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Regulatory updates for the month of February 2024

22 March 2024

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Introduction

This month’s edition covers some of the important updates on auditing and regulatory matters and other discussion/consultation papers from regulators for the period from 1 February 2024 to 29 February 2024.

Some of the key topics covered in this edition include:

- The revised implementation guide on reporting on audit trail issued by The Institute of Chartered Accountants of India (ICAI)
- Revision of limits of fixed remuneration granted to Non-Executive Directors (NEDs) of banks by the Reserve Bank of India (RBI)
- The draft disclosure framework on climate-related financial risks, 2024 issued by RBI.

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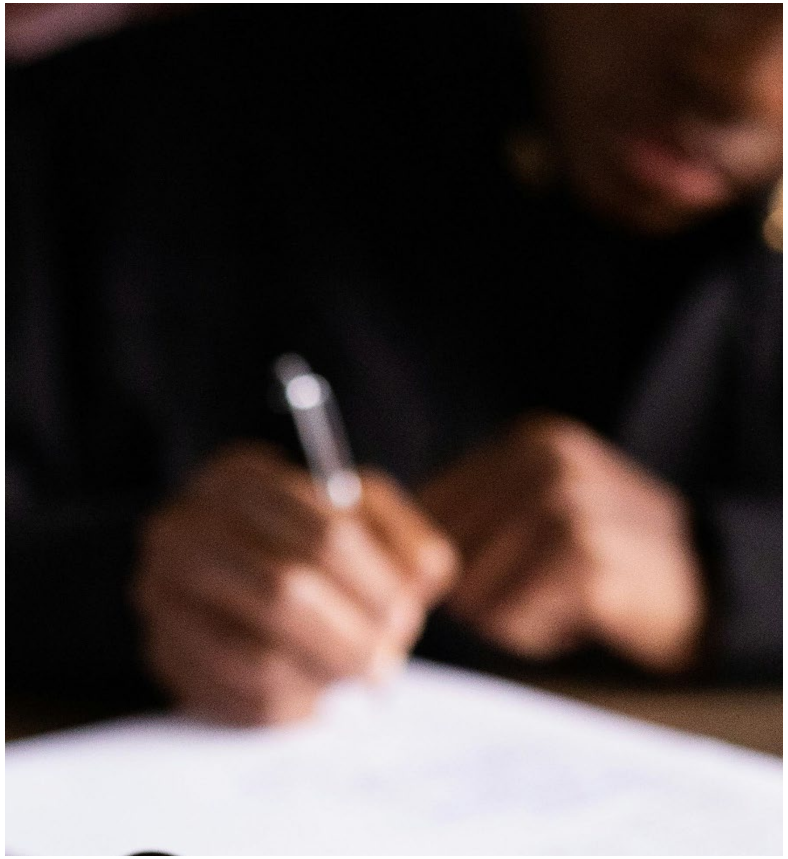
Revised Implementation Guide on reporting on audit trail

On 24 March 2021, the Ministry of Corporate Affairs (MCA) issued the Companies (Audit and Auditors) Amendment Rules, 2021, notifying certain changes to Rule 11[1] of the Companies (Audit and Auditors) Rules, 2014 (the Audit and Auditors Rules). Rule 11(g) was introduced, which specified that auditors should report on the use of accounting software by companies having audit trail (edit log) feature.

Consequently, in March 2023, ICAI issued the Implementation Guide on Reporting under Rule 11(g) of the Companies (Audit and Auditors) Rules, 2014 (the implementation guide). Based on the feedback and queries received from different stakeholders, in February 2024, ICAI has issued a revised Implementation Guide on Reporting under Rule 11(g) (the revised implementation guide). The revised implementation guide comprises of detailed guidance on various aspects of the reporting requirement as well as includes a new section on Frequently Asked Questions (FAQs). Some of the important FAQs include:

- **Definition of books of account:** The FAQs have clarified that the following would be considered as 'books of account' maintained in an accounting software and accordingly, an audit trail for the same should be maintained.
  - ***Master data:*** Vendor/customer master data complements the transaction record and provides further information pertaining to books of account
  - ***Purchase order/sales order:*** Purchase order/sales order or contracts are used by companies as control/governance mechanism to establish the contractual obligations of the parties. Where the terms of such purchases or sales are agreed at the time of receipt or at the time of booking the invoice and thus depending upon the likely interface/input to the 'books of account', one may conclude it to be part of accounting software requiring existence of an audit trail feature
  - ***Records of Property, Plant and Equipment/intangible assets:*** Property, plant and equipment /intangible assets register may be classified as accounting software, if the same provides direct and auto feed to the accounting software[2].
  - ***Use of spreadsheets:*** End-user computing tools, like spreadsheets, may be classified as accounting software if the same provides direct and auto feed to the accounting software.



[1] Other matters to be included in auditors report

[2] Auto feed to books of account by a PPE register would be in terms of depreciation, profit or loss on sale of property, plant and equipment/intangible assets, etc.

Auditing updates

- **No exemptions from audit trail requirements:** In case a company maintains its books of account in electronic mode, then it is required to comply with the requirements of Rule 3 of the Companies (Accounts) Rules, 2014[3] (Accounts Rules). This requirement is applicable to **all companies** and no exemption is available for the small and medium companies or for banks and Non-Banking Finance Companies (NBFCs)

- **No requirement to report on audit trail in the limited review report:** The revised implementation guide has clarified that currently, there is no requirement prescribed under the Companies Act, 2013 or any of the SEBI Regulations for the auditors to report on the audit trail feature of accounting software while issuing their limited review report

- **Use of specialist/expert or reliance on information system audit report by the auditor:** It has been specified that the auditor may consider involvement of a specialist or expert in the field of information technology to assist in evaluation of management controls and configurations in the accounting software regarding audit trail. However, while doing so, the auditor must comply with the requirements of SA 620, Using the Work of an Auditor's Expert.

Similarly, where accounting software is provided by a service provider, the auditor may consider using independent auditor's report on service organisation (for example, SOC 1/SOC 2/ SAE 3402) for compliance with audit trail requirements[4]. While doing so, statutory auditor of the company is required to comply with the requirements of SA 402, Audit Considerations Relating to an Entity Using a Service Organisation.

However, the ultimate responsibility for reporting on audit trail would remain with the statutory auditor only.

- **Implication of audit trail feature not operational throughout the year:** The revised implementation guide has clarified that in case there are no transactions during any part of the year, it would not be considered as a reason for not enabling the audit trail feature. Similarly, technical glitches in the accounting software during any part of the financial year due to which audit trail feature remains non-functional does not give any exemption to the management regarding their responsibility. Consequently, if the audit trail feature remains non-functional during any part of the year, the auditor would need to appropriately modify reporting under Rule 11(g) of the Audit and Auditors Rules[5]. It would also have an impact on reporting under Section 143(3)(b)[6] and Section 143(3)(h)[7] of the 2013 Act.

[3] Rule 3 of the Companies (Accounts) Rules, 2014 inter alia requires every company which uses accounting software for maintaining its books of account to include a feature of recording audit trail of each and every transaction. It also requires the software to create an edit log of each change made in the books of account, whether or not the underlying journal entry can be edited or not. This is applicable from 1 April 2023

[4] It has been further clarified that if the SOC or SAE report of the service organisation does not cover the full reporting year, then the auditor would need to modify the reporting under clause 11(g) of the Audit and Auditors Rules

[5] It has also been clarified that reporting on the audit trail feature is independent of any adverse findings by the auditor

[6] The auditor's report should state whether proper books of account as required by law have been kept by the company, so far as appears from the examination of those books and proper returns

[7] The auditor's report should state any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith

Auditing updates

- **Applicability of materiality concept for reporting on audit trail:** Rule 11(g) of the Audit and Auditors Rules states that audit trail is required for each and every transaction, creating an edit log of each change made in the books of account. Thus, reporting would apply for all the transactions, irrespective of the amount involved. Reporting on audit trail is a factual reporting. Auditor's reporting is based on test checks which would require application of the concept of materiality for the purpose of sample selection

