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Department of Labor (DOL) Issues Final Overtime Rule



In September 2019, the DOL issued the final overtime rule, effective January 1, 2020. The final rule, among other things, updates the earnings thresholds necessary to exempt executive, administrative, and professional employees from the Fair Labor Standards Act's (FLSA) minimum wage and overtime pay requirements, and allows employers to count a portion of certain bonuses (and commissions) towards meeting that salary level.

In order to qualify for the overtime exemption under the FLSA, an employee must be 1) employed in a bonafide executive, administrative, or professional capacity; 2) salaried; 3) paid more than the standard salary level threshold; and 4) satisfy a duties test.

The final rule raises the standard salary level from the current level of \$455 per week to \$684 per week (equivalent to \$35,568 annually) and it increases the annual compensation level for a "highly compensated employee" (HCE) from \$100,000 to \$107,432.

Also, under the new rule, nondiscretionary bonuses and incentive payments (including commissions) may satisfy up to 10%

of the standard salary level test if the bonuses and payments are paid at least annually.

The new rule rescinds a 2016 proposal, which a federal court had previously invalidated. The previous proposal sought to raise the standard threshold to \$913 a week and the HCE salary requirement to \$134,004 a year. In addition, the previous proposal proposed increasing both salary levels every 4 years, while under the new rule, salary levels won't rise automatically.

The DOL estimates that an estimated 1.2 million more salaried employees in "white-collar" positions will become entitled to minimum wage and overtime pay because of the increased standard salary level. Also, an additional 101,800 workers are estimated to be entitled to overtime pay with the increase of the annual HCE threshold.

Practical Consideration:

Refer to the Department of Labor's website at www.dol.gov for further information on the final rules.

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Guidance Issued on Auditor Reporting

Technical Q&A on SAS 134

As discussed in the July 2019 issue of this newsletter, in May 2019 the AICPA issued SAS 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, a suite of auditor reporting standards. SAS 134 makes sweeping changes to the auditor's report and is effective for audits of financial statements for periods ending on or after December 15, 2020, with no early adoption.

In October 2019, the AICPA issued new Technical Question and Answer (Q&A) 8100.04, *Reporting Guidance Upon Initial Implementation of Statement on Auditing Standards No. 134, as Amended*, to provide nonauthoritative guidance on implementing SAS 134. Q&A 8100.04 discusses when a continuing auditor is engaged to perform an audit of comparative financial statements in the first year of implementation of SAS 134.

When a continuing auditor performs an audit of comparative financial statements in the initial year of implementation of SAS 134, he or she may issue one report in accordance with SAS 134 that refers to each period for which financial statements are presented and on which an opinion is expressed (for example, for the years ended December 31, 2020 and 2019). Alternatively, the auditor may issue two separate reports: one in accordance with SAS 134 for the current year (year ended December 31, 2020) and one in accordance with extant AU-C section 700A for the prior year (year ended December 31, 2019).

Auditing Interpretation No. 5 of AU-C 700A

In October 2019, the AICPA issued Auditing Interpretation No. 5 (AU-C 9700A.22–.26), *Communicating Critical Audit Matters When Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB*. The Interpretation was issued to help auditors comply with AU-C 700A in the context of the PCAOB reporting standards when critical audit matters (CAMs) are required. (Note that this auditing interpretation applies before implementation of SAS 134 to the extant auditing standards, AU-C 700A, *Forming an Opinion and Reporting on Financial Statements*.) The interpretation applies when reporting on audits of

nonissuer entities that are not within the jurisdiction of the PCAOB, but the audit is conducted in accordance with the standards of the PCAOB and GAAS. The interpretation notes that the auditor is required to communicate CAMs in accordance with paragraphs .11–.17 of AS 3101 unless it is determined by management that the entity is not subject to CAM reporting.



FASB ASC 606 Financial Statement Presentation Methods

Nonpublic entities are required to implement FASB ASC 606, *Revenue from Contracts with Customers*, effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Accordingly, nonpublic entities with calendar fiscal years that didn't elect early adoption, will soon prepare annual financial statements that include the requirements of the new revenue recognition accounting guidance. [The date of initial application for those entities is January 1, 2019. For a nonpublic entity whose fiscal year ended on June 30, 2019 (for example), and early adoption wasn't chosen, the date of initial application is July 1, 2019.]

Implementing the requirements of FASB ASC 606 includes choosing how the entity will adopt the new guidance: using the full retrospective method or the cumulative effect method (also referred to as the modified retrospective method). Entities significantly impacted by the new revenue recognition guidance will have probably already made the decision as to which of those two methods to use. However, some entities haven't made that decision, either because they don't expect to experience significant accounting changes under FASB ASC 606, or they haven't yet considered the new guidance in detail.

Entities should carefully consider which method of adoption is best to apply, as both have benefits and challenges. Considering the appropriate method includes assessing which method is the most appropriate to the entity and its stakeholders. The retrospective method requires more work to accomplish but it provides comparative financial information for trend and variance analyses for both users and entities that won't be available under the cumulative effect method.

Summary-level information about the two methods of adoption is discussed below.

Full Retrospective Method

Entities that choose full retrospective adoption apply FASB ASC 606 to all periods presented in the financial statements as if the guidance had been applied to all contracts with customers presented in the financial statements since the inception of those contracts. Certain practical expedients, or shortcuts, are permitted for the following customer contract situations: (1) those that begin and end in the same annual reporting period, (2) include variable consideration, and/or (3) were modified before the beginning of the earliest period presented. Additionally, certain required disclosures may be ignored for the periods presented that are before the date of initial application of the accounting guidance.

