FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ROBERT P. MOSIER, as Receiver for Private Equity Management Group Inc. and Private Equity Management Group, LLC and their subsidiaries and affiliates, *Plaintiff-Appellant*,	No. 13-56453
	D.C. No. 2:11-cv-02666-PSG-E
v.	OPINION
STONEFIELD JOSEPHSON, INC., CPAS, a California corporation, *Defendant-Appellee*.	

Appeal from the United States District Court
for the Central District of California
Philip S. Gutierrez, District Judge, Presiding

Argued and Submitted
October 23, 2015—Pasadena, California

Filed February 23, 2016

Before: Harry Pregerson and Stephen S. Trott, Circuit Judges and William H. Stafford,* Senior District Judge.

Opinion by Judge Trott

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* The Honorable William H. Stafford, Jr., Senior District Judge for the U.S. District Court for the Northern District of Florida, sitting by designation.

SUMMARY**

California Tort Law

The panel affirmed the district court's summary judgment in favor of accountants on tort claims brought by a court appointed receiver against the accountants who audited the financial statements for fraudulent offerings of the companies for which the receiver was appointed.

The panel affirmed the district court's grant of summary judgment on the receiver's claims for professional negligence and aiding and abetting the wrongful conversion of the companies' assets under California law. The panel held that the receiver did not raise a genuine issue as to causation because he did not show that either the companies or its investors relied on the audits. The panel also affirmed the district court's grant of summary judgment on a claim of unjust enrichment.

COUNSEL

Randall A. Smith (argued), Ronald Rus, Sara A. Milroy, and Laurel R. Zaeske, Brown Rudnick LLP, Irvine, California, for Plaintiff-Appellant.

Stephen J. Tully (argued) and Efren A. Compeán, Garrett & Tully, P.C., Westlake Village, California, for Defendant-Appellee.

** This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

Michael C. Kelley, Bradley H. Ellis, Mark E. Haddad, and Collin P. Wedel, Sidley Austin LLP, Los Angeles, California, for Amici Curiae California Society of Certified Public Accountants and American Institute of Certified Public Accountants.

OPINION

TROTT, Senior Circuit Judge:

Appellant Robert Mosier is the court appointed receiver for Private Equity Management Group, Inc. and its interrelated subsidiaries and affiliates (collectively, "PEMGroup"). Mosier was appointed after the former directors and mangers of PEMGroup used the companies to defraud investors of approximately $950 million in what the district court called a "massive Ponzi scheme."

Mosier sued Appellee Stonefield Josephson, Inc., the CPAs who audited the financial statements for six of PEMGroup's fraudulent offerings. Mosier contends that Stonefield's reports and related conduct materially misrepresented PEMGroup's financial condition, allowing PEMGroup's management to prolong the life of their scheme and to loot and to dissipate assets from PEMGroup. According to Mosier, if Stonefield had performed its audits competently or simply resigned after it caught wind of management's fraud, PEMGroup could not have attracted new investors. Mosier seeks $51 million from Stonefield in compensation for damages the firm allegedly caused to PEMGroup.

Mosier's first amended complaint stated three causes of action: 1) professional negligence, 2) aiding and abetting the wrongful conversion of PEMGroup's assets, and 3) unjust enrichment. On summary judgment challenging all three claims, the district court dismissed the first two, holding that Mosier had not raised a genuine issue as to the existence of an essential aspect of his case: proof of causation. Specifically, the district court held that to show causation, Mosier ultimately would have to demonstrate that either PEMGroup or its investors relied on Stonefield's audits, but that Mosier had utterly failed to satisfy this legal requirement. Moreover, the court concluded that any reliance on the audits by the investors would have been unreasonable. As to claim three for unjust enrichment, the court also granted summary judgment. Although Stonefield challenged this cause of action in its motion, Mosier did not respond to or defend it in his response.

We have jurisdiction over this timely appeal pursuant to 28 U.S.C. § 1291, and we affirm.

I

BACKGROUND

Danny Pang founded PEMGroup. Together with PEMGroup's directors and management, Pang established Genesis Voyager Equity Corporation ("GVEC") and its related entities GVEC II and GVEC IV as subsidiaries of PEMGroup. These entities, known as "special purpose vehicles," eventually became parts of an integrated swindle.

GVEC made debt and equity offerings in life insurance policies and commercial real estate mortgages. These offerings allegedly raised $951 million. In its offering memoranda, GVEC told investors to expect a return on their investments of between approximately six to seven percent. However, eventually the "returns" GVEC paid did not come from its investments. GVEC fraudulently paid its investors with money from new investors and by selling GVEC's assets to GVEC II and GVEC IV at over-inflated prices. In addition to paying old investors with new investor money, management used the ill-gotten money from unsuspecting investors to prop up GVEC by paying GVEC's overhead and retiring older offerings. Management also looted money from PEMGroup for their own personal benefit.

In 2003, GVEC hired Stonefield to audit the financial statements for six of its offerings. Stonefield issued ten audit reports for fiscal years 2003 through 2007. Mosier alleged that these reports fell below Generally Accepted Auditing Standards ("GAAS") in a variety of ways. However, Stonefield's cardinal sin in Mosier's eyes was Stonefield's alleged failure sufficiently to warn investors that GVEC's management had not accurately reported the value of its assets in accordance with Generally Accepted Accounting Principles ("GAAP"). Mosier estimates that GVEC misstated the value of eighty to ninety percent of the assets in the financial statements.

Beginning with its March 2004 report, a wary Stonefield issued "qualified" opinions about their client's operations. "A qualified opinion states that, except for the effects of the matter(s) to which the qualification relates, the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with generally accepted accounting principles."[1]

Extending through the end of Stonefield's relationship with PEMGroup, each of Stonefield's audit reports expressed significant reservations about its client's improper method of assigning value to its assets and the unknown effects of those questionable practices on its financial statements. For example, Stonefield's "Independent Auditors' Report" dated March 4, 2005 says,

> [T]he Company has valued certain investments ("Growth Special Assets") at a method similar to an amortized cost basis, which basis values the investment at historical cost. Any potential unrealized gain resulting from these Growth Special Assets is then amortized on a straight-line basis over their estimated life. In our opinion, accounting principles generally accepted in the United States of America require that all investments be presented at fair value, and all corresponding changes in fair value between balance sheet dates be recorded to the statement of operations. The Company has elected to not disclose the exact nature of all of the special assets for confidentiality purposes, which is also a departure from accounting principles generally accepted in the United States of America. The effects on

[1] *Reports on Audited Financial Statements*, AU § 508.10, *available at* http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00508.pdf.

> the financial statements of the preceding practice is not reasonably determinable.

In a summary note to Stonefield's report, the misgivings continued:

> The Company is recognizing unrealized gain resulting from the Growth Special Assets . . . on a straight-line basis method over the estimated life of the Growth Special Assets, which method is not in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). US GAAP requires that all investments be presented at fair value, and all corresponding changes in fair value between balance sheet dates be recorded to the statement of operations. The effects on the financial statements of this non US GAAP practice are not reasonably determinable.

In a letter dated April 18, 2008 addressed to "Board of Directors and Inventors Genesis Voyager Equity Corporation," Stonefield warned that GVEC's

> [r]ecording of the sale of Special Assets were not in accordance with accounting principles generally accepted in the United States of America. The Special Assets of the Portfolio were sold to an affiliated entity that shares the same advisor as [GVEC]. Furthermore the valuation for the sale price of the Special Assets could not be concluded to be Fair

> Market Value independently of management's internal valuation.

In Mosier's opinion, however, Stonefield's series of qualified reports did not go far enough. Given the extent to which GVEC admittedly misstated asset values, Mosier alleges that Stonefield should have issued either an adverse opinion or refused to issue any opinion at all and simultaneously to unload GVEC as a client. "An adverse opinion states that the financial statements do not present fairly the financial position, results of operations, or cash flows of the entity in conformity with generally accepted accounting principles." AU § 508.10, *supra*.

Stonefield's involvement with GVEC and PEMGroup went beyond issuing qualified audit reports. Stonefield attended a meeting with at least one investor, although the record does not reveal what Stonefield said during the meeting. Also, Stonefield authored "comfort letters," which stated that its qualified audit reports were prepared in accordance with GAAS and fairly described the "quality or reliability of the [relevant] financial statements." Two of Stonefield's auditors served as a character reference for Danny Pang and another of PEMGroup's managers. Finally, Stonefield prepared for GVEC's board of directors and investors net asset valuations and limited reports concerning two of the sales between GVEC and its affiliates.

Stonefield never had an entirely comfortable relationship with GVEC. Early on, Stonefield learned that its predecessor had resigned as GVEC's CPA after GVEC misrepresented the predecessor's involvement with GVEC's initial funding period. Furthermore, the manner in which PEMGroup structured GVEC and its offerings – e.g, soliciting only

Chinese investors, basing its operations in the British Virgin Islands, and promising seemingly unsustainable rates of return – raised Stonefield's concerns. As time went on, Stonefield began seriously to question GVEC's operations, management's integrity and competence, and whether Stonefield should resign. Ultimately, Stonefield did resign, but not until April 29, 2009, after it learned that the SEC had filed a complaint against Pang and PEMGroup, and that the FBI had arrested Pang.

II

DISCUSSION

1. On whose behalf may Mosier sue Stonefield?

To understand this controversy, some focus is useful.

At the early stages of the litigation, Stonefield moved to dismiss Mosier's First Amended Complaint pursuant to Fed. R. Civ. P. 12(b)(6) on the ground that Mosier lacked standing to sue on behalf of the defrauded investors. The court concluded that Mosier had standing to sue Stonefield, but not to do so on behalf of the investors. The court explained its analysis and ruling as follows:

> In general, a receiver has capacity to bring only such actions as could have been brought by the entity or individual whose property is in a receivership, and thus may sue only to redress injuries to the entity in receivership. *Grant v. A.B. Leach & Co.*, 280 U.S. 351, 50 S.Ct. 107, 74 L.Ed 470 (1930); *see also Scholes v. Lehmann*, 56 F.3d 750, 753 (7th

Cir. 1995). In contrast, equity receiver or trustee of an entity cannot pursue claims where the alleged harm was suffered only by third-party investors in that entity. *See Williams v. California 1st Bank*, 859 F.2d 664, 666 (9th Cir. 1988); *cf. Hays v. Adam*, 512 F. Supp. 2d 1330, 1341 (N.D. Ga. 2007) (noting that third party investors may nonetheless indirectly benefit from the receiver's action as creditors of the receivership). As the Ninth Circuit has noted, "[a]lthough the line between 'claims of the debtor, which a trustee [or equity receiver] has statutory authority to assert, and 'claims of creditors,' which [*Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416, 92 S.Ct. 1678, 32 L.Ed.2d 195 (1972)] bars the trustee from pursuing, is not always clear, the focus of the inquiry is on whether the Trustee is seeking to redress injuries to the debtor itself caused by the defendants' alleged conduct." *Smith v. Arthur Andersen LLP*, 421 F.3d 989, 1002 (9th Cir. 2005).

Here, upon reviewing the FAC, the Court finds that the allegations show that, in bringing this action, the Receiver seeks to redress injuries caused to PEMGroup and its affiliate entities by Stonefield's alleged misconduct. The Receiver, for example, has alleged that Stonefield owed, and breached, a contractual duty of care to PEMGroup and GVEC to conduct and audit of the company's financial statements using the appropriate industry standards. *FAC* ¶¶ 30–32, 43–47. He goes on to assert that Stonefield's breach of this duty allowed the PEMGroup Principals to dissipate GVEC's assets through transfers to other Tranches when GVEC was unable to pay its operating expenses, which ultimately led to the "retirement" of GVEC portfolios once those portfolios had been looted of their assets. *FAC* ¶¶ 25–26, 35. Further, according to the pleading, "[h]ad the misuse of funds been revealed earlier, Pang and the PEMGroup Management Team would have been stopped and investigated, preventing millions of dollars of additional losses." *FAC* ¶ 35.

