

**REPORTING UNDER RULE 11(g) OF THE
COMPANIES (AUDIT AND AUDITORS) RULES,
2014**

PRESENTATION

BY

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INTRODUCTION

- ❑ Proviso to Rule 3 (1) of Companies (Accounts) Rules, 2014, lays down that 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 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

AUDIT TRAIL - MEANING

- ❑ Audit trail (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.

ACCOUNTING SOFTWARE - MEANING

- 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 organization today employs multiple software for accounting, its operations and other requirements like consolidation, collection of data.

BOOKS OF ACCOUNTS

- ❑ **Books of Account as per Section 2(13) of the Companies Act, 2013 includes records maintained in respect of—**
 - ✓ **all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;**
 - ✓ **all sales and purchases of goods and services by the company;**
 - ✓ **the assets and liabilities of the company; and**
 - ✓ **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;**
- **Any software that maintains records or transactions that fall under the definition of Books of Account as per the section 2(13) of the Act will be considered as accounting software for purpose of Rule 11(g).**
- **Example: if sales are recorded in a standalone software and only consolidated entries are recorded monthly into the software used to maintain the general ledger, the sales software should also have the audit trail feature since sales invoices would be covered under Books of Account.**

WHICH RECORDS DO NOT REQUIRE AUDIT TRAIL

- ❑ The requirements of audit trail are applicable to the extent a company maintains its records in electronic form by using an accounting software.
- ❑ **Thus, where the books of account are entirely maintained manually** – the assessment and reporting responsibility under Rule 11(g) will not be applicable and accordingly, same would need to be reported as statement of fact by the auditor against this clause.



MANAGEMENT'S RESPONSIBILITY

- ❑ Accounts Rules require that every company which uses an accounting software for maintaining its books of account, should use only such accounting software which has the following features:
 - Records an audit trail of each and every transaction, creating an edit log of each change made in the books of account along with the date when such changes were made; and
 - Ensuring that audit trail is not disabled.
- ❑ **Thus, it is the management, who is primarily responsible for ensuring selection of the appropriate accounting software for ensuring compliance with applicable laws and regulations.**

MANAGEMENT'S RESPONSIBILITY (CONTD.)

- ❑ Accounting software may be hosted and maintained in India or outside India or may be on-premise or on cloud or subscribed to as Software as a Service (SaaS) software. Further, a company may be using a software which is maintained at a service organisation. For example, the company may have outsourced its payroll processing with a shared service centre and the shared service centre may use its own software to process payroll for the company.

AUDITOR'S RESPONSIBILITY

- ❖ Rule 11(g) requires auditor to report on audit trail by making a specific assertion in audit report under the section 'Report on Other Legal and Regulatory Requirements'.
- ❖ In addition to comment on whether company is using an accounting software which has a feature of recording audit trail, auditor is expected to verify following aspects:
 - whether audit trail feature is configurable (i.e., if it can be disabled or tampered with)?
 - whether audit trail feature was enabled/operated throughout the year?
 - whether all transactions recorded in the software are covered in audit trail feature?
 - whether audit trail preserved as per statutory requirements for record retention?

AUDITOR'S RESPONSIBILITY (CONTD)

- ❖ Any software used to maintain books of account will be covered within the ambit of this Rule.
- ❖ Any software that maintains records or transactions that fall under the definition of books of account as per section 2(13) of the Act will be considered as accounting software for this purpose.

INTERPLAY OF ACCOUNTS RULES WITH AUDIT RULES

- ✓ The requirement of accounting software having feature of audit trail has been prescribed only in the context of books of account. This is evidenced by the fact that as per proviso to Rule, accounting software should be capable of creating an edit log of **“each change made in books of account.”**
- ✓ However, Rule 11(g) requires auditor to comment as to 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 software and audit trail feature has not been tampered with and audit trail has been preserved by company as per statutory requirements for record retention.
- ✓ Therefore, companies are required to maintain audit trail (edit log) for each change made in the books of account. Accordingly, the term ‘all transactions recorded in the software’ would refer to all transactions that result in change to the books of account.

APPLICABILITY

- ❖ Considering the applicability date of amended audit rules, it implies that the auditor is not required to assess appropriateness of audit trail of previous years and the assessment will be only for prospective financial years.

Applicability for FY 2022-23

- ❖ Applicability of Account Rules will commence on or after April 1, 2023. Thus, there is likely to be a scenario for FY 2022-23 where in absence of compliance requirement for companies, auditors would not be able to report under Audit Rules.