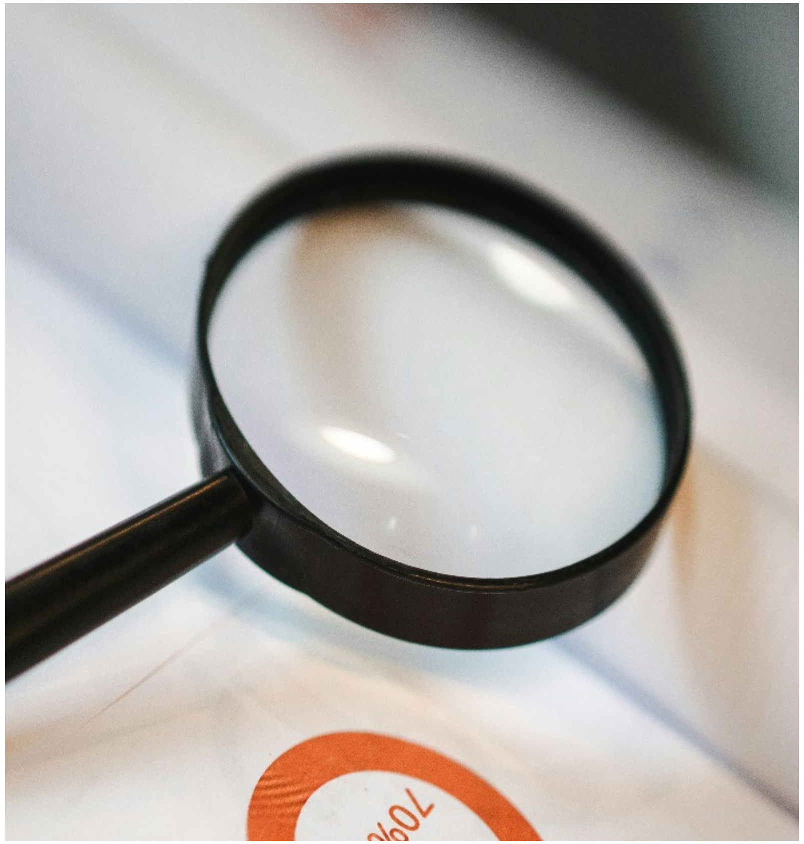
- **Requirement to comment on details of audit trail logs:** As per Rule 11(g) of the Audit and Auditors Rules, the auditor needs to comment only on the below aspects:
  - Whether the company has **used such accounting software** for maintaining its books of account which has a feature of recording audit trail (edit log) facility
  - Whether the audit trail has **operated throughout the year** for all transactions recorded in the software
  - Whether audit trail feature has **not been tampered** with, and
  - Whether audit trail has been **preserved by the company** as per the statutory requirements for record retention.

  Thus, there is no requirement for auditors to comment on the details of audit trail logs.

- **Log of all changes:** In case of multiple changes made in the books of account, the log of entire chain of changes should be maintained. Retaining only the last/latest changes will not serve the purpose of compliance with audit trail requirements. In a situation where only the last/latest changes are maintained, the auditor would need to appropriately modify the reporting under Rule 11(g) of the Audit and Auditors Rules

- **Reporting on accounting software outside India**: Audit trail requirements are applicable even for accounting software maintained outside India if the company is incorporated in India. In case the auditor is relying on the work of another auditor, then audit trail feature requirement should form part of SOC/SAE report

- **Requirement of audit trail to remain accessible in India at all times:** There may be a situation wherein the audit trail is recorded at back-end on a server/cloud maintained outside India.



Auditing updates

Rule 3 of the Accounts Rules requires companies to maintain a daily back-up of books of account[8] maintained in electronic mode (including at a place outside India), to be kept in servers physically located in India. Since audit trail would fall under the definition of books of account, a daily backup of the audit trail **would also be required to be maintained in a server physically located in India.**

To access the text of the revised implementation guide, please click here

Action points for auditors

Maintaining an audit trail is a significant requirement for the companies in terms of resources and infrastructure needed for implementing the same. It also casts an important responsibility on the auditors to report on, in accordance with Rule 11(g) of the Audit and Auditors Rules read with Section 143(3) of the Companies Act, 2013. Thus, the auditors should evaluate the necessary audit procedures required and audit evidence needed to report on the same. While the requirement to implement this for companies was 1 April 2023, there may be companies that are now in the process of adopting these. In such cases members of the profession should engage with such companies and discuss about the key organisational-level changes that may be required for implementing this.