While certain allegations in the FAC could conceivably be said to allege injury to investors as well, this does not necessarily vitiate the Receiver's standing to pursue claims on behalf of the receivership entities. Rather, as the Ninth Circuit has acknowledged, so long as an entity in receivership has suffered harm, an equity receiver has standing to pursue a claim for such injuries – even if the creditors of the receivership entity may also have a claim arising from the same underlying misconduct. *Smith v. Arthur Andersen LLP*, 421 F.3d 989, 1002–04 (9th Cir. 2005) (noting that the "dissipation of assets limited the firm's ability to repay its debts . . . is not, however, a concession that only the creditors, and not [the corporate entity] itself, have sustained any injury. [I]t is a recognition of the economic reality that any injury to an insolvent firm is necessarily felt by its creditors."). . . .

Here, similarly, the Receiver has alleged that Stonefield's failures to (1) conduct rigorous audits in accordance with GAAS standards, *FAC* ¶ 35; (2) to make disclosures regarding, *inter alia*, allegedly improper inter-Tranche transfers, *FAC* ¶¶ 32, 46; and (3) Stonefield's allegedly false and misleading audit reports were all significant factors in concealing Pang and PEMGroup Principals' misuse of investor funds. *FAC*. ¶ 35. According to the pleading, had the misuse of funds been revealed earlier, additional losses would have not been incurred. *Id.* The Court finds that, as in *Smith*, these allegations qualify as a corporate injury traceable to Stonefield's conduct for which the Receiver is authorized to seek recovery. Additionally, while Stonefield contends that PEMGroup's use of funds from later Tranches to purchase life insurance policies from earlier GVEC Tranches at inflated prices actually *benefitted* GVEC in that it "served to maintain the illusion of the financial and operational strength of PEMGroup," *Reply* 1:13–16, evaluation of this assertion requires the Court to look beyond the pleadings. At this stage in the proceedings, however, the Court must take as true the Receiver's allegations that the PEMGroup and GVEC entities were harmed by, *inter alia*, their inability to repay various

> note and debenture holders as a result of Stonefield's alleged misconduct. See *Cousins v. Lockyer*, 568 F.3d 1063, 1067 (9th Cir. 2009).

The consequences of the district court's Rule 12(b)(6) holding on standing, which Mosier does not challenge on appeal, is that his lawsuit requires a viable cause of action not on behalf of the investors, but on behalf of PEMGroup.

Accordingly, there are two avenues Mosier as a receiver might pursue against Stonefield on behalf of the derelict PEMGroup. The first is a professional negligence claim, i.e., that Stonefield provided PEMGroup with substandard and misleading audit reports which wrongly enabled PEMGroup to continue to exist as it plundered its own assets. This path alleged a breach by Stonefield of its contractual duty to PEMGroup. The second avenue is an aiding and abetting claim, i.e., that Stonefield created substandard and misleading audit reports which caused investors to continue to pour money into PEMGroup, and which (1) kept it alive, (2) facilitated its illicit fundraising activities, (3) pumped up the enterprise, (4) gave it a badge of legitimacy, and (5) brought in millions of dollars which Danny Pang and associates then stole.

2. Reasonable reliance is a necessary component of Mosier's professional negligence and aiding and abetting claims.

No matter which avenue Mosier pursues, his professional negligence as well as his aiding and abetting claims require Mosier to prove that Stonefield's tortious conduct was a proximate cause of PEMGroup's harm. *See Williams v.*

Wraxall, 33 Cal.App.4th 120, 132 (1995) ("Causation [in a professional negligence claim] requires proof that the defendant's conduct was a '*substantial factor*' in bringing about the harm to the plaintiff." (emphasis added)); *Neilson v. Union Bank of California, N.A.*, 290 F. Supp. 2d 1101, 1135 (C.D. Cal. 2003) ("[C]ausation is an essential element of an aiding and abetting claim, i.e., plaintiff must show that the aider and abettor provided assistance that was a *substantial factor* in causing the harm suffered." (emphasis added)) cited with approval in *American Master Lease LLC v. Idanta Partners, Ltd.*, 225 Cal. App. 4th 1451, 1476 (2014).

Given Mosier's case, in order to prove *causation* he must ultimately prove reasonable reliance, even though reliance per se is not a technical element of his causes of action. Stonefield's work could not have been a "substantial factor" *or* given "substantial assistance" to PEMGroup in soliciting new investors unless the potential investors relied on Stonefield's reports. The district court therefore properly concluded that to survive summary judgment, Mosier would have to offer substantial evidence – meaning sufficient evidence to justify a verdict in his favor – that investors reasonably relied on Stonefield's audits in order to show causation. The cases the district court cited support that conclusion. *See Smolen v. Deloitte, Haskins & Sells*, 921 F.2d 959, 964 (9th Cir. 1990); *see also In re NM Holdings Co., LLC*, 622 F.3d 613, 619 (6th Cir. 2010) ("Although Gold is correct in pointing out that reliance is not per se an *element* of professional negligence, *proof* of reliance is necessary here in order to show that Deloitte's allegedly deficient audits were the cause in fact of Venture's tenuous financial position and resulting bankruptcy." (emphasis added)); *F.D.I.C. v. Ernst & Young*, 967 F.2d 166, 170 (5th

Cir. 1992) ("If nobody relied upon the audit, then the audit could not have been a substantial factor in bringing about the injury." (internal quotation marks omitted)).

Mosier disagrees that proof of reasonable reliance is necessary in order to show causation, relying on *Smith v. Arthur Andersen LLP*, 421 F.3d 989 (9th Cir. 2005). There, the bankruptcy trustee alleged that the debtor's auditors committed professional malpractice by concealing the debtor's deepening insolvency from its outside directors and investors. *Id.* at 1003. The auditor's concealment thereby artificially prolonged the life of the debtor corporation, wasting corporate assets that could have otherwise gone to its creditors in the process. *Id.* at 1003. *Smith* held that the bankruptcy trustee's "deepening insolvency" theory stated an injury-in-fact sufficient to give the trustee standing. *Id.* But standing was the *only* issue we decided in that case. We explicitly declined to say anything about the merits of the lawsuit, not even whether the complaint stated a valid claim for relief. *Id.* at 1006. *Smith* is of no help to Mosier.

3. Avenue #1, for a contractual breach of duty to PEMGroup.

As the district court correctly held,

> As participants in the fraud, GVEC and PEMGroup "cannot have relied on the truth of the fraudulent representations" in the audits. *See Cenco Inc. v. Seadman & Seidman*, 686 F.2d 449, 454 (7th Cir. 1982). In other words, "[b]ecause [GVEC and PEMGroup] knew of and participated in the fraud, [they] could not have justifiably relied on

> [Defendant's] audits to uncover a fraud of which it already was aware." *See Agribiotech*, 2005 WL 4122738, at *12; *see also PNC Bank, Ky.*, 899 F. Supp. at 1406 ("[I]t is clear that HMC as an institution did not rely upon the audits conducted by Grant Thornton in any manner in shaping its conduct, since it was aware, through the knowledge of its owners and top officers, of fraudulent conduct affecting the accuracy of the financial statements."). In sum, "the uncontested facts show fraud permeating the top management of [GVEC and PEMGroup]. In such a case the corporation should not be allowed to shift the entire responsibility for the fraud to its auditors." *Cenco*, 686 F.2d at 456.
>
> The Receiver's other arguments regarding causation all miss the point. The Receiver appears to believe the Defendant is seeking to assert an *in peri delicto* defense or attempting to impute knowledge from PEMGroup to the Receiver. *Opp.* 18:4–20:2. While the Receiver is correct that this Court has already rejected the notion that any wrongdoing or knowledge may be imputed from PEMGroup to the Receiver, this conclusion is irrelevant to the present motion. Defendant does not now seek to impute knowledge from PEMGroup to the Receiver . . . .

This correct analysis disposes of Avenue #1.

4. Avenue #2, for reliance by the investors.

Before the district court and at oral argument, Mosier admitted he did not submit direct evidence that investors relied on Stonefield's audit reports or how PEMGroup used them. During oral argument on the motion for summary judgment, the district court asked, "Is there any evidence that one investor was provided with the audit report?" Mosier's attorney answer was, "[T]he answer to that specific question is no, your Honor, but the evidence does show [circumstantial evidence of investor reliance]."

This void becomes all the more problematic considering what Mosier said on May 15, 2013 in his deposition regarding potential investor witnesses, a deposition that took place almost two months before the hearing on the motion for summary judgment:

> Q (Counsel for Stonefield) Well, you are telling me that certain investors have told you they relied upon Stonefield's audit reports for GVEC tranches to do something, and I just want to know specifically?
>
> A (Robert Mosier) Let me draw a picture for you. I'm having a meeting with the investors and they are all sitting around this table talking about what induced them to come to PEM. And one investor said, I relied on the audit report. And the other investors agreed with him, yes, that's correct. We all relied on the audit reports.

> Q And which investor, what individual at the investors, representative of the investor said that?
>
> A I would have to go back and tell you who were at the meetings.

Mosier concedes he made a deliberate decision to oppose summary judgment without direct evidence of reliance by investors because he believed the circumstantial evidence of reliance and causation was sufficient. When the issue arose in district court, the court excluded his information of alleged reliance as hearsay, and correctly so. Mosier agrees with and does not challenge that ruling on appeal.

We find it difficult on this record to swallow the idea that PEMGroup showed Stonefield's qualified audits to investors in Taiwan. Mosier would have us believe that numerous Taiwanese investors lost millions to this fraud, yet he has not produced a single victim willing to step forward to help in a process that could indirectly recoup his or her losses. Were the audits translated into their language? Do they read English? In his deposition, Mosier testified that he had a meeting with defrauded investors to discuss what "induced them to come" to PEMGroup. Mosier said – and this was excluded hearsay – that the investors said, "We all relied on the audit reports." Did Mosier ask the investors for any paperwork corroborating their assertion? At least one of them might have had paperwork and files to scaffold their alleged statements and Mosier's assertions. Did he ask them for it? It's axiomatic that when stronger evidence of a fact is available, weaker evidence becomes even more so. If Conan Doyle had authored this scenario, he could have called it "The Case of the Missing Link."

Mosier argues in the alternative that there is "strong" circumstantial evidence of investor reliance. He points to (1) GVEC's offering memoranda, which stated that Stonefield was the auditor; (2) emails between Stonefield's accountants questioning GVEC's integrity; (3) the "comfort" letters; (4) GVEC's request for a statement explaining the impact of a qualified opinion; (5) and a May 23, 2006 "To Whom It May Concern" letter in which Stonefield stated that GVEC's "financial statements present fairly, in all material respects, the financial position and results of operations and cash flows of each of the six projects."

The fatal problem for Mosier is that he has no evidence whatsoever demonstrating how these materials were used and, given Stonefield's qualifications, what weight, if any, investors placed on them. Instead, he asks us to draw the inference from his circumstantial evidence that indeed investors did rely on them. This equivocal evidence does not warrant such an inference. First, because of the clear qualifications in Stonefield's audit reports, which amount to red flags, it is just as likely – without any evidence to the contrary – that PEMGroup did *not* show them to people it was attempting to deceive. It defies logic to assume that a crook would waive cautionary "buyer-beware" alerts in front of potential innocent victims of a Ponzi scheme. Stonefield's qualifications previously quoted amount to a warning that PEMGroup was using improper and unreliable valuation methods, methods that violated GAAP; and that PEMGroup's financial statements might not be reliable.

In *United States v. Arthur Young*, 465 U.S. 805, 818 n.14 (1984), the Supreme Court said,

> The inclusion in an audited financial statement of anything less than an unqualified opinion [, such as a qualified opinion,] could send signals to stockholders, creditors, potential investors, and others that the independent auditor has been unable to give the corporation a clean bill of financial health.