APPLICABILITY (CONTD)

- ❖ Auditors of all class of companies would be required to report on these matters including section 8 companies, foreign companies.
- ❖ Where the books of account are entirely maintained manually – the assessment and reporting responsibility under Rule 11(g) will not be applicable and accordingly, same would need to be reported as statement of fact by the auditor against this clause.
- ❖ Auditor is required to comment on Rule 11(g) both in case of standalone financial statements and consolidated financial statements (CFS).
- ❖ In case of CFS, the principal auditor should apply professional judgment and comply with applicable Standards on Auditing, in particular, SA 600, “Using the Work of Another Auditor” while assessing the matters reported by the auditors of components that are Indian companies.

PRESERVATION OF AUDIT TRAILS

- ❖ Auditor is required to comment whether the audit trail has been preserved by the company as per the statutory requirements for record retention.
- ❖ Section 128(5) of the Act requires books of account to be preserved by companies for a minimum period of eight years.
- ❖ So, company would need to retain audit trail for a minimum period of eight years i.e., effective from the date of applicability of the Account Rules (i.e., currently April 1, 2023, onwards).

ENSURE THAT AUDIT TRAIL FEATURE WAS FUNCTIONAL

- ❖ In order to demonstrate that audit trail feature was functional, operated and not disabled, a company would have to design and implement specific internal controls (predominantly IT controls) which in turn, would be evaluated by the auditors. Examples:
 - Controls to ensure that audit trail feature has not been disabled or deactivated.
 - Controls to ensure that User IDs assigned to each individual and User IDs not shared.
 - Controls to ensure that changes to configurations of audit trail are authorized and logs of such changes are maintained.
 - Controls to ensure that access to audit trail (and backups) is disabled or restricted and access logs, whenever audit trails have been accessed, are maintained.
 - Controls to ensure that periodic backups of audit trails are taken and archived as per the statutory period specified under Section 128 of the Act.

ACCOUNTING SOFTWARE SUPPORTED BY **SERVICE PROVIDERS**

- ❖ In case accounting software is supported by service providers, management and auditor may consider using independent auditor's report of service organisation e.g. Service Organisation Control Type 2 (SOC 2)/ SAE 3402, "Assurance Reports on Controls At a Service Organization" for compliance with audit trail requirements.
- ❖ It is expected that management ensures that the administrative access to the audit trail is restricted to authorized representatives.

AUDIT APPROACH

❖ **In respect of preservation of audit trails:**

- Inquire with management to understand the procedures implemented
 - Review, on a sample basis, audit trail records maintained by management for each applicable year
- ✓ Unlike reporting on IFC, Rule 11(g) requires auditor to report that the feature of recording audit trail facility has “operated throughout the year for all transactions recorded in the accounting software”.
- ✓ Auditor is expected to evaluate reporting implications specifically giving due consideration to SA 250, “Consideration of Laws and Regulations in an Audit of Financial Statements”.

AUDIT APPROACH (CONTD)

Expected Scenarios

- ❖ In respect of audit trail, following are likely to be expected scenarios:
 - i. Management may maintain adequate audit trail as required by 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 under Rule 11(g).

ILLUSTRATIVE REPORTING: FY 2022-23 AS PER IMPLEMENTATION GUIDE ISSUED BY ICAI

❖ In respect of financial year 2022-23, where management has not been mandated to use accounting software with requisite audit trail facility, reporting 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 REPORTING: STANDALONE FINANCIAL STATEMENTS AS PER IMPLEMENTATION GUIDE ISSUED BY ICAI

❖ Unmodified Reporting

- Based on our examination which included test checks, the company has used an accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has operated throughout the year for all relevant transactions recorded in the software.
- Further, during the course of our audit we did not come across any instance of audit trail feature being tampered with. Additionally, the audit trail has been preserved by company as per the statutory requirements for record retention.

ILLUSTRATIVE REPORTING: CONSOLIDATED FINANCIAL STATEMENTS AS PER IMPLEMENTATION GUIDE ISSUED BY ICAI

❖ Unmodified Reporting

- Based on our examination which included test checks and that performed by the respective auditors of the subsidiaries, associates and joint ventures/ joint operations which are companies incorporated in India whose financial statements have been audited under the Act, the company, subsidiaries, associates and joint ventures/ joint operations have used an accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has operated throughout the year for all relevant transactions recorded in the software. Further, during the course of our audit we did not come across any instance of audit trail feature being tampered with. Additionally, the audit trail has been preserved by the company as per the statutory requirements for record retention.

