Sudit K. Parekh & Co. LLP
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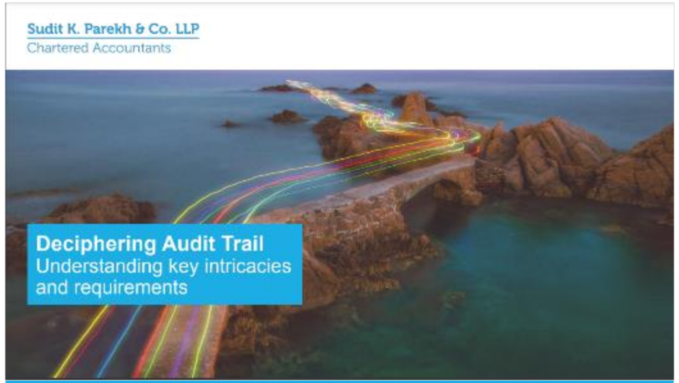
# Deciphering Audit Trail
## Frequently Asked Questions

# Audit Trail

In our previous article, the first of two installments on Audit Trail, we discussed the amendments brought in by the Ministry of Corporate Affairs (MCA) to mandate the use of accounting software having the feature of an Audit Trail. The previous article also discussed the responsibilities cast on management and the auditors and how they affect the other stakeholders.

In this article, we cover some of the frequently asked questions surrounding the Audit Trail. These are primarily based on the 'Implementation Guide on Reporting under Rule 11(e) and Rule 11(f) of the Companies (Audit and Auditors) Rules, 2014' (Implementation Guide) issued by the Institute of Chartered Accountants of India (ICAI).

## Read our previous article on Audit Trail

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# Frequently Asked Questions

## What is the management's responsibility in relation to the Audit Trail and maintenance of books of accounts in an electronic format?

The management of a company is responsible for maintaining books of accounts and they might do so with the help of an accounting software. The amendment requires that the accounting software should have the feature of Audit Trail which includes:

- A log of 'when' changes were made viz date and time (timestamp)
- A record of 'who' made the change viz user ID of the maker and the approvers of the transactions
- A record of 'what' data was changed viz data/transaction reference, success/failure, etc.

The management also needs to ensure that such an Audit Trail is maintained for each and every transaction and that the Audit Trail is not tampered with, nor can it be disabled.

The management needs to further ensure that the books of accounts always remain accessible in India. An amendment introduced here is the requirement to have a daily backup on servers physically located in India.

## What are the auditor's reporting responsibilities in relation to the Audit Trail?

Auditors are required to perform fact-based reporting on whether a company has used an accounting software having the feature of Audit Trail.

Auditors also will have to report on whether:

- The Audit Trail has been operated throughout the year
- The Audit Trail has been maintained for all transactions recorded in the software
- The Audit Trail has not been tampered with at any time during the year

Additionally, from the second year onwards, auditors will have to comment on whether the Audit Trail has been retained/preserved in accordance with the retention requirements (i.e. retained for a period of eight years).

## Is it applicable to all companies? Are there any exemptions?

It is applicable to all companies incorporated in India without any exemptions. Thus, even a small business incorporated as a company will have to comply with all the requirements.

As an extension, companies incorporated outside India but having a place of business in India in the form of a Branch Office, Liaison Office, and Project Office are covered by these requirements.

Integrated components, such as a Branch Office outside India which gets included in the standalone financials of the Indian company are also covered. Non-integrated components incorporated outside India are not covered.

However, non-corporate entities or subsidiaries incorporated outside India are not covered.

Joint ventures outside India are at par with subsidiaries incorporated outside India and are not covered.

## Will the reporting requirements extend to the Auditor's Report on Consolidated Financial Statements (CFS)?

Yes, the applicability extends to the Auditor's Report on CFS as well. However, for the CFS, auditors are not required to comment on the components incorporated outside India. Similarly, if a component included in the CFS is a non-corporate (for example, an LLP), reporting is not extended to such components. In such cases, fact-based reporting will have to be done.

Therefore, it applies to parent companies and those components which are companies incorporated in India (check the response to Question 3 above).

# Frequently Asked Questions

### Apart from accounting software, is there any other software/tool to which the requirement of the Audit Trail will apply?

Yes, it extends to more than just the accounting software.

Many companies that follow Enterprise Resource Planning (ERP), use various other software outside ERP (for maintaining inventory records of spares, fixed assets, GAAP reconciliation, etc.). These types of software will all fall under the ambit of applicability.

End user software, such as MS Excel, facilitates the completion/finalization of the process of books of accounts. Many companies maintain elimination entries in spreadsheets. Such cases also require the maintenance of an Audit Trail since these may also fall within the ambit of books of accounts. In many companies, final adjustment entries are passed in MS Excel (since ERP is locked after a particular date). In such cases, the Audit Trail would also be required. Generally speaking, MS Excel retains only the last modification rather than the entire trail. Thus, companies need to consider these requirements very carefully.

### Are there any special considerations to be applied for Indian companies that are subsidiaries of foreign companies and are using a global accounting software?

For companies that are using a global accounting software implemented by the parent company, the management of the Indian subsidiary should communicate with the parent company and ensure the necessary changes are done.

The Internal Audit Head should look into linking controls and the Audit Trail. This falls within the duties of the Internal Audit Head as the financial statement closure process controls stand questionable if the Audit Trail fails. Management may need to involve IT experts in this process.

Another critical aspect for such companies is the requirement to have a backup of electronic accounting records on a daily basis on a server physically located in India. This requirement may need a dialog with the parent company to understand the data backup policies and how they can be aligned with the legal and regulatory requirements in India.

### What are the challenges that these requirements bring for smaller businesses?

Generating and maintaining an Audit Trail over a period of eight years implies a huge quantum of generated data and would be a bigger challenge for small and medium businesses. There is also a need to be mindful that there are no exemptions for SMEs in this regard. Hence, global companies with smaller operations/subsidiaries in India might face a bigger challenge in terms of cost and other constraints to ensure that the backup of accounting records is maintained on a server physically located in India.

### What happens when companies say that the Audit Trail has been maintained from the middle of the year?

In such cases, fact-based reporting will be made by the auditor. The auditor will also have to conclude whether the Audit Trail has affected the ultimate audit opinion on the financial statements.

### How would the auditor establish that the Audit Trail has been maintained throughout the year?

An auditor will need evidence that the Audit Trail is being maintained throughout the entire year through readily available reports from widely used ERPs, Tally, Zoho, etc.

# Frequently Asked Questions

### As a member of the management, how do we ensure regular compliance with these requirements?

An approach similar to Internal Controls can be adopted. Under this approach, a test is performed on a semi-annual basis and after a period of three months period, the suggestions from the previous test must be revisited and there needs to be a check on whether they have been implemented.

### What are the penal consequences for non-compliance on the part of the company?

There is currently no specific penalty for non-compliance. However, some of the potential consequences would include:

- Adverse reporting by the auditor that the company has failed to adhere to the guidelines issued by the MCA
- There would be a general penalty to the officer of the company which may extend upto INR 500,000

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