In this regard, we agree with the district court that "[in] light of the statements in the audits regarding [GAAP] violations, it would not have been reasonable to rely on the audits to accurately reflect GVEC's financial condition . . . ."

Mosier has yet another problem. With the exception of the ill-advised glowing May 23, 2006 letter signed by Rick Poole, none of the materials provides an opinion on GVEC's financial statements. Instead, the materials either say nothing about the financials, or they direct the reader to the qualified audits. The "comfort" letters repeated the qualifications. The May 23, 2006 letter does provide an opinion on GVEC's financials, but, again, the record is devoid of any substantial evidence that investors relied on it.

Mosier also relies on (1) an agenda from an investor meeting that allotted time for Stonefield; (2) Poole's character references for Pang and another manager; (3) the net asset valuations, (4) the limited reports regarding the sales of GVEC's assets, and (5) the turncoat deposition testimony of Wilbur Quon, the CFO of PEMGroup, that "Stonefield audit reports were "[t]ypically . . . sent to our sales office in Taiwan."

Once again, Mosier offers no evidence showing how these materials were used, or what weight a *reasonable* investor would have placed on them. Reasonable reliance on them is dubious at best. Stonefield's net asset valuation stated its scope was "limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying statement of net assets and, accordingly, do not express an opinion or any other form of assurance on it." As quoted earlier, Stonefield's April 18, 2008 reports on the sale of GVEC's assets stated that the sales were not recorded "in accordance with the accounting principals [sic] generally accepted in the United States of America"; were "sold to an affiliated entity that share[d] the same Advisor as [GVEC]; and "the valuation for the sale price of [GVEC's assets] could not be concluded to be Fair Market Value independently of management's internal valuation." GVEC's Chief Financial Officer Wilbur Quon's evidence that the audit reports were "typically sent" to Taiwan suffers the same infirmity as the rest of Mosier's evidence: what happened to them when they got there?

The district court correctly said that "[t]he record is entirely devoid of any actual, admissible evidence of reliance by anyone – PEMGroup or GVEC principals, investors, or anyone else." The court was correct. We have combed the record from top to bottom and have yet to uncover significant evidence that any part of Stonefield's work product was delivered to a single investor. Without either direct or substantial circumstantial evidence of reasonable reliance, Mosier would simply hold Stonefield liable for granting its "imprimatur to PEMGroup and GVEC." What would amount to a strict liability standard in this context finds no support in the law.

5. Circumstantial Evidence

Mosier repeatedly reminds us that "[t]he law makes no distinction between the weight to be given to either direct or circumstantial evidence." Of course he is correct, but he misunderstands the difference in terms of what this means. As the rest of the jury instruction (which he fails to quote) says, "Direct evidence is direct proof of a fact," such as an investor testifying that he relied on Stonefield's audit reports. Circumstantial evidence, on the other hand, "is proof of one or more facts from which you could find another fact." Ninth Circuit Model Civil Jury Instructions 1.9 (2015). In other words, the probative value of circumstantial evidence depends entirely upon the strength of the inferences that can be drawn from the proven circumstances, and in this case, whether the equivocal circumstances Mosier offers would be sufficient to support a verdict in his favor. They are not. *Anderson v. Liberty Lobby*, 477 U.S. 242, 252 (1986) ("The mere existence of a scintilla of evidence in support of the plaintiff's position will be insufficient; there must be evidence on which the jury could reasonably find for the plaintiff.").

6. Expert Testimony

The final piece of Mosier's offered evidence was his expert's opinion that a proper reaction by Stonefield "would likely have had a significant adverse effect on attracting and obtaining funds from investors . . . ." The basis for the expert's "would likely have had" opinion seems to be his experience with how audit reports are generally used. He did not examine GVEC's sales practices or the specific effect on Stonefield's audits on GVEC's actual investors. This aspect of the expert's purely speculative opinion therefore does not support reliance or sufficient evidence of causation to go to a jury.

7. The district court did not err in sua sponte dismissing Mosier's unjust enrichment claim.

Although Stonefield challenged Mosier's unjust enrichment claim on summary judgment, Mosier inexplicably did not respond. Normally, we do not consider on appeal issues not properly raised before the district court. Accordingly, Mosier has forfeited this issue. However, even if we were to entertain it, he has no case.

Mosier claimed that Stonefield was unjustly enriched by accepting fees from PEMGroup ($770,365.54) and GVEC ($122,725.33) which Stonefield had earned in a "negligent and reckless" manner by providing defective services. Without the parties' input, the district court dismissed Mosier's unjust enrichment claim, holding that it could not survive in absence of Mosier's other claims. The district court was correct.

After oral argument, we requested Mosier to explain his theory of unjust enrichment against Stonefield. His unpersuasive explanation is that Stonefield earned $894,190 for services that knowingly facilitated PEMGroup's Ponzi scheme, not so much to the financial detriment of the crooked PEMGroup, but to the investors who lost money. Mosier's intention is to return Stonefield's fees to the investors, obviously not to PEMGroup. We are not aware of, nor has Mosier provided us with, any cases supporting this novel "pass through" theory. Moreover, "[A]s a matter of law, a quasi-contract action for unjust enrichment does not lie where, as here, express binding agreements exist and define the parties' rights." *Cal. Med. Ass'n, Inc. v. AETNA U.S. Healthcare of Cal., Inc.*, 94 Cal. App. 4th 151, 172 (2001).

The contractual engagement agreement between Stonefield and PEMGroup stated that Stonefield would not be responsible for any misrepresentations made by GVEC.

> We understand that you will provide us with the basic information required for our audit and that you are responsible for the accuracy and completeness of that information. We will advise you about appropriate accounting principles and their application and will assist in the preparation of your financial statements, but the responsibility for the financial statements remains with you. This responsibility includes the maintenance of adequate records and related internal control structure, the selection and application of accounting principles, and the safeguarding of assets. You are responsible for adjusting the financial statements to correct material misstatements and for confirming to us in the management representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. Management is also responsible for identifying and ensuring that the entity complies with applicable laws and regulations.

. . .

> Because of the importance of management's representations to the effective performance of our services, Genesis Voyager Equity Corporation will release Stonefield Josephson and its personnel from any claims, liabilities, costs and expenses relating to our services under this letter attributable to any misrepresentations in the representation letter referred to above.

If anyone breached this contract, it was PEMGroup, not Stonefield. Mosier admits PEMGroup deceived Stonefield and kept them in the dark about their scheme. Stonefield was not unjustly enriched vis-a-vis PEMGroup, period. PEMGroup got what it deserved: qualified reports. This result was hardly unjust. Unless the investors relied on Stonefield's audit reports, and unless Mosier can prove his claims of negligence and wrongful conversion as an underlying wrong, which he cannot, the investors – who have no standing in this case – are in no better position against Stonefield than PEMGroup. Thus, Mosier's failure to come forward with any substantial evidence of causation as to either claim is also fatal to his claim of unjust enrichment. Ironically, Mosier claims PEMGroup was a victim of unjust enrichment because Stonefield did *not* put them out of business.

III

THE RULES GOVERNING SUMMARY JUDGMENT

Mosier argues that the district court overstepped its bounds and ignored the rules of summary judgment. The record read as a whole refutes his claim. Mosier simply did not advance sufficient probative evidence of causation to support a verdict in his favor, and thus to merit consideration by a jury – and the district court said so: "Upon review of the record and the arguments before the Court, the Court concludes that the present motion turns on whether the Receiver has raised a triable fact regarding whether Defendant's conduct caused the alleged losses." The sentences that Mosier cherry-picks out of context from the district court's order do not prove otherwise.

AFFIRMED.

AU Section 508*

Reports on Audited Financial Statements

(Supersedes sections 505, 509, 542, 545, and 546.)

Source: SAS No. 58; SAS No. 64; SAS No. 79; SAS No. 85; SAS No. 93; SAS No. 98.

See section 9508 for interpretations of this section.

Effective for reports issued or reissued on or after January 1, 1989, unless otherwise indicated.

Introduction

.01 This section applies to auditors' reports issued in connection with audits[1] of historical financial statements that are intended to present financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. It distinguishes the types of reports, describes the circumstances in which each is appropriate, and provides example reports.

.02 This section does not apply to unaudited financial statements as described in section 504, *Association With Financial Statements*, nor does it apply to reports on incomplete financial information or other special presentations as described in section 623, *Special Reports*.

.03 Justification for the expression of the auditor's opinion rests on the conformity of his or her audit with generally accepted auditing standards and on the findings. Generally accepted auditing standards include four standards of reporting.[2] This section is concerned primarily with the relationship of the fourth reporting standard to the language of the auditor's report.

.04 The fourth standard of reporting is as follows:

> The auditor must either express an opinion regarding the financial statements, taken as a whole, or state that an opinion cannot be expressed, in the auditor's

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* This section has been revised to reflect the conforming changes necessary due to the issuance of Statement on Auditing Standards No. 93.

[1] An audit, for purposes of this section, is defined as an examination of historical financial statements performed in accordance with generally accepted auditing standards in effect at the time the audit is performed. Generally accepted auditing standards include the ten standards as well as the Statements on Auditing Standards that interpret those standards. In some cases, regulatory authorities may have additional requirements applicable to entities under their jurisdiction and auditors of such entities should consider those requirements.

[2] This section revises the second standard of reporting as follows:

> The report shall identify those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period.

Previously, the second standard required the auditor's report to state whether accounting principles had been consistently applied. As revised, the second standard requires the auditor to add an explanatory paragraph to his report only if accounting principles have not been applied consistently. (See section 420, *Consistency of Application of Generally Accepted Accounting Principles*.) Paragraphs .17–.19 of this section provide reporting guidance under these circumstances.

report. When the auditor cannot express an overall opinion, the auditor should state the reasons therefor in the auditor's report. In all cases where an auditor's name is associated with financial statements, the auditor should clearly indicate the character of the auditor's work, if any, and the degree of responsibility the auditor is taking, in the auditor's report.

[Revised, November 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 113.]

.05 The objective of the fourth standard is to prevent misinterpretation of the degree of responsibility the auditor is assuming when his or her name is associated with financial statements. Reference in the fourth reporting standard to the financial statements "taken as a whole" applies equally to a complete set of financial statements and to an individual financial statement (for example, to a balance sheet) for one or more periods presented. (Paragraph .65 discusses the fourth standard of reporting as it applies to comparative financial statements.) The auditor may express an unqualified opinion on one of the financial statements and express a qualified or adverse opinion or disclaim an opinion on another if the circumstances warrant.

.06 The auditor's report is customarily issued in connection with an entity's basic financial statements—balance sheet, statement of income, statement of retained earnings and statement of cash flows. Each financial statement audited should be specifically identified in the introductory paragraph of the auditor's report. If the basic financial statements include a separate statement of changes in stockholders' equity accounts, it should be identified in the introductory paragraph of the report but need not be reported on separately in the opinion paragraph since such changes are part of the presentation of financial position, results of operations, and cash flows.

The Auditor's Standard Report

.07 The auditor's standard report states that the financial statements present fairly, in all material respects, an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. This conclusion may be expressed only when the auditor has formed such an opinion on the basis of an audit performed in accordance with generally accepted auditing standards.

.08 The auditor's standard report identifies the financial statements audited in an opening (introductory) paragraph, describes the nature of an audit in a scope paragraph, and expresses the auditor's opinion in a separate opinion paragraph. The basic elements of the report are the following:

a. A title that includes the word *independent*[3]

b. A statement that the financial statements identified in the report were audited

c. A statement that the financial statements are the responsibility of the Company's management[4] and that the auditor's responsibility is to express an opinion on the financial statements based on his or her audit

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[3] This section does not require a title for an auditor's report if the auditor is not independent. See section 504, *Association With Financial Statements*, for guidance on reporting when the auditor is not independent.

