

OVERTIME
PAY

OVERTIME PAY FOR CPA FIRM AUDIT STAFF

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The Department of Labor, through the U.S. Federal Labor Standards Act (FLSA), regulates who should earn overtime pay and classifies different occupations as “exempt” or “non-exempt” from receiving overtime pay (Postol, 2004). The FLSA further categorizes employees exempt from earning overtime as administrative, executive or professional.

The accounting occupation has long fallen under the professional overtime exempt classification (Postol, 2004). However, some lower-level CPA firm audit employees have contested the exemption and argued for the right to receive overtime pay when working over 40 hours per week (Hanson & Mautz, 2017).

In this article, we discuss various viewpoints regarding lower-level audit staff receiving overtime pay, a matter affecting both these employees and the firms that hire them.

Criteria for the Exempt-Professional Classification

The FLSA uses three guidelines to resolve employees’ overtime pay issues: the Salary-Level, Salary-Basis and Standard-Duties tests (Postol, 2004). Those meeting all three of these tests are considered exempt from receiving overtime pay.

First, the Salary-Level test determines if an employee is paid below a specific level and thus eligible for overtime pay. Effective January 1, 2020, the “standard salary level” is \$684 per week or \$35,568 per year (U.S. Department of Labor, 2019). The Salary-Level test usually does not support exempting low-level staff from overtime.

Next, the Salary-Basis test examines if production or hours worked affects a fixed level of pay (Pollack, 2000). Also, a manager should be unable to dock an employee’s pay for lateness, which would change the classification to non-exempt and allow overtime pay (Pollack, 2000).

If the Salary-Basis test determines an employee is paid at equal intervals and rate, with no bearing on performance, that employee classifies as exempt from overtime pay (Postol, 2004). This test’s rigid guidelines generally do not impact lower-level professional accountants.

Third, the Standard-Duties test, and defining a “professional” employee, form the key overtime pay criteria for professional employees (Hanson & Mautz, 2017). As noted above, the FLSA identifies the type of employees exempt from overtime and auditors fall under the learned professional classification (Meade, 2009).

Per Postol (2004), a professional’s primary duty “consists of work requiring knowledge of an advanced type in a field of science or learning, customarily acquired by a prolonged course of specialized intellectual instruction.” Employees whose primary duties meet this FLSA standard become exempt from overtime (Pollack, 2000).

The Campbell v. PricewaterhouseCoopers Case (2011)

A group of current and former junior-level PwC staff members brought a class action case claiming that California law [particularly California Labor Code section 515(a)] entitled them to overtime compensation. They filed this case in federal court under the “Class Action Fairness Act” [28 U.S.C. § 1332(d)].

The case provides a comprehensive airing of the overtime pay issues for junior-level staff in CPA firms. As is true for many other states, the California overtime regulations parallel federal rules on overtime pay.

The opinions of the U.S. District Court for the Eastern District of California [602 F.Supp.2d 1163 (2009)] and the U.S. Court of Appeals Ninth Circuit [642 F.3d 820 (2011)] thoroughly discuss both sides' arguments regarding both the professional and administrative exemptions from overtime pay. Eventually, PwC settled this case for \$5 million, thus creating no legal precedents.

Arguments Favoring Overtime Pay for Auditing Staff

Many entry-level auditors maintain that their work requires no specialized education and their employers provide all the education needed to perform the work (*Pippins v. KPMG*, 2014). They also claim that their duties require no higher-level thinking, a role instead given to a senior-level staff (Hanson & Mautz, 2017). They also contend that their tasks require little or no expertise (*Campbell v. PricewaterhouseCoopers*, 2011). Further, audit staff can claim that under the Standard-Duties test, they perform routine mechanical and menial tasks that involve little discretion or independent judgment (Hanson & Mautz, 2017).

Pro-overtime advocates stress that audit staff requirements often do not coincide with the Standard-Duties test. Lower-level staff auditors need not be CPAs nor have taken any specialized accounting courses. The *Campbell v. PricewaterhouseCoopers, LLP* plaintiffs never obtained their CPA licenses, but still performed auditing staff duties. The plaintiffs argued their jobs did not require completion of specialized courses, violating the "knowledge of an advanced type" criterion (*Campbell v. PricewaterhouseCoopers*, 2011).

