SHARP & TANNAN

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Audit trail of accounting for companies with effect from 1 April 2023

Introduction

Proviso to Rule 3(1) of the Companies (Accounts) Amendment Rules, 2021 read together with section 143(3) of the Companies Act, 2013 ('the Act') has cast a responsibility on the company to ensure that every company using accounting software for maintaining its books of account, shall use only such accounting software which:

- has a feature of recording the audit trail of each and every transaction
- creating an edit log of each change made in books of account along with the date when such changes were made
- and ensuring that the audit trail cannot be disabled.

The above provision becomes applicable from 1 April 2023.

As per rule 11(g) of the Companies (Audit and Auditors) Amendment Rules, 2021 ('the Audit Rules'), the auditors have been cast a responsibility to verify whether the company 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
- the audit trail feature has not been tampered with
- the audit trail has been preserved by the company as per the statutory requirements for record retention.

However, the audit reporting will be triggered for financial years ('FY') commencing on or after 1 April 2022.

The Institute of Chartered Accountants of India ('ICAI') has issued an implementation guide to the auditors to ensure that they discharge their duties/attest function efficiently.

It may be noted that for the FY 2022-23, there is no requirement of maintaining such software by the companies, hence it may not be possible for the auditors to report under Rule 11(g) for the said period. An auditor may, in such case state that since the applicability for maintaining the software was not mandatory for FY 2022-23, the reporting under the said clause is not applicable. However, if the company has voluntarily adopted the implementation of the software, the auditor will report on it under Rule 11(g).

The following points are relevant in this regard.

Management

- The management of the company is primarily responsible for the selection of the appropriate accounting software (including compliance with laws, and regulations and also ensuring retention of the audit logs.)
- The software can be hosted/maintained in India, outside India, or on the cloud, or it can be subscribed to as 'software as a service.' (SaaS)

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- The ownership of the software can either be with the company itself or with the outsourced entity (within /outside the company.)
- The accounting software should be capable of creating an edit log of 'each change made in books of account.'

Auditor

- The auditor is expected to perform procedures in accordance with Standards on Auditing (which includes inquiry, observation, and examination, as applicable.)

- The reporting is applicable for both, standalone and consolidated financial statements ('CFS'). However, those components included in the CFS being non-companies and those incorporated outside India will not be covered by this compliance. Hence the auditor need not report on such entities.

- The implementation guide published by ICAI spells out that the auditor may obtain management representation (in the format prescribed therein) indicating
  - the prime responsibility of the management in implementing adequate and effective controls in respect of the software.
  - assurance to be given by the management about the evaluation of the software's effectiveness in terms of audit trail.
  - a brief description of deficiencies and their impact that needs to be disclosed by the management in its representation to the auditors.

Weblink

https://www.mca.gov.in/bin/ebook/dms/getdocument?doc=MTM0ODc=&docCategory=NotificationsAndCirculars&type=open

https://www.mca.gov.in/Ministry/pdf/AuditAuditorsAmendmentRules_24032021.pdf

Therefore

The clause of maintaining an audit trail and its reporting by the auditor has increased transparency in the financial reporting of corporate entities. To date, there is no parallel reporting requirement globally, and hence this will imply a positive step towards enhancing corporate governance in India. Though the primary obligation of implementing the requirement is of the company's management, the auditor is no less responsible for verifying that such an internal control does exist. The auditors need to evaluate management policies on a continuous basis to determine whether such audit trail features are in place and whether the same were operating throughout the financial year.