[4] In some instances, a document containing the auditor's report may include a statement by management regarding its responsibility for the presentation of the financial statements. Nevertheless, the auditor's report should state that the financial statements are management's responsibility.

d. A statement that the audit was conducted in accordance with generally accepted auditing standards and an identification of the United States of America as the country of origin of those standards (for example, auditing standards generally accepted in the United States of America or U.S. generally accepted auditing standards)

e. A statement that those standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement

f. A statement that an audit includes—

(1) Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements

(2) Assessing the accounting principles used and significant estimates made by management

(3) Evaluating the overall financial statement presentation[5]

g. A statement that the auditor believes that his or her audit provides a reasonable basis for his or her opinion

h. An opinion as to whether the financial statements present fairly, in all material respects, the financial position of the Company as of the balance sheet date and the results of its operations and its cash flows for the period then ended in conformity with generally accepted accounting principles. The opinion should include an identification of the United States of America as the country of origin of those accounting principles (for example, accounting principles generally accepted in the United States of America or U.S. generally accepted accounting principles[6])

i. The manual or printed signature of the auditor's firm

j. The date[7] of the audit report

The form of the auditor's standard report on financial statements covering a single year is as follows:

Independent Auditor's Report

We have audited the accompanying balance sheet of X Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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[5] [Footnote deleted, October 2009, to reflect conforming changes necessary due to the withdrawal of SAS No. 69.]

6 A U.S. auditor also may be engaged to report on the financial statements of a U.S. entity that have been prepared in conformity with accounting principles generally accepted in another country. In those circumstances, the auditor should refer to the guidance in section 534, *Reporting on Financial Statements Prepared for Use in Other Countries.* [Footnote added, effective for reports issued or reissued on or after June 30, 2001 by Statement on Auditing Standards No. 93.]

7 For guidance on dating the auditor's report, see section 530, *Dating of the Independent Auditor's Report*. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of X Company as of [at] December 31, 20XX, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

[*Signature*]

[*Date*]

The form of the auditor's standard report on comparative financial statements[8] is as follows:

<u>Independent Auditor's Report</u>

We have audited the accompanying balance sheets of X Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of X Company as of [at] December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

[*Signature*]

[*Date*]

[As amended, effective for reports issued or reissued on or after June 30, 2001, by Statement on Auditing Standards No. 93.]

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[8] If statements of income, retained earnings, and cash flows are presented on a comparative basis for one or more prior periods, but the balance sheet(s) as of the end of one (or more) of the prior period(s) is not presented, the phrase "for the years then ended" should be changed to indicate that the auditor's opinion applies to each period for which statements of income, retained earnings, and cash flows are presented, such as "for each of the three years in the period ended [date of latest balance sheet]." [Footnote renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

.09 The report may be addressed to the company whose financial statements are being audited or to its board of directors or stockholders. A report on the financial statements of an unincorporated entity should be addressed as circumstances dictate, for example, to the partners, to the general partner, or to the proprietor. Occasionally, an auditor is retained to audit the financial statements of a company that is not a client; in such a case, the report is customarily addressed to the client and not to the directors or stockholders of the company whose financial statements are being audited.

.10 This section also discusses the circumstances that may require the auditor to depart from the standard report and provides reporting guidance in such circumstances. This section is organized by type of opinion that the auditor may express in each of the various circumstances presented; this section describes what is meant by the various audit opinions:

- *Unqualified opinion*. An unqualified opinion states that the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with generally accepted accounting principles. This is the opinion expressed in the standard report discussed in paragraph .08.
- *Explanatory language added to the auditor's standard report*. Certain circumstances, while not affecting the auditor's unqualified opinion on the financial statements, may require that the auditor add an explanatory paragraph (or other explanatory language) to his or her report.
- *Qualified opinion*. A qualified opinion states that, except for the effects of the matter(s) to which the qualification relates, the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with generally accepted accounting principles.
- *Adverse opinion*. An adverse opinion states that the financial statements do not present fairly the financial position, results of operations, or cash flows of the entity in conformity with generally accepted accounting principles.
- *Disclaimer of opinion*. A disclaimer of opinion states that the auditor does not express an opinion on the financial statements.

These opinions are discussed in greater detail throughout the remainder of this section.

Explanatory Language Added to the Auditor's Standard Report

.11 Certain circumstances, while not affecting the auditor's unqualified opinion, may require that the auditor add an explanatory[9] paragraph (or other explanatory language) to the standard report.[10] These circumstances include:

a. The auditor's opinion is based in part on the report of another auditor (paragraphs .12–.13).

[9] Unless otherwise required by the provisions of this section, an explanatory paragraph may precede or follow the opinion paragraph in the auditor's report. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

[10] See footnote 3. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

b. To prevent the financial statements from being misleading because of unusual circumstances, the financial statements contain a departure from an accounting principle promulgated by a body designated by the AICPA Council to establish such principles (paragraphs .14–.15).

c. There is substantial doubt about the entity's ability to continue as a going concern.[11]

d. There has been a material change between periods in accounting principles or in the method of their application (paragraphs .16–.18).

e. Certain circumstances relating to reports on comparative financial statements exist (paragraphs .68–.69 and .72–.74).

f. Selected quarterly financial data required by SEC Regulation S-K has been omitted or has not been reviewed. (See section 722, *Interim Financial Information*, paragraph .50.)

g. When a designated accounting standard setter requires information to accompany the entity's basic financial statements (see paragraphs .07–.09 of section 558, *Required Supplementary Information*).

h. Other information in a document containing audited financial statements is materially inconsistent with information appearing in the financial statements. (See paragraph .11 of section 550, *Other Information in Documents Containing Audited Financial Statements*.)

In addition, the auditor may add an explanatory paragraph to emphasize a matter regarding the financial statements (paragraph .19). [As amended, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79. Revised, November 2002, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 100. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120.]

Opinion Based in Part on Report of Another Auditor

.12 When the auditor decides to make reference to the report of another auditor as a basis, in part, for his or her opinion, he or she should disclose this fact in the introductory paragraph of his or her report and should refer to the report of the other auditor in expressing his or her opinion. These references indicate division of responsibility for performance of the audit. (See section 543, *Part of Audit Performed by Other Independent Auditors*.)

.13 An example of a report indicating a division of responsibility follows:

Independent Auditor's Report

We have audited the consolidated balance sheets of ABC Company and subsidiaries as of December 31, 20X2 and 20X1, and the related consolidated statements of income, retained earnings, and cash flows for the years then ended.

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[11] Section 341A, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, describes the auditor's responsibility to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and, when applicable, to consider the adequacy of financial statement disclosure and to include an explanatory paragraph in the report to reflect his or her conclusions. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

> These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets of $_____ and $______ as of December 31, 20X2 and 20X1, respectively, and total revenues of $_____ and $_____ for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.
>
> We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.
>
> In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above, present fairly, in all material respects, the financial position of ABC Company and subsidiaries as of December 31, 20X2 and 20X1, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Departure From a Promulgated Accounting Principle

.14 Rule 203 [ET section 203.01] of the Code of Professional Conduct of the AICPA states:

> A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

.15 When the circumstances contemplated by Rule 203 (ET section 202 paragraph .01) are present, the auditor's report should include, in a separate paragraph or paragraphs, the information required by the rule. In such a case, it is appropriate for the auditor to express an unqualified opinion with respect to the conformity of the financial statements with generally accepted accounting principles unless there are other reasons, not associated with the departure from a promulgated principle, not to do so. [Title of section 411 amended, effective for reports issued or reissued on or after June 30, 2001, by Statement on Auditing Standards No. 93. Revised, October 2009, to reflect conforming changes necessary due to the withdrawal of SAS No. 69.]

Former paragraphs .16–.33 and related footnotes have been deleted and all subsequent paragraphs and footnotes renumbered by the issuance of Statement on Auditing Standards No. 79, effective for reports issued or reissued on or after February 29, 1996.

Lack of Consistency

.16 The auditor's standard report implies that the auditor is satisfied that the comparability of financial statements between periods has not been materially affected by changes in accounting principles and that such principles have been consistently applied between or among periods because either (*a*) no change in accounting principles has occurred, or (*b*) there has been a change in accounting principles or in the method of their application, but the effect of the change on the comparability of the financial statements is not material. In these cases, the auditor should not refer to consistency in the report. If, however, there has been a change in accounting principles or in the method of their application that has a material effect on the comparability of the company's financial statements, the auditor should refer to the change in an explanatory paragraph of the report. Such explanatory paragraph (following the opinion paragraph) should identify the nature of the change and refer the reader to the note in the financial statements that discusses the change in detail. The auditor's concurrence with a change is implicit unless he or she takes exception to the change in expressing his or her opinion as to fair presentation of the financial statements in conformity with generally accepted accounting principles.[12] When there is a change in accounting principles, there are also other matters that the auditor should consider (see paragraphs .50–.57). [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.17 Following is an example of an appropriate explanatory paragraph:

> As discussed in Note X to the financial statements, the Company changed its method of computing depreciation in 20X2.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.18 The addition of this explanatory paragraph in the auditor's report is required in reports on financial statements of subsequent years as long as the year of the change is presented and reported on. [13] However, if the accounting change is accounted for by retroactive restatement of the financial statements

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[12] With respect to the method of accounting for the effect of a change in accounting principle, see Financial Accounting Standards Board *Accounting Standards Codification* 250, *Accounting Changes and Error Corrections*. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[13] An exception to this requirement occurs when a change in accounting principle that does not require a cumulative effect adjustment is made at the beginning of the earliest year presented and reported on. That exception is addressed in the auditing interpretation of section 420, *Consistency of Application of Generally Accepted Accounting Principles*, titled "Impact on the Auditor's Report of FIFO to LIFO Change in Comparative Financial Statements," (section 9420.16–.23). [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

affected, the additional paragraph is required only in the year of the change since, in subsequent years, all periods presented will be comparable. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

Emphasis of a Matter

.19 In any report on financial statements, the auditor may emphasize a matter regarding the financial statements. Such explanatory information should be presented in a separate paragraph of the auditor's report. Phrases such as "with the foregoing [following] explanation" should not be used in the opinion paragraph if an emphasis paragraph is included in the auditor's report. Emphasis paragraphs are never required; they may be added solely at the auditor's discretion. Examples of matters the auditor may wish to emphasize are—

- That the entity is a component of a larger business enterprise.
- That the entity has had significant transactions with related parties.
- Unusually important subsequent events.
- Accounting matters, other than those involving a change or changes in accounting principles, affecting the comparability of the financial statements with those of the preceding period.

[Paragraph renumbered and amended, effective for reports issued or reissued on or after February 29, 1996, by the issuance of Statement on Auditing Standards No. 79.]

Departures From Unqualified Opinions

Qualified Opinions

.20 Certain circumstances may require a qualified opinion. A qualified opinion states that, *except for* the effects of the matter to which the qualification relates, the financial statements present fairly, in all material respects, financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. Such an opinion is expressed when—

a. There is a lack of sufficient appropriate audit evidence or there are restrictions on the scope of the audit that have led the auditor to conclude that he or she cannot express an unqualified opinion and he or she has concluded not to disclaim an opinion (paragraphs .22–.34).

b. The auditor believes, on the basis of his or her audit, that the financial statements contain a departure from generally accepted accounting principles, the effect of which is material, and he or she has concluded not to express an adverse opinion (paragraphs .35–.57).