ILLUSTRATIVE REPORTING: CONSOLIDATED FINANCIAL STATEMENTS AS PER IMPLEMENTATION GUIDE ISSUED BY ICAI

❖ Modified Reporting

- Based on our examination, which included test checks, and that performed by the respective auditors of the subsidiaries, associates and joint ventures/ joint operations which are companies incorporated in India whose financial statements have been audited under the Act, **except for the instances mentioned below**, the company, subsidiaries, associates and joint ventures/ joint operations have used an accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has operated throughout the year for all relevant transactions recorded in the software. Further, during the course of our audit, we and respective auditors of the above referred subsidiaries, associates and joint ventures/ joint operations did not come across any instance of audit trail feature being tampered with. Additionally, the audit trail has been preserved by the Holding Company and above referred subsidiaries, associates and joint ventures/joint operations as per the statutory requirements for record retention.

Illustrative wordings for Modified Reporting :
STANDALONE FINANCIAL STATEMENTS
AS PER IMPLEMENTATION GUIDE ISSUED BY ICAI

Nature of Exception	Illustrative wordings
<p>1. Audit trail feature was disabled for one of the books of account/ records or for an accounting software - (e.g., property, plant and equipment software did not have audit trail feature)</p>	<p>“Based on our examination, the company, has used accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility except in respect of maintenance of property, plant and equipment 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 relevant transactions recorded in the software except for the instances reported below..... Further, during the course of our audit we did not come across any instance of audit trail feature being tampered with.”</p>

Illustrative wordings for modified reporting

Nature of Exception	Illustrative wordings
2. 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 accounting software AAA (database SQL) and BBB (database db2) to log any direct data changes.....”
3. Accounting software is 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 account and in absence of [state the type of control report] we are unable to comment whether audit trail feature of the said software was enabled and operated throughout the year for all relevant transactions recorded in the software or whether there were any instances of the audit trail feature been tampered with.” ²⁴

Illustrative wordings for modified reporting AS PER IMPLEMENTATION GUIDE ISSUED BY ICAI

Nature of Exception	Illustrative wordings
4. 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 second year of reporting and onwards
5. 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 documentations regarding audit trail. Consequently, we are unable to comment on audit trail feature of the said software.

IF THE AUDIT TRAIL WAS NOT OPERATING FOR PART OF THE YEAR OR THROUGHOUT THE YEAR, THE AUDITOR WILL ALSO BE REQUIRED TO CONSIDER THIS WHILE REPORTING UNDER SECTION 143(3)(B) AND SECTION 143(3)(H) IN ADDITION TO REPORTING UNDER RULE 11(G).

Given below is an example for illustrative reporting.

Example - Audit Trail feature is not operating effectively during the reporting period.

Illustrative reporting in the “Section - Report on Other Legal and Regulatory Requirements” in auditor’s report

Rule 11 (g)

Based on our examination which included test checks, the company has used an accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has operated throughout the year for all relevant transactions recorded in the software except that the audit trail feature of YYY software used by the company to maintain payroll records did not operate throughout the year. Further, during the course of our audit we did not come across any instance of audit trail feature being tampered with. [Additionally, the audit trail has been preserved by the company as per the statutory requirements for record retention]

IF THE AUDIT TRAIL WAS NOT OPERATING FOR PART OF THE YEAR OR THROUGHOUT THE YEAR, THE AUDITOR WILL ALSO BE REQUIRED TO CONSIDER THIS WHILE REPORTING UNDER SECTION 143(3)(B) AND SECTION 143(3)(H) IN ADDITION TO REPORTING UNDER RULE 11(G).

Section 143(3)(b) – Company has maintained proper books of account except for audit trail

In our opinion, proper books of account as required by law have been kept by the company so far as it appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from the branches not visited by us] except for the matters stated in the paragraph (...) below on reporting under Rule 11(g)

Section 143(3)(h)

The [qualification/ adverse remark/ reservation]⁹ relating to the maintenance of accounts and other matters connected therewith are as stated in the paragraph (...) above on reporting under Section 143(3)(b) and paragraph (...) below on reporting under Rule 11(g).

