Mandatory requirement of Audit trail

Management responsibility

Proviso to Rule 3(1) of the Companies (Accounts) Rules, 2014 (hereinafter referred as “the Account Rules”) states 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 the books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.

The amendments require every company that uses an accounting software to use such software that has a feature of audit trail which cannot be disabled. The management has a responsibility for effective implementation of the requirements prescribed by account rules i.e., every company which uses an accounting software for maintaining its books of account, should use only such accounting software which has the following features.

a. 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
b. Ensuring that audit trail is not disabled.

Thus, the management is primarily responsible for ensuring selection of the appropriate accounting software for ensuring compliance with applicable laws and regulations (including those related to retention of audit logs).

Amendments to Rule 11(g) of Companies (Audit and Auditors) Rules, 2014

1. Section 143(3) of the Companies Act, 2013 provides various matters on which auditors are required to report in their auditor’s report. Clause (j) of Section 143(3) states that auditor’s report shall also state such other matters as may be prescribed. Rule 11 of the Companies (Audit and Auditors) Rules, 2014 specifies such other matters that are to be reported by the auditor.

   Rule 11(g) is reproduced below:

   “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.”

Rule 11(g) casts responsibility on the auditor in terms of reporting on audit trail by making a specific assertion in the audit report under the section ‘Report on Other Legal and Regulatory Requirements’. This has been explained in the paragraph below.

To elaborate, in addition to requiring auditor to comment on whether the company is using an accounting software which has a feature of recording audit trail, the auditor is expected to verify the following aspects:

- Whether the audit trail feature is configurable (i.e., if it can be disabled or tampered with)?
- whether the audit trail feature was enabled/operated 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 statutory requirements for record retention?

It may be noted that any software used to maintain books of account will be covered within the ambit of this Rule. For e.g., 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 as defined under section 2(13) of the Act. Auditors would need to evaluate whether management has also considered such software in their compliance to the Account Rules. Accordingly, 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 this purpose.
It may be noted that the requirement of the accounting software having a feature of audit trail has been incorporated as a proviso to Rule 3(1) of the Account Rules and have been prescribed only in the context of books of account. This is evidenced by the fact that as per the proviso to the Rule, the accounting software should be capable of creating an edit log of **“each change made in books of account.”**

However, Rule 11(g) requires the 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 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.

By reading of the Account Rules, it may be noted that 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.

For example, creation of a user in the accounting software may be construed as a transaction in the software. However, creating a user account in the accounting software would not change the records of books of account as defined in Section 2(13) of the Act whereas adding a new journal entry or changing an existing journal entry will be construed as a change made in books of account.

Giving due cognizance to the definition of "books of account" as envisaged under Section 2(13) of the Act and Rule 3 of the Account Rules which provides for the management responsibilities for maintenance of books of account and other relevant books and papers maintained in electronic mode, the auditor would be expected to check whether the audit trail is enabled for such transactions which result in a change to the books of account.

Preservation of Audit Trails

The auditor is required to comment whether 'the audit trail has been preserved by the company as per the statutory requirements for record retention'. Considering the requirement of Section 128(5) of the Act, which requires books of account to be preserved by companies for a minimum period of eight years, the company would need to retain audit trail for a minimum period of eight years3 i.e., effective from the date of applicability of the Account Rules (i.e., currently April 1, 2023, onwards).

As part of the audit approach, the auditor would need to ensure that the management assumes the primary responsibility 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, Data Warehouses, data lakes, cloud infrastructure, or any other IT component used for processing and or storing data for creation and maintenance of books of account;
3. ensure such software have the audit trail feature; ensure that the audit trail captures changes to each and every transaction of books of account; information that needs to be captured may include the following:
   a. when changes were made,
   b. who made those changes
   c. what data was changed

4. ensure that the audit trail feature is always enabled (not disabled);
5. ensure that the audit trail is enabled at the database level (if applicable) for logging any direct data changes
6. ensure that the audit trail is appropriately protected from any modification;
7. ensure that the audit trail is retained as per statutory requirements for record retention;
8. ensure that controls over maintenance and monitoring of audit trail and its feature are designed and operating effectively throughout the period of reporting.

In order to demonstrate that the audit trail feature was functional, operated and was 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, as appropriate.

An illustrative list of internal controls which may be required to be implemented and operated are given below:

a. Controls to ensure that the audit trail feature has not been disabled or deactivated.
b. Controls to ensure that User IDs are assigned to each individual and that User IDs are not shared.
c. Controls to ensure that changes to the configurations of the audit trail are authorized and logs of such changes are maintained.
d. 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.
e. Controls to ensure that periodic backups of the audit trails are taken and archived as per the statutory period specified under Section 128 of the Act.

Most of the commonly used accounting software, including Enterprise Resource Planning (ERP) software, have an audit trail feature that can be enabled or disabled at the discretion of the company. The management of the company may have put in place 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 have been implemented and operating effectively throughout the reporting period.

