

FEDERAL COURT OF AUSTRALIA

Australian Securities and Investments Commission v Godfrey [2017] FCA 1569

File number: VID 690 of 2017

Judge: **MOSHINSKY J**

Date of judgment: 22 December 2017

Catchwords: **CORPORATIONS** – financial reporting – obligation of director under s 344(1) of *Corporations Act 2001* (Cth) to take all reasonable steps to comply with, or to secure compliance with, Pt 2M.3 – where director failed to take all reasonable steps to ensure that financial reports complied with the requirements of Pt 2M.3 – where director admitted contravening s 344(1) – where parties prepared agreed statement of facts and jointly proposed declarations and orders that the director be disqualified from managing corporations for five years and pay a pecuniary penalty of \$25,000 – whether proposed orders appropriate – proposed orders made

Legislation: *Corporations Act 2001* (Cth), ss 111AC, 111AI, 206C, 206E, 206G, 283AA, 292-323DA, 344, 1317DA, 1317E, 1317G, 1317J

Cases cited: *Australian Competition and Consumer Commission v Coles Supermarkets Australia Pty Ltd* [2014] FCA 1405
Australian Competition and Consumer Commission v High Adventure Pty Ltd [2006] ATPR 42-091; [2005] FCAFC 247
Australian Securities and Investments Commission v Beekink (2007) 238 ALR 595
Australian Securities and Investments Commission v Healey (2011) 196 FCR 291
Australian Securities and Investments Commission v Healey (No 2) (2011) 196 FCR 430
Australian Securities and Investments Commission v Lindberg (2012) 91 ACSR 640
Australian Securities and Investments Commission v John Barrie Loiterton & Ors [2004] NSWSC 172
Australian Securities and Investments Commission v Vizard (2005) 145 FCR 57
Australian Securities and Investments Commission v White (2006) 58 ACSR 261

Australian Securities Commission v Fairlie (1993) 11
ACLJ 669
*Commonwealth v Director, Fair Work Building Industry
Inspectorate* (2015) 258 CLR 482
Elliott v Australian Securities and Investments Commission
(2004) 10 VR 369
*NW Frozen Foods Pty Ltd v Australian Competition and
Consumer Commission* (1996) 71 FCR 285
*Re HIH Insurance Ltd (in prov liq) and HIH Casualty and
General Insurance Ltd (in prov liq); Australian Securities
and Investments Commission v Adler* (2002) 42 ACSR 80
Rich v Australian Securities and Investments Commission
(2004) 220 CLR 129
*Trade Practices Commission v Allied Mills Industries Pty
Ltd (No 5)* (1981) 60 FLR 38; 37 ALR 256

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Solicitor for the Plaintiff: Australian Securities and Investments Commission
Counsel for the Defendant: Mr R Peters
Solicitor for the Defendant: King & Wood Mallesons

ORDERS

VID 690 of 2017

BETWEEN: **AUSTRALIAN SECURITIES AND INVESTMENTS
COMMISSION**
Plaintiff

AND: **PATRICK JOHN GODFREY**
Defendant

JUDGE: **MOSHINSKY J**

DATE OF ORDER: **22 DECEMBER 2017**

THE COURT DECLARES THAT:

1. The defendant, Patrick John Godfrey (**Mr Godfrey**), contravened s 344(1) of the *Corporations Act 2001* (Cth) (the **Act**) in relation to Banksia Securities Limited (**BSL**), in that, being a director of BSL, by the conduct described in paragraph 2 below, he failed to take all reasonable steps to secure compliance by BSL with:
 - (a) sections 296 and 297 of the Act in relation to the annual financial report for the year ended 30 June 2011 (the **BSL 2011 financial report**) (Contravention 1);
 - (b) sections 304 and 305 of the Act in relation to the half-year financial report for the half year ended 31 December 2011 (the **BSL 2011-12 half-year financial report**) (Contravention 2); and
 - (c) sections 296 and 297 of the Act in relation to the annual financial report for the year ended 30 June 2012 (the **BSL 2012 financial report**) (Contravention 3),

in that the provisioning for bad and doubtful debts was inadequate as set out in the table below:

Accounting period ended	Bad and doubtful debt provisioning deficiency	Shareholders' capital (as mis-stated in the relevant balance sheet)	Adjusted shareholders' capital (accounting for provisioning deficiency)
30 June 2011	\$4,322,517	\$24,061,249	\$19,738,732

31 December 2011	\$4,280,540	\$22,972,650	\$18,692,110
30 June 2012	\$4,755,046	\$24,192,965	\$19,437,919

2. Mr Godfrey:

- (1) was, in respect of the accounting periods ended 30 June 2011 and 31 December 2011, the officer of BSL charged with primary responsibility for making recommendations to the other directors and the management of BSL as to the appropriate amount of provision for bad and doubtful debts;
- (2) was, in respect of the accounts for the period ended 30 June 2012, a director of BSL and a signatory to those accounts;
- (3) failed to have or obtain a sufficient understanding of the requirements of AASB 139 for the recognition of and assessment of impairment of financial assets, including mortgage investments;
- (4) as a result of the failure set out in sub-paragraph (3) above, failed to ensure that BSL's policies and practices with respect to:
 - (a) the identification of loans that ought to be assessed for impairment;
 - (b) the process of assessment of loans for impairment; and
 - (c) the process by which calculation of provisions for impairment were made,
were:
 - (d) consistent with the requirements of AASB 139;
 - (e) when applied, likely to result in the production of financial statements that:
 - (i) complied with AASB 139; and
 - (ii) showed a true and fair view,
- (5) as a result of the failure set out in sub-paragraphs (3) and (4) above, failed to identify that BSL's policies and procedures for determining impairment of mortgage investments were not appropriate to determine:
 - (a) the fair value, at the relevant times, of; and

- (b) the appropriate level of impairment, at the relevant times, for, four mortgage investments giving rise to the deficiencies listed in paragraph 1 above;
- (6) as a result of the failures identified in sub-paragraphs (3), (4) and (5) above, failed to bring to the attention of the other directors and the management of BSL:
- (a) the fair value, at the relevant times, of; and
- (b) the appropriate level of impairment, at the relevant times, for, four mortgage investments giving rise to the deficiencies listed in paragraph 1 above, and the consequences of those deficiencies to the balance sheets and profit and loss statements for the relevant periods.
3. The four loans in respect of which there was inadequate provision for bad and doubtful debts were as follows:

Loan	Required Additional Provisions		
	BSL 2011 financial report	BSL 2011-12 half-year financial report	BSL 2012 financial report
Java Court	\$0	\$451,918	\$461,567
A Michelmores	\$1,359,725	\$825,372	\$822,325
Mirage Property	\$721,636	\$738,463	\$1,649,271
Southbeach Developments	\$2,241,156	\$2,264,787	\$1,821,883
Totals	\$4,322,517	\$4,280,540	\$4,755,046

THE COURT ORDERS THAT:

4. Mr Godfrey be disqualified from managing corporations for a period of five years from 4.30 pm on 1 February 2018.
5. Mr Godfrey pay to the Commonwealth a pecuniary penalty of \$25,000.
6. There be no order as to costs.
7. There be liberty to apply.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

MOSHINSKY J:

Introduction

1 The defendant, Patrick John Godfrey (**Mr Godfrey**), was, at the relevant times, a director of Banksia Securities Limited (**BSL**) and, until 5 July 2012, the managing director of BSL. Section 344(1) of the *Corporations Act 2001* (Cth) (the **Act**) relevantly provides that a director of a company contravenes the section if he or she fails to take all reasonable steps to comply with, or to secure compliance with, Pt 2M.3. Part 2M.3 of the Act deals with financial reporting. In this proceeding, the plaintiff (**ASIC**) alleges that Mr Godfrey contravened s 344 by failing to take all reasonable steps to ensure that the following documents complied with Pt 2M.3:

- (a) BSL's financial report for the year ended 30 June 2011 (the **BSL 2011 financial report**);
- (b) BSL's half-year financial report for the half-year ended 31 December 2011 (the **BSL 2011-12 half-year financial report**); and
- (c) BSL's financial report for the year ended 30 June 2012 (the **BSL 2012 financial report**).

2 In its originating process, ASIC seeks: declarations of contravention under s 1317E of the Act; an order pursuant to s 1317G(1) that Mr Godfrey pay to the Commonwealth a pecuniary penalty of such amount as the Court considers appropriate; and an order pursuant to s 206C, or alternatively s 206E, that Mr Godfrey be disqualified from managing corporations for such period as the Court considers appropriate.

3 Mr Godfrey admits that he contravened s 344 of the Act. ASIC and Mr Godfrey have reached agreement on a statement of agreed facts (the **SOAF**), a copy of which is annexed to these reasons (save that footnotes have been omitted and an agreed correction to paragraph 299 has been incorporated). The parties have also reached agreement on proposed declarations and proposed orders. The proposed declarations are set out in a document headed "Agreed Declaration of Contravention" that is annexed to an affidavit of Mr Godfrey. The proposed orders, which relate to disqualification from managing corporations and a pecuniary penalty, are set out in ASIC's outline of submissions. These orders are agreed to

by Mr Godfrey in his outline of submissions, save that he makes a submission as to the form of the disqualification order (as discussed below).

4 The proposed declarations are in substance as follows:

1. The defendant, Patrick John Godfrey (**Mr Godfrey**), contravened s 344(1) of the *Corporations Act 2001* (Cth) (the **Act**) in relation to Banksia Securities Limited (**BSL**), in that, being a director of BSL, by the conduct described in paragraph 2 below, he failed to take all reasonable steps to secure compliance by BSL with:
 - (a) sections 296 and 297 of the Act in relation to the annual financial report for the year ended 30 June 2011 (the **BSL 2011 financial report**) (Contravention 1);
 - (b) sections 304 and 305 of the Act in relation to the half-year financial report for the half year ended 31 December 2011 (the **BSL 2011-12 half-year financial report**) (Contravention 2); and
 - (c) sections 296 and 297 of the Act in relation to the annual financial report for the year ended 30 June 2012 (the **BSL 2012 financial report**) (Contravention 3),

in that the provisioning for bad and doubtful debts was inadequate as set out in the table below:

Accounting period ended	Bad and doubtful debt provisioning deficiency	Shareholders' capital (as mis-stated in the relevant balance sheet)	Adjusted shareholders' capital (accounting for provisioning deficiency)
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30 June 2012	\$4,755,046	\$24,192,965	\$19,437,919

2. Mr Godfrey:
 - (1) was, in respect of the accounting periods ended 30 June 2011 and 31 December 2011, the officer of BSL charged with primary responsibility for making recommendations to the other directors and the management of BSL as to the appropriate amount of provision for bad and doubtful debts;
 - (2) was, in respect of the accounts for the period ended 30 June 2012, a director of BSL and a signatory to those accounts;
 - (3) failed to have or obtain a sufficient understanding of the requirements of AASB 139 for the recognition of and assessment of impairment of financial assets, including mortgage investments;
 - (4) as a result of the failure set out in sub-paragraph (3) above, failed to ensure that BSL's policies and practices with respect to:
 - (a) the identification of loans that ought to be assessed for

impairment;

- (b) the process of assessment of loans for impairment; and
- (c) the process by which calculation of provisions for impairment were made,

were:

- (d) consistent with the requirements of AASB 139;
- (e) when applied, likely to result in the production of financial statements that:
 - (i) complied with AASB 139; and
 - (ii) showed a true and fair view,

and therefore:

- (f) did not result in the mis-statements set out in paragraph 1 above;
- (5) as a result of the failure set out in sub-paragraphs (3) and (4) above, failed to identify that BSL’s policies and procedures for determining impairment of mortgage investments were not appropriate to determine:
 - (a) the fair value, at the relevant times, of; and
 - (b) the appropriate level of impairment, at the relevant times, for,

four mortgage investments giving rise to the deficiencies listed in paragraph 1 above;

- (6) as a result of the failures identified in sub-paragraphs (3), (4) and (5) above, failed to bring to the attention of the other directors and the management of BSL:
 - (a) the fair value, at the relevant times, of; and
 - (b) the appropriate level of impairment, at the relevant times, for,

four mortgage investments giving rise to the deficiencies listed in paragraph 1 above, and the consequences of those deficiencies to the balance sheets and profit and loss statements for the relevant periods.

