

First Notes



Accounting software for maintaining books of account, changes to board's report and additional reporting in an auditor's report - New norms

14 April 2021

First Notes on

Financial reporting
Corporate law updates
 Regulatory and other information
 Disclosures

Sector

All
 Banking and insurance
 Information, communication, entertainment
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 Infrastructure and government

Relevant to

All
 Audit committee
 CFO
 Others

Transition

Immediately
 Within the next three months
 Post three months but within six months
Post six months
 Forthcoming requirement

Introduction

On 24 March 2021, the Ministry of Corporate Affairs (MCA) has issued certain amendments to the provisions of the Companies (Accounts) Rules, 2014 (Accounts Rules) and the Companies (Audit and Auditors) Rules, 2014 (Audit Rules) under the Companies Act, 2013 (2013 Act).

The amendments mainly relate to the following:



Manner of books of account to be kept in electronic mode



Additional disclosures in the board's report



Additional matters to be reported in the auditor's report

On 1 April 2021, MCA amended the circulars issued on 24 March 2021 regarding the applicability date of the newly prescribed requirements on the 'manner of books of account to be kept in electronic mode' and the 'related auditor's report'. Now these two requirements would be applicable from the financial year commencing on or after 1 April 2022.

This issue of First Notes aims to provide an overview of these amendments.

Overview of the amendments



Manner of books of account to be kept in electronic mode (Rule 3 of Accounts Rules)

In accordance with the provisions of Section 128 of the 2013 Act, every company is required to prepare and keep at its registered office, books of account, other relevant books and papers and financial statements for every financial year which give a true and fair view of the state of the affairs of the company.



Manner of books of account to be kept in electronic mode (cont.)

Further, a company may keep its books of account or other relevant papers in electronic mode subject to compliance with the requirements prescribed under Rule 3 of the Accounts Rules. As per the requirements of Rule 3(1), the books of account and other relevant books and papers maintained in electronic mode should remain accessible in India so as to be usable for subsequent reference.

Amendment

The amendments have inserted a proviso to Rule 3(1) of the Accounts Rules which further specifies 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:

- a. Records an audit trail of each and every transaction
- b. Creates an edit log of each change made in books of account along with the date when such changes were made.

Additionally, companies would need to ensure that the audit trail is not disabled.



Effective date: The requirement is effective for the financial year commencing on or after 1 April 2022.



Additional disclosures in the board's report (Rule 8 of Accounts Rules)

The financial statements of a company should accompany a report by its board of directors in accordance with the requirements of Section 134 of the 2013 Act. Further, Rule 8 of the Account Rules specifies the matters to be included in the board's report of a company. The matters, *inter alia*, include:

- a. Details of directors or key managerial personnel who were appointed or have resigned during the years
- b. A statement regarding opinion of the board with regard to integrity, expertise and experience (including the proficiency) of the independent directors appointed during the year
- c. Details in respect of adequacy of internal financial controls with reference to the financial statements
- d. Details of significant and material orders passed by the regulators, courts, or tribunals impacting the going concern status and company's operations in future.

Amendment

In addition to the current matters, the amendments require board of directors of every company to make following disclosures in its report:

- a. Details of application made or any proceeding pending under the Insolvency and Bankruptcy Code, 2016 (IBC) during the year along with their status as at the end of the financial year
- b. Details of difference between amount of the valuation done at the time of one-time settlement and the valuation done while taking loan from the banks or financial institutions along with the reasons thereof.



Effective date: The amendment is effective from 1 April 2021.



Additional matters to be reported in the auditor's report (Rule 11 of Audit Rules)

In accordance with the requirements of Section 143(2) of the 2013 Act, an auditor reports to the members of the company on the accounts examined by him/her and on every financial statements to be laid before the company in general meeting. An auditor should prepare the report after considering the provisions of the 2013 Act and accounting and auditing standards.

Section 143 of the 2013 Act read with Rule 11 of the Audit Rules prescribe matters to be included in an auditor's report. Amongst others, an auditor should include its views and comments on the following key matters in the auditor's report:

- a. Whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement
- b. Whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts
- c. Whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company
- d. Whether the company had provided requisite disclosures in its financial statements as to holdings as well as dealings in Specified Bank Notes (SBNs) during the period from 8 November 2016 to 30 December 2016. If so, whether these disclosures are in accordance with the books of accounts maintained by the company.

Amendment

As per the amendments, an auditor is required to include his/her views and comments on the following additional matters in the auditor's report:

- a. The management has represented that to the best of its knowledge and belief, other than as disclosed in the notes to the accounts:
 - i. No funds have been advanced or loaned or invested (either from borrowed funds, share premium or any other sources/kind of funds) by the company to/in any other person(s) or entity(ies), including foreign entities (intermediaries), with the understanding (recorded in writing or otherwise) that the intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company (ultimate beneficiaries) or provide any guarantee, security or the like on behalf of the ultimate beneficiaries.
 - ii. No funds have been received by the company from any person(s) or entity(ies), including foreign entities (funding parties), with the understanding (recorded in writing or otherwise) that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the funding party (ultimate beneficiaries) or provide any guarantee, security or the like on behalf of the ultimate beneficiaries.
- b. Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to its notice that has caused an auditor to believe that the representations under points (i) and (ii) above contain any material misstatement.
- c. The dividend declared or paid during the year by the company is in compliance with Section 123 of the 2013 Act.
- d. The company has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility. Further, an auditor should also comment on whether:
 - i. The audit trail feature has been operated throughout the year for all transactions recorded in the software
 - ii. The audit trail feature has not been tampered with and
 - iii. The audit trail has been preserved by the company as per the statutory requirements for record retention.