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

.21 When the auditor expresses a qualified opinion, he or she should disclose all of the substantive reasons in one or more separate explanatory paragraph(s) preceding the opinion paragraph of the report. The auditor should also include, in the opinion paragraph, the appropriate qualifying language and a reference to the explanatory paragraph. A qualified opinion should include the word *except* or *exception* in a phrase such as *except for* or *with the exception of*. Phrases such as *subject to* and *with the foregoing explanation* are not clear or forceful enough and should not be used. Since accompanying notes are part of the financial statements, wording such as *fairly presented, in all material respects, when read in conjunction with Note 1* is likely to be misunderstood and should not be used. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

Scope Limitations

.22 The auditor can determine that he or she is able to express an unqualified opinion only if the audit has been conducted in accordance with generally accepted auditing standards and if he or she has therefore been able to apply all the procedures he considers necessary in the circumstances. Restrictions on the scope of the audit, whether imposed by the client or by circumstances, such as the timing of his or her work, the inability to obtain sufficient appropriate audit evidence, or an inadequacy in the accounting records, may require the auditor to qualify his or her opinion or to disclaim an opinion. In such instances, the reasons for the auditor's qualification of opinion or disclaimer of opinion should be described in the report. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

.23 The auditor's decision to qualify his or her opinion or disclaim an opinion because of a scope limitation depends on his or her assessment of the importance of the omitted procedure(s) to his or her ability to form an opinion on the financial statements being audited. This assessment will be affected by the nature and magnitude of the potential effects of the matters in question and by their significance to the financial statements. If the potential effects relate to many financial statement items, this significance is likely to be greater than if only a limited number of items is involved. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.24 Common restrictions on the scope of the audit include those applying to the observation of physical inventories and the confirmation of accounts receivable by direct communication with debtors.[14] Another common scope restriction involves accounting for long-term investments when the auditor has not been able to obtain audited financial statements of an investee. Restrictions on the application of these or other audit procedures to important elements of the financial statements require the auditor to decide whether he or she has examined sufficient appropriate audit evidence to permit him or her to express an unqualified or qualified opinion, or whether he or she should disclaim an opinion. When restrictions that significantly limit the scope of the audit are imposed by the client, ordinarily the auditor should disclaim an opinion on the financial statements. [Paragraph renumbered by the issuance of Statement on

[14] Circumstances such as the timing of the work may make it impossible for the auditor to accomplish these procedures. In this case, if the auditor is able to satisfy himself or herself as to inventories or accounts receivable by applying alternative procedures, there is no significant limitation on the scope of the work, and the report need not include a reference to the omission of the procedures or the use of alternative procedures. It is important to understand, however, that section 331, *Inventories*, states that "it will always be necessary for the auditor to make, or observe, some physical counts of the inventory and apply appropriate tests of intervening transactions." [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

Auditing Standards No. 79, December 1995. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

.25 When a qualified opinion results from a limitation on the scope of the audit or an insufficiency of audit evidence, the situation should be described in an explanatory paragraph preceding the opinion paragraph and referred to in both the scope and opinion paragraphs of the auditor's report. It is not appropriate for the scope of the audit to be explained in a note to the financial statements, since the description of the audit scope is the responsibility of the auditor and not that of the client. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

.26 When an auditor qualifies his or her opinion because of a scope limitation, the wording in the opinion paragraph should indicate that the qualification pertains to the possible effects on the financial statements and not to the scope limitation itself. Wording such as "In our opinion, except for the above-mentioned limitation on the scope of our audit . . ." bases the exception on the restriction itself, rather than on the possible effects on the financial statements and, therefore, is unacceptable. An example of a qualified opinion related to a scope limitation concerning an investment in a foreign affiliate (assuming the effects of the limitation are such that the auditor has concluded that a disclaimer of opinion is not appropriate) follows:

<u>Independent Auditor's Report</u>

[*Same first paragraph as the standard report*]

Except as discussed in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at $_____and $_____at December 31, 20X2 and 20X1, respectively, or its equity in earnings of that affiliate of $_____ and $_____, which is included in net income for the years then ended as described in Note X to the financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the foreign affiliate investment and earnings, the financial statements referred to in the first paragraph above, present fairly, in all material respects, the financial position of X Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.27 ***Other scope limitations.*** Sometimes, notes to financial statements may contain unaudited information, such as pro forma calculations or other similar disclosures. If the unaudited information (for example, an investor's share, material in amount, of an investee's earnings recognized on the equity method) is such that it should be subjected to auditing procedures in order for the auditor to form an opinion with respect to the financial statements taken as a whole, the auditor should apply the procedures he or she deems necessary to the unaudited information. If the auditor has not been able to apply the procedures he or she considers necessary, the auditor should qualify his or her opinion or disclaim an opinion because of a limitation on the scope of the audit. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.28 If, however, these disclosures are not necessary to fairly present the financial position, operating results, or cash flows on which the auditor is reporting, such disclosures may be identified as *unaudited* or as *not covered by the auditor's report*. For example, the pro forma effects of a business combination or of a subsequent event may be labelled unaudited. Therefore, while the event or transaction giving rise to the disclosures in these circumstances should be audited, the pro forma disclosures of that event or transaction would not be. The auditor should be aware, however, that section 530, *Dating of the Independent Auditor's Report*, states that, if the auditor is aware of a material subsequent event that has occurred after the date of the auditor's report but before issuance of the report that should be disclosed, the auditor's only options are to dual date the report or date the report as of the date of the subsequent event and extend the procedures for review of subsequent events to that date. Labelling the note unaudited is not an acceptable alternative in these circumstances. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Revised, December 2005, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 103.]

.29 ***Uncertainties and scope limitations.*** A matter involving an uncertainty is one that is expected to be resolved at a future date, at which time conclusive audit evidence concerning its outcome would be expected to become available. Uncertainties include, but are not limited to, contingencies covered by FASB *Accounting Standards Codification* (ASC) 450, *Contingencies*, and matters related to estimates covered by FASB ASC 275, *Risks and Uncertainties*. [Paragraph added, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105. Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

.30 Conclusive audit evidence concerning the ultimate outcome of uncertainties cannot be expected to exist at the time of the audit because the outcome and related audit evidence are prospective. In these circumstances, management is responsible for estimating the effect of future events on the financial statements, or determining that a reasonable estimate cannot be made and making the required disclosures, all in accordance with generally accepted accounting principles, based on management's analysis of existing conditions. An audit includes an assessment of whether the audit evidence is sufficient to support management's analysis. Absence of the existence of information related to the outcome of an uncertainty does not necessarily lead to a conclusion that the audit evidence supporting management's assertion is not sufficient. Rather, the auditor's judgment regarding the sufficiency of the audit evidence is based on the audit evidence that is, or should be, available. If, after considering the existing conditions and available evidence, the auditor concludes that sufficient audit evidence supports management's assertions about the nature of a matter involving an uncertainty and its presentation or disclosure in the financial statements, an unqualified opinion ordinarily is appropriate. [Paragraph added, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

.31 If the auditor is unable to obtain sufficient audit evidence to support management's assertions about the nature of a matter involving an uncertainty and its presentation or disclosure in the financial statements, the auditor should consider the need to express a qualified opinion or to disclaim an opinion because of a scope limitation. A qualification or disclaimer of opinion because of a scope limitation is appropriate if sufficient audit evidence related to an uncertainty does or did exist but was not available to the auditor for reasons such as management's record retention policies or a restriction imposed by management. [Paragraph added, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

.32 Scope limitations related to uncertainties should be differentiated from situations in which the auditor concludes that the financial statements are materially misstated due to departures from generally accepted accounting principles related to uncertainties. Such departures may be caused by inadequate disclosure concerning the uncertainty, the use of inappropriate accounting principles, or the use of unreasonable accounting estimates. Paragraphs .45–.49 provide guidance to the auditor when financial statements contain departures from generally accepted accounting principles related to uncertainties. [Paragraph added, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79.]

.33 ***Limited reporting engagements.*** The auditor may be asked to report on one basic financial statement and not on the others. For example, he or she may be asked to report on the balance sheet and not on the statements of income, retained earnings or cash flows. These engagements do not involve scope limitations if the auditor's access to information underlying the basic financial statements is not limited and if the auditor applies all the procedures he considers necessary in the circumstances; rather, such engagements involve limited reporting objectives. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.34 An auditor may be asked to report on the balance sheet only. In this case, the auditor may express an opinion on the balance sheet only. An example of an unqualified opinion on a balance-sheet-only audit follows (the report assumes that the auditor has been able to satisfy himself or herself regarding the consistency of application of accounting principles):

Independent Auditor's Report

We have audited the accompanying balance sheet of X Company as of December 31, 20XX. This financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the balance sheet is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the balance sheet. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall balance sheet presentation. We believe that our audit of the balance sheet provides a reasonable basis for our opinion.

In our opinion, the balance sheet referred to above, presents fairly, in all material respects, the financial position of X Company as of December 31, 20XX, in conformity with accounting principles generally accepted in the United States of America.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

Departure From a Generally Accepted Accounting Principle

.35 When financial statements are materially affected by a departure from generally accepted accounting principles and the auditor has audited the statements in accordance with generally accepted auditing standards, he or she should express a qualified (paragraphs .36–.57) or an adverse (paragraphs .58–.60) opinion. The basis for such opinion should be stated in the report. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.36 In deciding whether the effects of a departure from generally accepted accounting principles are sufficiently material to require either a qualified or adverse opinion, one factor to be considered is the dollar magnitude of such effects. However, the concept of materiality does not depend entirely on relative size; it involves qualitative as well as quantitative judgments. The significance of an item to a particular entity (for example, inventories to a manufacturing company), the pervasiveness of the misstatement (such as whether it affects the amounts and presentation of numerous financial statement items), and the effect of the misstatement on the financial statements taken as a whole are all factors to be considered in making a judgment regarding materiality. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.37 When the auditor expresses a qualified opinion, he or she should disclose, in a separate explanatory paragraph(s) preceding the opinion paragraph of the report, all of the substantive reasons that have led him or her to conclude that there has been a departure from generally accepted accounting principles. Furthermore, the opinion paragraph of the report should include the appropriate qualifying language and a reference to the explanatory paragraph(s). [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.38 The explanatory paragraph(s) should also disclose the principal effects of the subject matter of the qualification on financial position, results of operations, and cash flows, if practicable.[15] If the effects are not reasonably

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[15] Section 431, *Adequacy of Disclosure in the Financial Statements*, defines *practicable* as ". . . the information is reasonably obtainable from management's accounts and records and that providing the information in the report does not require the auditor to assume the position of a preparer of financial information." For example, if the information can be obtained from the accounts and records without the auditor substantially increasing the effort that would normally be required to complete the audit, the information should be presented in the report. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

determinable, the report should so state. If such disclosures are made in a note to the financial statements, the explanatory paragraph(s) may be shortened by referring to it. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.39 An example of a report in which the opinion is qualified because of the use of an accounting principle at variance with generally accepted accounting principles follows (assuming the effects are such that the auditor has concluded that an adverse opinion is not appropriate):

> Independent Auditor's Report
>
> [*Same first and second paragraphs as the standard report*]
>
> The Company has excluded, from property and debt in the accompanying balance sheets, certain lease obligations that, in our opinion, should be capitalized in order to conform with accounting principles generally accepted in the United States of America. If these lease obligations were capitalized, property would be increased by $_____ and $_____, long-term debt by $_____ and $_____, and retained earnings by $_____ and $_____ as of December 31, 20X2 and 20X1, respectively. Additionally, net income would be increased (decreased) by $_____ and $_____ and earnings per share would be increased (decreased) by $_____ and $_____, respectively, for the years then ended.
>
> In our opinion, except for the effects of not capitalizing certain lease obligations as discussed in the preceding paragraph, the financial statements referred to above, present fairly, in all material respects, the financial position of X Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.40 If the pertinent facts are disclosed in a note to the financial statements, a separate paragraph (preceding the opinion paragraph) of the auditor's report in the circumstances illustrated in paragraph .39 might read as follows:

> As more fully described in Note X to the financial statements, the Company has excluded certain lease obligations from property and debt in the accompanying balance sheets. In our opinion, accounting principles generally accepted in the United States of America require that such obligations be included in the balance sheets.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.41 ***Inadequate disclosure.*** Information essential for a fair presentation in conformity with generally accepted accounting principles should be set forth in the financial statements (which include the related notes). When such information is set forth elsewhere in a report to shareholders, or in a prospectus, proxy statement, or other similar report, it should be referred to in the financial statements. If the financial statements, including accompanying notes, fail to disclose information that is required by generally accepted accounting principles, the auditor should express a qualified or adverse opinion because of the departure from those principles and should provide the information in the report, if practicable,[16] unless its omission from the auditor's report is recognized as

[16] See footnote 15. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

appropriate by a specific Statement on Auditing Standards. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.42 Following is an example of a report qualified for inadequate disclosure (assuming that the auditor has concluded that it is not practicable to present the required information and the effects are such that the auditor has concluded an adverse opinion is not appropriate):

> Independent Auditor's Report
>
> [*Same first and second paragraphs as the standard report*]
>
> The Company's financial statements do not disclose [*describe the nature of the omitted information that it is not practicable to present in the auditor's report*]. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.
>
> In our opinion, except for the omission of the information discussed in the preceding paragraph, . . .