- 3. The four loans in respect of which there was inadequate provision for bad and doubtful debts were as follows:

Loan	Required Additional Provisions		
	BSL 2011 financial report	BSL 2011-12 half-year financial report	BSL 2012 financial report
Java Court	\$0	\$451,918	\$461,567
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Southbeach	\$2,241,156	\$2,264,787	\$1,821,883

Developments			
Totals	\$4,322,517	\$4,280,540	\$4,755,046

5 The proposed orders are to the effect that:

- (a) Mr Godfrey be disqualified from managing corporations for a period of five years; and
- (b) Mr Godfrey pay to the Commonwealth a pecuniary penalty of \$25,000.

6 In his outline of submissions, Mr Godfrey seeks that the disqualification order be in the form:

The defendant, Patrick John Godfrey, is disqualified from managing corporations for a period of [period] from 4.30pm on [date].

7 It is explained that if, on ASIC's application, the Court decides to make an order under s 206C of the Act disqualifying Mr Godfrey from managing corporations, Mr Godfrey will immediately apply under s 206G(1) of the Act for leave to manage the corporate trustee of his and his wife's self-managed superannuation fund, P&M Godfrey Holdings Pty Ltd. It is stated that Mr Godfrey's application would relate only to that company and he would discontinue as a director of all other companies if so ordered by the Court. It is also stated that Mr Godfrey has confirmed that, at least for the duration of any disqualification order made by the Court on ASIC's application, P&M Godfrey Holdings Pty Ltd would not perform any function or conduct any business other than as trustee of the superannuation fund and for the purposes of the fund.

8 The evidence before the Court at the hearing comprised:

- (a) an affidavit of Brendan Caridi, a senior manager in ASIC's Corporations & Corporate Governance Enforcement Team – the SOAF was annexed to this affidavit;
- (b) a bundle of documents comprising the relevant financial reports; and
- (c) an affidavit of Mr Godfrey.

9 At the hearing, the parties made oral submissions in support of the proposed declarations and orders. In the course of the hearing, I indicated that I had concerns as to the sufficiency of the proposed pecuniary penalty. I gave leave for the parties to file further material. Subsequently, Mr Godfrey filed an outline of further submissions. This included some additional facts which, it was indicated, were agreed between the parties.

10 For the reasons that follow, I consider there to be a proper basis for making the proposed declarations. I also consider there to be a proper basis to make a disqualification order to the effect that Mr Godfrey be disqualified from managing corporations for a period of five years. I will make this order in the form sought by Mr Godfrey, so as to enable an application to be brought to, in effect, carve out the corporate trustee of his and his wife's superannuation fund. Notwithstanding my initial reservations, on the basis of the facts and matters set out in the SOAF and the additional matters contained in Mr Godfrey's outline of further submissions, I consider the proposed penalty of \$25,000 to be an appropriate penalty and will make an order to this effect. I will also make an order, as agreed between the parties, that there be no order as to costs.

Applicable principles

11 The applicable principles as regards the making of orders by agreement and as regards declarations were summarised by Gordon J in *Australian Competition and Consumer Commission v Coles Supermarkets Australia Pty Ltd* [2014] FCA 1405 at [70]-[79] as follows:

2.3.1 Orders sought by agreement

...

70 The applicable principles are well established. First, there is a well-recognised public interest in the settlement of cases under the Act: *NW Frozen Foods Pty Ltd v Australian Competition & Consumer Commission* (1996) 71 FCR 285 at 291. Second, the orders proposed by agreement of the parties must be not contrary to the public interest and at least consistent with it: *Australian Competition & Consumer Commission v Real Estate Institute of Western Australia Inc* (1999) 161 ALR 79 at [18].

71 Third, when deciding whether to make orders that are consented to by the parties, the Court must be satisfied that it has the power to make the orders proposed and that the orders are appropriate: *Real Estate Institute* at [17] and [20] and *Australian Competition & Consumer Commission v Virgin Mobile Australia Pty Ltd (No 2)* [2002] FCA 1548 at [1]. Parties cannot by consent confer power to make orders that the Court otherwise lacks the power to make: *Thomson Australian Holdings Pty Ltd v Trade Practices Commission* (1981) 148 CLR 150 at 163.

72 Fourth, once the Court is satisfied that orders are within power and appropriate, it should exercise a degree of restraint when scrutinising the proposed settlement terms, particularly where both parties are legally represented and able to understand and evaluate the desirability of the settlement: *Australian Competition & Consumer Commission v Woolworths (South Australia) Pty Ltd (Trading as Mac's Liquor)* [2003] FCA 530 at [21]; *Australian Competition & Consumer Commission v Target Australia Pty Ltd* [2001] FCA 1326 at [24]; *Real Estate Institute* at [20]-[21]; *Australian*

Competition & Consumer Commission v Econovite Pty Ltd [2003] FCA 964 at [11] and [22] and *Australian Competition & Consumer Commission v The Construction, Forestry, Mining and Energy Union* [2007] FCA 1370 at [4].

73 Finally, in deciding whether agreed orders conform with legal principle, the Court is entitled to treat the consent of Coles as an admission of all facts necessary or appropriate to the granting of the relief sought against it: *Thomson Australian Holdings* at 164.

2.3.2 *Declarations*

74 The Court has a wide discretionary power to make declarations under s 21 of the Federal Court Act: *Forster v Jododex Australia Pty Ltd* (1972) 127 CLR 421 at 437–8; *Ainsworth v Criminal Justice Commission* (1992) 175 CLR 564 at 581–2 and *Tobacco Institute of Australia Ltd v Australian Federation of Consumer Organisations Inc (No 2)* (1993) 41 FCR 89 at 99.

75 Where a declaration is sought with the consent of the parties, the Court’s discretion is not supplanted, but nor will the Court refuse to give effect to terms of settlement by refusing to make orders where they are within the Court’s jurisdiction and are otherwise unobjectionable: see, for example, *Econovite* at [11].

76 However, before making declarations, three requirements should be satisfied:

- (1) The question must be a real and not a hypothetical or theoretical one;
- (2) The applicant must have a real interest in raising it; and
- (3) There must be a proper contradictor:

Forster v Jododex at 437–8.

77 In this proceeding, these requirements are satisfied. The proposed declarations relate to conduct that contravenes the ACL and the matters in issue have been identified and particularised by the parties with precision: *Australian Competition & Consumer Commission v MSY Technology Pty Ltd* (2012) 201 FCR 378 at [35]. The proposed declarations contain sufficient indication of how and why the relevant conduct is a contravention of the ACL: *BMW Australia Ltd v Australian Competition & Consumer Commission* [2004] FCAFC 167 at [35].

78 It is in the public interest for the ACCC to seek to have the declarations made and for the declarations to be made (see the factors outlined in *ACCC v CFMEU* at [6]). There is a significant legal controversy in this case which is being resolved. The ACCC, as a public regulator under the ACL, has a genuine interest in seeking the declaratory relief and Coles is a proper contradictor because it has contravened the ACL and is the subject of the declarations. Coles has an interest in opposing the making of them: *MSY Technology* at [30]. No less importantly, the declarations sought are appropriate because they serve to record the Court’s disapproval of the contravening conduct, vindicate the ACCC’s claim that Coles contravened the ACL, assist the ACCC to carry out the duties conferred upon it by the Act (including the ACL) in relation to other similar conduct, inform the public of the harm arising from Coles’ contravening conduct and deter other corporations from contravening the ACL.

79 Finally, the facts and admissions in Annexure 1 provide a sufficient factual

foundation for the making of the declarations: s 191 of the Evidence Act; *Australian Competition & Consumer Commission v Dataline.Net.Au Pty Ltd* (2006) 236 ALR 665 at [57]–[59] endorsed by the Full Court in *Australian Competition & Consumer Commission v Dataline.Net.Au Pty Ltd* (2007) 161 FCR 513 at [92]; *Hadgkiss v Aldin (No 2)* [2007] FCA 2069 at [21]–[22]; *Secretary, Department of Health & Ageing v Pagasa Australia Pty Ltd* [2008] FCA 1545 at [77]–[79] and *Ponzio v B & P Caelli Constructions Pty Ltd* (2007) 158 FCR 543.

- 12 Disqualification from managing corporations is dealt with in, among other provisions, s 206C of the Act. Section 206C(1) relevantly provides that, on application by ASIC, the Court may disqualify a person from managing corporations for a period that the Court considers appropriate if: a declaration is made under s 1317E that the person has contravened a corporation/scheme civil penalty provision; and the Court is satisfied that the disqualification is justified. A contravention of s 344(1) is a “corporation/scheme civil penalty provision”: s 1317DA; s 1317E(1), table, item 5. In determining whether the disqualification is justified, the Court may have regard to: the person’s conduct in relation to the management, business or property of any corporation; and any other matters that the Court considers appropriate: s 206C(2).
- 13 The Court will generally have regard to the following categories of matters in considering whether a disqualification order is justified: the nature and seriousness of the contraventions; protection of the public; retribution and deterrence; and mitigating factors: *Rich v Australian Securities and Investments Commission* (2004) 220 CLR 129 (**Rich**) at [47]–[58] per McHugh J; *Australian Securities and Investments Commission v White* (2006) 58 ACSR 261 at [18] per Hargrave J. Personal and general deterrence are “central factors in determining whether an order for disqualification should be made and, if so, for what period”: *Australian Securities and Investments Commission v Beekink* (2007) 238 ALR 595 at [84]; see also *Rich* at [52]; *Elliott v Australian Securities and Investments Commission* (2004) 10 VR 369 at [137]. Consideration of general deterrence will be central, even in the event that the Court is satisfied that personal deterrence might have a lesser role to play: *Australian Competition and Consumer Commission v High Adventure Pty Ltd* [2006] ATPR 42-091; [2005] FCAFC 247 (in the context of pecuniary penalties), cited with approval in relation to disqualification orders in *Australian Securities and Investments Commission v Lindberg* (2012) 91 ACSR 640 at [87]; see also *Australian Securities and Investments Commission v Healey (No 2)* (2011) 196 FCR 291 at [123].

