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REPORTING ON AUDIT TRAIL

[under Rule 11(g) of the Companies (Audit and Auditors) Rule, 2014]

Introduction

The Companies Act, 2013 mandates auditors to report on various matters in their auditor's report, and Section 143(3)(j) requires them to state any other prescribed matters. Rule 11 of the Companies (Audit and Auditors) Rules, 2014 specifies these additional matters. Rule 11(g) requires auditors to report on the use of accounting software by the company for maintaining its books of account which has a feature of recording an audit trail.

The Auditor is required to report on '*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*'.

Management's Responsibility

- To identify the records and transactions that constitute books of account under sec. 2(13) of Act.
- To identify the software (software can be hosted and maintained in India or outside India or can be on premise or on cloud or subscribed to as Software as a Service (SaaS) software or use a software maintained at a service organisation).
- Ensure such software have the audit trail feature.
- Ensure that the audit trail captures changes to each and every transaction of books of account i.e. includes when changes were made, who made those changes and what data was changed.
- Ensure that the audit trail feature is always enabled (not disabled or deactivated).
- Ensure that the audit trail is enabled at the database level i.e. controls to ensure that User IDs

Management's Responsibility

are assigned to each individual and not shared.

- Ensure that the audit trail is appropriately protected from any modification through implementing controls to ensure that changes to the configurations of the audit trail are authorized and logs of such changes are maintained
- Ensure that the audit trail is retained as per statutory requirements for record retention through periodic backups.
- Implement Controls to ensure that access to the audit trail (and backups) is disabled or restricted and access logs, whenever the audit trails have been accessed, are maintained.
- Ensure that controls over maintenance and monitoring of audit trail and its feature are designed and operating effectively throughout the period of reporting.

Auditor's Responsibility

The auditor is required to report on the audit trail under the section 'Report on Other Legal and Regulatory Requirements'. The auditor is required to comment on whether the company is using an accounting software which has a feature of recording audit trail (edit log), for this auditor shall verify:

- whether the audit trail feature is configurable (i.e., if it can be disabled or tampered with)?
- 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?
- whether the audit trail feature was enabled/operated throughout the year?

“All transactions recorded in the software' would refer to all transactions that result in change to the books of account. Any software used to maintain records or transactions that fall under the definition of Books of Account as will be covered within the ambit of this Rule.

Management is responsible for maintenance of books of account in electronic mode and the Auditor is responsible to check audit trail enabled for transactions which result in a change to books of account.

Applicability

For all class of companies (including foreign companies, Section 8 companies) Audit reporting will be required from the financial year 2022-23 and the auditor is not required to assess the appropriateness of the audit trail of previous years and the assessment will be only for prospective financial years.

The requirements of audit trail are applicable to the extent a company maintains its records in the electronic mode by using an accounting software. Thus, where the books of account are entirely maintained manually – the assessment and reporting responsibility under Rule 11(g) will not be applicable and accordingly, same would need to be reported as statement of fact by the auditor against this clause.

The auditor is required to comment on the above matters both in case of reporting on standalone financial statements and consolidated financial statements. However, for certain components included in the consolidated financial statements are (a) either not companies under the Act, or (b) some components are incorporated outside India, auditor is not required to report on these matters since the provisions of the Act do not apply to them.

Preservation of Audit trail

The company would need to retain audit trail for a minimum period of 8 years i.e., effective from the date of applicability of the Account Rules (i.e., April 1, 2023, onwards).

Audit Approach

- Evaluate the management's approach regarding identification of accounting software which have been considered for the purposes of maintenance of audit trail.
- Assess on a test basis, whether the audit trail has been configured and enabled for the identified accounting software.
- Inquire with the management on how they evaluated changes that are required for the maintenance of audit trail as part of changes or upgrades to the accounting software.
- Check software configuration that controls enabling or disabling of the audit trail and whether audit trail was enabled throughout the period. Review access log, edit log and periodic review mechanism implemented and operated by management for any changes to the audit trail configuration.
- Ensure completeness and accuracy of audit trail or edit logs that are generated through the software functionalities or directly recorded in the underlying database.
- Involve IT specialists or experts in to assist in evaluation of management controls and configurations in the accounting software with regard to audit trail

Audit Approach

- Evaluate management controls for maintenance of audit trail records without any alteration and retrievability of logs maintained for the required period of retention, on sample basis.
- 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 for compliance with audit trail requirements.