Cumulative Effect Method

Entities that choose the cumulative effect method apply FASB ASC 606 to new and uncompleted contracts with customers in the period of initial application of the guidance and subsequent periods. Prior periods presented in the financial statements aren't restated. A practical expedient is available for customer contracts that were modified before the beginning of the earliest period presented. The cumulative effect method requires additional disclosures, however, in the year of initial adoption.

Practical Consideration:

The transitional accounting guidance for both the full retrospective method and the cumulative effect method is found at FASB ASC 606-10-65-1.



AICPA Proposals on Materiality and Audit Evidence

In June 2019, the AICPA issued two exposure drafts of proposed SASs. The first, *Amendments to the Description of the Concept of Materiality*, was approved to ballot for final vote by the Auditing Standards Board (ASB) in October 2019. The second, *Audit Evidence*, had comments due in September 2019, which the ASB is now analyzing.

Materiality

In June 2019, the AICPA issued an exposure draft document that would amend the definition of *materiality*

for both auditing and attestation engagements. The amendments are being made to converge the AICPA definition with those used by the FASB and PCAOB. Currently, the AICPA uses the same definition as the International Accounting Standards Board (IASB) in IFRS and the International Auditing and Assurance Standards Board (IAASB) in the ISAs. Meanwhile, the FASB and PCAOB use a definition that is aligned with that of the U.S. judicial system, which dates back to the U.S. Supreme Court opinion in *TSC Industries, Inc. v. Northway, Inc.* in 1976. In the 43 years that followed, the definition used by U.S. and international standard setters and regulators has evolved numerous times. The FASB only recently amended their definition in to match the judicial meaning in August 2018 with the amendments to FASB Concept Statement No. 8.

The differences in the *materiality* definitions are subtle and aren't expected to significantly change practice, but practitioners need to be aware of the differences. The IASB and IAASB definition used in AICPA extant guidance states that misstatements are considered *material* if they *could reasonably be expected* to influence the financial statement user's decisions. On the other hand, the U.S. judicial system, FASB, and PCAOB definition being adopted in the new audit and attest guidance states that a misstatement is *material* if there is a *substantial likelihood* that the misstatement or omission *would* influence the financial statement user's judgement.

The upcoming SAS amends the following AU-C sections:

- AU-C 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards.*
- AU-C 320, *Materiality in Planning and Performing an Audit.*
- AU-C 450, *Evaluation of Misstatements Identified During the Audit.*
- AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors.)*
- AU-C 700, *Forming an Opinion and Reporting on Financial Statements.*
- AU-C 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA.*

An accompanying SSAE amends AT-C 205, *Examination Engagements*, and AT-C 210, *Review Engagements*.

The effective date of the SAS, as proposed, is for audits of financial statements for periods ending on or after December 15, 2020, with early application permitted. The SSAE would be effective for practitioners' reports dated on or after December 15, 2020.

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Audit Evidence

In June 2019, the AICPA also issued an exposure draft of a proposed SAS to amend AU-C 500, *Audit Evidence*. The objective of the amendments is to expand the guidance in AU-C 500 to address evidence obtained via new methods, such as automated tools and techniques such as audit data analytics (ADA) and artificial intelligence (AI). The proposed amendments draw on information gathered in a project spearheaded by the IAASB, on which the AICPA has representatives, that began in 2016. The IAASB solicited feedback on the use of technology in financial statement audits, focusing on audit data analytics. After compiling and summarizing the comments received, the IAASB determined that the focus of the related standard-setting activity should be around audit evidence and using professional skepticism. The AICPA has also been working independently on initiatives around technology in the audit, such as the nonauthoritative *Guide to Audit Data Analytics*, published in 2017.

The proposed standard would replace and supersede AU-C 500, *Audit Evidence*, and amend the following:

- AU-C 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*.
- AU-C 230, *Audit Documentation*.
- AU-C 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.
- AU-C 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.
- AU-C 505, *External Confirmations*.
- AU-C 530, *Audit Sampling*.
- AU-C 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

The exposure draft also proposes relocating content dealing with management's specialists from AU-C 500 to AU-C 501, *Audit Evidence—Specific Considerations for Selected Items*, or to a new standard. However, there would be no significant changes to the guidance itself at this time. (The ASB does note in the introductory material that they are considering requirements in PCAOB Release 2018-006, *Amendments to Auditing Standards for Auditor's Use of the Work of Specialists*, as a separate project.)

The revised evidence standard wouldn't alter the fundamental requirements around sufficient appropriate audit evidence, but it would shift the way the quality of evidence is evaluated. Historically, when evaluating evidence auditors have focused on the nature of the procedures performed to obtain it. Under the proposed guidance, the focus would shift from the procedures used to attributes of the evidence itself, regardless of how it is obtained. The auditor would be required to consider the source (internal or external information sources), relevance, and reliability of information used as audit evidence, as well as whether the information corroborates or contradicts the assertions made in the financial statements. When assessing relevance and reliability, the auditor considers accuracy, completeness, authenticity, and risk of bias. The exercise of professional skepticism throughout the evaluation process is a key point emphasized in the proposed guidance.

As proposed, the revised SAS and related amendments would be effective for audits of financial statements for periods beginning on or after June 15, 2021. It is unlikely, however, that the ASB would vote on this before May 2020, so the actual effective date will likely be deferred.