- 14 Section 1317G(1) of the Act provides that the Court may order a person to pay a pecuniary penalty of up to \$200,000 if: a declaration of contravention by the person has been made under s 1317E; the contravention is of a corporation/scheme civil penalty provision; and the contravention (among other things) is serious. An application for a declaration of contravention and a pecuniary penalty order may be made by ASIC: s 1317J(1).
- 15 The principles applicable to the discretion to impose pecuniary penalties have been discussed in many cases. In the context of the imposition of penalties for breaches of the corporations law under s 1317G of the Act, I refer, in particular, to *Re HIH Insurance Ltd (in prov liq) and HIH Casualty and General Insurance Ltd (in prov liq); Australian Securities and Investments Commission v Adler* (2002) 42 ACSR 80 at [125]-[132] per Santow J.
- 16 In *Commonwealth v Director, Fair Work Building Industry Inspectorate* (2015) 258 CLR 482 (*FWBII*), the High Court held that, in the context of civil penalty provisions, it was open to the Court to receive submissions, including joint submissions, as to an appropriate penalty. French CJ, Kiefel, Bell, Nettle and Gordon JJ (with whom Keane J agreed) stated at [46] that there is “an important public policy involved in promoting predictability of outcome in civil penalty proceedings” and that “the practice of receiving and, if appropriate, accepting agreed penalty submissions increases the predictability of outcome for regulators and wrongdoers”. Their Honours stated that, as was recognised in *Trade Practices Commission v Allied Mills Industries Pty Ltd (No 5)* (1981) 60 FLR 38; 37 ALR 256 and determined in *NW Frozen Foods Pty Ltd v Australian Competition and Consumer Commission* (1996) 71 FCR 285 (*NW Frozen Foods*), “such predictability of outcome encourages corporations to acknowledge contraventions, which, in turn, assists in avoiding lengthy and complex litigation and thus tends to free the courts to deal with other matters and to free investigating officers to turn to other areas of investigation that await their attention”.
- 17 Their Honours stated, at [57], that in civil proceedings there is generally very considerable scope for the parties to agree on the facts and their consequences; and that there “is also very considerable scope for them to agree upon the appropriate remedy and for the court to be persuaded that it is *an appropriate remedy*”. In relation to civil penalty proceedings, their Honours stated at [58]:

Subject to the court being sufficiently persuaded of the accuracy of the parties’ agreement as to facts and consequences, and that the penalty which the parties propose is *an appropriate remedy* in the circumstances thus revealed, it is consistent with principle and, for the reasons identified in *Allied Mills*, highly desirable in

practice for the court to accept the parties' proposal and therefore impose the proposed penalty.

(Footnote omitted.)

18 Their Honours in *FWBII* also made observations, at [60]-[61], regarding submissions by a regulator in such a context.

19 It follows from the above that the questions to be determined in the present case include: first, whether the Court is sufficiently persuaded of the accuracy of the parties' agreement as to facts and consequences; and secondly, whether the penalty that the parties propose is *an* appropriate remedy in the circumstances thus revealed.

20 In *FWBII*, French CJ, Kiefel, Bell, Nettle and Gordon JJ explained the purpose of a civil penalty as follows at [55]:

... whereas criminal penalties import notions of retribution and rehabilitation, the purpose of a civil penalty, as French J explained in *Trade Practices Commission v CSR Ltd*, is primarily if not wholly protective in promoting the public interest in compliance:

“Punishment for breaches of the criminal law traditionally involves three elements: deterrence, both general and individual, retribution and rehabilitation. Neither retribution nor rehabilitation, within the sense of the Old and New Testament moralities that imbue much of our criminal law, have any part to play in economic regulation of the kind contemplated by Pt IV [of the *Trade Practices Act*] ... The principal, and I think probably the only, object of the penalties imposed by s 76 is to attempt to put a price on contravention that is sufficiently high to deter repetition by the contravenor and by others who might be tempted to contravene the Act.”

(Footnotes omitted.)

Application of principles in the present case

The contraventions of s 344

21 The facts and circumstances are set out in the SOAF, supplemented by the further agreed facts contained in Mr Godfrey's outline of further submissions. It is not necessary to set out all these facts and circumstances in detail. Nevertheless, I set out some of the main aspects, and my conclusions as to the operation of the Act, based substantially on ASIC's outline of submissions, with which Mr Godfrey agreed.

22 The parties submit, and I accept, that each of the steps that Mr Godfrey admits that he failed to take was a step that it was reasonable for him to take to ensure that BSL complied with its legislative obligations. Consideration of that proposition requires the Court to consider: first, what was required by BSL to comply with the requirements in Pt 2M.3 of the Act; and

secondly, what steps Mr Godfrey reasonably ought to have taken to secure BSL's compliance with those requirements: *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291 (*Healey*) at [150] per Middleton J.

23 Pt 2M.3 of the Act (comprising ss 292-323DA) concerns the preparation and content of financial reports. The requirements in the Part are obligations of the entities to which the Part applies: *Healey* at [126].

24 BSL raised money from members of the public by the issue of debentures. At all material times it was required by s 283AA of the Act to appoint a trustee to protect the interests of debenture holders.

25 By reason of that requirement, at all times during the period from 1 July 2010 until 25 October 2012 (the **Relevant Period**), BSL was a disclosing entity within the meaning of s 111AC of the Act (see s 111AI) and therefore required:

- (a) to prepare a financial report for the financial years that ended on each of 30 June 2011 and 30 June 2012 (s 292(1)(a)); and
- (b) to prepare a financial report for the half-year that ended on 31 December 2011 (s 302).

26 Sections 295 and 303 of the Act set out the requirements for the content of the financial reports that BSL was required to prepare.

27 In addition to those specific requirements, BSL was required to prepare its financial reports and half-year financial reports such that the financial reports, and the notes to those reports:

- (a) complied with the requirements of the accounting standards published by the Australian Accounting Standards Board (the **AASB**) (ss 296(1), 304); and
- (b) gave a true and fair view of BSL's financial position and performance (ss 297, 305).

28 Each of those provisions, at all times during the Relevant Period, was contained in Pt 2M.3 of the Act.

29 At all relevant times, BSL's business involved raising money from the public through the issue of debentures, and advancing the funds raised to third party borrowers for property investment and development (SOAF, [14]). Those loans were advanced either directly by

BSL, or by Banksia Mortgages Limited (**BML**), a related party of BSL and the responsible entity for the Banksia Mortgage Fund (**BMF**).

30 Whether a loan was advanced by BSL or BML, loans were generally secured by: a loan agreement between BSL or BMF and the borrower; and a first ranking mortgage over real property.

31 As a result, at all times during the Relevant Period, BSL was required to recognise on its balance sheet the value of the loans advanced to third parties as a loan receivable (accounting standard AASB 101, entitled “Presentation of Financial Statements”, [54]). At all times during the Relevant Period, the preponderance of assets on the balance sheet of BSL were loans and receivables (referred to by BSL in its financial statements as “mortgage investments”).

32 Accounting standard AASB 139, entitled “Financial Instruments: Recognition and Measurement” (**AASB 139**), was the standard that BSL was required at all times to apply to determine:

- (a) the value at which loans and receivables were recognised on its balance sheet; and
- (b) whether it was required to make a provision for any loan receivable so recognised and, if so, the quantum of such a provision.

33 A comprehensive description of the content and requirements of AASB 139 that BSL was required to apply when determining those matters appears at [73]-[79] of the SOAF. In summary, BSL was required:

- (a) at each reporting date:
 - (i) to assess whether there existed any objective evidence that any of the loans and receivables recognised on its balance sheet was impaired; and
 - (ii) if so, to determine the amount of any impairment loss;
- (b) to recognise that an impairment loss had occurred if the impact of any identified loss event or events had an impact on the estimated future cash flows of the financial asset or group of financial assets that could be reliably estimated (AASB 139, [58]-[59]); and

- (c) to measure the quantum of such an impairment loss, and recognise an impairment, as the difference between:
 - (i) the carrying amount of the loan receivable; and
 - (ii) the present value of estimated future cash flows, discounted at the loan receivable's original effective interest rate (AASB 139, [63]).

34 The application guide to AASB 139 suggested that once an entity had identified objective evidence of impairment of a collateralised financial asset, the calculation of the present value of that asset reflected the cash flows that may result from foreclosure, less costs for obtaining and selling the collateral, whether or not foreclosure was probable (AASB 139, [AG84]).

35 By reason of the foregoing, at all times in the Relevant Period, in order to satisfy the requirements of ss 296(1) and 304, and therefore Pt 2M.3 of the Act, BSL was required to:

- (a) apply the terms of AASB 139 to determine:
 - (i) whether a loan receivable recognised on its balance sheet was impaired; and
 - (ii) if so, the quantum of that impairment; and
- (b) determine the quantum of any such impairment as the difference between:
 - (i) the carrying value of the loan; and
 - (ii) the estimate of the future cash flows that may result from the foreclosure of the collateral for that loan, less the costs for obtaining and selling that collateral,
appropriately discounted to account for the time it would take to realise the value of the collateral.

36 The next step in the analysis is to ascertain what steps a director of BSL ought reasonably to have taken to secure compliance by BSL with those requirements: *Healey* at [150].

37 The determination of the steps that a director ought reasonably to have taken to secure compliance with the requirements of Pt 2M.3 of the Act: is an objective one (*Healey* at [178]-[179]); and will depend on all the circumstances (*Australian Securities Commission v Fairlie* (1993) 11 ACLC 669 (*Fairlie*) at 681; *Australian Securities and Investments Commission v John Barrie Loiterton & Ors* [2004] NSWSC 172 at [45]).

38 In the present case, considerations that inform the steps that it was reasonable for a director to take to secure compliance with Pt 2M.3 include both the characteristics of BSL and those of Mr Godfrey's role as a director of that company.

39 In relation to BSL, those characteristics include: the nature of BSL's business, which was effectively that of a quasi-bank (SOAF, [14]); and the fact that, at all times during the Relevant Period, BSL's main asset was its loan portfolio, which at the time of the appointment of receivers to BSL, totalled approximately \$527 million.