Audits for the year/period ending 31 March 2024 would be the first year/period in which the auditor would report on the audit trail maintained by the companies since it is applicable for companies for financial years commencing on or after 1 April 2023. Some of the important points that auditors may consider while reporting on audit trail include:

- Has the company identified all accounting software that would get covered under the requirements of the audit trail rules?
- Has the company made necessary arrangement and additional investment for maintenance of daily backups and generating and maintaining audit trails?
- Whether necessary processes and controls are in place regarding the access of audit trail, avoidance of data tampering and ensuring that audit trail feature is not disabled at any point in time?
- Whether a periodic review of the user access (i.e., the users who can access, review, make changes etc. to the accounting software) performed?
- In case of a third party or outsourced software, has the company obtained Service and Organisation Control (SOC) report for evaluating compliance with the regulatory requirements of daily backup and audit trail?
- Whether the logs are being maintained as per the retention requirements and retrieval of the same is possible?

[8] This includes other books and papers of the company

Auditing updates

ICAI issues revised Standards on Auditing

On 7 February 2024, ICAI issued the following revised Standards on Auditing (SAs):

- SA 800 (Revised), *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*
- SA 805 (Revised), *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*
- SA 810 (Revised), *Engagements to Report on Summary Financial Statements*

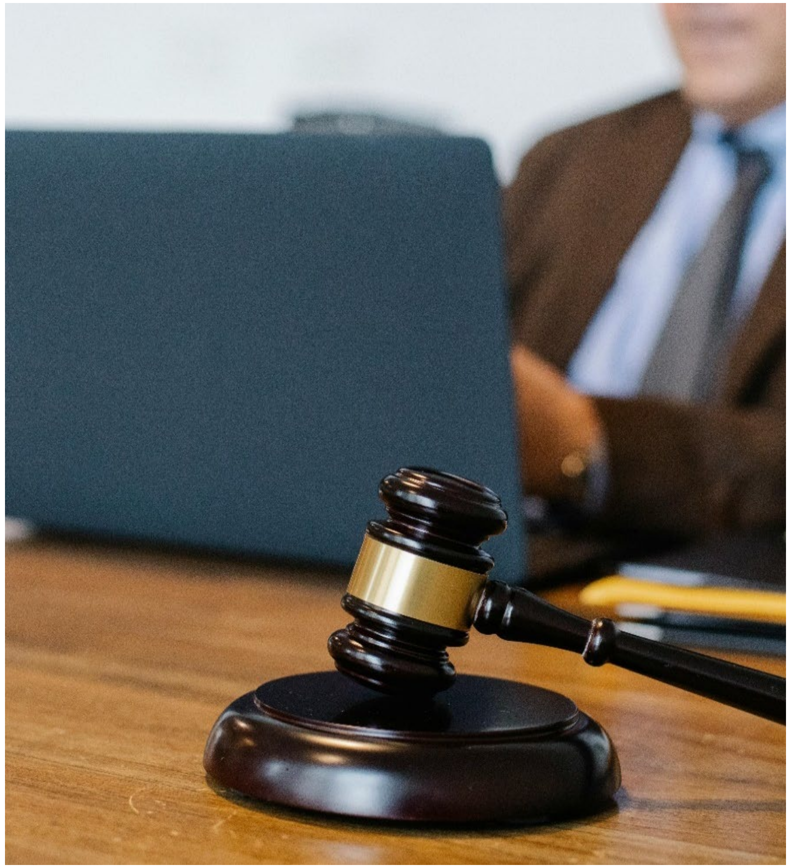
(Together referred to as the 'revised standards')

The key changes in the revised standards is:

- Auditors should consider the requirements of SA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, while forming their opinion
- Auditors should also address specific considerations relating to issues such as going concern, key audit matters, other information, etc. while forming their opinion.