Illustrative Wordings for Reporting

Unlike reporting on internal financial controls over financial reporting, Rule 11(g) requires the auditor to report that the feature of recording audit trail (edit log) facility has "operated throughout the year for all transactions recorded in the accounting software". In respect of audit trail, following are likely to be expected scenarios:

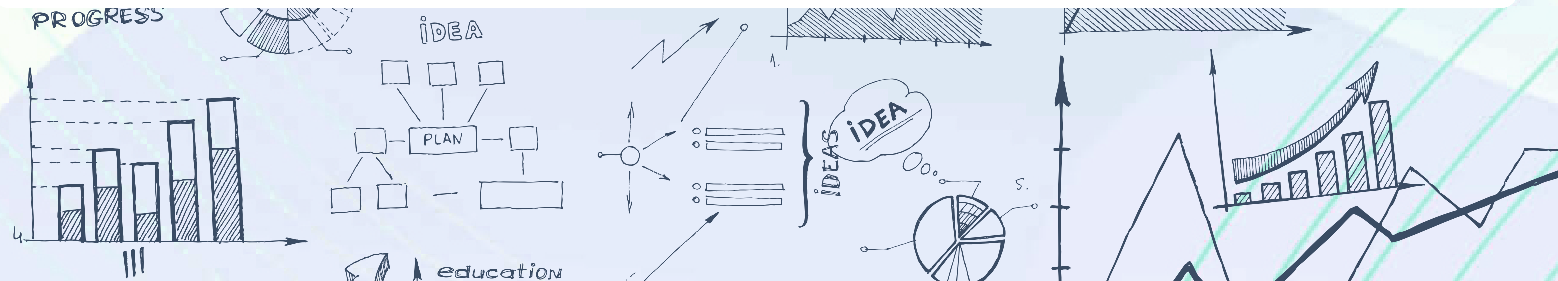
- Management may maintain adequate audit trail as required by the Account Rules.
- Management may not have identified all records/transactions for which audit trail should be maintained.
- The accounting software does not have the feature to maintain audit trail, or it was not enabled throughout the audit period.

Scenarios (ii) and (iii) mentioned above would result in a modified/ adverse reporting against this clause. In case of Modified reporting, mention no. of exception instances (where audit trail not recorded, not operated throughout the year, not preserved and being tempered) without mentioning name of components.

In respect of financial year 2022-23, where management has not been mandated to use the accounting software with requisite audit trail facility, the reporting against this clause can be *"As proviso to Rule 3(1) of the Companies (Accounts) Rules, 2014 is applicable for the company only w.e.f. April 1, 2023, reporting under this clause is not applicable".*

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.



Reporting under Rule 11(g) vis-à-vis Reporting under Section 143(3)(i)

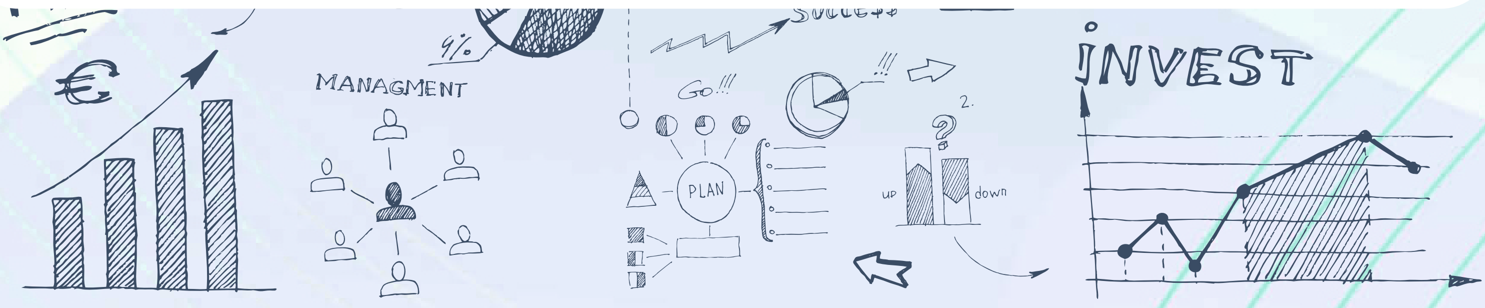
Section 143(3)(i) of the Act requires the auditor to state in his audit report whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls.

Paragraph 52 of the ICAI Guidance Note on Audit of Internal Financial Controls Over Financial Reporting uses expression 'audit trail' to describe the control activities in relation to policies and procedures related to information processing system that may be relevant to an audit. However, the Guidance Note does not entail any detailed audit procedures in respect of reporting against Rule 11(g). Accordingly, where the feature of audit trail has not operated throughout the year, the auditor may need to appropriately modify his comment while reporting under Rule 11(g) depending upon the further testing as may be required to conclude the wider impact on the reporting implication.

