

13-889-CV

IN THE
United States Court of Appeals
FOR THE SECOND CIRCUIT

LISA B. FRALEY, STEPHEN MARSALA, JR., JOSHUA ADAM MANDELBERGER,
WAKANA KAMESATO SEBACHER, TAMMIE FOSSACECA, AHN ROMERO, MARC
RYAN FILLARI, MONA AFLATOONI, PAUL THOMAS MORRONE, CHRISTOPHER
JOHN HOWE COLLATO, MATTHEW JOHN JEFFERIES, RUSSELL JAMES MONSON,
NEIL THOMAS PUNT, MARK M. ULRICH, PAUL JAMES DICARLO, MATTHEW
WILLIAM WILPERS, JAE Y. CHUNG, ASHLEY ALBERS AUSTIN, EMILY DIANE
TOWERS, RYAN FARRELL HOLMES, KIMBERLY DANIELLE BLAISE, VANESSA

(caption continued on inside cover)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK (McMAHON, J.)

**BRIEF OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC
ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF THE
DEFENDANT-APPELLEE KPMG LLP AND AFFIRMANCE**

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Plaintiffs,

KYLE PIPPINS, individually and on behalf of all others similarly situated,
JAMIE SCHINDLER, individually and on behalf of all others similarly situated,
EDWARD LAMBERT, individually and on behalf of all others similarly situated,

Plaintiffs-Appellants,

—against—

KPMG LLP,

Defendant-Appellee.

RULE 26.1 CORPORATE DISCLOSURE STATEMENT

The American Institute of Certified Public Accountants is a nonprofit corporation formed under the laws of the District of Columbia. It has no parent companies, subsidiaries or affiliates that have issued shares to the public.

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The American Institute of Certified Public Accountants (the “AICPA” or the “Institute”) submits this *amicus* brief in support of the Defendant-Appellee KPMG LLP (“KPMG”).¹

I. STATEMENT OF INTEREST

The AICPA is the national organization of the certified public accounting profession; more than 360,000 of its members are certified public accountants (“CPAs”). The AICPA’s service spans more than one hundred and twenty-five years, and extends to those in academia, government and business, as well as those who provide accounting services through firms of all sizes, including solo practitioners.

Chief among the AICPA’s purposes is the promotion and maintenance of high professional standards of practice. In pursuit of these ends, the AICPA develops standards for the performance of audits of private company financial statements and other services by CPAs; develops and grades the Uniform CPA Examination (the “CPA Exam”); monitors and enforces compliance with the profession’s technical and ethical standards; and participates on the Governing Board of the Center for Audit Quality (“CAQ”). The CAQ is an autonomous

¹ Pursuant to Fed. R. App. P. 29(c)(5) and Second Circuit Local Rule 29.1, the Institute certifies that (A) no party’s counsel authored the brief in whole or in part; (B) no party and no party’s counsel contributed money that was intended to fund preparing or submitting the brief; and (C) no person – other than the *amicus curiae*, its members, or its counsel – contributed money that was intended to fund preparing or submitting the brief.

public policy organization, affiliated with the AICPA, dedicated to enhancing investor confidence and public trust in the global capital markets by fostering high quality performance by public company auditors, and advocating policies and standards that promote auditors' objectivity and effectiveness, among other things.

Because of its role in formulating standards relating to audits, reviews, compilations, and attest engagements, and the reports issued thereon, the AICPA maintains a strong interest in both the professional knowledge and skills that accounting professionals are generally expected to possess, and the standards relevant to the work that accounting professionals typically perform, including entry-level personnel. Many of the Institute's members are employed by, or are partners at, firms similar to KPMG. The AICPA regularly submits *amicus* briefs in actions concerning its members in state and federal courts, including this Court and the U.S. Supreme Court. Counsel for both Appellants and Appellee have consented to the filing of this *amicus* brief.

In granting KPMG's motion for summary judgment, the District Court discussed various auditing standards and accountant educational requirements. (Decision and Order, *Pippins v. KPMG*, No. 11 Civ. 0377 (S.D.N.Y. Nov. 30, 2012) ("SJ Order") at 3-4.) Because of its role in standard-setting and enforcement, as well as administration of the CPA Exam, the AICPA believes it is

in a unique position to provide expertise that may aid this Court in its review of the District Court's ruling.

