




COMPANIES (AUDIT AND AUDITORS) RULES 2014

Rule 11 (g) - Accounting Software Audit Trails



CONTENTS

Topic

- 1 Background
 - 2 Applicability
 - 3 Management Vs. Auditor's responsibilities
 - 4 Audit Approach
 - 5 Reporting
- 

BACKGROUND


Proviso to Rule 3 (1) of Companies (Accounts) Rules, 2014, for the financial year beginning on or after April 1, 2021*, every company that uses accounting software to maintain its books of account shall use only Accounting Software that has a feature of recording an:

- 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.
- Ensuring that the audit trail **cannot be disabled**.

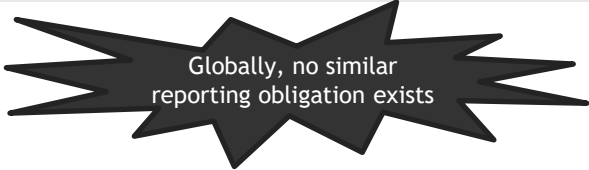
** Subsequently deferred twice and now applicable from April 1, 2023*

Clause (g) of Rule 11 of Companies (Audit and Auditors) Rules, 2014 (the “Audit Rules”) read with sub-section 3 of Section 143 of the Companies Act, 2013 (“the 2013 Act” or “the Act”) requires the auditors’ report to state whether the company, has used such accounting software for maintaining its **books of accounts**:

- ✓ 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



Auditors to exercise their professional judgement while reporting on such matters



Globally, no similar reporting obligation exists

MANAGEMENT VS. AUDITORS RESPONSIBILITIES

Management's responsibilities

Every company which uses accounting software for maintaining its books of accounts,

- 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 accounts along with the **date** when such changes were made and ensuring that the audit trail **cannot be disabled**.

The Accounting Software maybe hosted and maintained in India or outside India or may be on-premises or on cloud or subscribed to as Software as a Service (SaaS) application. The above steps will need to be performed by the Management with appropriate reporting to those charged with governance

Auditor's responsibilities

To comment on whether the company is using an accounting software which has a feature of recording audit trail of each, and every transaction auditor would be expected to verify the following:

- whether the trail feature is configurable (i.e., if it can be disabled)?
- whether the feature was enabled/available 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 record retention requirements?
- whether the audit trails have been tampered with?

Any software or system will be in-scope of this rule in case the records maintained in such software form part of Books of accounts as per section 2(13) of the Act

APPLICABILITY

For Companies

FY commencing on or after **1-Apr-23**

For Auditors

FY commencing on or after **1-Apr-22**

Although the applicability of using audit trail enabled software for the Company was deferred for the management by amending the provisions of the Account Rules, same stands applicable for the auditors in event of no amendment to the Audit Rules

Accounting - Manual Vs. Software

The requirements of audit trail and edit log are applicable to the extent a company maintains its **books and records** in the **electronic form** by using an accounting software. Thus, where the books of accounts are entirely maintained manually - the assessment and reporting responsibility will not be applicable

Types of Companies

Applicable to all companies including **Sec 8 companies** and **foreign companies**