SPECIAL CONSIDERATION IN CASE OF FRAUD SCENARIOS

- ❖ An auditor may come across a scenario where occurrence of an error/ fraud could not be established due to lack of maintenance, availability/ retrievability of audit trails.
- ❖ In evaluating the severity of a deficiency for such instances specifically in cases of fraud, the auditor should primarily consider two factors
 - the likelihood that the deficiency will result in a material misstatement, and
 - the magnitude of such an outcome.
- ❖ This scenario would, in essence, call for performing an assessment of risk of material misstatement due to fraud and would consider both qualitative and quantitative factors in assessing a deficiency or combination of deficiencies as a significant deficiency or material weakness.
- ❖ It would accordingly require application of professional judgement while linking the reporting against Rule 11(g) and section 143(12) of the Act/ clause (x) of CARO 2020 (as the case may be).

OBTAINING WRITTEN REPRESENTATION

- ❖ Auditor shall obtain written representations from management on the following aspects:
 - Acknowledging management's responsibility for establishing and maintaining adequate controls for identifying, maintaining, controlling, and monitoring of audit trails on a consistent basis.
 - Stating that management has performed an evaluation and assessed the adequacy and effectiveness of the 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 the company's procedures w.r.t. 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.

OBTAINING WRITTEN REPRESENTATION (CONTD)

- Describing instances where identification of 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 audit trail facility of the accounting software.
- Stating whether control deficiencies identified and communicated to the audit committee in relation to audit trail during previous engagements have been resolved, and specifically identifying any deficiency that have not been resolved.

AUDIT DOCUMENTATION

- ❖ Auditor may document the work performed on audit trail such that it provides:
 - ✓ A sufficient and appropriate record of basis for auditor's reporting under Rule 11(g); and
 - ✓ evidence that audit was planned and performed in accordance with this Implementation Guide, applicable Standards on Auditing and applicable legal and regulatory requirements.

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

ROTATION OF AUDITORS

SEC-139. APPOINTMENT OF AUDITORS

- (1) Subject to the provisions of this Chapter, every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed:
- Explanation.—For the purposes of this Chapter, “appointment” includes reappointment.

SEC- 139. APPOINTMENT OF AUDITORS (CONTD..)

- (2) No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint—
- (a) an individual as auditor for more than one term of five consecutive years; and
- (b) an audit firm as auditor for more than two terms of five consecutive years:

SEC-139. APPOINTMENT OF AUDITORS (CONTD..)

- [Provided that—
- (i) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;
- (ii) an audit firm which has completed its term under clause (b), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term:
- Provided further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years:

SEC- 139. APPOINTMENT OF AUDITORS (CONTD..)

- (3) Subject to the provisions of this Act, members of a company may resolve to provide that—
 - (a) in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or
 - (b) the audit shall be conducted by more than one auditor.

CHAPTER X – THE COMPANIES (AUDIT AND AUDITORS) RULES, 2014

5. CLASS OF COMPANIES.(APPLICABILITY)

- For the purposes of sub-section (2) of [section 139](#), the class of companies shall mean the following classes of companies excluding one person companies and small companies:-
- (a) **all unlisted public companies having paid up share capital of rupees ten crore or more;**
- (b) **all private limited companies having paid up share capital of rupees ¹[fifty] crore or more;**
- (c) **all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.**

CHAPTER X - THE COMPANIES (AUDIT AND AUDITORS) RULES, 2014

6. MANNER OF ROTATION OF AUDITORS BY THE COMPANIES ON EXPIRY OF THEIR TERM

- (1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
- (2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

6. MANNER OF ROTATION OF AUDITORS BY THE COMPANIES ON EXPIRY OF THEIR TERM (CONTD..)

- (3) For the purpose of the rotation of auditors-
- (i) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;
- (ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.
- *Explanation. I-* For the purposes of these rules the term "same network" includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

6. MANNER OF ROTATION OF AUDITORS BY THE COMPANIES ON EXPIRY OF THEIR TERM (CONTD..)

- Explanation. II - For the purpose of rotation of auditors,-
- (a) a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;
- (b) if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

6. MANNER OF ROTATION OF AUDITORS BY THE COMPANIES ON EXPIRY OF THEIR TERM (CONTD..)

- (4) Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

The background is a dark blue gradient with a subtle pattern of white stars. Overlaid on this are several technical diagrams in a lighter blue color. In the top right, there is a large circular gauge with a scale from 0 to 210 and a needle pointing towards 180. Below it is a smaller circular diagram with concentric circles and arrows. In the bottom left, there is another circular diagram with arrows. The text 'THANK YOU!' is centered in a bold, yellow, sans-serif font.

THANK YOU!