Obtaining Written Representations

The auditor shall obtain written representations from management on the following aspects:

- Acknowledging management's responsibility for establishing and maintaining adequate controls for identifying, maintaining, controlling, and monitoring of audit trails
- Stating that management has performed an evaluation and assessed adequacy and effectiveness of the company's procedures for complying to the requirements prescribed for audit trails.
- Stating management's conclusion, as set forth in its assessment, about the adequacy and effectiveness of the company's procedures in relation to audit trails.
- Stating that management has disclosed to the auditor all deficiencies in the design or operation of controls maintained for audit trails identified as part of management's evaluation.
- Describing instances where identification of fraud, if any, resulting in a material misstatement to the company's financial statements is identified while reviewing and testing the samples related to the disablement of audit trail facility of the accounting software.
- Stating whether control deficiencies identified and communicated to the audit committee in relation to audit trail during previous engagements have been resolved, and specifically identifying any deficiency that have not been resolved.



Audit Documentation

The auditor may document the work performed on audit trail such that it provides: (a) a sufficient and appropriate record of the basis for the auditor's reporting under Rule 11(g); and (b) evidence that the audit was planned and performed in accordance with this Implementation Guide, applicable Standards on Auditing and applicable legal and regulatory requirements.

Glossary

Audit Trail (or Edit Log) 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.

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.

"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.

Frequently Asked Questions (FAQ)

Q1: Is there exemption to small and medium companies from maintaining books of account in accounting software with audit trail feature?

A1: No. If a company (irrespective of its size and nature) is maintaining its books of account in the electronic mode, then it is required to use an accounting software with audit trail feature.

Q2: Is there a requirement to report on the audit trail feature in the limited review report?

A2: No requirement prescribed under the Companies Act, 2013 and SEBI Regulations to report on the audit trail feature in the limited review report.

Q3: Reporting implication in case of accounting software which does not allow modification

A3: Irrespective of the fact whether already posted journal entry could be edited or not, accounting software used by company is required to have an audit trail feature. In case, this feature is not present, then Rule 3(1) of the Companies (Accounts) Rules, 2014 is not complied with.

Q4: Reporting implication in case of technical glitches in accounting software during financial year.

A4: If audit trail feature remains non-functional during year or is not able to function properly, the auditor would need to appropriately modify the comment while reporting under Rule 11(g).

Q5: Auditor's reliance on audit trail feature of accounting software in case of failure of General IT Controls

A5: In case the auditor evaluates that the failure of General IT controls poses a risk over the effective operation of audit trail configurations and the auditor is unable to obtain sufficient and appropriate audit evidence for continued operation of audit trail feature during the year, then the auditor would need to appropriately modify the comment while reporting under Rule 11(g).

Q6: Reliance on information system audit report like SOC 2, etc. (where applicable)

A6: In case where accounting software is provided by a service provider, the auditor may consider using independent auditor's report on service organisation (for example, SOC 1/SOC 2/ SAE 3402) for compliance with audit trail requirements. The independent auditor's report should specifically cover the maintenance of audit trail in line with the requirements of the Companies Act, 2013 and should cover the period of the company's reporting. While doing so, auditor is required to comply with the requirements of SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation". However, the ultimate responsibility to report on the audit trail feature of the accounting software lies with the company's auditor.

Frequently Asked Questions (FAQ)

Q7: Is reporting on audit trail should be done based on each and every change made by the company or reporting should be done on materiality concept?

A7: Rule 11(g) states that the audit trail is required for each and every transaction, creating an edit log of each change made in books of account. So, the reporting will apply for all transactions irrespective of the amount involved. Reporting on audit trail is a factual reporting. The auditor's reporting is based on test checks which would require application of concept of materiality for purpose of sample selection.

Q8: Reporting implication where after 100% checking of records, nothing adverse is found by the auditor regarding financial statements, however, accounting software is not audit trail enabled.

A8: Reporting on audit trail is independent of any adverse findings regarding financial statements. If audit trail as required by Rule 3(1) of the Companies (Accounts) Rules, 2014 is not maintained, the auditor would need to appropriately modify the comment while reporting under Rule 11(g).

Q9: Whether banks and NBFCs are covered under audit trail requirement?

A9: Yes.

Q10: Are auditors required to comment on details of audit trail logs?

A10: No.

Q11: Is audit trail required to be enabled at database level even if access to database in an ERP is restricted to only one user and the log of such user making any such change is enabled.

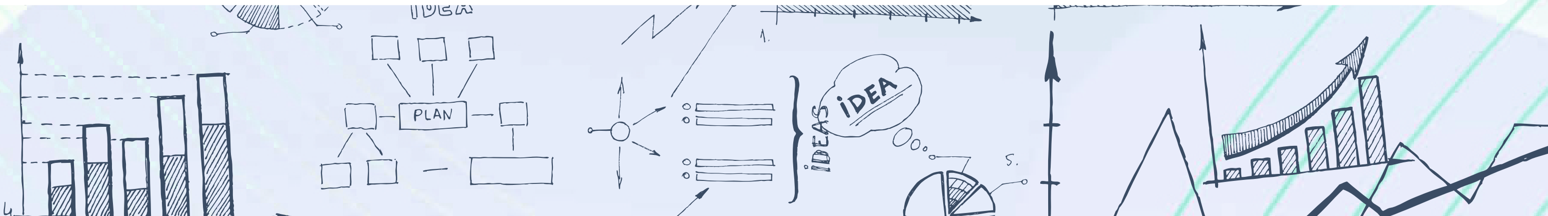
A11: Yes.

