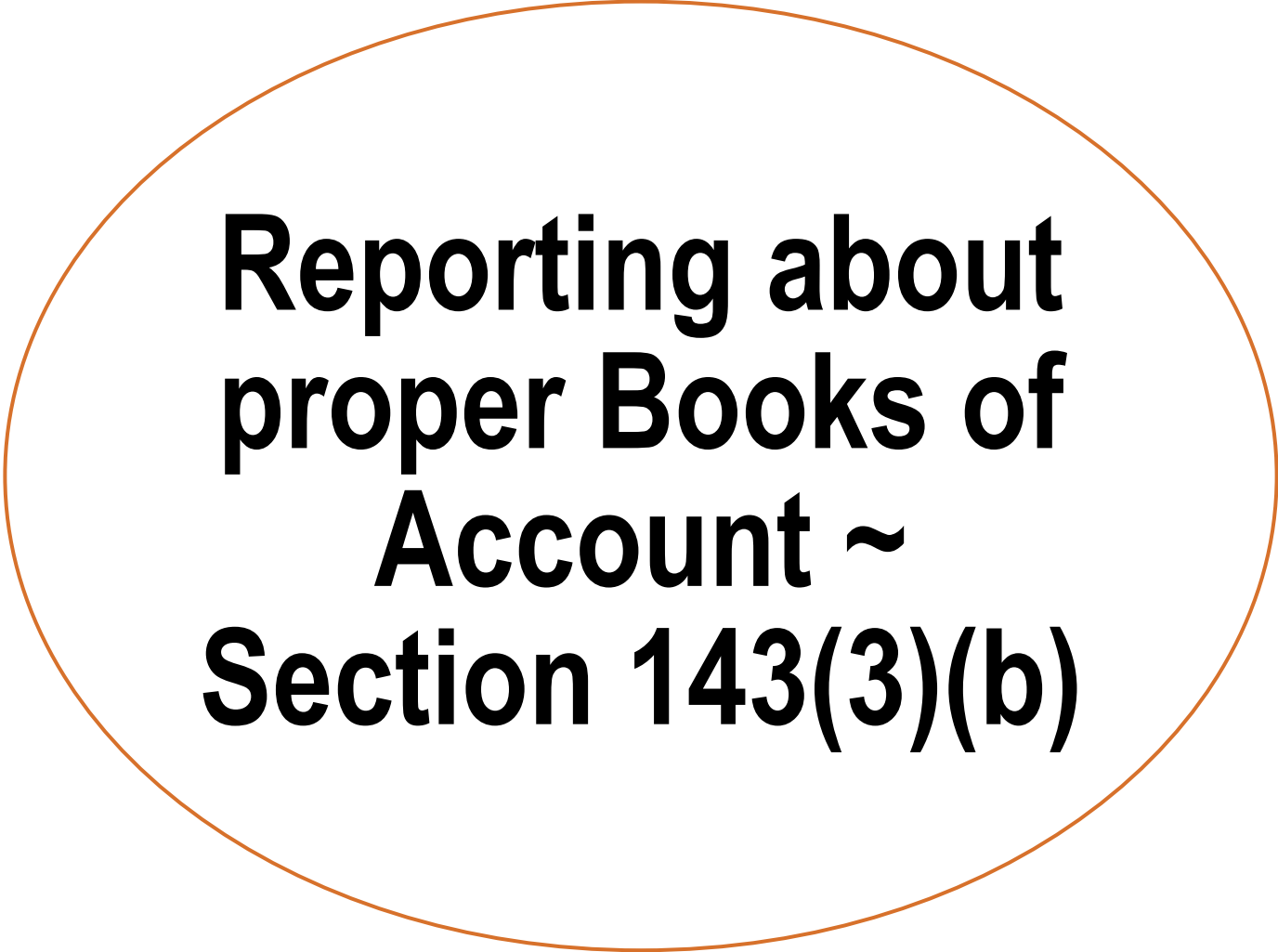


Audit Trail under the Companies Act, 2013

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**Reporting about
proper Books of
Account ~
Section 143(3)(b)**

