

**ECONOMIC, LEGAL AND OTHER CONSIDERATIONS OF CPA FIRMS PAYING
OVERTIME TO ITS STAFF AND ADVISING ITS CLIENTS ON THIS MATTER**

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Setting the Stage

Current unprecedented turbulence in the employment environment causes us to evaluate whether CPA firms should pay their staff accountants overtime pay—and advising its clients on this matter. Current trends such as remote working, increased job hopping, and the millennials often viewing work as a less central life interest could alter many key employment expectations. We often see employees ready to jump ship for better work conditions, increased compensation, or improved job security. Technology has spurred the “gig economy” based on flexible, short-term, or freelance work rather than permanent jobs, thereby fostering job impermanence as the drum beat for work-life balance grows louder. The pandemic and the government’s massive economic response led many workers to quit their jobs, though some were lured back by promises of a better work-life balance and potentially elevated wages. Many employers must also chose between paying their own employees overtime pay or hiring gig and other contract workers. All of these sources of turbulence factor into our attention into overtime compensation.

The federal government is a silent partner in many employment relationships since Congress passed the 1938 Fair Labor Standards Act (FLSA). The amended Act establishes the boundaries of acceptable terms of employment. While employment and the work environment have changed greatly since the Act’s passage, employers and employees should understand its parameters—including an employer’s obligation to pay an overtime premium for work that exceeds 40 hours per week. While FLSA overtime rules tend to exclude professional employees, this classification may not affect certain accounting interns and many CPA firm clients.

The Department of Labor Fact Sheet 17A (<https://www.dol.gov/agencies/whd/fact-sheets/17a-overtime>) defines professional employees as those who routinely perform “work

requiring advanced knowledge, defined as work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgement.” This distinction from nonexempt employees is often difficult, especially given our emerging service economy and the professionalization of many occupations. Both CPA and many of their clients’ staff are unlikely to be so highly paid relative to the general work force, especially considering their hours worked, to make overtime premiums unnecessary. Managers should also be so closely identified with owners that they would be paid an annual salary (rather than hourly wages), obviating the need to closely monitor the hours they worked.

As the economy and technologies changed since passage of the FLSA, many relatively low paid workers began performing what were predominately managerial duties. In more recent times, software has made it easier to evaluate the data that led to management decisions. Also, the very conception of defining a worker relative to whom they worked for has changed, as work has become flexible, short-term, or even freelance.

Some Legal Considerations

The U.S. Department of Health and Human Services denotes many factors to discern employees from independent contractors including the extent of company control over the employee’s duties, how the employee does the job, how the employee is paid, who provides the facilities to work, if the relationship will continue after some tasks are completed, and if such benefits such as insurance plans and vacation pay exist. The FLSA requires non-exempt employees who earn over \$41, 401 to receive overtime pay. Individual states can increase this threshold; e.g., it is \$65,478 for California employers with over 26 employees. Employers can no longer benefit from simultaneously paying low wages and denying overtime premiums for work beyond the basic work week. But this new threshold limit does not resolve the issue because

even higher wage earners might not be exempt if they do not actually perform managerial-type work. For these purposes, we examine some recent judicial precedents for guidance.

The Legal Basics

Some cases capture the overtime pay context, but substantial uncertainty remains. In *Pippins v. KPMG* (759 F. 3d 235, 2014), a Second Circuit of the Federal Court of Appeals case strongly endorsed exempt status for all staff accountants. It found accountants were in a field of advanced science and learning, deployed knowledge customarily acquired by a prolonged course of specialized education and exercised independent professional discretion and judgment, and thus were properly classified as exempt under the FLSA. This holding opposes a prior Ninth Circuit case that interpreted the California statute that was crafted with similarities to the FLSA's provisions on exempt employees. In *Campbell v. PricewaterhouseCoopers* (642 F. 3d 820, 2011), the court did not extend a blanket overtime exclusion for staff accountants. This holding made a jury trial necessary to deliberate issues of fact; this led to the firm's expensive settlement. While a future U.S. Supreme Court ruling would resolve the disagreement among the Circuits, waiting for such a ruling is not a proactive CPA firm strategy. In the interim we should examine accounting professionals' overtime practices to develop successful compensation approaches.

What is Different about Accounting Practice?

Applying legal precedent to specific situations requires considering public accounting firm's environment. The accounting profession prides itself as the equal of such classic professions as medicine and law, with common attributes of a licensing exam, a code of ethics, specialized training in a demanding body of knowledge, and strong disciplinary sanctions. But the FLSA does not specifically exclude professional groups. Firms could assert that their staff are akin to owners in training, and thus not really employees—but this could stretch credibility.