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.43 If a company issues financial statements that purport to present financial position and results of operations but omits the related statement of cash flows, the auditor will normally conclude that the omission requires qualification of his opinion. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.44 The auditor is not required to prepare a basic financial statement (for example, a statement of cash flows for one or more periods) and include it in the report if the company's management declines to present the statement. Accordingly, in these cases, the auditor should ordinarily qualify the report in the following manner:

> Independent Auditor's Report
>
> We have audited the accompanying balance sheets of X Company as of December 31, 20X2 and 20X1, and the related statements of income and retained earnings for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
>
> [*Same second paragraph as the standard report*]
>
> The Company declined to present a statement of cash flows for the years ended December 31, 20X2 and 20X1. Presentation of such statement summarizing the Company's operating, investing, and financing activities is required by accounting principles generally accepted in the United States of America.
>
> In our opinion, except that the omission of a statement of cash flows results in an incomplete presentation as explained in the preceding paragraph, the financial statements referred to above, present fairly, in all material respects, the financial position of X Company as of December 31, 20X2 and 20X1, and the results of its operations for the years then ended in conformity with accounting principles generally accepted in the United States of America.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.45 ***Departures from generally accepted accounting principles involving risks or uncertainties, and materiality considerations.***

Departures from generally accepted accounting principles involving risks or uncertainties generally fall into one of the following categories:

- Inadequate disclosure (paragraphs .46–.47)
- Inappropriate accounting principles (paragraph .48)
- Unreasonable accounting estimates (paragraph .49)

[Paragraph added, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79.]

.46 If the auditor concludes that a matter involving a risk or an uncertainty is not adequately disclosed in the financial statements in conformity with generally accepted accounting principles, the auditor should express a qualified or an adverse opinion. [Paragraph added, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79.]

.47 The auditor should consider materiality in evaluating the adequacy of disclosure of matters involving risks or uncertainties in the financial statements in the context of the financial statements taken as a whole. The auditor's consideration of materiality is a matter of professional judgment and is influenced by his or her perception of the needs of a reasonable person who will rely on the financial statements. Materiality judgments involving risks or uncertainties are made in light of the surrounding circumstances. The auditor evaluates the materiality of reasonably possible losses that may be incurred upon the resolution of uncertainties both individually and in the aggregate. The auditor performs the evaluation of reasonably possible losses without regard to his or her evaluation of the materiality of known and likely misstatements in the financial statements. [Paragraph added, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79.]

.48 In preparing financial statements, management estimates the outcome of certain types of future events. For example, estimates ordinarily are made about the useful lives of depreciable assets, the collectibility of accounts receivable, the realizable value of inventory items, and the provision for product warranties. Paragraphs 10–11 of FASB ASC 310-10-35 and FASB ASC 460-10-25-6 describe situations in which the inability to make a reasonable estimate may raise questions about the appropriateness of the accounting principles used. If, in those or other situations, the auditor concludes that the accounting principles used cause the financial statements to be materially misstated, he or she should express a qualified or an adverse opinion. [Paragraph added, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79. Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

.49 Usually, the auditor is able to satisfy himself or herself regarding the reasonableness of management's estimate of the effects of future events by considering various types of audit evidence, including the historical experience of the entity. If the auditor concludes that management's estimate is unreasonable (see section 312, *Audit Risk and Materiality*, and section 342, *Auditing Accounting Estimates*) and that its effect is to cause the financial statements to be materially misstated, he or she should express a qualified or an adverse opinion. [Paragraph added, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

.50 ***Accounting changes.*** The auditor should evaluate a change in accounting principle to satisfy himself that (*a*) the newly adopted accounting principle is a generally accepted accounting principle, (*b*) the method of accounting for the effect of the change is in conformity with generally accepted accounting principles, and (*c*) management's justification for the change is reasonable. If a change in accounting principle does not meet these conditions, the auditor's report should so indicate, and his opinion should be appropriately qualified as discussed in paragraphs .51–.52. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.51 If (*a*) a newly adopted accounting principle is not a generally accepted accounting principle, (*b*) the method of accounting for the effect of the change is not in conformity with generally accepted accounting principles, or (*c*) management has not provided reasonable justification for the change in accounting principle, the auditor should express a qualified opinion or, if the effect of the change is sufficiently material, the auditor should express an adverse opinion on the financial statements. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.52 According to FASB ASC 250-10-45-2, a reporting entity shall change an accounting principle only if either of the following apply:

a. The change is required by a newly issued codification update.

b. The entity can justify the use of an allowable alternative accounting principle on the basis that it is preferable.

If management has not provided reasonable justification for the change in accounting principle, the auditor should express an exception to the change having been made without reasonable justification. An example of a report qualified for this reason follows:

Independent Auditor's Report

[*Same first and second paragraphs as the standard report*]

As disclosed in Note X to the financial statements, the Company adopted, in 20X2, the first-in, first-out method of accounting for its inventories, whereas it previously used the last-in, first-out method. Although use of the first-in, first-out method is in conformity with accounting principles generally accepted in the United States of America, in our opinion the Company has not provided reasonable justification for making this change as required by those principles.[17]

In our opinion, except for the change in accounting principle discussed in the preceding paragraph, the financial statements referred to above, present fairly, in all material respects, the financial position of X Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

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[17] Section 420, *Consistency of Application of Generally Accepted Accounting Principles*, states that a change from an accounting principle that is not generally accepted to one that is generally accepted is a correction of an error and that such a change requires recognition in the auditor's report as to consistency. Therefore, the auditor should add an explanatory paragraph to the report discussing the accounting change.

However, because the middle paragraph included in the example presented contains all of the information required in an explanatory paragraph on consistency, a separate explanatory paragraph (following the opinion paragraph) as required by paragraphs .16–.18 of this section is not necessary in this instance. A separate paragraph that identifies the change in accounting principle would be required if the substance of the disclosure did not fulfill the requirements outlined in these paragraphs. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

.53 Whenever an accounting change results in an auditor expressing a qualified or adverse opinion on the conformity of financial statements with generally accepted accounting principles for the year of change, the auditor should consider the possible effects of that change when reporting on the entity's financial statements for subsequent years, as discussed in paragraphs .54–.57. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.54 If the financial statements for the year of such change are presented and reported on with a subsequent year's financial statements, the auditor's report should disclose his or her reservations with respect to the statements for the year of change. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.55 If an entity has adopted an accounting principle that is not a generally accepted accounting principle, its continued use might have a material effect on the statements of a subsequent year on which the auditor is reporting. In this situation, the independent auditor should express either a qualified opinion or an adverse opinion, depending on the materiality of the departure in relation to the statements of the subsequent year. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.56 If an entity accounts for the effect of a change prospectively when generally accepted accounting principles require restatement or the inclusion of the cumulative effect of the change in the year of change, a subsequent year's financial statements could improperly include a charge or credit that is material to those statements. This situation also requires that the auditor express a qualified or an adverse opinion. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.57 If management has not provided reasonable justification for a change in accounting principles, the auditor's opinion should express an exception to the change having been made without reasonable justification, as previously indicated. In addition, the auditor should continue to express his or her exception with respect to the financial statements for the year of change as long as they are presented and reported on. However, the auditor's exception relates to the accounting change and does not affect the status of a newly adopted principle as a generally accepted accounting principle. Accordingly, while expressing an exception for the year of change, the independent auditor's opinion regarding the subsequent years' statements need not express an exception to use of the newly adopted principle. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

Adverse Opinions

.58 An adverse opinion states that the financial statements do not present fairly the financial position or the results of operations or cash flows in conformity with generally accepted accounting principles. Such an opinion is expressed when, in the auditor's judgment, the financial statements taken as a whole are not presented fairly in conformity with generally accepted accounting principles. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.59 When the auditor expresses an adverse opinion, he or she should disclose in a separate explanatory paragraph(s) preceding the opinion paragraph of the report (*a*) all the substantive reasons for his or her adverse opinion, and (*b*) the principal effects of the subject matter of the adverse opinion on financial position, results of operations, and cash flows, if practicable.[18] If the effects are not reasonably determinable, the report should so state.[19] [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.60 When an adverse opinion is expressed, the opinion paragraph should include a direct reference to a separate paragraph that discloses the basis for the adverse opinion, as shown as follows:

Independent Auditor's Report

[*Same first and second paragraphs as the standard report*]

As discussed in Note X to the financial statements, the Company carries its property, plant and equipment accounts at appraisal values, and provides depreciation on the basis of such values. Further, the Company does not provide for income taxes with respect to differences between financial income and taxable income arising because of the use, for income tax purposes, of the installment method of reporting gross profit from certain types of sales. Accounting principles generally accepted in the United States of America require that property, plant and equipment be stated at an amount not in excess of cost, reduced by depreciation based on such amount, and that deferred income taxes be provided.

Because of the departures from accounting principles generally accepted in the United States of America identified above, as of December 31, 20X2 and 20X1, inventories have been increased $_____ and $_____ by inclusion in manufacturing overhead of depreciation in excess of that based on cost; property, plant and equipment, less accumulated depreciation, is carried at $_____ and $_____ in excess of an amount based on the cost to the Company; and deferred income taxes of $_____ and $_____ have not been recorded; resulting in an increase of $_____ and $_____ in retained earnings and in appraisal surplus of $_____ and $_____, respectively. For the years ended December 31, 20X2 and 20X1, cost of goods sold has been increased $_____ and $_____, respectively, because of the effects of the depreciation accounting referred to above and deferred income taxes of $_____ and $_____ have not been provided, resulting in an increase in net income of $_____ and $_____, respectively.

In our opinion, because of the effects of the matters discussed in the preceding paragraphs, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of X Company as of December 31, 20X2 and 20X1, or the results of its operations or its cash flows for the years then ended.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

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[18] See footnote 15. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No 93, October 2000.]

[19] When the auditor expresses an adverse opinion, he or she should also consider the need for an explanatory paragraph under the circumstances identified in paragraph .11, subsection (*c*), (*d*), and (*e*) of this section. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

Disclaimer of Opinion

.61 A disclaimer of opinion states that the auditor does not express an opinion on the financial statements. An auditor may decline to express an opinion whenever he or she is unable to form or has not formed an opinion as to the fairness of presentation of the financial statements in conformity with generally accepted accounting principles. If the auditor disclaims an opinion, the auditor's report should give all of the substantive reasons for the disclaimer. [Paragraph renumbered and amended, effective for reports issued or reissued on or after February 29, 1996, by the issuance of Statement on Auditing Standards No. 79.]