Effective Date: The revised SAs would be applicable to audits/engagements for financial years beginning on or after 1 April 2024. The extant SA 800, SA 805 and SA 810 would continue to apply to audits/engagements for the financial year 2023-24.

To access the text of the revised SAs, please click here



Action points for auditors

Considering that the revised SAs would become applicable to audit engagements beginning on or after 1 April 2024, auditors should evaluate the impact of the changes introduced and discuss them with the management.

Auditors should continue to apply the existing SA800, 805 and 810 for periods beginning prior to 1 April 2024.

Updates from SEBI

Guidelines for returning of draft offer document and its resubmission

Schedule VI[9] of the Securities and Exchange Board of India (SEBI) (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations) prescribes the information that needs to be disclosed in the draft/final offer document or letter of offer.

SEBI observed that, at times, the draft offer documents/draft letter of offer filed for public issue/rights issue of securities are not compliant with the instructions provided under Schedule VI of the ICDR Regulations. As a result, such documents require revisions/changes and thus, lead to a longer processing time.

In this regard, recently SEBI issued the 'Guidelines for returning of draft offer document and its resubmission' (the circular).

As per the circular, the draft offer documents submitted to SEBI would be scrutinised in accordance with the broad guidelines prescribed in the circular. The documents which are not compliant with the circular and Schedule VI of the ICDR Regulations would be returned to the issuer.

The guidelines for returning of the draft offer document and its resubmission to SEBI are provided in Annexure A of the circular.

Effective Date: The circular came into force with effect from 6 February 2024.

To access the text of the circular, please click here

[9] Schedule VI of the ICDR Regulations: Disclosures in the Offer Document, Abridged Prospectus and Abridged Letter of Offer

Updates from RBI

Review of fixed remuneration granted to Non-Executive Directors

The RBI vide its notification dated 26 April 2021[10] provided instructions on corporate governance for banks (corporate governance notification).

Paragraph 9 of the corporate governance notification deals with remuneration of Non-Executive Directors (NEDs) of banks. It states that in addition to sitting fees and expenses for attending meetings of the board and its committees, NEDs may be paid a compensation in the form of a fixed remuneration which should not exceed INR20 lakh per annum[11].

However, considering their significant role in the efficient functioning of banks, RBI, vide a notification dated 9 February 2024 (the notification) revised the aforementioned ceiling to **INR30 lakh per annum**.

Further, it has been clarified that:

- The Board of a bank may fix a lower amount within the revised ceiling limit, depending upon the size of the bank, experience of the NED and other relevant factors
- Banks should disclose the remuneration paid to directors on an annual basis at a minimum, in their annual financial statements.

Applicability and Effective Date: The above requirement would be applicable to all private sector banks, including Small Finance Banks (SFBs) and Payment Banks (PBs), as also the wholly owned subsidiaries of foreign banks. The notification came into force with effect from 9 February 2024.