A major cause of the overtime issue is that public accounting firms' work tends to be seasonal. Many audit clients are calendar year-end entities with regulatory filing dates that compress audit work. Tax work is based on filing deadlines with little flexibility for those performing such compliance work. Public accounting's culture must meet client demands during "busy season" that usually requires both hourly and staff accountants to work over 40 hours per week. Providing compensating time off during other parts of the year might satisfy some employees, but it does not conform to the FLSA language of measuring each work week separately from other weeks. Those most likely to complain about unpaid overtime are ex-accounting firm employees who may no longer be able to accept compensation time for some of the overtime worked. Instead, they will not be willing to accept anything but money from their former firm. Thus, the overtime issue has large consequences for public accounting whose massive number of December 31 year-end auditing and tax work impairs greatly its ability to balance the work load for its employees across the year.

Public accounting's licensing exam adds another dimension to its unique workplace. The court cases are sensitive to the license status of those claiming overtime compensation. *Ceteris paribus*, passing the CPA exam and consequent licensing adds credibility that the employee is indeed a professional, and perhaps a manager. Others appear to be more provisional employees who can do less important work and operate autonomously, rendering them as employees to be managed. Firms with many non-CPA accountants could minimize the work differences between certified and non-certified accountants. Firm insisting upon rapid certification should instead significantly elevate the responsibilities and autonomy of their newly certified accountants.

Class Action, Arbitration, and Other Legal Remedies

Employers' financial stakes related to overtime liability are higher than some might imagine. Overtime pay for one individual is likely trivial, especially over a limited number of pay periods. However, overtime pay for possibly thousands of employees over decades of time can accumulate into significant court ordered "back pay" awards. Overtime class action suits are not uncommon. Some states have also created penalties for the misclassification of employees as exempt. Management of accounting firms, both large and small, should recognize this matter.

A more radical response to the overtime issue is to classify workers as non-employees, making the FLSA moot as it exempts independent contractors. This position changes only the nature of the legal question. Much case law has examined the employee vs. independent contractor classification, deriving inconsistent court decisions for accounting firm workers. In essence, great difficulty exists in simultaneously legally distancing oneself from a worker, while still possessing sufficient control over their efforts. Generally, case law finds that an employer controlling the manner to perform the work gives that worker an employee status. But, if close supervision is unneeded to achieve the quality desired, the employer could outsource it, creating independent contractors. The negotiated compensation can occur without concern over how long its production took, making many overtime claims moot. While this strategy has been successful for many other industries, it is a poor fit to the highly specialized public accounting arena.

If future litigation trends follow the Ninth Circuit precedent, juries might sympathize and thereby support employees' claims for overtime compensation. But to counter this exposure, employers could require new employees to consent to arbitration as a condition of initial employment. Despite some state-to-state variation, the courts have generally upheld employers asking employees to negotiate away their access to the courts. Having arbitrators—who are

constrained by the letter of the law—hear overtime claims is a partial employer victory, especially if judicial interpretations of the FLSA become less favorable.

The split noted in the legal precedents on the overtime issue could persist unless and until the Supreme Court settles this matter. While states like California often seem to resolve the doubt in the employee’s favor, in November 2020, California voters decisively approved Proposition 22, which kept Uber and Lyft drivers, plus other gig economy company employees, as independent contractors rather than as employees. In 2021 California’s Alameda Superior Court ruled this ballot initiative as unconstitutional. This state of flux recommends that CPA firms should keep track of current trends in state overtime rules.

Arbitration

Per Eisenberg, Miller, and Sherwin,¹ federal and state courts typically enforce arbitration clauses—another legal remedy—in standard-form consumer agreements unless they contain provisions that violate state contract law. However, some recent rulings, particularly in California, view class action waivers in consumer arbitration agreements as unconscionable and contradictory to generally applicable state law—at least when the consumers’ claims were too small to support individual actions. Thus, we are unsure why consumer arbitration would appeal to companies. Particularly when the company has agreed to subsidize a portion of the consumers’ costs, fair arbitration provides little clear advantage for companies. Ernst & Young has successfully argued in two cases that an arbitration clause in its employment agreement precludes employees from bringing a class action lawsuit against the firm.

