

THE PPC ACCOUNTING AND AUDITING UPDATE

JANUARY 2020, VOLUME 29, NO. 1

Payroll and Nonemployee Compensation Changes for 2020



New 2020 Form W-4 Issued

On December 5, 2019, the IRS issued a redesigned 2020 Form W-4 (Employee's Withholding Certificate). The new form no longer uses withholding allowances. Instead, there is a five-step process and a new Publication 15-T (Federal Income Tax Withholding Methods) for determining employee withholding.

The form was redesigned to conform with changes made by the Tax Cuts and Jobs Act (TCJA). Because personal exemptions are suspended for tax years 2018–2025, the revised Form W-4 bases the amount of income tax withholding on an employee's projected taxable income instead of the number of withholding allowances claimed by an employee.

The IRS is not requiring all employees to complete a 2020 Form W-4. The IRS designed the federal withholding tables so that they will work with both the 2020 Form W-4 and prior-year versions of the form. However, the following employees must use the 2020 Form W-4: (1) those hired in 2020 and (2) any employee who makes withholding changes in 2020.

An employer can request that each employee hired before 2020 submit a new Form W-4 but can't require employees to do so. However, the employer should convey to employees that completing a new Form W-4 may ensure that their income tax withholding is more accurate based on the current tax rates and standard deductions. Withholding for employees who do not complete a 2020 Form W-4 will continue to be based on the number of withholding allowances claimed on their most recently completed Form W-4.

Changes in 2020 for Reporting Nonemployee Compensation

The IRS released the "Info Copy Only" 2020 versions of Form 1099-MISC (Miscellaneous Income) and a new Form 1099-NEC (Nonemployee Compensation). Currently, Form 1099-MISC is filed to report payments totaling at least \$600 for services performed in a trade or business by someone who is not treated as an employee [box 7 (Nonemployee

In this Issue:

- Payroll and Nonemployee Compensation Changes for 2020
- ASU Effective Date Deferrals
- Audit Confirmations



compensation)]. Due to separate deadlines for Form 1099-MISC that report NEC in box 7 and all other Form 1099-MISC, the IRS has released Form 1099-NEC beginning in 2020 to end confusion and complications for taxpayers.

Box 1 of the new 2020 Form 1099-NEC is used to report nonemployee compensation and nonqualified deferred compensation (NQDC). NQDC amounts reported in box 1 are included in the recipient's gross income for failing to meet Code Sec. 409A requirements. Boxes 2 and 3 are reserved. Box 4 is used to report backup withholding when a payer fails to provide a taxpayer identification number (TIN). Boxes 5 through 7 are used to report state income withholding. Form 1099-NEC for the 2020 tax year must be furnished to recipients and filed with the IRS by February 1, 2021.

With the reporting of nonemployee compensation moving to Form 1099-NEC, box numbers for the 2020 Form 1099-MISC have changed. Box 12 is used to report Code Sec. 409A deferrals (previously, box 15a of the 2019 form) and box 14 is used to report nonqualified deferred compensation (previously, box 15b and entitled "Section 409A income"). The 2020 Form 1099-MISC must be furnished to recipients by February 1, 2021, but may be extended to February 16, 2021, if reporting payments in box 8 or 10. Form 1099-MISC must be filed with the IRS by March 1, 2021, if filing by paper, or by March 31, 2021, if filed electronically.

ASU Effective Date Deferrals

In November 2019, the FASB issued ASU 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*, to defer the effective date of a few major ASUs as follows:

- **ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments***. For public business entities that do not meet the definition of an SRC, the effective date remains fiscal years beginning after December 15, 2019, including interim periods within those years. For all other entities, the effective date is deferred to fiscal years beginning after December 15, 2022, including interim periods within those years.
- **ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities***. For public business entities, the effective date remains as fiscal years beginning after December 15, 2018, including interim periods within those years.

For all other entities, the effective date is deferred to fiscal years beginning after December 15, 2020, and interim periods within years beginning after December 15, 2021.