COMPONENTS OF AUDIT TRIALS

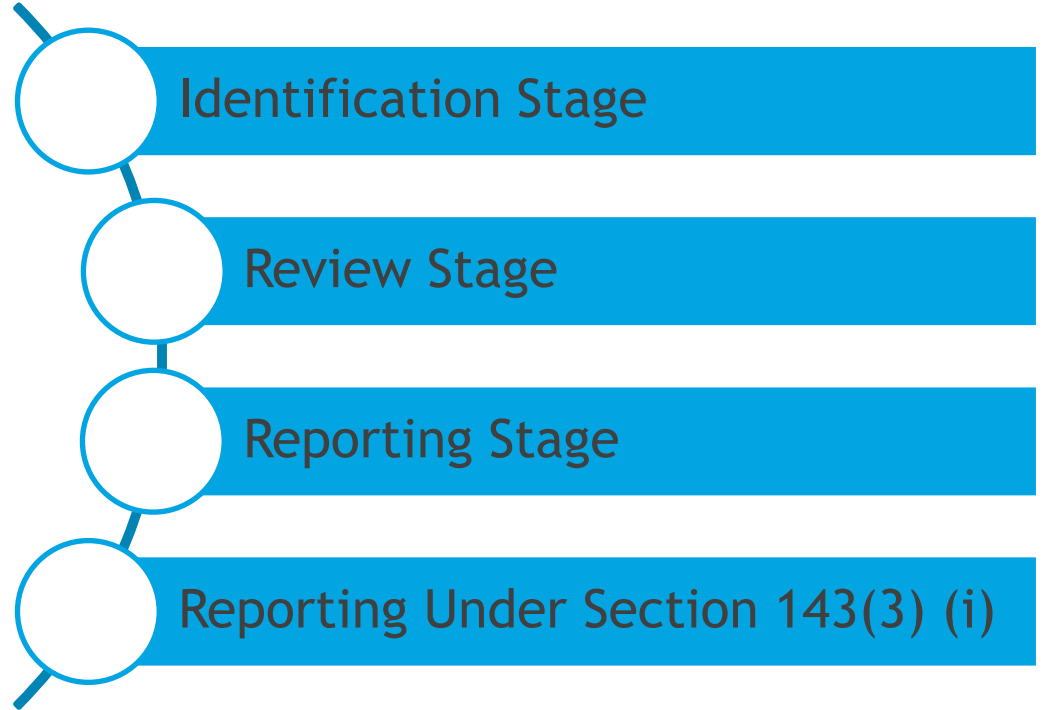
AUDITOR'S COVERAGE OF ACCOUNTING SOFTWARE

- The accounting software should be capable of creating an edit log of “*each change made in books of account.*” However, the auditors’ responsibilities have been prescribed for “all transactions recorded in the software”.
- Management responsibilities for maintenance of books and accounts and other relevant books and papers maintained in electronic mode the auditor’s responsibility under the Auditors Rules will be restricted to transactions that have been recorded in the accounting software and subsequent modifications made to those transactions by way of addition/deletion

PRESERVATION OF THE AUDIT TRAILS

- Section 128(5) of the Act requires Books of Accounts to be preserved by the companies for a minimum period of eight years.
- Accordingly, by the operation of law of enforceability the provision of audit trail retention will apply from April 1, 2023, only for the subsequent financial years.
- The auditor is also required to report whether the audit trail has been preserved by the company as per the statutory requirements for record retention.
- Auditor is expected to perform certain procedures in the subsequent year of reporting to assess if the logs have been maintained for the period required and are retrievable in case of a need.

AUDIT APPROACH





AUDIT APPROACH

Identification Stage

Management assumes primary responsibility to:

- Identify the records and transactions that constitute books of account under section 2(13) of the Act;
- Identify the software's 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 books of accounts
- The audit trail feature is enabled (not disabled);
- The audit trail captures changes to each and every transaction; changes (when changes were made, who made those changes, what data was changed)
- The audit trail is enabled at the database level (if applicable) for logging any direct data changes
- Audit trail is appropriately protected from any modification, and is retained as per statutory record retention requirements.
- Controls over maintenance and monitoring of audit trail and its feature are designed and operating effectively throughout the period of reporting.



AUDIT APPROACH

Identification Stage... contd

Company would have to design and implement specific internal controls (predominantly IT) which is to be evaluated by the auditors:

- Controls to ensure that the audit trail feature has not been disabled or deactivated
- User IDs are assigned to each individual and are not shared
- Changes to the configurations are authorised and logs of such changes are maintained
- Access to the audit trail (and backups) is disabled or restricted and access logs, whenever audit trails have been accessed have been maintained
- Periodic backups of the audit trails are taken and archived as per statutory period specified under Sec 128 of the Act

AUDIT APPROACH

Identification Stage... contd

- Assess management's identification of records and transactions where the audit trail needs to be captured and verified, on a test basis, whether the Audit Trail has been configured and enabled for the identified accounting software.
- Evaluate the management's approach regarding the identification of accounting software which have been considered for the purposes of maintenance of audit trails.
- Inquire with the management on how they evaluated changes that are required for the maintenance of Audit Trails as part of changes or upgrades to the accounting software.
- Where applicable, consider involvement of specialists or experts in the field of IT
- In case of accounting software supported by service providers, management and auditor may consider using independent auditor's report of service organisation (Eg. SOC1/SAE3402). The independent auditors report should specifically cover the maintenance of audit trail in line with the requirements of the Act.