Further, the amendments have omitted the requirement to comment on requisite disclosures made by the company as to the holdings and dealings in SBNs (point (d) above) by an auditor in its report.



Effective date: The amendments for points (a) to (c) above is effective from 1 April 2021 and point (d) would be applicable from financial year commencing on or after 1 April 2022.

Our comments

Use of accounting software with audit trails

The amendments require every company that uses an accounting software to ensure that it provides an audit trail and help prevent fraudulent activities through data tampering. These amendments are now applicable from 1 April 2022. The change in the applicability date provides the much needed relief for the companies as the implementation of these new requirements would require time and effort to modify the IT systems, and hence warrants a suitable transition period. While companies proceed with its implementation, we would need to consider the following implications where MCA would need to provide clarity:

- **Term 'accounting software':** The amendment does not provide any clarity on the term 'accounting software'. One interpretation could be that only the main accounting software that generates financial statements would be covered under this amendment. Companies may have a range of subsystems supporting the main accounting software and they would need to evaluate whether such subsystems would also be covered within the meaning of the term accounting software.

Companies would need to evaluate whether the transaction level data is being captured outside the accounting software relevant for financial reporting. For example, for banks there could be a core banking accounting software, various other sub-ledger billing systems and many peripheral systems. Similarly, for an e-commerce company, the sales and purchases may be generated through digital platforms that may not be part of the core accounting software for financial reporting and only summary information is being captured by the core accounting software.

On the other hand, companies may have peripheral systems that do not capture transaction level detail e.g., lease calculation software or debtor aging or evaluation. Such peripheral systems that are not capturing transaction level data may not be required to be covered within the definition of 'accounting software'.

- **Types of accounting software:** In India, we could bucket companies into three categories: a) those that have deployed an audit trail enabled accounting software (where the software could generate a report highlighting instances where changes have been made to the original transaction data and its audit trail), b) those that have deployed an accounting software with an audit trail feature but where such feature has not been enabled and, c) those where the accounting software does not have an audit trail feature (rudimentary software).

In our experience, majority of large companies in India would fall in category (a) or (b) while many small and medium companies would fall in category (c).

As this amendment applies to every company that uses an accounting software, companies would need to assess their present systems as to whether they would be able to facilitate the implementation of the new requirement of maintaining an audit trail for each transaction and ensure that this feature should not be disabled during the year. The implementation of this amendment is likely to involve deliberation at the management, involvement of specialists including technology and information risk management professionals and auditors. This is not likely to be a quick exercise and would require a paradigm shift for many companies in India.

- **Applicable throughout the accounting year:** As per the amendment, the audit trail feature should be operated through out the year for all transactions recorded in the software. The companies have one year of transition window and should consider this aspect while implementing this amendment and ensure that the systems are compliant with these new requirements from the first day of the coming financial year.
- **Auditor's report:** An auditor is also required to comment on the functioning of the software including commenting as to whether the audit trail has not been tampered with and has been preserved by the company as per the statutory requirements for record retention. This puts an onerous responsibility for an auditor and he/she would need to take assistance of specialists in technology and information risk management field. Additionally, for companies that would be unable to implement this amendment from 1 April 2022, an auditor would be required to comment on the non-compliance aspect of the accounting software amendment.

Our comments (cont.)

Use of accounting software with audit trails (cont.)

- **Compliance costs:** The companies in India would need to incur various costs to meet this requirement of audit trail - starting from a new ERP system, data storage, external experts, auditors and involvement of management time.
- **Retention of electronic records:** The audit trail has to be preserved by a company as per the statutory requirements for record retention. Accordingly, the data providing the audit trail would be part of the electronic records required to be retained by the company from 1 April 2022 onwards.
- **Non-compliance with Section 128 of the 2013 Act:** In case of non-compliance with the audit trail requirements, the provisions of Section 128 would be applicable. Section 128 states that 'if the managing director, the whole-time director in charge of finance, the Chief Financial Officer (CFO) or any other person of a company charged by the Board with the duty of complying with the provisions of Section 128 (maintenance of books of account), contravenes such provisions, such managing director, whole-time director in charge of finance, CFO or such other person of the company shall be punishable with fine which shall not be less than INR50,000 but which may extend to INR5 lakh'.

Additional disclosures in the board's report

The additional disclosures required in the board's report are status of proceedings pending under the IBC and details of difference between amount of the valuation done at the time of one-time settlement and the valuation done while taking loan from the banks or financial institutions along with the reasons thereof. Generally, for taking loans from the banks or financial institutions, companies provide security of their assets. It is not clear whether the amendment is referring to valuation of assets/project/enterprise.