II. SUMMARY OF ARGUMENT

The District Court concluded that Audit Associates employed by KPMG are "learned professionals" and accordingly, were not entitled to overtime pursuant to the Fair Labor Standards Act (the "FLSA"), 29 U.S.C. §§ 201 *et seq.* (SJ Order at 2.) The education and applicable auditing standards relevant to performing even basic audit tasks further buttressed the District Court's findings that Audit Associates are "well-educated" and engage in work requiring the "consistent exercise of judgment and discretion." (*Id.* at 50.)

To qualify as a "learned professional," an employee's "primary duty" must be the performance of (1) "work requiring advanced knowledge" (2) "in a field of science or learning" (3) that is "customarily acquired by a prolonged course of specialized intellectual instruction." 29 C.F.R. § 541.301(a). (SJ Order at 28.) Accountancy and auditing clearly qualify as a "field of science and learning." (SJ Order at 29.)

Under the FLSA regulations, "[t]he phrase 'customarily acquired by a prolonged course of specialized intellectual instruction' restricts the exemption to professions where specialized academic training is a standard prerequisite for entrance into the profession." (29 C.F.R. § 541.301(d).) Typically, this is an

appropriate academic degree, but it also includes employees in professions who have substantially the same knowledge level and perform substantially the same work as the degreed employees, but attained advanced knowledge through work experience and intellectual instruction. (*Id.*) The FLSA regulations also provide that “[t]he phrase ‘work requiring advanced knowledge’ means work which is predominantly intellectual in character,” and includes work requiring the consistent exercise of discretion and judgment, as opposed to routine mental, manual, mechanical or physical work. (29 C.F.R. § 541.301(b).)

In support of Defendant-Appellee KPMG, the AICPA describes below the critical, advanced professional knowledge and skills that even entry-level auditors are generally expected to possess. The AICPA also discusses professional standards applicable to the work that entry-level audit professionals typically perform, which demonstrate the importance of that work; the discretion and judgment involved in its execution; and why advanced knowledge and education is critical to its performance.²

III. OVERVIEW OF THE AUDIT PROCESS

To provide context for the District Court’s conclusion that Audit Associates are “learned professionals,” it is important to understand the general role of the outside auditor. The District Court identified the primary job responsibility of

² This *amicus* brief does not address the other issues underlying the District Court’s summary judgment ruling.

Audit Associates as “perform[ing] audit work for audits of clients’ financial records.” (SJ Order at 8.)

“An independent financial statement audit ... includes examining, on a test basis, evidence supporting the amounts and disclosures in the company’s financial statements, an assessment of the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation to form an opinion on whether the financial statements taken as a whole are free of material misstatement.” (CAQ’s In-Depth Guide to Public Company Auditing: The Financial Statement Audit, May 2011 (“CAQ Audit Guide”) at 3.)³ Generally Accepted Accounting Principles (“GAAP”) are the standards of financial accounting that govern the preparation of financial statements. GAAP are developed primarily by the Financial Accounting Standards Board (“FASB”), a private, nonprofit organization. The process culminates in a report issued by the auditor as to whether the company’s financial statements are fairly presented, in all material respects, in conformity with GAAP. (*Id.*)

The District Court properly recognized that the performance of an audit is governed by “professional auditing standards,” which “apply to every member of the audit team.” (SJ Order at 8.) Audits of private companies are governed by Generally Accepted Auditing Standards (“GAAS”). GAAS is implemented

³ The CAQ Audit Guide is available at http://www.thecaq.org/publications/In-Depth_GuidetoPublicCompanyAuditing.pdf

through Statements on Auditing Standards (“SAS”), which are issued by a senior technical body of the AICPA. SAS is codified and cited as “AU” sections. Audits of public companies are governed by the standards issued by the Public Company Accounting Oversight Board (“PCAOB”). In 2003, the PCAOB adopted the AICPA’s GAAS, and since then the PCAOB has also promulgated its own auditing standards, cited as “AS” sections. Collectively, GAAS and PCAOB standards represent the “professional standards” applicable to audits.

“With a mindset of professional skepticism, [] auditors seek to gather sufficient, appropriate audit evidence to support their opinion about the financial statements. Because the facts and circumstances of an audit typically vary dramatically between companies, the standards describe a principles-based process and provide guidance to help [] auditors use their judgment in the application of these principles on a particular engagement.” (CAQ Audit Guide at 11.)