Q12: Does the auditor need to do testing in the ERP of the company or the auditor can simply rely on representation from the management?

A12: Auditor is required to carry out necessary audit procedures and obtain sufficient and appropriate audit evidence for their reporting under Rule 11(g). He cannot simply rely on representation from the management

Q13: If the audit trail is recorded at back-end on a server/ cloud maintained outside India, then whether audit trail is also required to remain accessible in India at all times as per Rule 3 of the Companies (Accounts) Rules, 2014?

A13: Yes



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Q14: Where the independent auditor's report of service organisation that includes the maintenance of audit trail, is not co-terminus with the company's financial year, how should the auditor of the company consider such SOC 2/SAE 3402 report for their reporting under Rule 11(g)?

A14: If the company is unable to obtain sufficient and appropriate audit evidence for the full reporting period with regard to maintenance of audit trail, the auditor would need to appropriately modify the comment while reporting under Rule 11(g).

Q15: If company software provides error log or voucher listing, will this satisfy Audit trail compliance?

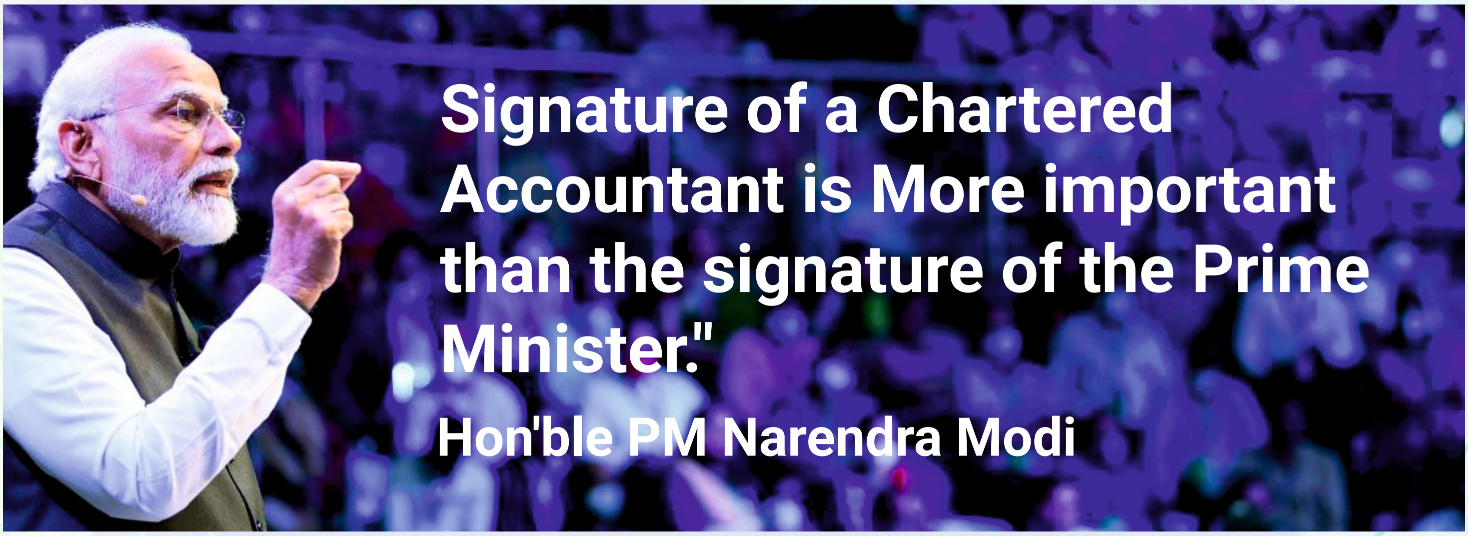
A15: No

Q16: If the auditor has modified the comment while reporting under Rule 11(g) on audit trail, whether this will also impact the reporting pursuant to Section 143(3)(b) and Section 143(3)(h)?

A9: Yes.

Q17: Whether 'books of account' maintained in accounting software would include Vendor Master Data, Purchase Order/ Sales Order, Records of Property, Plant and Equipment/Intangible Assets and Use of Spreadsheets?

A 17: Yes. If changes to data linked to transactions recorded in books of accounts, such data should also have audit trail.



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