To access the text of the notification, please click here

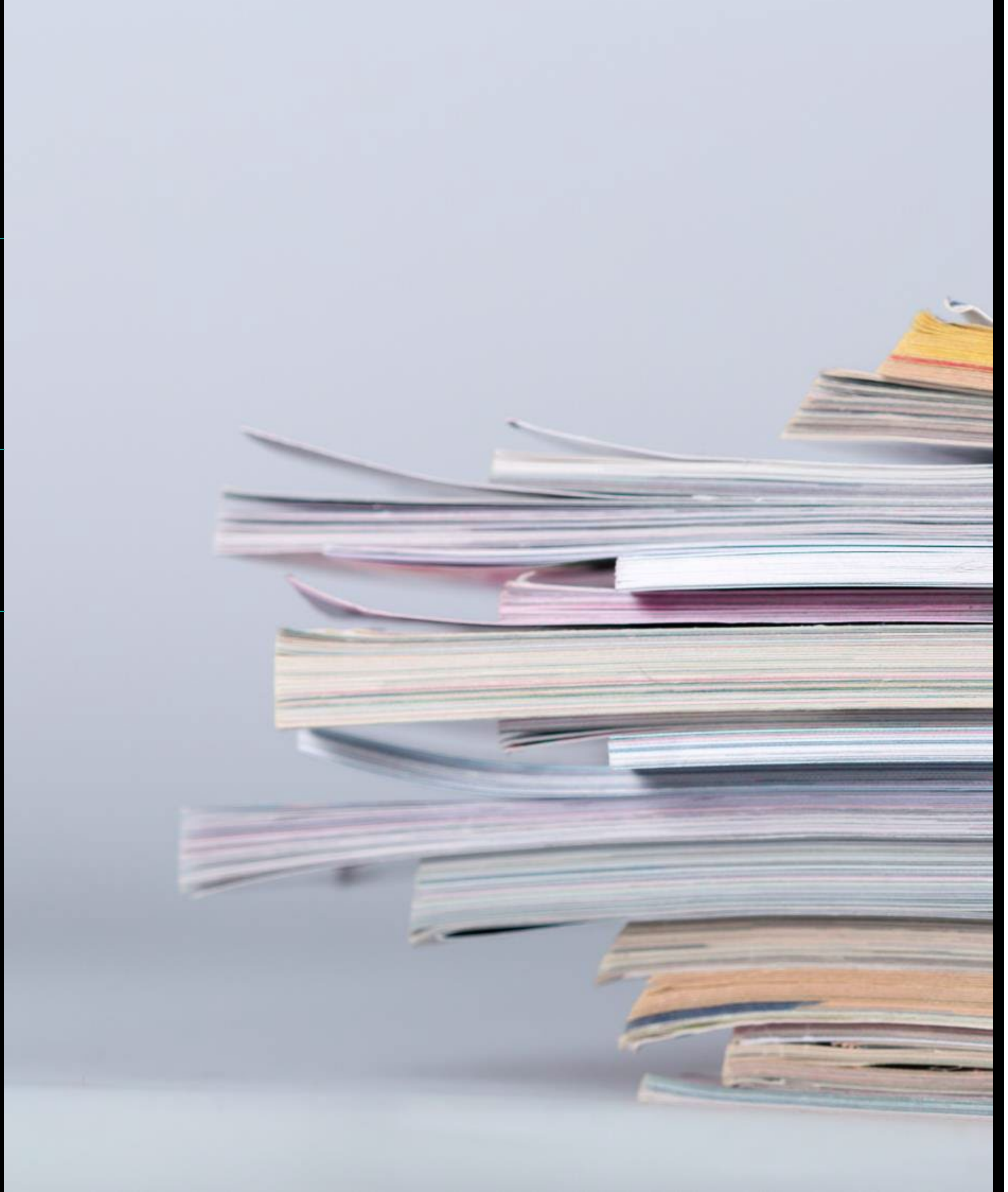
[10] Notification no. RBI/2021-22/24 DOR.GOV.REC.8/29.67.001/2021-22 dated 26 April 2021- Corporate Governance in Banks - Appointment of Directors and Constitution of Committees of the Board, provides instructions with regard to the chair and meetings of the board, composition of certain committees of the board, age, tenure and remuneration of directors, and appointment of the whole-time directors (WTDs)

[11] This limit would not be applicable to the chairman of the board of directors

Discussion/Consultation papers and Publications

Exposure Drafts/consultation papers – India and international

India publications



EDs/Consultation papers

The table below provides an overview of some important exposure drafts/consultation papers released by various regulators during this month:

Regulator	Publication	Particulars
SEBI	**Consultation paper on flexibility to category I and II AIFs to create encumbrance on their holding of equity in infrastructure sector investee companies to facilitate raising of debt by such investee companies**	On 2 February 2024, SEBI issued the consultation paper on flexibility to category I and II AIFs to create encumbrance on their holding of equity in infrastructure sector investee companies to facilitate raising of debt by such investee companies (the consultation paper). Through the consultation paper, SEBI has proposed amendment to the SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations). Some of the key proposals include: • Category I and II AIFs may create encumbrance on the equity of an investee company, only for the purpose of borrowing by the said investee company (if the investee company is in the business of development, operation or management of projects in any of the infrastructure sub-sectors) • The duration of encumbrance on equity should not be greater than the residual tenure of the scheme of the AIF • AIFs should not create encumbrance on equity of foreign investee company The comment period ended on 23 February 2024. To access the text of the consultation paper, please click here