Audit interns add further controversy into the overtime pay argument, with hours and tasks similar to the entry-level auditing staff, but interns normally get overtime pay when they cross the 40-hour threshold. Auditing staff contend that if interns get paid overtime for similar work, they too should receive overtime pay. However, the "prolonged course of specialized intellectual instruction" requirement of professionally exempt employees is not fulfilled by the interns, thus making their job non-exempt (Hanson & Mautz, 2017).

Arguments Against Overtime Pay for Audit Staff

Others believe that low-level audit employees should receive no overtime pay, often relying on AICPA rules to bolster their case. AU-C Section 200.14, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*,

explains professional skepticism and judgement. AU-C Section 200 describes professional judgement as "the application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards" (AICPA, AU-C 200.14).

Audit firms explain that entry-level auditors are required to exercise professional judgment on all audits and some of them help "manage the day-to-day activities of the engagement" (*Campbell v. PricewaterhouseCoopers*, 2011). Furthermore, firms contend that audit associates rely on auditing, accounting and ethical skills, thus satisfying the "knowledge of advanced type" requirement of the Standard-Duties test.

Firms cite AU-C Section 200.14 to explain professional skepticism as "an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence."

Firms insist that a "questioning mind and being alert" fit the narrative of discretion (Hanson & Mautz, 2017). Also, the "critical assessment of audit evidence" concept implies that no audit staff work is strictly routine, addressing a key overtime issue (Hanson & Mautz, 2017).

Accounting firms claim that AICPA-mandated professional skepticism and judgement standards satisfy the Standard-Duties test. The firms add that new auditors must use professional judgment to supervise their interns, thus making the new auditors' jobs much more than clerical in nature.

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The Pippins v. KPMG, LLP Case (2014)

The *Pippins v. KPMG* (2004) case examines the auditor overtime controversy. Pippins and other former KPMG junior-level audit associates sued KPMG for requiring them to work over 40 hours per week with no overtime pay. The plaintiffs maintained that they needed no high level of knowledge, since KPMG provides all required training; e.g., to meet state laws.

KPMG countered that the plaintiffs work in a learned profession in a field of science or learning and were

exempt from overtime pay. The District Court ruled for KPMG, reinforcing the precedent of audit staff exemption from overtime pay.

The Conclusion: Audit Staff Should Not Receive Overtime Pay

Low-level auditing staff should be classified as professionally exempt from overtime pay, as they face the same AICPA and PCAOB professional standards, regardless of their level of education or type of performed work (*Campbell v. PricewaterhouseCoopers*, 2011). Despite the routine nature of tasks performed, auditors should always exercise professional skepticism and judgement (AICPA, AU-C 200.14), thus ensuring that the work audit staff members perform is not routine and requires higher levels of education.

Audit staff members must apply ever more complex accounting standards as their careers progress (Hanson & Mautz, 2017), demonstrating such work is not ordinary and requires higher learning. Moreover, all employees obtain

In its ruling, the District Court reinforced the precedent of audit staff exemption from overtime pay.

on-the-job training to enhance their knowledge and add value to their audit clients. Lower-level staff will eventually move to a senior audit staff role and thus increasingly apply their advanced audit knowledge. New jobs take time to learn and newer staff members continually progress from menial tasks to more complex ones, contradicting the pro-overtime argument.

Classifying low-level auditors as "non-exempt" from overtime pay could disrupt the accounting market, where audit firms often bid against one another for fixed-price contracts (Hanson & Mautz, 2017). This bidding competition considers the time the staff needs to take to complete the audit. However, changing overtime pay could increase audit fees, costs that clients' shareholders and customers must bear. Instead of overtime, the FLSA allows firms to give salaried employees monetary or fringe benefit bonuses for working extra hours (Postol, 2004).

The Department of Labor calls accountants professionally exempt in the FLSA. CPA firms bill lower-level audit staff members at hourly rates commensurate with professional activities and present these employees internally, to clients, and to other outside parties as "professional staff" members.

Because robotic process automation (Vaserhelyi and Rozario, 2018), machine learning and other technology applications are quickly replacing many menial tasks that lower-level audit staff traditionally perform, these employees will increasingly perform tasks requiring more critical thinking. All these factors suggest that CPA firms can generally avoid paying overtime to their lower-level audit staff.

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