What does Companies Act say

- Every **company shall prepare and keep at its registered office books of account and other relevant books and papers** and financial statement for every financial year which give a true and fair view of the state of the affairs of the company – Section 128(1);
- The company **may keep such books of account or other relevant papers in electronic mode** in accordance with Rule 3 of the Companies (Accounts) Rules, 2014 – 2nd Proviso;
- The **auditor's report shall state** whether, in his opinion, **proper books of account** as required by law have been kept by the company - Section 143(3)(b)

Books of account, etc., in electronic mode – prescribed manner

- *The books of account and other relevant books and papers shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered – Rule 3(2) of Companies (Accounts) Rules, 2014.*

- Let's assume you are using accounting software which allows back dated entry (insertion, alteration, etc.)
- **Question:** whether as an auditor you can report that proper books of account have been maintained by the company?



Audit Trail

Manner of books of account to be kept in electronic mode

- The books of account and other relevant **books and papers maintained in electronic mode shall remain accessible in India** so as to be usable for subsequent reference ~ Rule 3(1) of the Companies (Accounts) Rules, 2014;
- 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 books of account along with the date when such changes were made and ensuring that the **audit trail cannot be disabled** ~ Proviso to Rule 3(1) of the Companies (Accounts) Rules, 2014 as inserted by the Companies (Accounts) Amendment Rules, 2021, w.e.f. 1-4-2021
- **Note:** Substituted for "1st day of April, 2022" by the Companies (Accounts) Second Amendment Rules, 2022, w.e.f. 31-3-2022.

Other Matters to be included in auditors report ~ Rule 11



Reporting as to Audit Trail

- The auditor's report shall also include their views on the following matters, namely:
 - ✓ Clauses (a) to (f) ~ not discussed here in the extant presentation
 - ✓ 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 – Clause (g)

Books of Account and Financial Statements

Sec. 2(12)	Sec. 2(13)	Sec. 2(40)
"book and paper" and "book or paper" include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form	"books of account" includes <u>records</u> maintained in respect of— <ul style="list-style-type: none">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; andiv. 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	"financial statement" in relation to a company, includes— <ul style="list-style-type: none">i. a balance sheet as at the end of the financial year;ii. a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;iii. cash flow statement for the financial year;iv. a statement of changes in equity, if applicable; andv. any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv)

Audit Trail ~ meaning

- An audit trail, at its most basic, is a record of financial transactions which is listed in order, step-by-step, and serves as proof of a transaction's history, right from recording to tracking all changes that may take place.
- This can be used to keep track of and verify various types of transactions.

- **Question 1:** whether audit trail is required only for Books of Account or even for Books and Papers
- **Question 2:** The words used are “ensuring that the **audit trail cannot be disabled**”. Say if the accounting software does not have feature of enabling or disabling ‘audit trail’, can such software be used and if yes, whether auditor has to comment anything?

Questions

- 1) Whether any change in minute book is required to be captured for audit trail purposes
- 2) Whether any change in fixed asset (FA) register is required to be captured for audit trail purposes
- 3) Suppose that FA register is maintained on excel Sheets ~ whether audit trail is required
- 4) Suppose that FA register is maintained on manual Sheets ~ whether audit trail is required

Case Study

- Normally what happens, accountants compute depreciation in Excel Sheet and then feed the same in accounting software
- **Question 1:** if computation is changed in Excel Sheet whether this requires audit trail record
- **Question 2:** if computation is not changed but classification in Excel Sheet is changed (say earlier it was office equipment but now it is plant and machinery) whether this requires audit trail record

Comparative read through

Proviso to Rule 3(1) w.e.f. 1 st April, 2023	Rule 11(g) w.e.f. 1 st April, 2022
for the financial year commencing on or after the 1st day of April, 2023	in respect of financial years commencing on or after the 1st April, 2022
every company which uses accounting software for maintaining its <u>books of account</u> , shall use only such accounting software	has used such accounting software for maintaining its <u>books of account</u>
which has a feature of recording audit trail of each and every transaction , creating an edit log	which has a feature of recording audit trail (edit log) facility and the same has been <u>operated throughout the year</u> for all transactions recorded in the software and
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 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