40 In relation to Mr Godfrey's role within BSL, those characteristics include: Mr Godfrey's role as the managing director of BSL; his responsibility in the accounting periods that ended on 30 June 2011 and 31 December 2011 for recommending to the board of BSL the quantum of any impairment that should have been recognised for those loans that the Default Management Committee (the **DMC**) had classified as "non-performing"; the fact that Mr Godfrey, acting as a director of BSL, signed the declaration required for the purposes of s 295(1)(c) of the Act (in relation to BSL's financial reports for the reporting periods ending on 30 June 2011 and 30 June 2012) and s 303(1)(c) (in relation to BSL's financial report for the half-year reporting period ending on 31 December 2011).

41 The parties submit, and I accept, that those circumstances support the contention that each of the steps set out in paragraph 2 of the agreed declarations of contravention was a step that Mr Godfrey reasonably ought to have taken to secure BSL's compliance with its obligations in Pt 2M.3 of the Act. Why these steps were reasonable, and how they would have secured compliance, requires consideration of how BSL in fact determined provisions for impairment of loan receivables, and why that process failed to comply with the requirements of AASB 139.

42 A description of the process that BSL employed to determine whether loan receivables were recognised on its balance sheet appears from [80] of the SOAF. In summary, the process employed by BSL to determine whether a loan was impaired, and if so the quantum of impairment, was as follows:

- (a) The DMC, an executive committee of BSL, made a determination as to whether any loan that was:
 - (i) in arrears within its first 12 months;
 - (ii) in arrears over 30 days; or

- (iii) subject to legal action,
should be classified as “non-performing”, which occurred when the committee formed the opinion that it was unlikely that further interest on the loan advanced would be recovered.
- (b) Each quarter, Mr Godfrey prepared a report titled “non-performing loans and provisions” for consideration by the board of BSL, which contained, among other things, a description (in respect of each loan that the DMC had categorised as non-performing) of:
 - (i) the borrower;
 - (ii) the carrying value of the loan; and
 - (iii) a “notional provision” for the loan.
- (c) At the time of the preparation of the financial reports and half-year financial reports of BSL, Mr Godfrey decided what would be the recommended “notional provision” for each loan that had been categorised as non-performing.
- (d) In determining whether a provision should be recognised for a particular loan, Mr Godfrey used the criteria set out in the policy document used by the DMC to determine whether a loan should be categorised as non-performing, which included the following considerations:
 - (i) any valuation by a registered valuer or current municipal valuation, or any appraisal by a real estate agent, of the property that secured the loan;
 - (ii) market intelligence within the Banksia Financial Group;
 - (iii) recoverability of the loan from other persons such as guarantors, prior valuers, introducing brokers and accountants;
 - (iv) the economic assessment of the opportunity to hold the property and manage the risk over time, including any “economic case” for holding a particular security for a “longer term and manage the risk through a down cycle”; and
 - (v) the opportunity to further develop the property to enhance value.
- (e) In addition to those considerations, in determining the quantum of the provision, Mr Godfrey may also have had regard to the following criteria:

- (i) sales of any part of the secured property concerned;
- (ii) the prospect of better recovery by means of further advances and development of the property secured;
- (iii) market conditions;
- (iv) progress in any legal proceedings concerning the loan;
- (v) BSL's historical performance of recoveries in respect of non-performing loans; and
- (vi) views in regard to short-term and long-term strategies adopted for recovery of the debt.

43 By the application of that approach:

- (a) the provisions for three loans recognised in the BSL 2011 financial report were \$4,322,517 less than they ought to have been had BSL properly applied the requirements of AASB 139;
- (b) the provisions for four loans recognised in the BSL 2011-12 half-year financial report were \$4,280,540 less than they ought to have been had BSL properly applied the requirements of AASB 139; and
- (c) the provisions for four loans recognised in the BSL 2012 financial report were \$4,755,046 less than they ought to have been had BSL properly applied the requirements of AASB 139.

44 It should be noted that, in each of the three relevant accounting periods, it is the same four loans that were inadequately provided for (except for the June 2011 accounts, at which time Java Court was not inadequately provided for). Mr Godfrey submits in his outline of further submissions (and I accept) that the SOAF requires some clarification as follows:

- (a) In respect of the first relevant accounts, being the BSL 2011 financial report, it is noted at [252](a) of the SOAF that, had the required additional provision of \$4,322,517 been incorporated in the profit and loss account at that time, the reported profit of \$3,541,533 would have been reported as a loss before tax of \$1,217,764.
- (b) In respect of the second relevant accounts, being the BSL 2011-12 half-year financial report, at [254] of the SOAF it is noted that the additional provision should have been \$4,280,540.

- (c) However, as the underprovided loans are the same loans at each reporting date, and the additional provision required for December 2011 was less than that required at June 2011, no additional provision at all would have been required in the December 2011 accounts if the provision had been made in June 2011.
- (d) Similarly, had the additional provision been made in June 2011 or December 2011, the additional provision required in June 2012 would have been limited to \$432,529 (being \$4,755,046 less \$4,322,517).
- (e) In other words, the additionally required provisions listed in the table at paragraph 1 of the proposed declarations are not cumulative; there was a single failure to provide for bad and doubtful debts in an amount in the range of (approximately) \$4.3 million to \$4.7 million, which failure continued through the whole of the Relevant Period. Nevertheless, the occasion to make an adequate provision arose on three separate occasions.

45 In respect of the specific loans that are the subject of Section G of the SOAF, the process that Mr Godfrey and BSL employed to determine the provisions for impairment in the Relevant Period, and the factors taken into account when determining the quantum of the relevant provisions, did not comply with the requirements of AASB 139 because that process:

- (a) allowed BSL, in assessing the estimated future cash flows from the security for a loan:
 - (i) to assume that the relevant security might, at an undefined future time, realise an amount that was more than its value at the time of the assessment as a result of: a future appreciation in its value; and/or development or other improvements to the property (beyond what may have been required to put the property in a saleable condition) that BSL might carry out to the property; and/or
 - (ii) to have regard to the possible recovery of compensation or damages from valuers, introducers or any parties other than the borrower and any guarantor; and
- (b) by reason of the matters set out in paragraph (a):
 - (i) did not involve the assessment of the present value of the estimated future cash flows of the relevant loan receivables as the equivalent of

the cash flows that may result from sale of the security held for that investment; and/or

- (ii) included a measure of guidance used to determine the value of the security held for the relevant loans contingent on future events that should not have been taken into account.

46 It is established that it is part of the duty of a director to acquire a degree of financial literacy so as to equip him or her for the task of reviewing financial statements in discharge of the responsibility to monitor the progress of the company (*Healey* at [124]). The acquisition of the requisite degree of financial literacy is the first step that a director of BSL ought reasonably to have taken to secure compliance by the company with the requirements of Pt 2M.3.

47 The parties submit, and I accept, that for a company in the circumstances of BSL, the financial literacy required of directors to discharge their obligation to take all reasonable steps to ensure compliance by the company with the requirements of Pt 2M.3 of the Act extended to an awareness that:

- (a) financial statements must incorporate proper provisions for impairment of loan receivables; and
- (b) in circumstances where the collateral for a loan was effectively the only source of repayment, the provision for that loan must be equal to the difference between:
 - (i) the carrying value of the loan; and
 - (ii) the present value of the estimated future cash flows from the realisation of that collateral, discounted to account for the time that it would take to sell it.

48 Obtaining an understanding of these matters was, in the circumstances, a step that it was reasonable for Mr Godfrey to have taken to ensure BSL's compliance with the requirements of Pt 2M.3 of the Act. But Mr Godfrey did not take this step (SOAF, [263]).

49 Moreover, in determining what steps Mr Godfrey ought reasonably to have taken to ensure BSL's compliance with the requirements of Pt 2M.3, regard is to be had to the role that Mr Godfrey performed within BSL. In the Relevant Period, that role included determining proposed provisions for loans that the DMC had categorised as "non-performing", and

making recommendations to the board of BSL as to the appropriate provisions for those loans to be included in the financial reports of BSL.

50 The parties submit, and I accept, that these specific responsibilities placed upon Mr Godfrey a higher duty to inform himself of the matters set out in [47] above than if he were a non-executive director, or did not otherwise have those responsibilities.

51 Having failed to obtain an understanding of the matters described in [47] above, Mr Godfrey was unable to, and did not:

- (a) ensure that BSL had in place a policy for the assessment of provisions of loan receivables that was consistent with the terms of AASB 139;
- (b) identify that BSL's policies and procedures for determining impairment of mortgage investments were not appropriate to ensure that proper provisions were recognised for loan receivables; and
- (c) bring to the attention of the other directors or management of BSL the deficiencies in the four mortgage investments set out in Section G of the SOAF, and the consequences of those deficiencies to the balance sheet and profit and loss of BSL.

52 The parties submit, and I accept, that each of those failures represented a failure by Mr Godfrey to take a step that:

- (a) would have been available to him had he obtained an understanding of the matters set out in [47] above; and
- (b) would have avoided the misstatements that ultimately appeared in the financial reports prepared by BSL during the Relevant Period; and

by reason of the matters set out in paragraphs (a) and (b), was a step that he reasonably ought to have taken to ensure that BSL complied with its obligations in Pt 2M.3 of the Act.

53 None of the steps that I have found to be steps that Mr Godfrey ought reasonably to have taken to ensure compliance by BSL with the requirements in Pt 2M.3 of the Act was an obligation that could be abrogated by reliance on the management of BSL, its internal Audit and Corporate Governance Committee or its external auditors. It may be accepted that a director is entitled to rely on others to assist him or her in fulfilling a requirement (*Healey* at [240](b)). While that is the case, in this instance: Mr Godfrey took on the responsibility for

the initial determination and recommendation of the quantum of provisions to the board of BSL; and in any event, in BSL's circumstances, each of the steps set out in paragraph 2 of the agreed declarations of contravention were steps that its directors ought reasonably to have taken to ensure BSL complied with the requirements of Pt 2M.3, regardless of the role or contribution of the company's auditors or management.

Declarations

54 In relation to the declarations proposed by the parties, Mr Godfrey has admitted that he contravened s 344 of the Act. I am satisfied that the steps identified by the parties, and described above, were steps that he ought reasonably to have taken to ensure BSL's compliance with the requirements of Pt 2M.3 of the Act. Further, the three requirements for the making of declarations referred to by Gordon J in *Coles* are satisfied. The question that is being resolved by the declarations (namely, whether s 344 of the Act was contravened) is real and not a hypothetical or theoretical one. ASIC, as the public regulator under the Act, has a real interest in raising the question. And there is a proper contradictor, namely Mr Godfrey (albeit that he now consents to the declarations and orders).