The MCA should consider providing more clarity on the valuation requirements referred to in this amendment.

Additional matters to be reported in the auditor's report

- **Illegitimate diversion of funds:** The amendments seek management representation affirming that there has been no illegitimate diversion of funds through an intermediary. This would need to be reviewed and reported by an auditor in the auditor's report.

The amendment refers to any fund that has been advanced, loaned, or invested. It could be either from borrowed funds, share premium or any other sources/kind of funds by the company to/in any other person(s) or entity(ies), including foreign entities (intermediaries), with the understanding (recorded in writing or otherwise) that the intermediary shall, whether directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company (ultimate beneficiaries). The intermediary could provide any guarantee, security or the like on behalf of the ultimate beneficiaries.

Additionally, the companies would have to represent that no funds have been received by the company from any person(s) or entity(ies), including foreign entities (funding parties), with the understanding (recorded in writing or otherwise) that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the funding party (ultimate beneficiaries) or provide any guarantee, security or the like on behalf of the ultimate beneficiaries.

Our comments (cont.)

Additional matters to be reported in the auditor's report (cont.)

The amendment needs to be carefully evaluated as it could cover practically all types of outflows/inflows including funds advanced in the form of supplier advances. Additionally, the term 'intermediary' has not been defined and may also cover a branch, subsidiary, associate or joint venture. It seems whenever a company makes an investment in another company, gives loans or advances, it may have to put in place a mechanism for tracking the end use of the funds, where relevant, and also take an end use confirmation from the counterparty to provide this representation letter to its auditors.

The MCA should consider providing more clarity on the requirements of this amendment.

It is important to note that the Companies (Auditor's Report) Order, 2020 (CARO 2020) also requires specific reporting by an auditor on the following matters:

- i. Report loans or advances in the nature of loans, or guarantee, or security of all parties
 - ii. Ensure terms and conditions of loans, advances, guarantees are not prejudicial to the company's interest
 - iii. Identify instances of 'evergreening' of loans or advances or loans renewed or extended
 - iv. Details of loans granted to promoters and related parties.
- **Payment of dividend:** An auditor needs to comment that the dividend declared or paid during the year by the company is in compliance with Section 123 of the 2013 Act. Accordingly, the company would need to ensure the following:
 - a. **Profits:** When dividend is declared out of the profits, then profits for that year are arrived at after providing for depreciation. If dividend is declared out of the profits of the company for any previous financial year or years then it is arrived at after providing for depreciation in accordance with the 2013 Act.

While computing profits, any amount representing unrealised gains, notional gains or revaluation of assets and any change in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded.
 - b. **Inadequate or no profits:** If a company has inadequate or no profits in any financial year, and it proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the free reserves then it has to follow rules given in the 2013 Act.
 - c. **Interim dividend:** Interim dividend may be declared during any financial year or at any time during the period from closure of financial year till holding of the annual general meeting out of the surplus in the profit and loss account or out of profits of the financial year for which such interim dividend is sought to be declared or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend. However, in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.
 - d. **Government:** Dividend can be declared out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

A company would need to ensure that when dividend is declared, carried over previous losses and depreciation not provided in previous year or years are set off against profit of the company for the current year. Further, while calculating the profits or reserves available for distribution, due care has to be taken to ensure that amounts representing unrealised gains, notional gains or revaluation of assets and any change in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded. This is particularly relevant for companies that are reporting under Ind AS, as the extensive use of fair values in the financial statements could result in such amounts being included in its profits or reserves.

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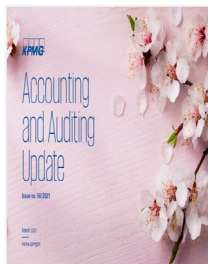
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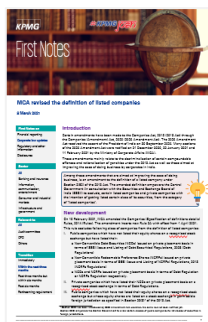
Missed an issue of Accounting and Auditing Update or First Notes?



Issue no. 56 – March 2021

The topics covered in this issue are:

- Disclosure of contingent liability in the standalone financial statements
- SEBI reviews regulatory provisions related to independent directors
- Regulatory updates.



MCA revised the definition of listed companies

8 March 2021

Certain amendments have been made to the Companies Act, 2013 (2013 Act) through the Companies (Amendment) Act, 2020 (2020 Amendment Act). The 2020 Amendment Act received the assent of the President of India on 30 September 2020. Many sections of the 2020 Amendment Act were notified on 21 December 2020, 22 January 2021 and 11 February 2021 by the Ministry of Corporate Affairs (MCA).

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This issue of the First Notes provides an overview of the recently amended rules.



Voices on Reporting

KPMG in India is pleased to present Voices on Reporting (VOR) – a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 8 April 2021, KPMG in India held a VOR webinar to discuss key financial reporting and regulatory matters that are expected to be relevant for stakeholders. The webinar covered key updates for the quarter ended 31 March 2021 and certain important updates relevant for financial year 2021-22.

To access the presentation and recording, please click [here](#).

Feedback/queries can be sent to aaupdate@kpmg.com

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