EDs/Consultation papers

<table>
<tr><th>Regulator</th><th>Publication</th><th>Particulars</th></tr>
<tr><td>RBI</td><td>Draft disclosure framework on climate-related financial risks, 2024</td><td>
On 28 February 2024, RBI issued the draft disclosure framework on climate-related financial risks, 2024 (the draft framework). It would be applicable to the following entities:

All Scheduled Commercial Banks (SCBs) (excluding local area banks, payments banks and regional rural banks)
All Tier-IV primary (Urban) Co-operative Banks (UCBs)
All-India Financial Institutions (AIFs) (i.e., EXIM Bank, NABARD, NaBFID, NHB and SIDBI)
All top and upper layer Non-Banking Financial Companies (NBFCs)

As per the draft framework, the disclosures should cover four thematic areas/pillars – Governance, Strategy, Risk management, Metrics and Targets.

The glide path for the disclosures is given below:
<table>
<tr><th>Entity</th><th>Governance, Strategy, and Risk management</th><th>Metrics and Targets</th></tr>
<tr><td>SCBs, AIFIs, Top and upper layer NBFCs</td><td>FY 2025-26 onwards</td><td>FY 2027-28 onwards</td></tr>
<tr><td>Tier IV UCBs</td><td>FY 2026-27 onwards</td><td>FY 2028-29 onwards</td></tr>
</table>
To access the text of the draft framework, please click here
</td></tr>
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EDs/Consultation papers

Regulator	Publication	Particulars
IAASB	**IAASB moves to strengthen auditors' efforts related to fraud**	Recently, the International Auditing and Assurance Standards Board (IAASB) proposed a significant strengthening of the International Standard on Auditing (ISA) 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*. Some of the key changes proposed include: • Clarification regarding auditor responsibilities relating to fraud in an audit • Emphasis on professional skepticism to ensure auditors remain alert to possible fraud • Strengthening identification and assessment of risks of material misstatement due to fraud • Clarification regarding response to fraud or suspected fraud identified during the audit • Increased communication with management and those charged with governance regarding fraud • Enhanced transparency regarding auditors' responsibilities and fraud-related procedures in the auditor's report, etc. The comments are invited up to 5 June 2024. To access the text of the proposed amendments, please click here

India Publications

The table below provides an overview of some important publications released by various regulators during this month:

Regulator	Publication	Particulars
ICAI	**Guidance note on audit of banks**	Recently, ICAI issued the Guidance note on audit of banks (2024 edition) (the guidance note). The guidance note incorporates the latest developments and changes in the banking landscape. It comprises of two sections: • Section A – Statutory Central Audit (SCA) • Section B – Bank branch audit To access the text of the guidance note, please click here
ICAI	**Commonly found errors in reporting practices**	Recently, ICAI released a publication – Commonly found errors in reporting practices. The publication aims to dissect the prevalent errors frequently found in reporting practices. From financial misstatements to inconsistencies in data presentation, it seeks to identify and rectify such issues. The publication comprises of the following three parts: • Part I – Financial information • Part II – Non-financial information • Part III – Industry-specific observations To access the text of the publication, please click here

India Publications

Regulator	Publication	Particulars
ICAI	**Internal audit checklist**	The Companies Act, 2013, has provided a strong legal mandate for the crucial role of internal auditors in the corporate governance structure. With a view to aid the members in discharging their duties effectively, in February 2024, ICAI issued the internal audit checklist (the checklist). The checklist is illustrative in nature and consists of four main parts: • Part I: Introduction • Part II: Internal audit of specific function • Part III: Review and reporting, and • Part IV: Other Aspects. To access the text of the checklist, please click here
ICAI	**Implementation guide on maintenance of Property, Plant and Equipment (PPE) register: Best practices**	Recently, ICAI issued the Implementation guide on maintenance of Property, Plant and Equipment (PPE) register: Best practices (the implementation guide), thereby providing comprehensive details that can be included in a PPE register. The implementation guide also incorporates the related Schedule III and CARO requirements, as well as the illustrative contents of PPE register format. To access the text of the implementation guide, please click here

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