55 In the circumstances, it is in the public interest for the proposed declarations to be made. A significant legal controversy is being resolved. The declarations are appropriate because they serve to record the Court's disapproval of the conduct, vindicate ASIC's claim that the relevant provision was contravened, assist ASIC in carrying out its regulatory duties in the future, inform the public of the relevant conduct, and deter others from engaging in such conduct.

56 There was some discussion during the hearing as to the number of contraventions involved, that is, whether the conduct of Mr Godfrey constituted one, or more, contraventions of s 344(1). In circumstances where the contravention involves a *failure* to take all reasonable steps, and essentially the same failure was involved in relation to each of the financial reports, the answer to this question is not straightforward. It is not necessary to resolve this question as, in my view, it would not affect the relief to be ordered in the present case. Whether the number of contraventions was one or (say) three (being one with respect to each financial report) would not affect the relief to be ordered, as the relief would in any event reflect the fact that the same underlying conduct was involved. I note that the form of the declarations proposed by the parties seems to proceed on the basis that there were three contraventions, one with respect to each financial report. This is indicated by the labels

“Contravention 1”, “Contravention 2” and “Contravention 3” in sub-paragraphs (a), (b) and (c) of proposed paragraph 1. I am content to adopt this formulation.

Disqualification order

57 As noted above, the power to make a disqualification order under s 206C is relevantly enlivened if: the Court has made a declaration of contravention under s 1317E of the Act; and the Court is satisfied that the disqualification is justified. On the basis of the facts and matters set out above, I am satisfied that: a disqualification order is justified; and a disqualification of five years is an appropriate period of disqualification in all the circumstances. My reasons are as follows.

58 First, while the failure by Mr Godfrey to take all reasonable steps to ensure that BSL complied with the requirements in Pt 2M.3 of the Act resulted in significant misstatements in the financial reports prepared by BSL in the Relevant Period, ASIC does not suggest, and the SOAF does not support a finding, that Mr Godfrey acted dishonestly. Moreover, Mr Godfrey has cooperated with ASIC in its investigation. Nevertheless, Mr Godfrey’s responsibilities for the determination of provisions recognised by BSL, and the nature of BSL’s business, point to the magnitude of the contraventions.

59 Secondly, a disqualification of five years is appropriate to achieve the goal of general deterrence. As was the case in this instance, failures by directors of disclosing entities to take reasonable steps to ensure compliance with the requirements of Pt 2M.3 of the Act have the real potential to result in the publication to investors, and potential investors, of information regarding that entity that is misleading or deceptive.

60 Thirdly, Mr Godfrey has, until the admitted contraventions, led a corporate life free of blemish. Nevertheless, in contraventions of this kind, it is the nature of the contravention, not the character of the defendant, that should be the principal consideration in determining the ‘punishment’ to be imposed: *Australian Securities and Investments Commission v Vizard* (2005) 145 FCR 57 at [37]. Despite Mr Godfrey’s otherwise good character, the primary importance of general deterrence supports a significant period of disqualification.

61 Fourthly, the comfort derived by Mr Godfrey from the work of BSL’s auditors (SOAF, [289]) does not detract from the need for general deterrence. Mr Godfrey’s failure to gain an understanding of the matters set out in [47] above was a failure to take a step that, in the circumstances of BSL’s business, was a responsibility of a director. Directors in analogous

circumstances ought not to consider it appropriate to avoid that responsibility by delegating it to external auditors.

62 In all the circumstances, the five year period of disqualification, to which Mr Godfrey has agreed, is appropriate. I am prepared to make this order in the form proposed by Mr Godfrey as described in [6]-[7] above.

Pecuniary penalty

63 The parties propose a pecuniary penalty of \$25,000, in addition to the agreed period of disqualification.

64 The statutory preconditions to enliven the power of the Court to order that a defendant pay a pecuniary penalty are set out above. Those preconditions are satisfied in the present case as: the Court will have made a declaration of contravention under s 1317E; and it is common ground, and I find on the basis of the facts and matters set out above, that the contraventions were serious.

65 It is convenient to set out some additional facts agreed between the parties that are contained in Mr Godfrey's outline of further submissions. During the course of the hearing, I raised a question about Mr Godfrey's accounting qualifications. The parties have agreed the following additional facts in this regard:

- (a) Mr Godfrey obtained by distance education a Diploma in Accountancy from the Commercial Education Society of Australia Inc on 10 February 1978; and
- (b) Mr Godfrey holds no other qualification.

66 During the hearing, I enquired as to Mr Godfrey's remuneration package from BSL. Mr Godfrey received a salary from Securities Holdco Limited (**SHL**) in relation to his work for the entire Banksia Group, which included BSL. The parties have agreed the following additional facts:

- (a) In the year ended 30 June 2010, Mr Godfrey was paid \$100,149 in salary and \$37,986 in employer superannuation contribution by SHL, and had use of a Ford Fairlane company motor vehicle.
- (b) In the year ended 30 June 2011, Mr Godfrey was paid \$192,740 in salary and \$35,953 in employer superannuation contribution by SHL, and had use of a Ford Fairlane company motor vehicle.

- (c) In the year ended 30 June 2012, Mr Godfrey was paid \$159,600 in salary and \$32,635 in employer superannuation contribution by SHL, and had use of a Ford Fairlane company motor vehicle.
- (d) Mr Godfrey received no further remuneration benefits as a director/manager of the Banksia Group.
- (e) Mr Godfrey was personally and through other entities a shareholder of SHL. Following receivers and managers being appointed to BSL, those shares in SHL became worthless.

67 In the circumstances, and notwithstanding my initial reservations as to the sufficiency of the penalty, I consider the proposed pecuniary penalty to be *an* appropriate penalty. My reasons are as follows.

68 The principal purpose of a pecuniary penalty order is deterrence. In this case, for the reasons set out above in relation to the disqualification orders, the pecuniary penalty to which Mr Godfrey has consented is an appropriate order to achieve the purpose of general deterrence. The penalty is to be considered against the maximum penalty that the Court may order upon the statutory requirements of s 1317G(1) having been established. The maximum pecuniary penalty is \$200,000 for each contravention. The amount of the proposed penalty is an appropriate amount taking into account the following considerations:

- (a) the length of the disqualification period that I propose to order;
- (b) that the contraventions by Mr Godfrey did not involve any element of dishonesty;
- (c) that Mr Godfrey considered that he and BSL had appropriately applied the terms of AASB 139;
- (d) that the losses occasioned to debenture holders, while significant, were relatively limited in that, to date, each debenture holder has been paid at least 80 cents for each dollar invested in a debenture;
- (e) that Mr Godfrey has co-operated fully with ASIC's investigation in relation to his possible contraventions of the Act (SOAF, [298]); and
- (f) that there is no evidence that Mr Godfrey has engaged in any previous wrongdoing.

69 The proposed sanctions on Mr Godfrey must be viewed in totality when assessing adequacy.
The elements are:

- (a) declaration of contraventions;
- (b) disqualification from managing corporations for a period of five years; and
- (c) the pecuniary penalty.

70 As noted above, Mr Godfrey has fully co-operated with ASIC's investigation. Further, rather than requiring ASIC (and hence the community) to incur the expense of a complex trial, involving (as is likely) competing expert opinions on the proper application of the accounting standards, Mr Godfrey admitted liability at a very early stage of the proceeding. Had it not been for Mr Godfrey's full co-operation with ASIC's investigation, and his early admission of liability in this proceeding, a substantially higher penalty would have been required.

71 It is also relevant that ASIC, the public regulator in relation to the Act, proposes this pecuniary penalty and submits that it is appropriate in all the circumstances.

72 Accordingly, I will make an order that Mr Godfrey pay a pecuniary penalty in the proposed amount of \$25,000.

Conclusion

73 For the above reasons, I will make declarations and orders substantially in the form proposed by the parties.

I certify that the preceding seventy-three (73) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Moshinsky.

Associate:

A handwritten signature in black ink, appearing to read 'J. Moshinsky', followed by a horizontal line extending to the right.

Dated: 22 December 2017

APPENDIX

AGREED STATEMENT OF FACTS

(Footnotes omitted.)

1. This Statement of Agreed Facts is made jointly by the Plaintiff, the Australian Securities and Investments Commission (**ASIC**), and the Defendant, Patrick John Godfrey (**Mr Godfrey**), in support of proposed orders to be provided to the Federal Court by the parties in relation to admitted contraventions of s 344 of the *Corporations Act 2001* (Cth) (the **Act**) by Mr Godfrey. The admitted contraventions are set out in the accompanying Declaration of Contraventions.

A. Contents of this Statement

2. This statement sets out the following matters which have been agreed between ASIC and Mr Godfrey:

Section of this Statement	Subject matter
B	Role of ASIC
C, E.1, F	Factual background to the contraventions
D, E.2	Legal foundation for the contraventions
G	Detail of the specific contraventions – the Underprovided Mortgage Investments
H, I	Consequences of the contraventions
J, K	Matters going to seriousness and mitigation

B. ASIC

3. ASIC is the body corporate established by s 7 of the *Australian Securities Commission Act 1989* (Cth) and continued in existence by s 261 of the *Australian Securities and Investments Commission Act 2001* (Cth).

C. Banksia Financial Group and Banksia Securities Limited

C.1 Relevant Entities

4. At all times during the period from 1 July 2010 until 25 October 2012 (**Relevant Period**), BSL was an unlisted public company registered and taken to be registered under the provisions of the Act.
5. At all times during the Relevant Period, BSL was part of the Banksia Financial Group of companies (**Banksia Financial Group**). Securities Holdco Limited (**SHL**) was an unlisted public company with approximately 100 shareholders, and the parent entity in the Banksia Financial Group. BSL was a wholly owned subsidiary of SHL. SHL employed most of the staff in the Banksia Financial Group. SHL provided staff and services to the Banksia Financial Group.

6. The shareholders of SHL were, for the most part, the owners of the various businesses that amalgamated to form the Banksia Financial Group. The Banksia Financial Group's operations were conducted from its offices in Kyabram in central Victoria.
7. Banksia Mortgage Fund (**BMF**) was a contributory mortgage scheme operated by the Banksia Financial Group and registered with ASIC.
8. Banksia Mortgages Limited (**BML**):
 - (a) was a wholly owned subsidiary of SHL and was part of the Banksia Financial Group;
 - (b) was the Banksia Financial Group's lender and loan portfolio manager;
 - (c) managed investment schemes for retail clients;
 - (d) as the result of the matters in (c), was the responsible entity for BMF; and
 - (e) raised its funds for short term lending from BSL and for longer term lending from the investors in BMF.
9. Tony McGrath, Joseph Hayes, Matthew Caddy and Robert Kirman (**Receivers**) of McGrathNicol were appointed as Receivers to each of SHL, BSL and BML on 25 October 2012. On 24 June 2014, John Lindholm and Peter McCluskey of Ferrier Hodgson were appointed as liquidators of BSL, pursuant to an order of the Supreme Court of Victoria. On 30 September 2015, the liquidators were appointed as special purpose receivers of certain assets of BSL (**Special Purpose Receivers**), pursuant to an order of the Supreme Court of New South Wales.

