





We would like to introduce you to the Assurance Gazette of this month, which delves into the critical topic of audit trail and their indispensable role in maintaining financial transparency and accountability. This edition sheds light on the necessity of audit trail in today's corporate environment, especially considering recent regulatory mandate under Companies Act. As companies navigate the complex landscape of audit trail compliance, this gazette offers valuable insights into the challenges faced and the solutions available. We hope this gazette will serve as a practical guide for ensuring rigorous financial oversight and protecting the integrity of corporate records.

This Edition also briefs about the exposure Draft for a new Standard on Auditing (SA) focused on audits of financial statements for Less Complex Entities (LCEs). This proposed standard aims to adapt the audit process to the specific needs of LCEs, ensuring effectiveness and efficiency while maintaining alignment with professional standards.



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Challenges in the Audit Trail

Necessity of Audit Trail

In the corporate world, financial transparency and accountability are fundamental principles that underpin trust and integrity. A key component in upholding these principles is the practice of auditing, particularly through the use of audit trails. An audit trail serves as a comprehensive digital record that meticulously logs each financial transaction and any changes made within a company's accounting records. This digital footprint not only provides a historical record of financial activities but also acts as a crucial defence against fraudulent or erroneous actions. In alignment with these principles, companies are now mandated to comply with Rule 11(g) of the Companies (Audit and Auditors) Rules, 2014. As of April 1, 2023, companies are required to use accounting software with an audit trail (edit log) feature, ensuring the audit trail remains operational throughout the year. This feature is crucial for accurately documenting all transactions and protecting records from tampering, in line with statutory retention policies.

Hidden/Practical Challenges of Audit Trails

During the financial year 2023-24, which marks the first year of implementing and reporting on the audit trail, it has been noted that many listed entities, whose audit reports are publicly available, have encountered numerous practical challenges. These challenges have made it difficult for even listed companies to obtain an unqualified audit opinion. A compilation of some of these challenges are provided below.

Common Issues:

- Database Oversights: Audit trails were often not activated at the database level, missing logs of direct changes in accounting software. Many companies activate their audit trails midway through the year, making it challenging to track initial changes.
- Payroll and Consolidation Gaps: Supporting software for payroll and consolidation processes frequently lacked proper audit trail activation, leading to data integrity issues.
- General Ledger Weaknesses: Non-editable fields in general ledger software sometimes failed to log direct data changes at the master data level, compromising transparency.



Partial Implementations

- Delayed Activation: Many companies did not update their software or lacked audit trail features for parts of the year, leading to gradual and incomplete implementation.
- Manual Interventions: In critical areas like Privileged Access Management (PAM), manual interventions without embedded controls weakened financial integrity.

Challenges with Third-Party Management:

- Restricted Access: When software is managed by thirdparty service providers, assessing compliance with audit trail requirements is challenging due to restricted access and limited knowledge to system configurations at the service provider level.
- Limited Oversight: When software is managed or maintained by parent companies abroad at the corporate level, assessing compliance with audit trail requirements is challenging due to limited access to system configurations.

Additional Challenges:

- Complex Integration: Integrating audit trail features across diverse software systems is complex and resource-intensive, causing delays and inconsistencies.
- Training Deficiencies: Lack of proper training for staff on using audit trail features leads to errors and oversight, reducing the effectiveness of these controls.
- compliance Costs: The cost of updating software and ensuring full compliance with audit trail requirements can be high, posing financial challenges for companies.