Comparison of Overtime Payment vs. Exempt Status

¹ 2007, Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts. *University of Michigan Journal of Law Reform*, 41, 871-896

Based upon our experiences in this area, we summarize below the different evidence supporting payment of overtime vs. exempt status:

Basic Summary	
Junior accountants do nothing more complex than do bookkeepers and accounting clerks, and they are entitled to overtime	Junior accountants employ advanced knowledge of accounting that they acquire by a prolonged course of study

Evidence Supporting Payment of Overtime	Evidence Supporting Exempt Status
Employees' Background	
Not licensed CPAs	Upon passing all components of the CPA exam they will become licensed CPAs
Least amount of experience of all employees, including paraprofessionals	College graduates that monitor others and direct the work of clerks, secretaries, etc.
Report to non-licensed, non-supervisor staff who have little authority over others	Report to professionals who monitor other professionals' work
Perform repetitive often mind-numbing work, requiring little education	Perform sophisticated work, requiring much education and thorough training
Have few opportunities for promotion	Have many opportunities for advancement
In states requiring 150 hours of education to sit for the CPA exam, a bachelor's degree could deny obtaining non-exempt status	Complete all educational requirements to take the CPA exam
Employees' Normal Duties	
Perform predominately routinized and menial work (e.g., "comparing one number to another number to see if they agree")	Perform work that is "integral" to a firm's "attest" services
Sit at a computer, doing primarily "highly routinized and nondiscretionary steps"	Exercise much discretion and independent judgment
Follow strict instructions, and exercise little or no discretionary judgment	Help assure that financial statements adhere to Generally Accepted Accounting Principles
Use comprehensive computer auditing software to merely input data	Client CFO and top management review the developed output and other schedules
Extensive work-review systems make analytical thinking non-existent	Provide professional advice to clients, e.g., client's accounting practice deficiencies
Report to many levels of review that often detect employee errors	Few reporting levels, so errors cause "significant consequences," e.g., missing a \$500,000 unrecorded liability
Apply routine auditing procedures that require little training	Apply audit software that requires extensive training and much documentation
Use high-level "name only" job titles, but are little more than puffery	Use detailed, "actual" accounting firm manuals explaining job roles and procedures
Report most results to their managers, they exercise little or no independent judgment	Work with management to coordinate day-to-day engagement activities
Do not advise clients, which is the	Play a significant role to alert engagement

engagement partner’s responsibility under Auditing Standard 10 of the PCAOB	partners of problems with clients’ practices and procedures
Their work is well- known and mostly clerical and supervised	They often work on higher-level engagements soon after joining their firms
Federal regulations provide that “accounting clerks, bookkeepers and other employees who normally perform a great deal of routine work generally will not qualify as exempt professionals” and most junior accountants do the latter	Federal regulations provide that if the work is “predominantly intellectual” in character and “require[s] the consistent exercise of discretion and judgment, as distinguished from performance of routine mental, manual, mechanical or physical work,” the employee is not entitled to overtime
Have no authority to waive or deviate from established policies and procedures without prior approval	“Learned professionals [like accountants] need not exercise management authority to operate as professionals; what matters is whether they exercise intellectual judgment within the domain of their particular expertise”
Spend most of their time on nonjudgmental or clerical work	Spending some time performing “nonjudgmental” or “clerical and administrative” tasks does not in itself defeat their classification as learned professionals
Lack discretion to deviate from standardized procedure	If the employee retains discretion to decide when to depart from standard operating procedures, they may be exempt

Some caveats exist in making this determination for both sides. Regarding supporting overtime payment, occasionally exercising professional judgment does not constitute a primary duty, nor does merely noting and reporting irregularities or errors in the process of tabulation suffice to exempt someone from overtime. Rather than exercise any discretion, they “simply perform the audit steps that are assigned to them.” For the caveats supporting the exempt status, tasks can be broken down into component parts and they receive step-by-step instructions to perform their functions effectively; this does not imply that they performed their tasks with adequate professional skepticism and training. Their “primary duty” must deploy such skepticism to ensure the integrity of the financial accounting process, and their individual tasks typically involve exercising professional skepticism.

The more of these “facts” than can be assembled and proven in a court of law by an

employer or by an employee (or group of employees in a collective action), the more likely that a jury will decide in the 9th Circuit (at least under California law) or that a judge will determine in the 2nd Circuit whether unlicensed accountants are entitled to overtime.

Are Staff Accountants Managers Per FSLA Guidelines?

Regarding how the FSLA managerial exemption impacts those that ply a professionalized trade—like accountants—the closer the practitioner’s work behavior resembles that of a classic professional, the more likely one will be classified as exempt. A professional becomes exempt by doing work that a lesser trained person does not routinely do. Technology in modern accounting firms has blurred the duties of degreed and non-degreed accounting employees.

Legal precedents focus on the frequency and nature of personal and on-line staff interactions with the client. This outcome is made somewhat problematic when most audit team contacts with client executives are reserved for the engagement partner or senior manager. Accounting firms should clarify how they define the client and should do so in liberal terms. This issue demands keeping good records of the staff-client involvement on an engagement.

