Important Change/ updation in accounting software for all the corporates

The Companies (Audit and Auditor) Rules, 2014 (Audit Rules) have been correspondingly amended wherein auditors are now required to report, as part of the auditors report (in the section Report on Other Legal and Regulatory Requirements, as to whether,

(a) the accounting software used by the company being audited has the feature of recording audit trail (edit logs),

(b) the audit trail feature was operational throughout the financial year and had not been tampered with and

(c) such audit trails have been retained for the period as statutorily prescribed.

The MCA has notified that the aforesaid amendments will be effective from April 1, 2023, which implies that the accounting software employed by companies will need to be compliant with the Accounts Rules from FY 2023-24 onwards. The requirement was initially made applicable for the financial year commencing on or after the 1st day of April 2021, however the applicability was deferred to the financial year commencing on or after April 1, 2022 and thereafter to April 1, 2023.

These are applicable to all the companies registered under the Companies Act, 2013. The reporting requirements for the auditors have been prescribed for the audit of financial statements prepared under the Act. Accordingly, auditors of all classes of companies including section 8 companies would be required to report on these matters. As per Companies (Registration of Foreign Companies) Rules, 2014 the provisions of Audit and Auditors (i.e., Chapter X of the 2013 Act) and Rules made there under apply, mutatis mutandis, to a foreign company as defined in Companies Act, 2013.

The term audit trail can be defined as a chronological sequence of the history of a particular transaction, tracking who created/changed a record, what record, what time etc. Audit trails amongst others may help in investigating frauds, system breaches etc. and can be considered an essential tool of monitoring for organisations.

The companies would need to ensure that the audit trail captures changes to each and every transaction; changes that need to be captured may include the following: when changes were made, who made those changes, what data was changed.

The management will be responsible for compliance with the requirement of the rules including to:

1. identify the records and transactions that constitute books of account under section 2(13) of the Act;

2. identify the software i.e., IT environment (including applications, web portals, databases; Interfaces, or any other IT component used for processing and or storing data for the creation and maintenance books of accounts

3. ensure such software have the audit trail feature;

4. ensure that the audit trail captures changes to each and every transaction recorded in the books of account;

5. ensure that the audit trail feature is always enabled (not disabled);

ensure that the audit trail is appropriately protected from any modification;

6. ensure that the audit trail is retained as per statutory record retention requirements.

7. ensure that controls over maintenance and monitoring of the audit trail and its feature are designed and operating effectively throughout the period of reporting.

Considering the amendment has been made to the Rules, the non-compliance with the mandatory provisions would imply contravention with the provisions of the Companies Act, 2013. Further, based on procedures performed the auditor may evaluate the reporting implications in case of non-compliance and consider the requirements specified in Standards on Auditing 250, Consideration of Laws, and Regulations in an Audit of Financial Statements. In respect of the audit trail following could be the expected scenarios:

1. Management may maintain an adequate audit trail as required by the law.

2. Management may not have identified all records/transactions for which an audit trail should be maintained.

3. The accounting software does not have the feature to maintain an audit trail, or it was not enabled throughout the audit period.

Section 128(5) of the Act requires books of accounts to be preserved by the companies for a minimum period of eight years.

The auditor will be required to obtain written representations from management acknowledging managements responsibility for establishing and maintaining adequate controls for identifying, maintaining, controlling, and monitoring of audit trails as per the requirements on a consistent basis.

companies are required to keep back-up of books of account and other relevant books and papers maintained in electronic mode (including at a place outside India) in servers physically located in India on daily basis, instead of periodic basis.