Deeping dive into the prospective solution

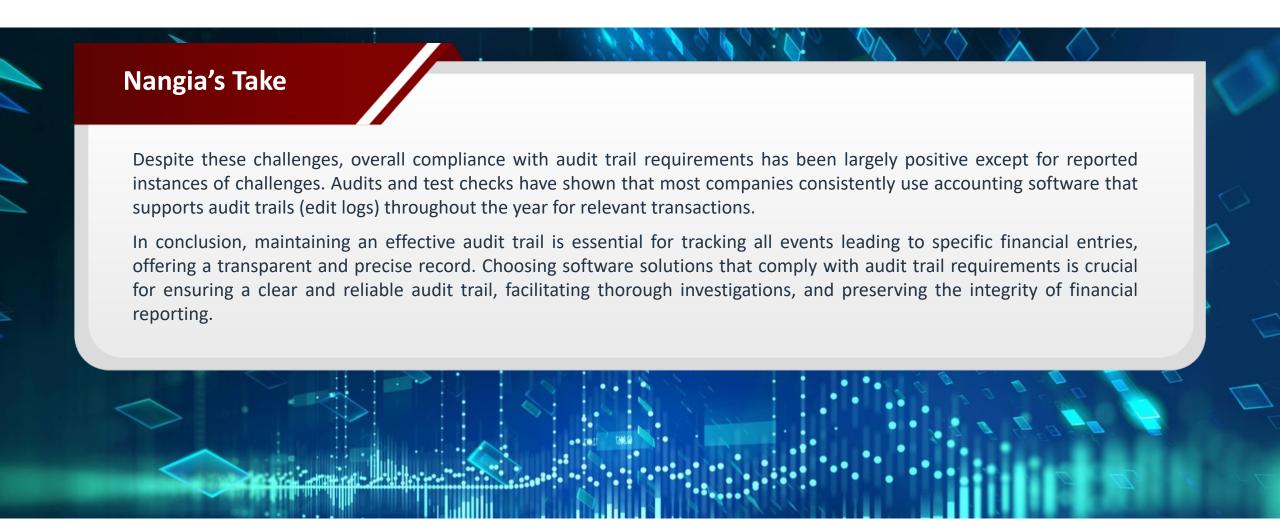


These are the list of possible solutions for the above listed challenge -:

- Activate and Monitor Audit Trails: Ensure that audit trails are fully activated across all databases and software systems, leaving no gaps in the financial record-keeping process.
- Regular Software Updates: Keep your software up to date with the latest features and security patches, ensuring audit trails are always functional and robust.



- Comprehensive Privileged Access Management (PAM): Embed strict PAM controls within your systems, minimizing manual interventions and maintaining the integrity of financial data.
- Enhanced Compliance Oversight: Establish clear protocols and regular audits, especially when relying on third-party providers or parent companies, to verify that audit trail requirements are consistently met.
- Centralized Monitoring and Reporting: Implement a centralized system for real-time monitoring and reporting of audit trails to quickly identify and address any compliance issues and try to have configuration level access in India.





Exposure Draft on the Standard on Auditing for Audits of Financial Statements of Less Complex Entities

The Auditing and Assurance Standards Board (AASB) has issued an Exposure Draft on the proposed Standard on Auditing (SA) for Audits of Financial Statements of Less Complex Entities (LCEs). This new standard seeks to tailor the audit process to the unique characteristics of LCEs, ensuring that audits remain effective, efficient, and aligned with professional standards while addressing the challenges faced by auditors in this context. The Exposure Draft is open for public consultation, and all stakeholders are invited to submit their comments by September 9, 2024.

Comments on this Exposure Draft should clearly specify the paragraph(s) being addressed, provide a reasoned rationale for the feedback, and, where possible, suggest alternative wording or approaches. This detailed feedback is critical for refining the standard to ensure it meets the needs of both auditors and LCEs. Please submit your comments to the Auditing and Assurance Standards Board.

Definition of Less Complex Entities (LCEs)



- Non-Listed Securities: The entity's equity or debt securities are not listed on any stock exchange, nor are they in the process of being listed, whether within India or internationally.
- Non-Financial Sector Entity: The entity is not a bank, financial institution, or insurance company at any point in time.
- Turnover Threshold: The entity's turnover, excluding other income, does not exceed INR 250 crore in the immediately preceding accounting year.
- Borrowing Limit: The entity does not have borrowings, including public deposits, exceeding INR 50 crore at any time during the immediately preceding accounting year.
- Grant/Donation Limit: The entity does not receive cumulative grants or donations exceeding INR 50 crore at any time during the immediately preceding accounting year.
- Subsidiary and Holding Exclusion: The entity is not a holding or subsidiary entity of an entity that does not qualify as an LCE.



Purpose and Scope of the SA for LCE

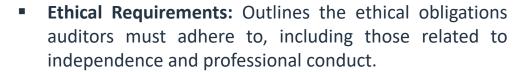
The SA for LCE has been developed to ensure that audits of financial statements for less complex entities are conducted with a level of rigor that aligns with professional auditing standards, while being proportionate to the nature and scale of these entities. The standard is intended to provide reasonable assurance that the financial statements are free from material misstatement, whether due to fraud or error.

This standard does not override local laws or regulations. It is meant to complement existing frameworks, ensuring that audits remain relevant and effective for LCEs without imposing unnecessary burdens on auditors or the entities they audit.

Structure of the Standard

The SA for LCE is organized into several key parts, each addressing specific aspects of the audit process. This structured approach is designed to guide auditors through the entire audit engagement, from planning to reporting.