IV. SPECIALIZED EDUCATION IS GENERALLY REQUIRED TO PERFORM EVEN ENTRY LEVEL AUDITOR TASKS.

The AICPA understands that it was “KPMG’s general policy [] to hire as Audit Associates only individuals who are ‘CPA-eligible’ in the state in which they will work.” (SJ Order at 5.) The AICPA also understands that KPMG provided the following “typical” qualification: “Must be CPA eligible in home-state. If individual has not passed CPA exam, there should be a short-term plan in

place to pass the CPA exam.” *Id.*⁴ As show below, sitting for the CPA Exam requires extensive, advanced accounting knowledge and skills.

The AICPA is responsible for administering the CPA Exam.⁵ Introduced in 1917, successful completion of the CPA Exam is required for licensure by the 55 states and territories of the United States. (CPA Exam: The Candidate Bulletin, Oct. 2013 (“Candidate Bulletin”) at 2.)⁶ The CPA Exam helps to protect the public interest by ensuring that only individuals who have demonstrated sufficient professional knowledge and skill, and met other prescribed requirements, are permitted to identify themselves to the public as CPAs and thereby perform CPA-restricted services. (*Id.* at 5.) The AICPA determines the content of the CPA Exam, prepares the questions, determines the method of scoring using recognized testing methodology, prepares advisory scores, and conducts statistical analyses of examination results. (*Id.* at 7.)

⁴ The AICPA was not involved in setting any of KPMG’s hiring criteria and did not participate in any of its hiring decisions.

⁵ The Uniform Accountancy Act (“UAA”), published by the AICPA and the National Association of State Boards of Accountancy (“NASBA”), serves as a model for many states’ regulations, and sets forth education, examination, and experience requirements for CPAs. (*See* UAA at Section 5.)

⁶ The Candidate Bulletin is available at, <http://www.aicpa.org/BecomeACPA/CPAExam/ForCandidates/CandidateBulletin/Pages/bulletin.aspx>.

The CPA Exam is a 14-hour examination covering four sections: Auditing and Attestation (“AUD”), Business Environment and Concepts (“BEC”), Financial Accounting and Reporting (“FAR”), and Regulation (“REG”). Each section is designed to assess different knowledge, and is composed of four groups of test questions, three of which contain 24 to 30 multiple-choice questions. (*Id.* at 12.) For example, a sample test question in the AUD section asks, “During an engagement to review the financial statements of a nonissuer, an accountant becomes aware of several leases that should be capitalized, but are not []. The accountant considers these leases to be material to the financial statements. The accountant decides to modify the standard review report because management will not capitalize the leases. Under these circumstances, the accountant should... .”⁷

For the AUD, FAR, and REG sections, the fourth group of test questions consists of several task-based simulations. These simulations are condensed case studies that use real life, work-related situations, and are intended to assess knowledge and skills that an entry-level accountant should possess. For the BEC section, the fourth group of questions consists of three written communication tasks. (*Id.*)

⁷ CPA Exam Sample Tests are available at available at, <http://www.aicpa.org/BecomeACPA/CPAExam/ForCandidates/CandidateBulletin/Pages/bulletin.aspx>.

To ensure that the CPA Exam continues to reflect what is necessary to perform accounting, auditing, and related tasks adequately, the AICPA Board of Examiners initiates “Practical Analysis” studies from time to time. The most recent “Practical Analysis” included a survey of more than 2,000 CPAs, among other things. (Practice Analysis Technical Report, Dec. 2008 (the “Report”) at 2-3.)⁸ The CPAs surveyed were presented with a list of 460 task, knowledge, and skill statements and asked to rate them for relevance, importance, and frequency. More than 90% of the respondents identified over 100 tasks, knowledge, and skills as relevant to an entry-level professional; over 75% of the respondents identified an *additional* 100 tasks, knowledge, and skills that were also relevant. (*Id.* at Appendix L.) These tasks, skills, and knowledge include “Professional Skepticism: An attitude that includes a questioning mind and a critical assessment of information or evidence obtained;” “Conduct analytical procedures to estimate expected results, acceptable variances associated with client’s financial data, and identify indications of transactions that would require further investigation and focus during the engagement;” and “Strategic Thinking: Developing and understanding goals, objectives, and strategies for dealing with potential issues, obstacles, or opportunities.” (*Id.*)