C.2 Directors of the Banksia Financial Group

10. During the Relevant Period, the directors of each of the entities in the Banksia Financial Group, including BSL, were:
 - (a) Mr Godfrey;
 - (b) Peter Keating (**Mr Keating**), who was the chairman of the Banksia Financial Group;
 - (c) Nicholas Carr (**Mr Carr**);
 - (d) Geoffrey Skewes (**Mr Skewes**); and
 - (e) from 27 January 2011, Neil Mathison (**Mr Mathison**).
11. At all times during the Relevant Period, Wesley Santilla (**Mr Santilla**) was the Company Secretary of the entities in the Banksia Financial Group and BSL's manager of corporate administration.
12. At all times during the Relevant Period until 5 July 2012, Mr Godfrey was the managing director of the Banksia Financial Group with a role equivalent to that of a chief executive officer. From that date, Mr Godfrey was no longer responsible for provision recommendations. Following his resignation as managing director, he continued to be employed as a consultant until 5 October 2012, on which date he resigned from that role. Following his resignation as a consultant, he continued as a non-executive director.

13. At all times during the Relevant Period, Warren Sinnott (**Mr Sinnott**), then a partner of Richmond Sinnott and Delahunty (**RSD**), was the auditor of the entities in the Banksia Financial Group.

C.3 Business of the Banksia Financial Group and BSL

14. The primary business of BSL involved raising money from the public through the issue of debentures, and advancing those funds to third party borrowers for property investment and development. BSL issued those debentures pursuant to approved registered prospectuses.
15. The Trust Company (Nominees) Limited (**Trustee**) held a first ranking security interest over all assets and undertakings of BSL for the interest of the BSL debenture holders.
16. BSL issued prospectuses for the issue of debentures pursuant to the requirements of the Act.
17. In addition, BSL invested a proportion of the funds raised from debenture holders with BMF.
18. When the Receivers were appointed, there were 16,115 debenture holders holding debentures totalling approximately \$660,534,068 together with interest.

C.4 BSL and BMF Lending

19. Debenture funds raised by BSL were advanced to third party borrowers through BML and Permanent Custodians Limited (**PCL**). PCL was unrelated to SHL, BSL and BML.
20. BML managed the loans advanced to third party borrowers.
21. PCL held the relevant loans on trust for BML pursuant to a bare trust deed, and BML in turn held the loans on trust for BSL.
22. The majority of BSL's and BMF's loans originated through mortgage brokers.
23. Generally, BSL advanced loans to third party borrowers. Interest rates were set to provide adequate margin for operations.
24. Whether a loan was advanced by BSL, BMF or both, the loan was generally secured by:
 - (a) a loan agreement between BSL or BMF and the borrower; further
 - (b) a first ranking mortgage over real property that purported to reflect the appropriate loan to value ratio for the particular loan; and
 - (c) where appropriate, depending on the circumstances of the loan:
 - (i) other lesser ranking mortgages over real property;
 - (ii) registered charges; and
 - (iii) personal guarantees.
25. At the date of the Receivers' appointment, BSL:
 - (a) had raised approximately \$660 million from debenture holders;

- (b) had advanced 956 loans to third party borrowers throughout Australia.
26. By reason of the matters in 25(a) and 25(b), BSL's main assets were its loan portfolio, which totalled approximately \$527 million in face value, together with cash held in BSL's bank account.
27. Of BSL's 956 loans, the summary of how they were made at the date of the Receivers' appointment is as follows:

Lending	Number	Approximate Amount \$ 000
Direct lending by BSL	779	480,953
Lending with or through BMF	172	41,625
Other lending involving BSL	5	4,703

C.5 BSL's management structure in the Relevant Period

28. During the Relevant Period, resources were shared within the Banksia Financial Group. Each entity was managed separately but the lending practices of BSL and BMF operated co-operatively from a commercial perspective.
29. During the Relevant Period, meetings of the board of SHL and its subsidiaries (**Board**) were held concurrently as one meeting.
30. During the Relevant Period, various management and board committees existed in the Banksia Financial Group. Those management and board committees considered matters for all entities in the Banksia Financial Group.
31. During the Relevant Period, employees of the Banksia Financial Group performed the same function – for example, preparing financial statements – for all entities within the Banksia Financial Group.
32. The board committees included (among others):
- (a) a Board Credit Committee; and
 - (b) an Audit and Corporate Governance Committee (**A&CGC**).
33. The management committees included (among others) the Default Management Committee (**DMC**). In July 2012, the Banksia Financial Group created a new management committee, the Impaired Assets Group. From that time, the DMC was merged with the Impaired Assets Group, and its name was changed to the Default and Impaired Assets Committee (**DIAC**). Mr Godfrey was never a member of the DIAC.

C.6 Board committee – Board Credit Committee

34. During the Relevant Period, the functions of the Board Credit Committee were predominantly to:
- (a) decide whether loan applications to borrow more than \$5,000,000 should be approved; and

- (b) review the status of all loans in arrears where the risk of loss was greater than \$500,000 against written recommendations from management about what action should be taken.
35. At all times during the Relevant Period, the members of the Board Credit Committee were Mr Godfrey and Mr Keating.
36. At all times in the Relevant Period, the Board Credit Committee met monthly prior to meetings of the Board. No minutes were kept of those meetings.
37. During the Relevant Period, prior to each Board meeting, the Board was provided with various papers by the Board Credit Committee and DMC. For each meeting the DMC provided a paper containing information about loans in arrears which showed, on a Banksia Financial Group basis, the number and value of loans which were “*non-performing*” and, separately, in respect of which legal action had been taken. As the occasion required, the Board Credit Committee provided detailed information regarding particular “*non-performing*” loans. Each quarter, the Board Credit Committee provided to the Board a list entitled “*Non-performing loans and provisions*”.

C.7 Board committee – Audit and Corporate Governance Committee

38. At all times in the Relevant Period, the A&CGC was chaired by Mike Hall (**Hall**), an accountant and, until the appointment of Mr Sinnott, the auditor of BSL. Mr Carr was the other member of the A&CGC. Mr Godfrey and Mr Santilla attended meetings of the A&CGC, but were not members of it.
39. Pursuant to its charter, during the Relevant Period, the A&CGC’s role included:
- (a) overseeing accounting and financial matters affecting BSL and the Banksia Financial Group, including compliance with the relevant accounting standards;
 - (b) reviewing the adequacy of financial controls over financial reporting that would detect any financial irregularities;
 - (c) reviewing the half-yearly and yearly financial statements prior to their presentation to the Board and subsequent external release;
 - (d) reviewing all significant accounting policy changes and where appropriate recommending them to the Board;
 - (e) monitoring the working relationship, the effectiveness and independence of the audit function including an annual discussion with Mr Sinnott;
 - (f) reviewing the scope of the audit of BSL prior to completion of the audit;
 - (g) reviewing all reports from BSL’s auditor and report to the Board on such reports;
 - (h) reviewing the half-yearly and annual accounts with BSL’s auditor and report to the Board and subsequent external release as appropriate;
 - (i) providing an open communication channel between the auditor and the Board;

- (j) reviewing, and in the case of the external audit, recommending to the Board, with respect to the appointment and replacement of BSL's auditor;
 - (k) ensuring the Board was aware of any matter that might have a significant impact on the financial conditions or affairs of BSL that comes to its attention;
 - (l) monitoring and reporting to the Board on the framework, adequacy and security of internal control and accounting and management information systems, including security of information in the company's computer system;
 - (m) assessing the adequacy of the risk management strategies and processes adopted by management, and to make recommendations to the Board on any issues arising from such assessment;
 - (n) monitoring changes to the taxation regime and make appropriate recommendations to the Board;
 - (o) satisfying itself about the integrity and content of management control systems, including the review of policies and/or practices;
 - (p) reviewing and assess the adequacy of financial management reporting to the Board in terms of quantity, quality and timing of information necessary to enable the Board to understand and report internally and externally about the company's risks, operations and financial condition;
 - (q) monitoring developments and changes in the law relating to the responsibilities and liabilities of directors to ensure that the Board was meeting its obligations.
40. The A&CGC met quarterly and kept minutes of its meetings.

C.8 Management committee – Default Management Committee

41. The role of the DMC was to discuss loans, make decisions about what actions should be taken to recover the money owed to BSL or BMF (or both) and to monitor the progress of recovery actions and to make decisions about whether a loan should be classified as “*non-performing*”.
42. At all times in the Relevant Period prior to his retirement as the managing director of the Banksia Financial Group, Mr Godfrey was the chair of the DMC. The DMC otherwise consisted of senior loan management and default management personnel employed by the Banksia Financial Group, including:
- (a) Trevor Goode (manager of Group Administration);
 - (b) Shane Templar (manager of Group Assets); and
 - (c) loan and administrative executives John Neale, Katrina Smith-Morvell, Alan Curnow, Peter McCluskey, Bob Arnold and Lucy Sorbello.
43. Prior to its change to the DIAC, the DMC met almost every week during the Relevant Period. Minutes were kept of the meetings of the DMC.

44. The responsibilities of the DMC included:
- (a) determining whether a loan should be categorised as “*non-performing*”;
 - (b) developing strategies to deal with non-performing loans and larger loans in arrears;
 - (c) developing “work out” strategies with respect to non-performing loans including:
 - (i) approving legal actions for recovery to be commenced against borrowers and all necessary legal and commercial remedies in order to obtain recovery of debt owing; and
 - (ii) approving advances against the secured property (up to a limit of \$500,000) to enhance the value of the secured property (for example through obtaining development plans) or to complete the construction or development of the secured loan.
45. In performing its role, the employees responsible for the loans informed the DMC of developments concerning each loan identified as “in arrears”. The information included matters such as:
- (a) the value of the land which was security for the loan as stated in any sworn valuation;
 - (b) the value of the land which was secured by mortgage as advised by a relevant real estate agent;
 - (c) sales of any part of the land concerned;
 - (d) the prospect of better recovery by means of further advances and development of the property secured;
 - (e) market conditions (e.g. for farm land and climatic conditions which would materially affect value);
 - (f) recoverability of the loan from other persons such as guarantors, prior valuers, introducing broker and accountants;
 - (g) progress in any legal proceedings;
 - (h) BSL’s historic performance of recoveries in respect of non-performing loans;
 - (i) views in regard to the short term and long term strategies adopted for recovery of the debt.
46. For the DMC’s purposes, a loan was:
- (a) regarded as “*in arrears*” if the borrower had not made a monthly payment;
 - (b) regarded as “*in arrears in legal action*” if the borrower had missed 2 monthly contractual payments, and legal action had been commenced against that borrower; and
 - (c) categorised as “*non-performing*” and the accrual of interest ceased if,

in the opinion of the DMC, it was unlikely that further interest on the loan advanced would be recovered.