- **ASU 2016-02, *Leases (Topic 842)***. For public business entities and certain nonprofit organizations and employee benefit plans, the effective date remains as fiscal years beginning after December 15, 2018, including interim periods within those years. For all other entities, the effective date is deferred to fiscal years beginning after December 15, 2020, and interim periods within years beginning after December 15, 2021.

Audit Confirmations

AU-C 505.6 defines an external confirmation as a direct response to the auditor from a third party either in paper form or by electronic other means, such as through the auditor's direct access to information held by a third party.

Type of Confirmations

The types of confirmations used vary depending on the entity's situation and the nature of its operations. The following are the forms of confirmations generally used:

- *Positive*. This type requests recipients to reply directly to the auditor and make a positive statement about whether they agree or disagree with the information included.
- *Negative*. This type requests recipients to reply directly to the auditor only if they disagree with the information presented on the confirmation.
- *Blank*. This type doesn't state the amount (or other information) on the request, but instead requests recipients to complete the confirmation form.

Electronic Confirmations

Auditors often use electronic confirmations rather than a mailed, written communication. Electronic confirmations may be in the form of an email submitted directly to the respondent by the auditor or a request submitted through a designated third-party provider like **www.confirmation.com** (Confirmation). Confirmation is a secure, online platform auditors use to submit confirmation requests for cash, accounts receivable, accounts payable, employee benefit plans, and legal confirmations.

Some financial institutions no longer respond to paper confirmation requests. Instead, they respond only to electronic confirmation requests submitted via Confirmation. Validated financial institutions,

considered “in-network,” will respond to requests directly through the platform by confirming the requested information, requesting more information from the auditor, or denying the request. Confirmation has over 4,000 financial institutions in-network and provides electronic and paper-based confirmation services for out-of-network responding parties.

Electronic confirmations can be considered reliable audit evidence. With traditional confirmations, AU-C 505.A13 indicates auditors need to consider the following risks to the reliability of such information:

- Response might not be from an authentic source.
- Responder may not be knowledgeable about the information.
- Integrity of the transmission might be compromised.

With Confirmation, auditors know that from in-network responders:

- Response is from an authentic source.
- Responder has been validated and will be certified and knowledgeable about the information.
- Fraud won't occur during the confirmation process, as Confirmation is ISO 27001 certified.

Confirmation's online platform can be considered a sufficient, valid confirmation response if the auditor is satisfied that the electronic confirmation process is secure and properly controlled. In determining whether Confirmation's platform is secure, the auditor might review the ISO 27001 certificate, TRUSTe certificate, or the SOC examinations all found by visiting Confirmation's Help Center at www.confirmation.com or contacting the Support Team at 1-866-325-7201.

Timing of Confirmation Procedures

Confirmation procedures may be performed as of a date on, before, or after the balance sheet date. If the procedures aren't performed as of the balance sheet date, the account balance should ordinarily be rolled forward or backward to the balance sheet date. Since effective internal control is one consideration in deciding whether to perform confirmation procedures at a date other than the balance sheet date, it may be most effective to perform confirmation procedures as of the balance sheet date.

Selecting the Accounts to be Confirmed

It is important to divide the population, if possible, to identify individually significant items. That approach produces an efficient audit, since sampling is unnecessary if groups tested 100% are sufficient to satisfy the objectives. Even when sampling is necessary,

testing individually significant items 100% is efficient and effective because sample size is reduced. When there are risks of material misstatement due to fraud, the auditor ought to incorporate an element of unpredictability by selecting some items smaller than the threshold for individually significant items. This is particularly important when the auditor has routinely used the audit approach of selecting only all items above a certain amount in prior years.

Management Refuses to Allow External Confirmations

According to AU-C 505.08, if the client objects to the auditor's external confirmation procedures, the auditor should inquire about the reason for the refusal, obtain corroborating evidence to support the client's reasoning, and evaluate the implications on the risk assessment, including fraud risk and planned audit procedures. If the reason is considered valid, alternative procedures should be applied to obtain sufficient appropriate audit evidence. The auditor might also consider obtaining a representation in the management representation letter regarding the reasons for not confirming. Auditors ought to be alert to the fact that a client's request that an account not be confirmed because it is in dispute may be intended to divert the auditor from an inappropriate transaction. If the client's reason isn't considered valid, or sufficient evidence can't be obtained from alternative procedures, the auditor should communicate with those charged with governance and consider the possible effect on the audit, such as the ability to rely on management's representations. If the restrictions significantly limit the scope of the audit, it may be necessary to modify the auditor's report or withdraw from the engagement.