The courts seem to have some difficulty envisioning how to define an audit—which involves both routine and judgmental work. The balance matters since the staff work could be characterized as clerical if it predominantly applies rigid protocols, making it distinctly non-exempt for overtime purposes. While audit work and tax services still require many judgement decisions, software programs are making the entry-level work much more clerical for staff accountants, even if there is less total routine work for humans to do.

How Can You Best Position Your Firm?

Firms giving staff substantial unsupervised self-determination of their tasks can avoid some overtime liability, but risk malpractice actions. The courts often focus on the presence of

intellectual work rather than tasks of a more mechanical nature. The essence of a professional, and apparently an exempt employee, is the exercise of discretion and informed judgement.

A firm whose work programs and tax compliance procedures contain highly rigid checklists of steps that leave the staff accountant little leeway to complete the engagement could pose a problem if the courts conclude that the work is excessively mechanical. Allowing staff to alter parts of risk-based the work program tend to support FLSA classification guidelines, but again risk malpractice suits if the audit or tax services are deemed insufficient or ineffective.

To help buttress their exempt classification during busy season, firms' junior staff could replace some work that interns normally do, giving them supervisory opportunities without using overtime-paid interns. But such practices could impact the CPA firms recruiting efforts. Also, a telling moment occurs when the staff accountant discovers an error or irregularity during an audit. Professional standards require that the accountant communicates such judgment findings to a superior, which strengthens the staff employee's exempt classification status.

While not a panacea, accounting firms can lean on their status as a recognized profession. The integrity of the capital markets and the need to preserve owners' investments has a public interest value. All accountants must adhere to a code of ethical conduct. Their work is governed by non-negotiable standards, even if it sometimes verges toward the routine.

Firms should carefully seek to control their overtime costs. For example, creating titles for people that do not align with real responsibilities seem disingenuous. Promotions should have work-related substance, and staff educational expectations should align with work assignments. Base pay reductions to be offset by the new payment of mandatory overtime premiums have counterproductive messaging since it highlights the need of long hours to potential recruits.

Advances in computer processing, data analytics, and artificial intelligence have already begun to revolutionize the public accounting practice. Anticipating that more change will soon occur could well affect the overtime issue. Its direction depends upon how the new technologies impact what remains as staff accountants' work. If staff accountants' duties continue to be outsourced through technological means, courts will look differently at what continues to be done inhouse. Work relying more on computer outputs makes it more clerical and makes staff work likely to be "non-exempt." Alternatively, if it frees people to do more innovative and creative projects, they will be less likely to qualify for overtime compensation. Many technological breakthroughs also did not initially result in the change that was first anticipated.

Conclusion

Do the "facts" on either side of the litigation discussed present issues of fact for a jury to resolve, or merely questions of law for the trial court to decide without using a jury? The 9th Circuit ruled that a jury was needed, at least under California's overtime law, while the 2nd Circuit saw no genuine disputes on what the junior accountants did, but rather simply on how to characterize their duties. Thus, the 2nd Circuit decided that the trial judge should make the decision without input from a jury, while in California a jury makes that determination.

However, it appears that whether a junior accountant is exempt from or entitled to overtime is a function of where they live, less than what they do, as we have seen with legislation. CPA firms should inform their employees why they do or do not pay overtime, especially during the recruiting process. As technology replaces many non-routine jobs in the profession, many companies or firms will hire less skilled employees to perform jobs that could pay below the Department of Labor overtime cap. The required new skills should remove the overtime issue, or they may see their jobs automated. We are also unsure on how the large

number of employees now working at home will affect overtime issues (e.g., does this new environment mean that accountants now exercise more judgment?)

While the legal system will ultimately resolve the CPA firm overtime compensation issue, our competitive environment may limit a firm's ability to pass on these extra labor costs to their clients. The problem is more extreme for firms with heavy concentrations of calendar year-end audit clients and tax filings, or for firms with heavy workloads in short, condensed periods. Accounting firms can generally lower their overtime compensation risk by consulting their own legal counsel and human resource functions to check whether they adhere to FLSA procedures.

In seeking to minimize overtime payments, let's also recognize some benefits of paying for overtime: (1) happy and satisfied employees are often more productive; (2) improving recruiting; (3) avoiding legal issues and legal costs; and (4) helping firms better managing their overall workflow (as in planning more work in less busy times). Yet, minimizing overtime payments to staff accountants relates closely to other major objectives. Obtaining consistent and predictable judgments requires standardized practices, which in turn require more checklists and tools—all in the name of proactive management. Courts might interpret the staff's work, following employer guidance, as clerical. More documentation about the judgments made and skepticism applied would help manage this matter. While planning and executing effective work is the ultimate objective, we should also strive to do so efficiently. Paying overtime for value added staff work for CCPA firms and their clients may well be a great investment.