⁸ The Report and its appendixes are available at http://www.aicpa.org/becomeacpa/cpaexam/examinationcontent/contentdevelopment/pages/practice_analysis.aspx

The AICPA Board of Examiners uses the survey to create and update the Content Specification Outlines (“CSOs”) and Skill Specification Outlines (“SSOs”) that provide the basis for CPA Exam questions. (Report at 3, 18.) The CSOs and SSOs demonstrate the vast technical content and skills an individual preparing to take the CPA Exam must comprehend. The CSO for the AUD Section alone has six headings, over 25 subheadings, and over 75 sub-subheadings. (Content and Skill Specifications For the CPA Exam (Oct. 1, 2012) at 4-11.)⁹

For the AUD section, the CSOs and SSOs include performing audit procedures and evaluating evidence; evaluating audit findings, accounting and review services engagements; and professional responsibilities. For the BEC section, the CSOs and SSOs focus on corporate governance; economic concepts and analysis; financial management; information systems and communications; strategic planning; and operations management. For the FAR section, they discuss, in part, the presentation of financial statements and financial statement accounts, including recognition, valuation, and disclosures. And for the REG section, the CSOs and SSOs cover ethics, professional, and legal responsibilities; business law; federal tax process, procedures, accounting, and planning; and federal taxation of property transactions, individuals and entities. (*See generally, id.* at 14.)

⁹ The Content and Skill Specifications For the CPA Exam are available at <http://www.aicpa.org/becomeacpa/cpaexam/examinationcontent/contentandskills/downloadabledocuments/csos-ssos-effective-jan-2014.pdf>

As discussed in the Brief of Defendant-Appellee KPMG at page 10, the educational requirements for CPA-eligibility vary by state. However, nearly all states require an undergraduate degree “with an accounting concentration or the equivalent, with at least 150 semester hours of college-level education.” (*Id.*) This education is necessary to enable entry-level audit professionals to perform tasks such as those discussed in the Report, and ultimately, to enable them sit for and pass all four sections of the CPA Exam. In short, it is the AICPA’s firm view that the skills required by CPA-eligible individuals to perform basic audit tasks involve “advanced knowledge,” which are “customarily acquired by a prolonged course of specialized intellectual instruction.”

V. EVEN ENTRY-LEVEL AUDIT PROFESSIONALS HAVE IMPORTANT RESPONSIBILITIES REQUIRING THE EXERCISE OF DISCRETION AND JUDGMENT IN THE PERFORMANCE OF AUDIT-RELATED TASKS.

As the District Court acknowledged, all audit professionals, including the Audit Associates, are obligated to adhere to general audit professional standards, which require the exercise of discretion and judgment. Citing to AU § 150.02, the District Court properly stated that “all auditors, whether licensed as CPAs or not [must]: (1) have the adequate technical training and proficiency as an auditor, (2) maintain ‘an independence in mental attitude’ throughout all matters relating to an audit assignment, and (3) exercise ‘due professional care’ in the performance of the audit and the preparation of the report.” (SJ Order at 22.) Elaborating on the

meaning of “due professional care,” other SASs explain that the standard “imposes a responsibility upon each professional within an independent auditor's organization to observe the standards of field work and reporting.” (AU Section 230.02.)

Appellants state that they “understood professional skepticism to mean bringing any errors to the attention of more senior team members, taking care in performing their work, being professional in communications, asking questions and not doing something ‘mindlessly’, and acting in a ‘conservative and ethical’ manner.” (Appellants’ Br. at 17) (internal citations omitted). Appellants grossly understate the importance of “professional skepticism.” As the CAQ has explained:

Professional skepticism is fundamental to an independent auditor’s objectivity and includes a questioning mind and an objective assessment of audit evidence ... The independent auditor uses his or her knowledge, skill, and ability to diligently perform, in good faith and with integrity, the gathering and objective evaluation of audit evidence. Given that evidence is gathered and evaluated throughout the audit, professional skepticism is exercised throughout the entire audit process.