Alternative Procedures

When using positive confirmations, the auditor ordinarily sends second requests and occasionally sends third requests to nonrespondents or contacts nonresponding recipients by phone or in person. If there is still no response, the auditor should perform alternative procedures.

Evaluating Confirmation Results

AU-C 505.16 indicates that the auditor should assess whether enough evidence about the assertions being tested has been obtained through confirmations and performing alternative procedures. If the level of evidence isn't adequate, the auditor should send additional confirmations, perform additional procedures, or both.

The PPC Accounting and Auditing Update is published monthly by Thomson Reuters/Tax & Accounting, P.O. Box 115008, Carrollton, Texas 75011-5008, (800) 431-9025. © 2020 Thomson Reuters/Tax & Accounting. Thomson Reuters, Checkpoint, PPC, and the Kinesis logo are trademarks of Thomson Reuters and its affiliated companies.

Reproduction is prohibited without written permission of the publisher. Not assignable without consent.



THOMSON REUTERS™

Tax & Accounting - Checkpoint
P.O. Box 115008
Carrollton, Texas 75011-5008
UNITED STATES OF AMERICA

ADDRESS SERVICE REQUESTED

PRSR STD
U.S. POSTAGE
PAID
Thomson

This publication is designed to provide accurate information regarding the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, investment, or other professional advice. If such assistance is required, the services of a competent professional should be sought. Reports on products or services are intended to be informative and educational; no advertising or promotional fees are accepted.

An important consideration in evaluating confirmation results relates to the reliability of the responses.

Factors to consider when evaluating reliability include—

- Whether the confirmation was received indirectly rather than directly from the confirming party.
- Whether the confirmation didn't appear to come from the intended recipient.
- Whether the confirmation contains restrictive language.
- Whether only an oral response or no response was received when the auditor determined that a written response was necessary to address risk.

Nontraditional Confirmations

Respondents sometimes use nontraditional means such as fax machines or email to answer confirmation requests. In those cases, AU-C 505.A14 states that additional evidence may be required to verify that the responses are valid. Auditors who receive nontraditional responses may consider the following additional steps:

- Verifying the source and content of the response over the telephone and documenting in the workpapers that this was done.
- Requesting that the respondent mail the original confirmation directly to the auditor.

As with confirmations received by mail, the auditor should receive the response directly. If the response is received by the client, the auditor should perform procedures to verify its authenticity. This is most easily done by confirming its contents with the respondent by telephone and requesting that the original be sent to the auditor directly by mail.

Use Client Personnel to Clear Confirmation Exceptions

AU-C 505.14 indicates that the auditor should investigate exceptions to confirmation requests to determine if they represent misstatements. As long as an auditor maintains control over selection, mailing, and receipt of confirmations as required by AU-C 505.07, he or she can use client personnel to help in clearing confirmation exceptions. Generally, the auditor will make a copy of a confirmation that has been returned with an exception, or a copy of the original confirmation request in cases of nonresponding confirmations, and request that the client provide the original documents that support the transaction. The auditor will examine the original documents to determine if the account is misstated.

Restrictions in Confirmation Responses

When restrictive language causes the auditor to have doubts about the reliability of a confirmation response, the auditor is required by AU-C 505.10 to obtain further audit evidence to resolve these doubts.

AU-C 505.A21 indicates that this may include meeting with the respondent to clarify the reasons for the response or obtaining legal advice. In accordance with AU-C 505.11, when the auditor can't resolve doubts about the reliability of the response, the auditor is required to evaluate the implications on the relevant risks of material misstatement, including fraud risk, and the effect on the nature, timing, and extent of other audit procedures.