47. In the event that a loan was declared non-performing, no further interest was accrued on that loan in the books of BSL.
48. In performing its role, the DMC relied on information provided to it by management and employees of Banksia Financial Group, including Mr Godfrey.

C.9 Demise of BSL

49. BSL commenced operations on 1 July 1999 as a result of an amalgamation of debenture companies North Central Securities Limited of Kyabram, First Legal Securities Limited of Warrnambool and Geelong, and shortly thereafter with Hedon Investments Limited of Ballarat. North Central Securities Limited was the dominant party to the amalgamation. It commenced business in 1968 under the guise of Kyabram Housing Investments Pty Ltd operating under the control of a legal firm which had a long history of operating a Solicitor's Mortgage practice.
50. As BSL's business expanded it established a branch network, initially throughout regional Victoria. During the Relevant Period BSL had a branch network of ten branches at Adelaide, Albury, Ballarat, Bendigo, Echuca, Geelong, Kyabram, Shepparton, Tatura and Warrnambool. The majority of moneys raised by BSL originated from its branch network with investors predominantly being locally based.
51. From around 2007, financial conditions led to the failure of a number of debenture issuers as well as to either the failure or freezing of investor funds held with virtually all the mortgage trusts and other non-APRA (Australian Prudential Regulation Authority) regulated entities. These conditions also led to the demise and closing of the operations of several overseas banking entities, and the forced amalgamation of some APRA regulated entities. During this period, BSL held strong liquidity and continued to trade with the expectation that market conditions would improve.
52. On 19 March 2009, SHL entered into a merger agreement with Statewide Secured Investments Limited (SSI). The merger was effected by SHL acquiring all the issued shares in SSI.
53. On 7 May 2012, the Banksia Financial Group appointed Warren Shaw (**Mr Shaw**) as its chief executive officer, replacing Mr Godfrey with effect from 5 July 2012.
54. On 7 June 2012, the Trustee wrote to Mr Godfrey (who at that stage was still the managing director of BSL) and requested that BSL provide a monthly report to the Trustee on the management of BSL's "top 20 loans in arrears" (**Closer Monitoring Regime**).
55. On 5 July 2012, Mr Shaw assumed the role of chief executive officer of BSL, and Mr Godfrey stepped down from his position as managing director.
56. BSL provided reports to the Trustee pursuant to the Closer Monitoring Regime on 10 July and 10 August 2012.
57. In September 2012, BSL provided the Trustee with a draft prospectus to follow prospectus 18, which was due to expire on 17 November 2012. BSL

requested the consent of the Trustee to be named in respect of what would have been prospectus 19.

58. On 25 October 2012, due to among other things, a lack of confidence in BSL's loan book, the Trustee appointed the Receivers to the assets and undertaking of BSL.

D. Legal requirements concerning financial accounts and reports

D.1 Relevant sections of the Act

59. At all times during the Relevant Period, s 344 of the Act stated:

344. Contraventions of Part 2M.2 or 2M.3, or of certain provisions of Part 2M.4

- (1) *A director of a company ... contravenes this section if they fail to take all reasonable steps to comply with, or to secure compliance with, Part 2M.2 or ...*

60. Parts 2M.2 and 2M.3 of the Act encompass ss 286-323C.

61. Sub-section 292(1)(b) of the Act required BSL to prepare a financial report and directors' report for each of the financial years ended 30 June 2011 and 2012.

62. Section 295 of the Act required that the financial report contain financial statements, notes to them and the directors' declaration about them and the notes. Section 295 relevantly provided:

Basic Content

- (1) *The financial report for a financial year consists of:*

- (a) *The financial statements for the year; and*
(b) *The notes to the financial statements; and*
(c) *The directors' declaration about the statements and notes.*

Financial Statements

- (2) *The financial statements for the year are:*

- (a) *... the financial statements in relation to the company ... required by the accounting standards;*

Notes to financial statements

- (3) *The notes to the financial statements are:*

- (a) *disclosures required by the regulations; and*
(b) *notes required by the accounting standards; and*
(c) *any other information necessary to give a true and fair view (see section 297).*

Directors' declaration

- (4) *The directors' declaration is a declaration by the directors:*

- (a) *...*
(d) *whether, in the directors' opinion, the financial statements and notes are in accordance with this Act, including:*
(i) *section 296 (compliance with accounting standards); and*
(ii) *section 297 (true and fair view); and*

- (5) *The declaration must:*

- (a) *be made in accordance with a resolution of the directors; and*

- (b) *specify the date on which the declaration is made;*
and
- (c) *be signed by a director.*

63. Section 296 of the Act relevantly provided:

296. Compliance with accounting standards and regulations

- (1) *The financial report for a financial year must comply with the accounting standards.*

64. Section 297 of the Act relevantly provided:

297. True and fair view

The financial statements and notes for a financial year must give a true and fair view of:

- (a) *The financial position and performance of the company, registered scheme or disclosing entity; and*
- (b) *If consolidated financial statements are required – the financial position and performance of the consolidated entity.*

65. Section 298 of the Act relevantly provided:

298. Annual directors' report

- (1) *The company ... must prepare a directors' report for each financial year.*

...

- (2) *The report must:*
 - (a) *be made in accordance with a resolution of the directors; and*
 - (b) *specify the date on which the report is made; and*
 - (c) *be signed by a director.*

66. Section 301 of the Act required BSL to obtain an auditor's report about its financial report.

67. Section 302 of the Act required BSL to prepare a financial report and a directors' report for the half-year ended 31 December 2012 and have the financial report audited or reviewed and obtain an auditor's report. By the time of those accounts, the Receivers had been appointed.

68. Sections 303, 304 and 305 of the Act are the equivalent for half-year financial reports of ss 295, 296 and 297 for annual financial reports.

69. Section 334 of the Act authorised the Australian Accounting Standards Board to make accounting standards for the purposes of the Act (AASBs).

D.2 Relevant AASBs

70. AASB 101 entitled "*Presentation of Financial Statements*" was the AASB which required BSL to include financial assets and trade and other receivables as line items in its financial statements. AASB 134 entitled "*Interim Financial Reporting*" applies the provisions of AASB 101 to half-yearly accounts.

71. Paragraphs 54, 55, 77, 78, 117, 122 of AASB 101 provide:
- 54. *As a minimum, the statement of financial position shall include line items that present the following amounts:*
 - ...
 - (d) *financial assets (excluding amounts shown under (e), (h) and (i));*
 - ...
 - (h) *trade and other receivables;*
 - 55. *An entity shall present additional line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.*
 - ...
 - 77. *An entity shall disclose, either in the statement of financial position or in the notes, further sub classifications of the line items presented, classified in a manner appropriate to the entity's operations.*
 - ...
 - 78. *The detail provided in sub classifications depends on the requirements of Australian Accounting Standards and on the size, nature and function of the amounts involved.*
 - ...
 - 117. *An entity shall disclose in the summary of significant accounting policies:*
 - (a) *the measurement basis (or bases) used in preparing the financial statements; and*
 - (b) *the other accounting policies used that are relevant to an understanding of the financial statements.*
 - ...
 - 122. *An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.*
72. AASB 139 entitled "Financial Instruments: Recognition and Measurement" was the AASB with which BSL was required to comply when recognising, and making, provisions for impairment in respect of, its loan receivables in its financial statements.
73. The value at which an entity was required initially to recognise a loan receivable is determined by the application of paragraph 43 in AASB 139:
- Initial Measurement of Financial Assets and Financial Liabilities***
- 43. *When a financial asset or financial liability is recognised initially, an entity shall measure it at its fair value, plus, in the case of a financial asset or financial liability not at fair value through profit and loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.*
74. Note 1 of Banksia's financial statements for the financial year that ended on 30 June 2011 states that loans and receivables are accounted for at amortised cost. Amortised cost is defined in paragraph 9 of AASB 139 as follows:

9. *The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectability.*
75. The circumstances in which an entity is required to derecognise a loan receivable are governed, in part, by paragraphs 36 and 37 of AASB 139:
36. *If a transferred asset continues to be recognised, the asset and the associated liability shall not be offset. Similarly, the entity shall not offset any income arising from the transferred asset with any expense incurred on the associated liability.*
37. *If a transferor provides non-cash collateral...to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted. The transferor and transferee shall account for the collateral as follows:*
- ...
- (c) *if the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognise the collateral, and the transferee shall recognise the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognise its obligation to return the collateral.*
76. The considerations applied to determine fair value are set out from paragraph 48 of AASB 139:

Fair Value Measurement Considerations

- 48 *In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, AASB 132 or AASB 7, an entity shall apply paragraphs AG69-AG82 of Appendix A.*
- 48A *The best evidence of fair value is quoted prices in an active market. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual*

market transactions, the entity uses that technique. The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on any available observable market data.

77. The application guide to AASB 139 provides guidance as to how the fair value of a loan receivable is to be determined, when there is no active market for that loan receivable:

Fair Value Measurement Considerations (paragraph 48-49)

AG69 Underlying the definition of fair value is a presumption that an entity is a going concern without any intention or need to liquidate, to curtail materially the scale of its operations or to undertake a transaction on adverse terms. Fair value is not, therefore, the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale. However, fair value reflects the credit quality of the instrument.

AG70 This Standard uses the terms “bid price” and “asking price” (sometimes referred to as “current offer price”) in the context of quoted market prices, and the term “the bid-ask spread” to include only transaction costs. Other adjustments to arrive at fair value (e.g. for counterparty credit risk) are not included in the term “bid-ask spread”.

Active Market: Quoted Price

AG71 A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm’s length basis. Fair value is defined in terms of a price agreed by a willing buyer and a willing seller in an arm’s length transaction. The objective of determining fair value for a financial instrument that is traded in an active market is to arrive at the price at which a transaction would occur at the end of the reporting period in that instrument (i.e. without modifying or repackaging the instrument) in the most advantageous active market to which the entity has immediate access. However, the entity adjusts the price in the more advantageous market to reflect any differences in counterparty credit risk between instruments traded in that market and the one being valued. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure the financial asset or financial liability.

AG72 The appropriate quoted market price for an asset held or

liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the asking price. When an entity has assets and liabilities with offsetting market risks, it may use midmarket prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. When current bid and asking prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (e.g. a change in the risk-free interest rate following the most recent price quote for a corporate bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate. Similarly, if the entity can demonstrate that the last transaction price is not fair value (e.g. because it reflected the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted. The fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price. If a published price quotation in an active market does not exist for a financial instrument in its entirety, but active markets exist for its component parts, fair value is determined on the basis of the relevant market prices for the component parts.

