by the company;
- iii. the assets and liabilities of the company; and
- iv. the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section;

Auditor's Responsibility

- ❖ The auditor is expected to verify the following aspects:
 - whether the audit trail feature is configurable (i.e., if it can be disabled or tampered with)?
 - whether the audit trail feature was enabled/operated throughout the year?
 - whether all transactions recorded in the software are covered in the audit trail feature?
 - whether the audit trail has been preserved as per statutory requirements for record retention?
 - Identify the software i.e., IT environment including applications, web-portals, databases, Interfaces, Data Warehouses, data lakes, cloud infrastructure, or any other IT component used for processing and or storing data for creation and maintenance of books of account.
 - In case of accounting software supported by service providers, the company's management and the auditor may consider using independent auditor's report of service organisation (e.g., Service Organisation Control Type 2 (SOC 2)/SAE 3402, "Assurance Reports on Controls At a Service Organization") for compliance with audit trail requirements.
- ❖ The accounting software should be capable of creating an edit log of **“each change made in books of account.”**
 - Accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

Preservation of Audit Trails

The auditor is required to comment whether 'the audit trail has been preserved by the company as per the statutory requirements for record retention'. Considering the requirement of Section 128(5) of the Act, which requires books of account to be preserved by companies for a minimum period of eight years, the company would need to retain audit trail for a minimum period of eight years i.e., effective from the date of applicability of the Account Rules (i.e., currently April 1, 2023, onwards).

Special Consideration in case of Fraud Scenarios

- An auditor may come across a scenario where occurrence of an error or fraud could not be established due to lack of maintenance, availability or retrievability of audit trails.
- In evaluating the severity of a deficiency for such instances specifically in cases of fraud, the auditor should primarily consider two factors (a) the likelihood that the deficiency will result in a material misstatement, and (b) the magnitude of such an outcome.
- In a nutshell, this scenario would, in essence, call for performing an assessment of risk of material misstatements due to fraud and would consider both qualitative and quantitative factors in assessing a deficiency or combination of deficiencies as a significant deficiency or material weakness and would accordingly require application of professional judgement while linking the reporting against Rule 11(g) and section 143(12) of the Act/clause(x) of the Companies (Auditor's Report) Order 2020 (as the case may be).

Point of View

- Auditee and Auditors shall be required to undertake a quick gap analysis of systems including (shadow, work from home and end user computing environment) to ascertain compliance obligation viz a viz the new “Audit Trail” Guidelines.
- The “Audit Trail” rules and guidelines have far reaching implications on the internal control environment of the company and for the auditor on his work with respect to CARO, Internal Controls environment and Annual Financial Statement Auditing.
- For Companies operating in multiple region/counties with different ERP/Accounting packages may need to re-assess implementation of Audit trail on a bottom up basis.
- Auditee may have to revisit SOPs & financial statements closure procedures. Auditors report format has undergone a change.
- Where Auditee companies have fully or partially outsourced accounting and book keeping processes they may be required to obtain additional assurance/certification and compliance with Audit Trail rules with respect to Companies Act, 2013.
- Scope of work of Internal Auditors and IT Auditors may be expanded to cover these new guidelines.
- Accounting Softwares may need modifications/upgradations.

Glossary of Terms

Audit Trail (or Edit Log) is a visible trail of evidence enabled one to trace information contained in statements or reports back to the original input source.

Audit trails are a chronological record of the changes that have been made to the data. Any change to data including creating new data, updating or deleting data that must be recorded.

Records maintained as audit trail may include the following information:

- **when** changes were made i.e., date and time (timestamp)
- **who** made the change i.e., User Id
- **what** data was changed i.e., data/transaction reference; success/failure

Audit trails may be enabled at the accounting software level depending on the features available in such software or same may be captured directly in the database underlying such accounting software.

Service Provider - An organization supplying services to one or more (internal or external) Customers.

Software as a Service a method of software delivery using licensing arrangements in which software is accessed online via a subscription rather than bought and installed on individual computers.

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Key Contributors:



Huzeifa Unwala



Zenab Topiwala



Sameer Qureshi



INDIA PRESENCE

Ahmedabad Office

206, Shital Varsha,
Shivranjani Cross Road,
Satellite, Ahmedabad, Gujarat
– 380 015

Delhi Office

304-306 DLF Centre,
Savitri Cinema Complex GK II, New
Delhi - 110 048

Kolkata Office

Suite no. 402, 4th Floor,
Vardaan Complex, 25A
Camac Street, Kolkata, West
Bengal – 700 016

Mumbai Office

504, 5th Floor, Sahar Plaza
Complex, Meadows, J.B.
Nagar, Andheri East, Mumbai,
Maharashtra –
400 059

Bangalore Office

No.589,3rd floor, Above SBI
Bank,60 Ft. Main Road,
AECS Layout, Kundalahalli,
Bengaluru-560037

Kalyan Office

Shop No. 11 & 12, Regency
Avenue, Below Gastrocare
Hospital, Near Syndicate Bus Stop,
Syndicate, Murbad Road,
Kalyan(W), Maharashtra -421 301

Mazgaon Office

Ground Floor, Shop No. 11A,
345, New Sai Niketan CHS Ltd.,
Dr. Mascarenhas Road, Mazgaon,
Mumbai, Maharashtra -400 010

Vadodara Office

4th Floor, Lila Chambers, Notus
Pride IT Park Part "C", Block
"E", Sarabhai Compound,
Vadiwadi, Vadodara – 390023.

Associate Presence : Chennai | Vapi | Hyderabad | Indore