.62 A disclaimer is appropriate when the auditor has not performed an audit sufficient in scope to enable him or her to form an opinion on the financial statements.[20] A disclaimer of opinion should not be expressed because the auditor believes, on the basis of his or her audit, that there are material departures from generally accepted accounting principles (see paragraphs .35–.57). When disclaiming an opinion because of a scope limitation, the auditor should state in a separate paragraph or paragraphs all of the substantive reasons for the disclaimer. He or she should state that the scope of the audit was not sufficient to warrant the expression of an opinion. The auditor should not identify the procedures that were performed nor include the paragraph describing the characteristics of an audit (that is, the scope paragraph of the auditor's standard report); to do so may tend to overshadow the disclaimer. In addition, the auditor should also disclose any other reservations he or she has regarding fair presentation in conformity with generally accepted accounting principles. [Paragraph renumbered and amended, effective for reports issued or reissued on or after February 29, 1996, by the issuance of Statement on Auditing Standards No. 79.]

.63 An example of a report disclaiming an opinion resulting from an inability to obtain sufficient appropriate audit evidence because of the scope limitation follows:

<u>Independent Auditor's Report</u>

We were engaged to audit the accompanying balance sheets of X Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management.[21]

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[20] If an accountant is engaged to conduct an audit of the financial statements of a nonpublic entity in accordance with generally accepted auditing standards, but is requested to change the engagement to a review or a compilation of the statements, he or she should look to the guidance in paragraphs 46–51 of Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* (AR section 100 paragraphs .46–.51]. Section 504, *Association With Financial Statements*, paragraph .05 provides guidance to an accountant who is associated with the financial statements of a public entity, but has not audited such statements. [Footnote renumbered and amended, effective for reports issued or reissued on or after February 29, 1996, by the issuance of Statement on Auditing Standards No. 79. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000. Footnote revised, November 2002, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 9.]

[21] The wording in the first paragraph of the auditor's standard report is changed in a disclaimer of opinion because of a scope limitation. The first sentence now states that "we were engaged to audit" rather than "we have audited" since, because of the scope limitation, the auditor was not able to perform an audit in accordance with generally accepted auditing standards. In addition, the last sentence of the first paragraph is also deleted, because of the scope limitation, to eliminate the reference to the auditor's responsibility to express an opinion. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

[*Second paragraph of standard report should be omitted*]

The Company did not make a count of its physical inventory in 20X2 or 20X1, stated in the accompanying financial statements at $_____ as of December 31, 20X2, and at $______ as of December 31, 20X1. Further, evidence supporting the cost of property and equipment acquired prior to December 31, 20X1, is no longer available. The Company's records do not permit the application of other auditing procedures to inventories or property and equipment.

Since the Company did not take physical inventories and we were not able to apply other auditing procedures to satisfy ourselves as to inventory quantities and the cost of property and equipment, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

Piecemeal Opinions

.64 Piecemeal opinions (expressions of opinion as to certain identified items in financial statements) should not be expressed when the auditor has disclaimed an opinion or has expressed an adverse opinion on the financial statements *taken as a whole* because piecemeal opinions tend to overshadow or contradict a disclaimer of opinion or an adverse opinion. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

Reports on Comparative Financial Statements

.65 The fourth standard of reporting requires that the auditor either express an opinion regarding the financial statements *taken as a whole* or an assertion to the effect that an opinion cannot be expressed, in the auditor's report. Reference in the fourth reporting standard to the financial statements *taken as a whole* applies not only to the financial statements of the current period but also to those of one or more prior periods that are presented on a comparative basis with those of the current period. Therefore, a continuing auditor[22] should update[23] the report on the individual financial statements of the one or more prior periods presented on a comparative basis with those of

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[22] A *continuing auditor* is one who has audited the financial statements of the current period and of one or more consecutive periods immediately prior to the current period.

If one firm of independent auditors merges with another firm and the new firm becomes the auditor of a former client of one of the former firms, the new firm may accept responsibility and express an opinion on the financial statements for the prior period(s), as well as for those of the current period. In such circumstances, the new firm should follow the guidance in paragraphs .65–.69 and may indicate in its report or signature that a merger took place and may name the firm of independent auditors that was merged with it. If the new firm decides not to express an opinion on the prior-period financial statements, the guidance in paragraphs .70–.74 should be followed. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

[23] An updated report on prior-period financial statements should be distinguished from a reissuance of a previous report (see section 530, *Dating of the Independent Auditor's Report*, paragraphs .06–.08), since in issuing an updated report the continuing auditor considers information that he or she has become aware of during his or her audit of the current-period financial statements (see paragraph .68) and because an updated report is issued in conjunction with the auditor's report on the current-period financial statements. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

the current period.[24] Ordinarily, the auditor's report on comparative financial statements should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to support the opinion for the most recent audit. (See section 530, *Dating of the Independent Auditor's Report*, paragraph .01.) [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. As amended, effective September 2002, by Statement on Auditing Standards No. 98. Revised, December 2005, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 103.]

.66 During the audit of the current-period financial statements, the auditor should be alert for circumstances or events that affect the prior-period financial statements presented (see paragraph .68) or the adequacy of informative disclosures concerning those statements. (See section 431, *Adequacy of Disclosure in Financial Statements*, and FASB ASC 205, *Presentation of Financial Statements*.) In updating his or her report on the prior-period financial statements, the auditor should consider the effects of any such circumstances or events coming to his or her attention. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

Different Reports on Comparative Financial Statements Presented

.67 Since the auditor's report on comparative financial statements applies to the individual financial statements presented, an auditor may express a qualified or adverse opinion, disclaim an opinion, or include an explanatory paragraph with respect to one or more financial statements for one or more periods, while issuing a different report on the other financial statements presented. Following are examples of reports on comparative financial statements (excluding the standard introductory and scope paragraphs, where applicable) with different reports on one or more financial statements presented.

Standard Report on the Prior-Year Financial Statements and a Qualified Opinion on the Current-Year Financial Statements

Independent Auditor's Report

[*Same first and second paragraphs as the standard report*]

The Company has excluded, from property and debt in the accompanying 20X2 balance sheet, certain lease obligations that were entered into in 20X2 which, in our opinion, should be capitalized in order to conform with accounting principles

[24] A continuing auditor need not report on the prior-period financial statements if only summarized comparative information of the prior period(s) is presented. For example, entities such as state and local governmental units frequently present total-all-funds information for the prior period(s) rather than information by individual funds because of space limitations or to avoid cumbersome or confusing formats. Also, not-for-profit organizations frequently present certain information for the prior period(s) in total rather than by net asset class. In some circumstances, the client may request the auditor to express an opinion on the prior period(s) as well as the current period. In those circumstances, the auditor should consider whether the information included for the prior period(s) contains sufficient detail to constitute a fair presentation in conformity with generally accepted accounting principles. In most cases, this will necessitate including additional columns or separate detail by fund or net asset class, or the auditor would need to modify his or her report. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000. Revised, April 2002, to reflect conforming changes necessary due to the issuance of FASB Statement No. 117.]

generally accepted in the United States of America. If these lease obligations were capitalized, property would be increased by $_____, long-term debt by $_____, and retained earnings by $_____as of December 31, 20X2, and net income and earnings per share would be increased (decreased) by $_____ and $_____, respectively, for the year then ended.

In our opinion, except for the effects on the 20X2 financial statements of not capitalizing certain lease obligations as described in the preceding paragraph, the financial statements referred to in the preceding present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Standard Report on the Current-Year Financial Statements With a Disclaimer of Opinion on the Prior-Year Statements of Income, Retained Earnings, and Cash Flows

Independent Auditor's Report

[*Same first paragraph as the standard report*]

Except as explained in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We did not observe the taking of the physical inventory as of December 31, 20X0, since that date was prior to our appointment as auditors for the Company, and we were unable to satisfy ourselves regarding inventory quantities by means of other auditing procedures. Inventory amounts as of December 31, 20X0, enter into the determination of net income and cash flows for the year ended December 31, 20X1.[25]

Because of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the results of operations and cash flows for the year ended December 31, 20X1.

In our opinion, the balance sheets of ABC Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the year ended December 31, 20X2, present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the year ended December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America.

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[25] It is assumed that the independent auditor has been able to satisfy himself or herself as to the consistency of application of generally accepted accounting principles. See section 420, *Consistency of Application of Generally Accepted Accounting Principles*, for a discussion of consistency. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995; the former footnote 29 has been deleted and subsequent footnotes renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

Opinion on Prior-Period Financial Statements Different From the Opinion Previously Expressed

.68 If, during the current audit, an auditor becomes aware of circumstances or events that affect the financial statements of a prior period, he or she should consider such matters when updating his or her report on the financial statements of the prior period. For example, if an auditor has previously qualified his or her opinion or expressed an adverse opinion on financial statements of a prior period because of a departure from generally accepted accounting principles, and the prior-period financial statements are restated in the current period to conform with generally accepted accounting principles, the auditor's updated report on the financial statements of the prior period should indicate that the statements have been restated and should express an unqualified opinion with respect to the restated financial statements. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

.69 If, in an updated report, the opinion is different from the opinion previously expressed on the financial statements of a prior period, the auditor should disclose all the substantive reasons for the different opinion in a separate explanatory paragraph(s) preceding the opinion paragraph of his or her report.[fn 29] The explanatory paragraph(s) should disclose (*a*) the date of the auditor's previous report, (*b*) the type of opinion previously expressed, (*c*) the circumstances or events that caused the auditor to express a different opinion, and (*d*) that the auditor's updated opinion on the financial statements of the prior period is different from his or her previous opinion on those statements. The following is an example of an explanatory paragraph that may be appropriate when an auditor issues an updated report on the financial statements of a prior period that contains an opinion different from the opinion previously expressed:

<u>Independent Auditor's Report</u>

[*Same first and second paragraphs as the standard report*]

In our report dated March 1, 20X2, we expressed an opinion that the 20X1 financial statements did not fairly present financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America because of two departures from such principles: (1) the Company carried its property, plant, and equipment at appraisal values, and provided for depreciation on the basis of such values, and (2) the Company did not provide for deferred income taxes with respect to differences between income for financial reporting purposes and taxable income. As described in Note X, the Company has changed its method of accounting for these items and restated its 20X1 financial statements to conform with accounting principles generally accepted in the United States of America. Accordingly, our present opinion on the 20X1 financial statements, as presented herein, is different from that expressed in our previous report.[26]

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of X Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years

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[26] See footnote 17. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

then ended in conformity with accounting principles generally accepted in the United States of America.

[Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

Report of Predecessor Auditor

.70 A predecessor auditor ordinarily would be in a position to reissue his or her report on the financial statements of a prior period at the request of a former client if he or she is able to make satisfactory arrangements with the former client to perform this service and if he or she performs the procedures described in paragraph .71.[27] [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

Predecessor Auditor's Report Reissued

.71 Before reissuing (or consenting to the reuse of) a report previously issued on the financial statements of a prior period, when those financial statements are to be presented on a comparative basis with audited financial statements of a subsequent period, a predecessor auditor should consider whether his or her previous report on those statements is still appropriate. Either the current form or manner of presentation of the financial statements of the prior period or one or more subsequent events might make a predecessor auditor's previous report inappropriate. Consequently, a predecessor auditor should (*a*) read the financial statements of the current period, (*b*) compare the prior-period financial statements that he or she reported on with the financial statements to be presented for comparative purposes, and (*c*) obtain representation letters from management of the former client and from the successor auditor. The representation letter from management of the former client should state (*a*) whether any information has come to management's attention that would cause them to believe that any of the previous representations should be modified, and (*b*) whether any events have occurred subsequent to the balance-sheet date of the latest prior-period financial statements reported on by the predecessor auditor that would require adjustment to or disclosure in those financial statements.[28] The representation letter from the successor auditor should state whether the successor's audit revealed any matters that, in the successor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor. Also, the predecessor auditor may wish to consider the matters described in section 543, *Part of Audit Performed by Other Independent Auditors*, paragraphs .10–.12. However, the predecessor auditor should not refer in his or her reissued report to the report or work of the successor auditor. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. As amended, effective for reports reissued on or after June 30, 1998, by Statement on Auditing Standards No. 85.]