Operated throughout the year

- Say the FY is 2023-2024 ~ first year for the companies to have accounting software with audit trail feature in use
- You are the auditor for the FY 2023-2024
- You came to an observation that the company engaged software consultants on 25th Feb., 2023 and the audit trail compliant accounting software was put to use from 5th April, 2023
- **Question:** can you say that accounting software was operating throughout the year

- Say the FY 2023-2024
- Closing balances of 31.3.2023 will become opening balances of 1.4.2023
- Ind AS are applicable
- During audit of FY 2023-2024, the company got to know some prior period items
- As per Ind AS 8, such prior period items need to be retrospectively restated
- Hence, the accounting changes were made in the books for the FY 2022-2023
- **Question:** whether such change needs to be captured for audit trail for FY 2023-2024

- Say the FY 2022-2023
- Closing balances of 31.3.2023 will become opening balances of 1.4.2023
- During FY 2023-2024, the audit of company for FY 2022-2023 is under progress
- On say 30th April, 2023, the auditors made some observations for accounting adjustments say for provision for bad debts and the company made such changes in the books on the same date for the FY 2022-2023
- Hence, the accounting changes were made in the books for the FY 2022-2023
- **Question:** whether such change needs to captured for audit trail for FY 2022-2023 because audit trail compliant software is required to be used only from FY 2023-2024

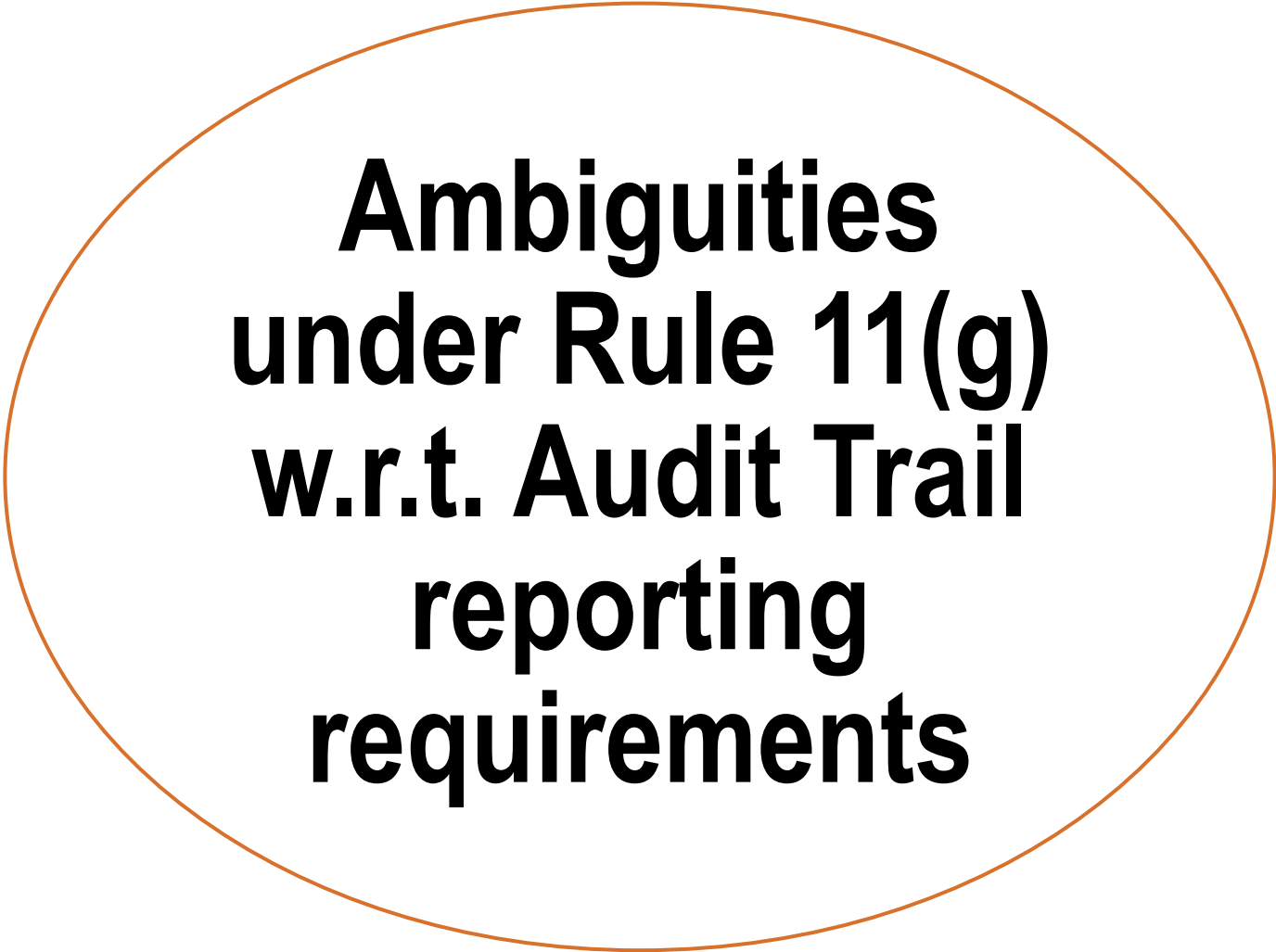
- Say the FY 2022-2023
- Closing balances of 31.3.2023 will become opening balances of 1.4.2023
- During FY 2023-2024, the audit of company for FY 2022-2023 is under progress
- On say 30th April, 2023, the auditors made some observations for wrong language of narrations in some accounting entries; and the company made changes in the books on the same date for the FY 2022-2023 (the narrations were modified)
- Hence, the narration changes were made in the books for the FY 2022-2023
- **Question:** whether such change needs to captured for audit trail for FY 2022-2023 because audit trail compliant software is required to be used only from FY 2023-2024