(CAQ Audit Guide at 14; *see also* AU Section 230.07; AU Section 316.13.)

“[T]he importance of professional skepticism to an effective audit cannot be overstated, particularly given the increasing judgment and complexity in financial reporting and issues posed by the current economic environment.” (PCAOB, Staff Audit Practice Alert No. 10, *Maintaining and Applying Professional Skepticism in*

Audits (Dec. 4, 2012) at 7.)¹⁰ “The planning and execution of an audit [] require a high degree of professional skill and judgment” and the final product, the audit report, is “based on the auditor’s interpretation and application of hundreds of professional standards, many of which are broadly phrased and readily subject to different constructions. ... [T]he report is the final product of a complex process involving discretion and judgment on the part of the auditor at every stage. (*Bily v. Arthur Young & Co.*, 3 Cal. 4th 370, 380, 400 (Cal. 1992).)

Although Appellants also state that their jobs consisted of “routine work” and “rarely, much less ‘consistently,’ [required the] exercise [of] discretion or judgment as part of their primary duty” (Appellants’ Br. at 2, 41), in fact several of the responsibilities Appellants themselves identify are substantive and meaningful enough to have their own applicable professional standards. For example, Appellants describe performing inventory observations as merely requiring the use of “common sense.” (Appellants’ Br. at 13.) An auditor’s observation of inventories is covered by its own SAS, AU Section 331, which explains that “it is ordinarily necessary for the independent auditor to be present at the time of count and, by suitable observation, tests, and inquiries, satisfy himself respecting the effectiveness of the methods of inventory-taking and the measure of reliance which may be placed upon the client’s representations about the quantities and physical

¹⁰ The PCAOB, Staff Audit Practice Alert No. 10 is available at http://pcaobus.org/Standards/QandA/12-04-2012_SAPA_10.pdf

condition of the inventories,” as inventory is typically a significant element of a balance sheet. (AU Section 331.09.)

Appellants also identify “walkthroughs” and the preparation of “work papers” as supposedly routine, menial tasks. (Appellants’ Br. at 11, 13 – 14.) In fact, such tasks are also covered by specific professional standards. For example, AS No. 12 describes an auditor’s role in “walkthroughs” as “question[ing] the company's personnel about their understanding of what is required by the company's prescribed procedures and controls. These probing questions ... allow the auditor to gain a sufficient understanding of the process and to be able to identify important points at which a necessary control is missing or not designed effectively.” (*Id.* at 38.) Likewise, AS No. 3 describes the critical role of “work papers,” stating that they “ provide[] the support for the representations in the auditor's report [and] should ... [s]upport the basis for the auditor's conclusions concerning every relevant financial statement assertion, and [d]emonstrate that the underlying accounting records agreed or reconciled with the financial statements.” (*Id.* at 5.)

Accordingly, the AICPA respectfully disagrees with the description of the tasks identified by the Audit Associates as “routine work” that “rarely, much less ‘consistently,’ [required the] exercise [of] discretion or judgment as part of their primary duty.” Indeed, as described in more detail in the CAQ Audit Guide, the

audit procedures performed by the Audit Associates are critical contributions to the gathering of evidence needed to support the auditor's opinion. (*See, e.g.*, CAQ Audit Guide at 12 – 15.) These basic auditor responsibilities require knowledge of the procedures and applicable GAAS; the underlying business reasons for, and accounting implications of, the matters in which they are involved (e.g., inventories and walkthroughs); and ethical, professional, and legal responsibilities, including, in particular, the exercise of professional skepticism to identify any risk of fraud. The AICPA therefore agrees with the District Court that even these typically entry-level tasks should be characterized as “work requiring advanced knowledge.” (SJ Order at 50.)

CONCLUSION

The Court should affirm the decision below.

Dated: October 3, 2013

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the length limitations set forth in Fed. R. App. P. 29(d) because it is no more than one-half the maximum length authorized by the Federal Rules of Appellate Procedure for a party's principal brief.

I further certify, pursuant to Fed. R. App. P. 32(a)(7)(C), that this brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B)(i) because it contains 3,207 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

I further certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word in 14 point Times New Roman font.

Dated: October 3, 2013

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CERTIFICATE OF SERVICE

I hereby certify that I caused the foregoing brief to be filed and served upon all the parties using the CM/ECF System.

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