- 1. Part 1: Fundamental Concepts, General Principles, and Overarching Requirements
 - Effective Date and Applicability: Specifies the effective date of the standard and its applicability to audits of LCEs.



- Quality Management: Discusses firm-level quality management systems and how they relate to the audit engagement.
- Overall Objectives of the Auditor: Defines the auditor's objectives, emphasizing the application of professional judgment and skepticism.
- General Requirements: Includes overarching requirements related to fraud detection, compliance with laws and regulations, communication with management, and interaction with those charged with governance.
- Communication Requirements: Establishes general communication guidelines that apply throughout the audit process, with additional specific communication requirements detailed in later parts.

2. Part 2: General Requirements for Audit Evidence and Documentation

 Audit Evidence: Provides guidelines for gathering and evaluating audit evidence to support the auditor's opinion.



 Documentation: Specifies the documentation requirements necessary to demonstrate that the audit was conducted in accordance with the standard. This includes the maintenance of audit working papers and other relevant records.

3. Part 3: Quality Management Responsibilities of the Auditor and Engagement Partner

- Quality Management at Engagement Level: Sets out the responsibilities of the engagement partner and the audit team in managing audit quality, ensuring that all aspects of the audit meet the required standards.
- Risk Assessment and Mitigation: Discusses the process of identifying and mitigating risks that could affect audit quality.

4. Parts 4 to 9: Detailed Requirements for the Audit Engagement

Part 4: Agreement on Audit Engagement Terms

- Preconditions for an Audit: Establishes the necessary preconditions for accepting an audit engagement, including the appropriateness of using the SA for LCE.
- **Engagement Terms:** Outlines the process for agreeing on the terms of the engagement with management and, where appropriate, those charged with governance.

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Part 5: Audit Planning and Materiality

- Planning the Audit: Focuses on the development of an audit strategy, including discussions within the engagement team and the assessment of materiality.
- Engagement Team Discussions: Encourages collaboration within the audit team to identify potential risks and set the direction for the audit.

Part 6: Understanding the Entity and Risk Assessment

- Entity and Environment Understanding: Describes the procedures for obtaining an understanding of the entity, its environment, and its internal control system.
- Risk Identification and Assessment: Involves identifying and assessing risks of material misstatement at both the financial statement and assertion levels, whether due to fraud or error.

Part 7: Responding to Assessed Risks

- Overall and Specific Responses: Details the design and implementation of audit procedures in response to assessed risks, including substantive procedures and tests of controls.
- Further Audit Procedures: Expands on the procedures necessary for specific topics, such as responding to fraud risks and evaluating significant transactions.

Part 8: Evaluating Audit Findings and Conclusions

- Evaluation of Misstatements: Sets out the requirements for evaluating both corrected and uncorrected misstatements identified during the audit.
- **Subsequent Events:** Provides guidance on how to evaluate events occurring after the balance sheet date but before the auditor's report is issued.
- Concluding Procedures: Outlines concluding activities, including going concern assessments, obtaining written representations, and performing final analytical procedures.

Part 9: Forming an Opinion and Reporting

- Audit Opinion: Discusses the process for forming an audit opinion based on the audit evidence obtained.
- Types of Audit Opinions: Explains the different types of opinions an auditor can issue, including unmodified, modified, and adverse opinions.
- Auditor's Report Content: Details the required content of the auditor's report, ensuring that it communicates the audit findings clearly and effectively.
- Other Information and Comparative Information: Provides guidance on how to address additional information and comparative information included in the financial statements.

5. Part 10: Special Considerations for Using the Work of Another Auditor

Using the Work of Another Auditor: Addresses the special considerations and procedures necessary when the auditor relies on the work of another auditor, particularly in group audits or situations where multiple components are audited by different auditors.

Alignment with System of Quality Management (SQM) 1

The SA for LCE aligns with the System of Quality Management (SQM) 1, which outlines the responsibilities of audit firms in managing quality at the engagement level. In certain instances, the SA for LCE may reference individual Standards on Auditing (SAs) to provide additional context or guidance. However, the SA for LCE is designed to be a standalone document, addressing the specific needs of LCE audits while maintaining consistency with broader quality management principles.



Nangia's Take

The AASB recognizes the significance of stakeholder input in shaping the final standard. Auditors, industry professionals, regulators, and other interested parties are encouraged to review the Exposure Draft and provide comprehensive feedback. Your insights will help ensure that the SA for LCE is practical, relevant, and capable of addressing the unique challenges faced in auditing less complex entities.



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