- Which of the following changes need to be captured by audit trail from FY 2023-2024:
 1. Date of accounting entry (from say 29th April to 26th April)
 2. Amount (from say Rs. 10,000 to Rs. 1,00,000)
 3. Account head (from say Repairs and Maintenance to Repairs and Maintenance Expenses)
 4. Account group (from say Other Income to Direct Income)
 5. Narration (from say Being amount paid to tea vendor to Being amount paid to tea vendor namely Mr. Shyam)

- How should audit reports have comment about audit trail for the FY 2022-2023
 - 1) Option 1: audit trail reporting is not applicable
 - 2) Option 2: audit trail reporting cannot be made because the companies are required to have audit trail based accounting software w.e.f. 1.4.2023

- You have provided depreciation as at year end (let's say that this entry was made on 31st March, 2023)
- The audit was going on and the auditor pointed out some mistakes in depreciation due to which you corrected the entry on (say) 30th May, 2023
- Corresponding changes were also made in the Excel Sheet where you have drafted your company's financial statements
- **Question:** for which change aspect as above audit trail is required
 - 1) Option 1: changes in accounting software
 - 2) Option 2: changes in MS Excel
 - 3) Option 3: Both

- The words used are “audit trail feature has not been **tampered**” ~ Rule 11(g) of Audit Rules
- The words used are “ensuring that audit trail feature is **not disabled**” ~ Proviso to Rule 3(1) of Accounts Rules
- **Question 1:** the audit trail feature was discontinued by the management for 28th March to 31st March 2024 for recording year end adjustment entries ~ is it tampering
- **Question 2:** the audit trail feature was not discontinued by the management but the record prepared (i.e., audit log or edit log) was opened in TXT file and few entries therein were deleted ~ is it tampering



**Ambiguities
under Rule 11(g)
w.r.t. Audit Trail
reporting
requirements**

Audit Trail – To include or exclude?