AUDIT APPROACH

Review Stage

- The Auditors need to verify certain controls such as restricting access to the administrators and monitoring changes to configurations that may impact the audit trail.
- Auditors are accordingly expected to evaluate management's policies in this regard and test such controls to determine whether the feature of audit trails has been implemented and operating effectively throughout the reporting period.
- Audit trail log may generate voluminous data and thus there may be a need for management to ensure that administrative access to the audit trail is granted to authorized representatives to manage the audit trail.
- The system configuration that controls enabling or disabling of the audit trail and whether it was enabled throughout the period
- Any changes to the audit trail configuration during the period
- Periodic review mechanism implemented and operated by management for any changes to the audit trail configuration



AUDIT APPROACH

Review Stage... contd

- Completeness and accuracy of an audit trail or edit logs that are generated through the software functionalities
- Recorded in the underlying database i.e., whether it captures the user ID that made the change, the date and time of change, and what fields were changed.
- Testing performed by management to assess the completeness and accuracy of the audit trail
- Review, on a sample basis, the audit trail records maintained by management for each applicable year and evaluate management controls for maintenance of such records without any alteration and retrievability of logs maintained for the required period of retention.



AUDIT APPROACH

Reporting Stage

An auditor is expected to evaluate the reporting implication specifically giving due considerations to SA250 “Consideration of Laws and Regulations in an Audit of Financial Statements”.

In respect of audit trail following are likely expected scenarios:

- i. Management may maintain adequate audit trail as required by the Account Rules.
- ii. Management may not have identified all records/transactions for which audit trail should be maintained.
- iii. 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 respect of FY22-23, where management has not been mandated to use the accounting software with requisite audit trail facility, the reporting against this clause can be as illustrated below:

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.

Illustrative wordings for modified reporting

| Nature of exception | Illustrative wordings |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Audit trail feature was disabled for one of the books of account records or for an accounting software - (e.g. fixed asset software did not have audit trail) | “Based on our examination, the company has used accounting software for maintaining its books of accounts which has a feature of recording audit trail (edit log) facility except in respect of maintenance of fixed asset records wherein the accounting software did not have the audit trail feature enabled throughout the year. Further, the audit trail facility has been operating throughout the year for all material and relevant transactions recorded in the software except for the instances reported below..... Also, based on our testing we did not come across any instance of audit trail feature been tampered with. |
| Audit Trail feature is not operating effectively during the reporting period | “.....except that the audit trail feature of YYY software used by the company to maintain payroll records did not operate throughout the year.....” “....except that no audit trail enabled at the database level for applications AAA (database SQL) and BBB (database db2) to log any direct data changes.....” |
| Accounting software if maintained by third party and auditor is unable to assess whether audit trail feature can be disabled during the reporting period | “Based on our examination, the company, has used an accounting software ABC which is operated by a third party software service provider, for maintaining its books of accounts and in absence of [state the type of control report] we are unable to comment whether audit trail feature of the said software was operating throughout the year for all material and relevant transactions recorded in the software or whether there were any instances of audit feature been tampered with.” |
| The audit trail has not been preserved by the company as per the statutory requirements for record retention. | “.....the audit trail has not been preserved by the company as per the statutory requirements for record retention” Note: This illustration is relevant from 2 nd year of reporting and onwards |
| Migration from one software to the other happened during the year or higher version of software installed and auditor is unable to obtain sufficient and appropriate evidence | The Company has migrated to [name of the software] from [old software/manual] during the year and is in the process of establishing necessary controls and documentation regarding audit trail. Consequently, we are unable to comment on the audit trail feature of the said software. |



AUDIT APPROACH

Special considerations in case of Fraud Scenarios

In evaluating the severity of a deficiency for such instances specifically in cases of fraud, the auditor should primarily consider two factors:

- a) Likelihood that the deficiency will result in a material misstatement and
- b) Magnitude of such an outcome

Calls for performing an assessment of risk of material misstatement due to fraud and would consider both qualitative and quantitative factors in assessing the deficiency or combination of deficiencies as a significant deficiency or material weakness and accordingly would require professional judgement.