.72 A predecessor auditor who has agreed to reissue his or her report may become aware of events or transactions occurring subsequent to the date of his

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[27] It is recognized that there may be reasons why a predecessor auditor's report may not be reissued and this section does not address the various situations that could arise. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

[28] See section 333, *Management Representations*, appendix C (paragraph .18), "Illustrative Updating Management Representation Letter." [Footnote added, effective for reports reissued on or after June 30, 1998, by Statement on Auditing Standards No. 85. Footnote renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

or her previous report on the financial statements of a prior period that may affect his or her previous report (for example, the successor auditor might indicate in the response that certain matters have had a material effect on the prior-period financial statements reported on by the predecessor auditor). In such circumstances, the predecessor auditor should make inquiries and perform other procedures that he or she considers necessary (for example, reviewing the working papers of the successor auditor as they relate to the matters affecting the prior-period financial statements). The auditor should then decide, on the basis of the audit evidence obtained, whether to revise the report. If a predecessor auditor concludes that the report should be revised, he or she should follow the guidance in paragraphs .68–.69 and .73 of this section. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

.73 A predecessor auditor's knowledge of the current affairs of his former client is obviously limited in the absence of a continuing relationship. Consequently, when reissuing the report on prior-period financial statements, a predecessor auditor should use the date of his or her previous report to avoid any implication that he or she has examined any records, transactions, or events after that date. If the predecessor auditor revises the report or if the financial statements are restated, he or she should dual-date the report. (See section 530, *Dating of the Independent Auditor's Report*, paragraph .05.) [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

Predecessor Auditor's Report Not Presented

.74 If the financial statements of a prior period have been audited by a predecessor auditor whose report is not presented, the successor auditor should indicate in the introductory paragraph of his or her report (*a*) that the financial statements of the prior period were audited by another auditor,[29] (*b*) the date of his or her report, (*c*) the type of report issued by the predecessor auditor, and (*d*) if the report was other than a standard report, the substantive reasons therefore.[30] An example of a successor auditor's report when the predecessor auditor's report is not presented is shown as follows:

Independent Auditor's Report

We have audited the balance sheet of ABC Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of ABC Company as of December 31, 20X1, were audited by other auditors whose report dated March 31, 20X2, expressed an unqualified opinion on those statements.

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[29] The successor auditor should not name the predecessor auditor in his or her report; however, the successor auditor may name the predecessor auditor if the predecessor auditor's practice was acquired by, or merged with, that of the successor auditor. [Footnote renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 85, November 1997. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

[30] If the predecessor's report was issued before the effective date of this section and contained an uncertainties explanatory paragraph, a successor auditor's report issued or reissued after the effective date hereof should not make reference to the predecessor's previously required explanatory paragraph. [Footnote added, effective for reports issued or reissued on or after February 29, 1996, by Statement on Auditing Standards No. 79. Footnote renumbered by the issuance of Statement on Auditing Standards No. 85, November 1997. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

> [*Same second paragraph as the standard report*]
>
> In our opinion, the 20X2 financial statements referred to above, present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X2, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

If the predecessor auditor's report was other than a standard report, the successor auditor should describe the nature of and reasons for the explanatory paragraph added to the predecessor's report or the opinion qualification. Following is an illustration of the wording that may be included in the successor auditor's report:

> . . . were audited by other auditors whose report dated March 1, 20X2, on those statements included an explanatory paragraph that described the change in the Company's method of computing depreciation discussed in Note X to the financial statements.

If the financial statements have been restated, the introductory paragraph should indicate that a predecessor auditor reported on the financial statements of the prior period before restatement. In addition, if the successor auditor is engaged to audit and applies sufficient procedures to satisfy himself or herself as to the appropriateness of the restatement adjustments, he or she may also include the following paragraph in his report:

> We also audited the adjustments described in Note X that were applied to restate the 20X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

[As amended, effective for reports issued after December 31, 1990, by Statement on Auditing Standards No. 64. Paragraph renumbered and amended, effective for reports issued or reissued on or after February 29, 1996, by the issuance of Statement on Auditing Standards No. 79.]

Effective Date and Transition

.75 This section is effective for reports issued or reissued on or after February 29, 1996. Earlier application of the provisions of this section is permissible. [Paragraph renumbered and amended, effective for reports issued or reissued on or after February 29, 1996, by the issuance of Statement on Auditing Standards No. 79.]

.76 An auditor who previously included an uncertainties explanatory paragraph in a report should not repeat that paragraph and is not required to include an emphasis paragraph related to the uncertainty in a reissuance of that report or in a report on subsequent periods' financial statements, even if the uncertainty has not been resolved. If the auditor decides to include an emphasis paragraph related to the uncertainty, the paragraph may include an explanation of the change in reporting standards.[31] [Paragraph renumbered and amended, effective for reports issued or reissued on or after February 29, 1996, by the issuance of Statement on Auditing Standards No. 79.]

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[31] [Footnote renumbered and deleted by the issuance of Statement on Auditing Standards No. 79, December 1995. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 85, November 1997. Footnote subsequently renumbered by the issuance of Statement on Auditing Standards No. 93, October 2000.]

United States Court of Appeals for the Ninth Circuit

Office of the Clerk
95 Seventh Street
San Francisco, CA 94103

Information Regarding Judgment and Post-Judgment Proceedings

Judgment

- This Court has filed and entered the attached judgment in your case. Fed. R. App. P. 36. Please note the filed date on the attached decision because all of the dates described below run from that date, not from the date you receive this notice.

Mandate (Fed. R. App. P. 41; 9th Cir. R. 41-1 & -2)

- The mandate will issue 7 days after the expiration of the time for filing a petition for rehearing or 7 days from the denial of a petition for rehearing, unless the Court directs otherwise. To file a motion to stay the mandate, file it electronically via the appellate ECF system or, if you are a pro se litigant or an attorney with an exemption from using appellate ECF, file one original motion on paper.

Petition for Panel Rehearing (Fed. R. App. P. 40; 9th Cir. R. 40-1)
Petition for Rehearing En Banc (Fed. R. App. P. 35; 9th Cir. R. 35-1 to -3)

(1) A. Purpose (Panel Rehearing):

- A party should seek panel rehearing only if one or more of the following grounds exist:
  - ► A material point of fact or law was overlooked in the decision;
  - ► A change in the law occurred after the case was submitted which appears to have been overlooked by the panel; or
  - ► An apparent conflict with another decision of the Court was not addressed in the opinion.
- Do not file a petition for panel rehearing merely to reargue the case.

B. Purpose (Rehearing En Banc)

- A party should seek en banc rehearing only if one or more of the following grounds exist:

- ► Consideration by the full Court is necessary to secure or maintain uniformity of the Court's decisions; or
- ► The proceeding involves a question of exceptional importance; or
- ► The opinion directly conflicts with an existing opinion by another court of appeals or the Supreme Court and substantially affects a rule of national application in which there is an overriding need for national uniformity.

(2) Deadlines for Filing:

- A petition for rehearing may be filed within 14 days after entry of judgment. Fed. R. App. P. 40(a)(1).
- If the United States or an agency or officer thereof is a party in a civil case, the time for filing a petition for rehearing is 45 days after entry of judgment. Fed. R. App. P. 40(a)(1).
- If the mandate has issued, the petition for rehearing should be accompanied by a motion to recall the mandate.
- *See* Advisory Note to 9th Cir. R. 40-1 (petitions must be received on the due date).
- An order to publish a previously unpublished memorandum disposition extends the time to file a petition for rehearing to 14 days after the date of the order of publication or, in all civil cases in which the United States or an agency or officer thereof is a party, 45 days after the date of the order of publication. 9th Cir. R. 40-2.

(3) Statement of Counsel

- A petition should contain an introduction stating that, in counsel's judgment, one or more of the situations described in the "purpose" section above exist. The points to be raised must be stated clearly.

(4) Form & Number of Copies (9th Cir. R. 40-1; Fed. R. App. P. 32(c)(2))

- The petition shall not exceed 15 pages unless it complies with the alternative length limitations of 4,200 words or 390 lines of text.
- The petition must be accompanied by a copy of the panel's decision being challenged.
- An answer, when ordered by the Court, shall comply with the same length limitations as the petition.
- If a pro se litigant elects to file a form brief pursuant to Circuit Rule 28-1, a petition for panel rehearing or for rehearing en banc need not comply with Fed. R. App. P. 32.

- The petition or answer must be accompanied by a Certificate of Compliance found at Form 11, available on our website at www.ca9.uscourts.gov under *Forms*.
- You may file a petition electronically via the appellate ECF system. No paper copies are required unless the Court orders otherwise. If you are a pro se litigant or an attorney exempted from using the appellate ECF system, file one original petition on paper. No additional paper copies are required unless the Court orders otherwise.

Bill of Costs (Fed. R. App. P. 39, 9th Cir. R. 39-1)

- The Bill of Costs must be filed within 14 days after entry of judgment.
- See Form 10 for additional information, available on our website at www.ca9.uscourts.gov under *Forms.*

Attorneys Fees

- Ninth Circuit Rule 39-1 describes the content and due dates for attorneys fees applications.
- All relevant forms are available on our website at www.ca9.uscourts.gov under *Forms* or by telephoning (415) 355-7806.

Petition for a Writ of Certiorari

- Please refer to the Rules of the United States Supreme Court at www.supremecourt.gov

Counsel Listing in Published Opinions

- Please check counsel listing on the attached decision.
- If there are any errors in a published opinion, please send a letter **in writing within 10 days** to:
  - ► Thomson Reuters; 610 Opperman Drive; PO Box 64526; St. Paul, MN 55164-0526 (Attn: Jean Green, Senior Publications Coordinator);
  - ► and electronically file a copy of the letter via the appellate ECF system by using "File Correspondence to Court," or if you are an attorney exempted from using the appellate ECF system, mail the Court one copy of the letter.

United States Court of Appeals for the Ninth Circuit

BILL OF COSTS

This form is available as a fillable version at:
http://cdn.ca9.uscourts.gov/datastore/uploads/forms/Form%2010%20-%20Bill%20of%20Costs.pdf.

Note: If you wish to file a bill of costs, it MUST be submitted on this form and filed, with the clerk, with proof of service, within 14 days of the date of entry of judgment, and in accordance with 9th Circuit Rule 39-1. A late bill of costs must be accompanied by a motion showing good cause. Please refer to FRAP 39, 28 U.S.C. § 1920, and 9th Circuit Rule 39-1 when preparing your bill of costs.

__________ v. __________ 9th Cir. No. __________

The Clerk is requested to tax the following costs against: __________

Cost Taxable under FRAP 39, 28 U.S.C. § 1920, 9th Cir. R. 39-1	**REQUESTED** *(Each Column Must Be Completed)*				**ALLOWED** *(To Be Completed by the Clerk)*			
	No. of Docs.	Pages per Doc.	Cost per Page*	TOTAL COST	No. of Docs.	Pages per Doc.	Cost per Page*	TOTAL COST
Excerpt of Record			$	$			$	$
Opening Brief			$	$			$	$
Answering Brief			$	$			$	$
Reply Brief			$	$			$	$
Other**			$	$			$	$
			TOTAL:	$			**TOTAL:**	$

* *Costs per page*: May not exceed .10 or actual cost, whichever is less. 9th Circuit Rule 39-1.

** *Other*: Any other requests must be accompanied by a statement explaining why the item(s) should be taxed pursuant to 9th Circuit Rule 39-1. Additional items without such supporting statements will not be considered.

Attorneys' fees **cannot** be requested on this form.

Continue to next page

Form 10. Bill of Costs - *Continued*

I, [ ] , swear under penalty of perjury that the services for which costs are taxed were actually and necessarily performed, and that the requested costs were actually expended as listed.

Signature [ ]

("s/" plus attorney's name if submitted electronically)

Date [ ]

Name of Counsel: [ ]

Attorney for: [ ]

(To Be Completed by the Clerk)

Date [ ] Costs are taxed in the amount of $ [ ]

Clerk of Court

By: [ ] , Deputy Clerk