(1/2)

- The **Rules don't specify the fields or data sets** for which audit trails are required to be maintained;
- In relation to a transaction, **data would comprise of two types:**
 - 1) transactional data (for e.g. amount, accounting date, ledger accounts, narration, i.e. information which is reflected in the financial records); and
 - 2) data pertaining to the transaction (for e.g. identity of the user accounting the transaction or the time on which the transaction was posted).
- With reference to (2) above, while it is obvious that the user identification ("User ID") and transaction timestamp are necessary fields, it may be possible that other fields such as approval information (user ID of the approver and time stamp where transactions are approved) may be required to be logged as a part of the audit trial.

Audit Trail – To include or exclude?

(2/2)

- It can be argued that transactional data does not form part of the audit trail as the data is recorded in the books of accounts and replicating this information in the audit trail would not serve any purpose.
- However, since the **Rules also mandate that "edit logs" are to be maintained**, one could also argue that the audit trail should provide sufficient information to reconstruct or identify the original data prior to the edit being undertaken. For example, if a transaction is deleted or edited, apart from logging information about who effected the deletion/edit, the audit trail should include sufficient information to either view or trace the transaction which had been deleted.

Modification of Audit Trail

(1/1)

- Audit Rules stipulate that the auditor should state as to whether, *"the audit trail feature has not been tampered with and the audit trail has been preserved by the company"*.
- In this regard, there is significant ambiguity on the remit of the word "tampered". Is the requirement for the auditor to assess whether, the accounting software's feature to create audit trails has not been tampered with per se (which would inter alia include unauthorized modifications to the settings of the audit trail) or whether tampering of the audit trail of transactions per se would also be covered (i.e. modification of the audit trail records)?
- Considering that modifications to the audit trail would defeat the purpose of maintaining audit trails, it would appear that the reference to tampering would be applicable to both the scenarios stated above.

Edits Logs & Audit Trails

(1/1)

- The Rules mandate that "edit logs" are to be maintained.
- The word "edit", when used in a grammatical context would mean a change to existing data and therefore it may be argued that edit logs would be required when an existing transaction has been modified.
- However, considering that the Account Rules refer to an "edit log of each change made in books of account", it can be construed that edit logs would have to be maintained for all transactions.
- As such, a harmonious reading could be taken that the terms audit trail and edits logs are synonymous.

Audit Trails for non-financial records

(1/1)

- Certain records such as purchase orders or master data, which are not transactions per se, at least from an accounting standpoint, may be relevant from an investigation standpoint.
- For example, in the event fraudulent payments are effected through modification of bank account, audit trails relating to changes to bank account details would be of significant relevance.
- As such, it is not clear whether the term "transactions" refers solely to financial transactions per se or whether the term has to be broadly interpreted to include non-financial records or events, such as purchase orders or changes to vendor master data, which are correlated to financial transactions.

Internal Controls

(1/2)

- In order to demonstrate that the audit trail feature was functional, operated and was otherwise preserved, a company would have to design and implement specific internal controls (predominantly IT controls) which in turn, would be audited by the auditors.
- A company may leverage their existent internal control framework to design internal controls, in consultation with their auditors.

Internal Controls

(2/2)

- An illustrative list of internal controls which may be required to be instituted are articulated below:
 - ◆ Controls to ensure that the audit trail feature has not been disabled or deactivated.
 - ◆ Controls to ensure that access to the accounting software is restricted to authorized users.
 - ◆ Controls to ensure that User IDs are assigned to each individual and that User IDs are not shared
 - ◆ Controls to ensure that changes to the configurations of the audit trail are authorized and logs of such changes are maintained.
 - ◆ 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.
 - ◆ Controls to ensure that periodic backups of the audit trails are taken and archived