AUDIT APPROACH

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

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

Para 52 of the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by ICAI uses the expression 'audit trail' to describe control activities in relation to policies and procedures related to information processing system, however, it does not entail any detailed audit procedures in respect of reporting against Rule 11(g)

Accordingly where the audit trail feature 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 on wider impact on the reporting implication.

However, it should be noted that mere non-availability of audit trail does not necessarily imply failure or material weakness in the operating effectiveness of IFCoFR.



AUDIT APPROACH

Obtaining Written Representations

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

- Acknowledging management's responsibility for establishing and maintaining adequate controls for identifying, maintaining, controlling, and monitoring audit trails as per the requirements on a consistent basis.
- Stating that management has performed an evaluation and assessed the adequacy and effectiveness of 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 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 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 the audit trail facility of the accounting software.
- Stating whether control deficiencies identified and communicated to the audit committee in relation to audit trails during previous engagements have been resolved, and specifically identifying any that have not been resolved.



AUDIT DOCUMENTATION

Audit documentation

The auditor may document the work performed on Audit Trails 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.

In this regard, the auditor may comply with the requirements of SA 230 "Audit Documentation" to the extent applicable.



GLOSSARY OF TERMS

Audit Trail

Audit Trail (or Edit Log) is a visible trail of evidence enabling 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
- **how** data was changed i.e, data added, modified or deleted or the command(s) used to make the change
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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.



GLOSSARY OF TERMS

Books of Account

"Books of Account" as per Section 2 (13) Companies Act 2013 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;



GLOSSARY OF TERMS

Accounting Software

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 organisation 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.

Service Provider


An organization supplying services to one or more (internal or external) Customers

Software as a Service


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.



Multiple Choice Questions

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1. Clause(g) under Rule 11 of Companies (Audit and Auditors) Rules, 2014 which requires the auditor to report whether the Company has used such accounting software for maintaining its books of accounts which has the facility of recording audit trail (edit log) is applicable from:
 - a) April 1, 2022
 - b) April 1, 2021
 - c) April 1, 2023
 - d) April 1, 2024


Correct Answer: a)

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2. In compliance with Rule 11(g) the auditor is expected to check whether the audit trail is enabled for such transactions which result in a change to the books of account:
- a) what data was changed
 - b) who made those changes and when
 - c) that the audit trails have been preserved from April 1, 2021
 - d) a and b only
 - e) a, b and c only


Correct Answer: d)

3. Company ABC Private Limited uses multiple IT applications for processing its business data. SAP is the main ERP where all transactions are recorded. Further, they have outsourced their Payroll processing to XYZ pvt. ltd. which uses 'MyPayy'. The company also uses 'AccuPPE' for maintaining fixed assets which is hosted on cloud. Which of the applications should be included by the auditor of ABC to report on compliance with Rule 11(g):
- a) SAP
 - b) MyPayy
 - c) SAP and AccuPPE
 - d) All of the above

Correct Answer: d), however, the auditor first determines which IT application software will constitute books of account as defined under Section 2(13) of the Act.

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4. The auditors of which companies are required to report on compliance with audit trail requirements:
- a) Section 8 (Not for Profit) Companies
 - b) Foreign Companies
 - c) Companies incorporated outside India
 - d) Companies incorporated in India
 - e) All of the above
 - f) a), b) and d)

Correct Answer: f)

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5. The auditor should consider issuing a modified report under which of the following circumstances:
- a) Audit trail feature is not operating effectively during the reporting period
 - b) Accounting software is maintained by a third party and auditor is unable to assess whether the audit trail feature can be disabled during the reporting period
 - c) Migration from one software to the other happened during the year and the auditor is unable to obtain sufficient and appropriate evidence
 - d) All of the above
 - e) a) and c) only

Correct Answer: d)

