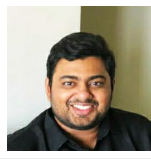


## Hansel and Gretel In Companies' Accounts

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The childhood fairy tale Hansel and Gretel would show that how a trail of white pebbles left by the brother would enable the children to return to their home and outfox their step mother. The Government wants the Hansel and Gretels of the business world to leave a trail. The Ministry of Corporate Affairs has introduced an [amendment in the Companies \(Accounts\) Rules, 2014](#), mandating every company maintaining books of accounts using an accounting software to use a software that has the feature of audit trail for every transaction recorded and edit log for every deletion or alteration made and there shall be no option to disable the audit trail.

Firstly, let us examine whether the MCA has the power to put in place such a requirement. The second proviso to Section 128(1) allows the companies to maintain books of accounts in the electronic mode in such manner as may be prescribed. Thus, the MCA has the power to prescribe the manner in which the books are to be maintained in the electronic mode.

The amendment has been made by inserting a proviso to Rule 3(1) of the said Rules. Rule 3 of the Companies (Accounts) Rules, 2014 prescribes the manner in which books of accounts are to be kept in the electronic mode. Rule 3(2) of the said rules reads as under:

*“(2) The books of account and other relevant books and papers referred to in sub-rule (1) shall be retained completely in the format in which they were originally generated, sent or received or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered”*

It is clear that it was never open to the companies to alter the data relating to an accounting entry as originally entered/posted or generated. The amendment reiterates this position. In a way what was already the requirement is being set out in clear terms. Thus it cannot be said that MCA does not have the power to put in place such a requirement.

One another interesting aspect to be noted is that the notification amending Rule 3(1) has been issued under Section 134 of the Companies Act, 2013. Section 134 deals with Financial Statements and Board Report. It is only Section 128 that deals with books of accounts. The notification should ideally have drawn powers from Section 128 and not Section 134. However, given the fact that the notification also refers to Section 469 which deals with general power to make rules there cannot be a serious legal challenge.

### Who will benefit from this requirement?

The government has not given out any press release or explanatory statement explaining the need for the amendment. Without going into the objective behind the amendment let us understand how the amendment can be beneficial.

In today's environment an Auditor is expected to do much more than what he was expected to do a few years back. Old school Auditors would not agree with this statement, but that is the reality. The level of comfort that users of audit reports expect out of an audit procedure is going through a change and the expectations from the Auditor in terms of diligence is on an all time high. With the explosion scams and the increased role played by ICAI in ensuring professional audits, there is increased skepticism amongst chartered accountants in taking up audits which requires certification. There are number of instances where sophisticated frauds have been committed in the preparation of accounts and the auditor also becomes a victim of fraud.

Traditionally, an audit process gives only a reasonable assurance that the financial statements give a true and fair view of the state of affairs of the business. However, reasonable assurance is fairly subjective. The extent of procedures an auditor chooses to perform for opining that he is reasonably sure that the financial statements are free from misstatements vary based on the risk environment of the company being audited. The variation in risk environment is dependent on various factors like strength of internal controls employed by the company, size of business etc. However, what is expected out of an auditor today is that he should detect every fraud that occurs in a company, be it fraud at the top management level or fraud at the employee level and still be accused of fraud in social media platforms.

Leaving aside the expectation to identify fraud, risk assessment is a very important part of Audit. The existence of an Audit Trail and Edit log would help the auditor make a fair assessment of risk. A higher amount of deletions or alterations could mean that the risk perception should be set at a higher level and ensure that commensurate audit procedures are carried out before forming an opinion. The risk perception is not limited to the number of deletions or alterations but also the time at which an entry is made, the user who has made the entry, etc would throw up various risk factors for an auditor to address by performing suitable procedures.

Management would also realize the fact that the Audit Trail and edit log will increase the chances of identifying employee frauds and embezzlements.

The added responsibility on an Auditor now would be to enquire and be satisfied with the management's response for the reasons for deletions and alterations.

### The Elephant in the room:

We cannot be oblivious to the fact that the data generated may possibly be open to the eyes of the Tax Authorities or other investigating agencies. Thus the companies should ensure that they have sufficient documentation to backup their reasons for deletion or alteration that was carried out.

Now let us address the elephant in the room, *Tally*. Tally is the most widely used accounting software in the country. The software has the feature of audit trail and edit log, however, the feature can be disabled at will by the user. Now, the amendment would probably drive Tally and other such entities implementing controls which would ensure that the feature cannot be disabled and probably also implement further user-friendly tools which will ensure better compliance of this new statutory requirement. One important facet which should not be forgotten is that deletion or alteration of entries need not always mean that there is fraud. Given the complexity of accounts and business transactions, errors are inevitable and materiality concept is even more relevant in ensuring that a clear distinction is made between normal accounting errors and their rectification as against deliberate deletions or alterations.

### **Is the timeline for implementation fair?**

The amendment mandates that the books of accounts should be maintained in this manner for financial years commencing from 01.04.2021. The amendment was notified on 24.03.2021. It is impossible to make such transition within a period of seven days. It is a matter of irony that the powers that be seem to think that shifting to a new IT software or enabling new features for an existing software or development of a new software can happen overnight magically. Therefore it becomes imperative that the requirement should become mandatory only for financial years commencing from 01.04.2022.

Last but not the least is the use of legislation as a tool for this exercise. In the grand majesty of things, the parent Act should deal with the substantive law and the delegation of powers should be to enable procedures for implementing the Act. Over a period of time, excessive delegation of powers has resulted in excessive legislation for rudimentary and ordinary matters. One cannot forget the fact that sometime back directors had to take a photograph in front of their registered office with the Company's name board in the background. Not long ago, foreign directors were compelled to update their e-KYC with a requirement of OTP being generated through an SMS which had to be shared with the professional providing the services in gross disregard of the RBI mandates of not sharing OTP. This was also implemented through a Notification. Time has come to pause and use the executive power and rule making power only for important procedures which support the implementation of the Act.