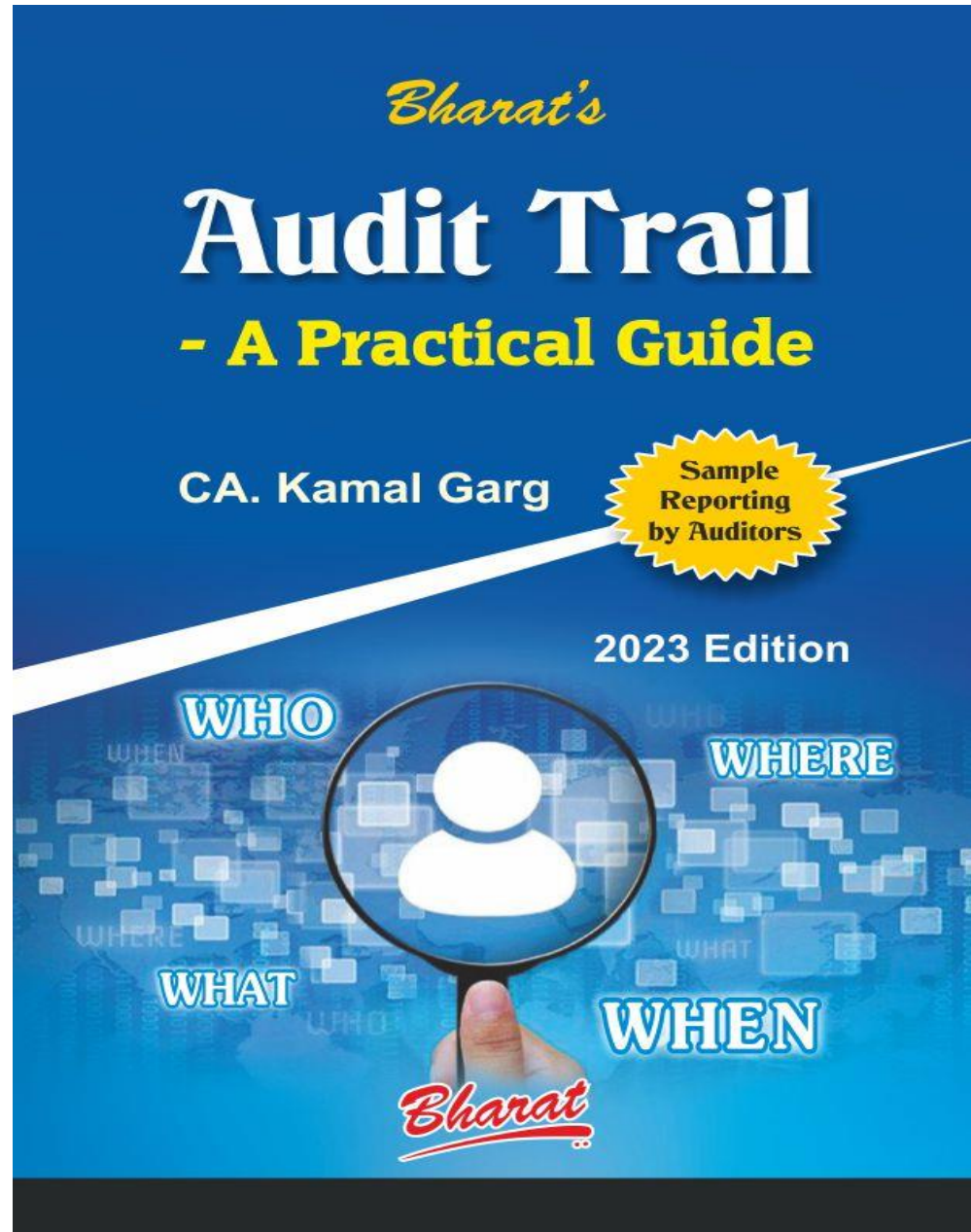


**ICoFR ~
Section
143(3)(i)**

Exemption to Private Companies

(1/1)

- In case of private companies, section 143(3)(i) shall not apply to a private company:
 - 1) which is a one person company; or
 - 2) which is a small company; or
 - 3) which has:
 - ☐ turnover < Rs. 50 crores as per latest audited financial statement **and**
 - ☐ aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year < Rs. 25 crore
- Source: Notification No. GSR 464(E), dated 5-6-2015, as amended by, Notification No. GSR No. 583(E), dated 13-6-2017



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Thank you

Kamal Garg & Associates