AG73 *If a rate (rather than a price) is quoted in an active market, the entity uses that market-quoted rate as an input into a valuation technique to determine fair value. If the market-quoted rate does not include credit risk or other factors that market participants would include in valuing the instrument, the entity adjusts for those factors.*

No Active Market: Valuation Technique

AG 74 *If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis, and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.*

AG75 *The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-specific inputs. A valuation technique would be expected to arrive at a realistic estimate of the fair value if*

(a) it reasonably reflects how the market could be expected to price the instrument and (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

AG76 Therefore, a valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on any available observable market data. An entity obtains market data consistently in the same market where the instrument was originated or purchased. The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

AG76A The subsequent measurement of the financial asset or financial liability and the subsequent recognition of gains and losses shall be consistent with the requirements of this Standard. The application of paragraph AG76 may result in no gain or loss being recognised on the initial recognition of a financial asset or financial liability. In such a case, AASB 139 requires that a gain or loss shall be recognised after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price.

AG77 The initial acquisition or origination of a financial asset or incurrence of a financial liability is a market transaction that provides a foundation for estimating the fair value of the financial instrument. In particular, if the financial instrument is a debt instrument (such as a loan), its fair value can be determined by reference to the market conditions that existed at its acquisition or origination date and current market conditions or interest rates currently charged by the entity or by others for similar debt instruments (i.e. similar remaining maturity, cash flow pattern, currency, credit risk, collateral, and interest basis). Alternatively, provided there is no change in the credit risk of the debtor and applicable credit spreads after the origination of the debt instrument, an estimate of the current market interest rate may be derived by using a benchmark interest rate reflecting a better credit quality than the underlying debt instrument, holding the credit spread constant, and adjusting for the change in the benchmark interest rate from the origination date. If conditions have changed since the most recent market

transaction, the corresponding change in the fair value of the financial instrument being valued is determined by reference to current prices or rates for similar financial instruments, adjusted as appropriate, for any differences from the instrument being valued.

AG78 *The same information may not be available at each measurement date. For example, at the date that an entity makes a loan or acquires a debt instrument that is not actively traded, the entity has a transaction price that is also a market price. However, no new transaction information may be available at the next measurement date and, although the entity can determine the general level of market interest rates, it may not know what level of credit or other risk market participants would consider in pricing the instrument on that date. An entity may not have information from recent transactions to determine the appropriate credit spread over the basic interest rate to use in determining a discount rate for a present value computation. It would be reasonable to assume, in the absence of evidence to the contrary, that no changes have taken place in the spread that existed at the date the loan was made. However, the entity would be expected to make reasonable efforts to determine whether there is evidence that there has been a change in such factors. When evidence of a change exists, the entity would consider the effects of the change in determining the fair value of the financial instrument.*

AG79 *In applying discounted cash flow analysis, an entity uses one or more discount rates equal to the prevailing rates of return for financial instruments having substantially the same terms and characteristics, including the credit quality of the instrument, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made. Short-term receivables and payables with no stated interest rate may be measured at the original invoice amount if the effect of discounting is immaterial.*

No Active Market: Equity Instruments

AG80 *The fair value of investments in equity instruments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 46(c) and 47) is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that instrument or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.*

AG81 *There are many situations in which the variability in the range of reasonable fair value estimates of investments in equity instruments that do not have a quoted market price and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 46(c) and 47) is likely not to be significant.*

Normally it is possible to estimate the fair value of a financial asset that an entity has acquired from an outside party. However, if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the instrument at fair value.

Inputs to Valuation to Techniques

AG82 *An appropriate technique for estimating the fair value of a particular financial instrument would incorporate observable market data about the market conditions and other factors that are likely to affect the instrument's fair value. The fair value of a financial instrument will be based on one or more of the following factors (and perhaps others).*

- (a) *The time value of money (i.e. interest at the basic or risk-free rate). Basic interest rates can usually be derived from observable government bond prices and are often quoted in financial publications. These rates typically vary with the expected dates of the projected cash flows along a yield curve of interest rates for different time horizons. For practical reasons, an entity may use a well-accepted and readily observable general rate, such as LIBOR or a swap rate, as the benchmark rate. (Because a rate such as LIBOR is not the risk-free interest rate, the credit risk adjustment appropriate to the particular financial instrument is determined on the basis of its credit risk in relation to the credit risk in this benchmark rate.) In some countries, the central government's bonds may carry a significant credit risk and may not provide a stable benchmark basic interest rate for instruments denominated in that currency. Some entities in these countries may have a better credit standing and a lower borrowing rate than the central government. In such a case, basic interest rates may be more appropriately determined by reference to interest rates for the highest rated corporate bonds issued in the currency of that jurisdiction.*
- (b) *Credit risk. The effect on fair value of credit risk (i.e. the premium over the basic interest rate for credit risk) may be derived from observable market prices for traded instruments of different credit quality or from observable interest rates charged by lenders for loans of various credit ratings.*
- (c) *Foreign currency exchange prices. Active currency exchange markets exist for most major currencies, and prices are quoted daily in financial publications.*
- (d) *Commodity prices. There are observable market prices for many commodities.*
- (e) *Equity prices. Prices (and indexes of prices) of traded equity instruments are readily observable in some markets. Present value based techniques may be used to estimate the current market price of*

equity instruments for which there are no observable prices.

- (f) Volatility (i.e. magnitude of future changes in price of the financial instrument or other item). Measures of the volatility of actively traded items can normally be reasonably estimated on the basis of historical market data or by using volatilities implied in current market prices.
- (g) Prepayment risk and surrender risk. Expected prepayment patterns for financial assets and expected surrender patterns for financial liabilities can be estimated on the basis of historical data. (The fair value of a financial liability that can be surrendered by the counterparty cannot be less than the present value of the surrender amount, see paragraph 49.)
- (h) Servicing costs of a financial asset or a financial liability. Costs of servicing can be estimated using comparisons with current fees charged by other market participants. If the costs of servicing a financial asset or financial liability are significant and other market participants would face comparable costs, the issuer would consider them in determining the fair value of that financial asset or financial liability. It is likely that the fair value at inception of a contractual right to future fees equals the origination costs paid for them, unless future fees and related costs are out of line with market comparables.

78. Impairment or uncollectability is further defined in paragraphs 58 to 65 (inclusive) in AASB 139:

Impairment and Uncollectability of Financial Assets

- 58. *An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the entity shall apply paragraph 63 (for financial assets carried at amortised cost), paragraph 66 (for financial assets carried at cost) or paragraph 67 (for available-for-sale financial assets) to determine the amount of any impairment loss.*
- 59. *A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognised. Objective evidence that a financial asset*

or group of assets is impaired includes observable data that comes to the attention of the holder of the asset about the following loss events:

- (a) significant financial difficulty of the issuer or obligor;*
- (b) a breach of contract, such as a default or delinquency in interest or principal interest;*
- (c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;*
- (d) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;*
- (e) the disappearance of an active market for that financial asset because of financial difficulties; or*
- (f) observable data including that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:*
 - (g) adverse changes in the payment status of borrowers in the group (e.g. an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or*
 - (h) national or local economic conditions that correlate with defaults on the assets in the group (e.g. an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).*

60. *The disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment (e.g. a decline in the fair value of an investment in a debt instrument that results from an increase in the risk-free interest rate).*

61. *In addition to the types of events in paragraph 59, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also*

objective evidence of impairment.

62. *In some cases the observable data required to estimate the amount of an impairment loss on a financial asset may be limited or no longer fully relevant to current circumstances. For example, this may be the case when a borrower is in financial difficulties and there are few available historical data relating to similar borrowers. In such cases, the entity uses its experienced judgement to estimate the amount of any impairment loss. Similarly, an entity uses its experienced judgement to adjust observable data for a group of financial assets to reflect current circumstances (see paragraph AG89). The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.*

Financial Assets Carried at Amortised Cost

63. *If there is objective evidence that an impairment loss on loans and receivables [...] has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognised in profit or loss.*
64. *An entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (see paragraph 59). If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.*
65. *If, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss shall be reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal shall be recognised in profit or loss.*

79. Paragraph 84 of the Application Guidance to AASB 139 provides:

Impairment and Uncollectability of Financial Assets (paragraphs 58-70)

Financial Assets Carried at Amortised Cost (paragraphs 63-65)

AG84. Impairment of a financial asset carried at amortised cost is measured using the financial instrument's original effective interest rate because discounting at the current market rate of interest would, in effect, impose fair value measurement on financial assets that are otherwise measured at amortised cost. If the terms of a loan, receivable or held-to-maturity investment are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial. If a loan, receivable or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss under paragraph 63 is the current effective interest rate(s) determined under the contract. As a practical expedient, a creditor may measure impairment of a financial asset carried at amortised cost on the basis of an instrument's fair value using an observable market price. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

E. BSL's application of AASBs

E.1 BSL's process for determining provisions for impairment in the Relevant Period

2003 Policy

80. In 2003 Mr Godfrey developed a policy for provisioning for impairment of mortgage investments (**2003 Policy**) which was adopted by the Board.
81. The 2003 Policy was that:
- (a) on the recommendation of the DMC (in 2003 called the "Arrears Management Committee") BSL shall make specific provisions against potential loan losses;
 - (b) BSL could maintain a general provision for doubtful debts of 0.5% of the total mortgage loans outstanding.

Variation of the 2003 Policy in June 2006

82. At the meeting held on 29 June 2006, the Board (which on the day comprised Ian Hankin, Mr Godfrey, James Lally and Mr Skewes) resolved that the provision for doubtful debts in the financial statements of BSL as at 30 June 2006 equated to the same balance as at 30 June 2005 and that that balance should be maintained until the then current formula for deriving the general provision for doubtful debts resulted in a greater amount of provision.

After June 2006

83. After 29 June 2006, there was no further revision of the 2003 Policy.
84. At all times during the Relevant Period, BSL had in place the following policy for Loan Arrears and Default Management (the Policy) which was contained in the Policy and Procedure Manual of the Banksia Financial Group:

The [DMC] will consider loans which are under legal action for recovery, for the potential for the debts owed incurring a loss to Banksia. If the Committee considers there is serious potential for a loss to be incurred the loan will be made non performing (i.e. the charging of interest to the loan will cease).

The determination of reasonable value of security for a particular loan and the likelihood of whether a loss could be incurred can be assessed using one or more various appropriate criteria and measures of guidance:

- *A valuation by a registered valuer or current municipal valuation.*
- *An appraisal by a real estate agent.*
- *Market intelligence within Banksia.*
- *The potential for recovery against guarantors, valuers, introducers etc.*
- *The economic assessment of the opportunity to hold the property and manage the risk overtime.*
- *The opportunity to further develop the property to enhance value.*

In reviewing the risk of potential loss, the Committee should exercise good business logic and judgment. It should recognise that the property market value in Australia is cyclical in nature where market demand and values fluctuate from period to period. There may be an economic case for holding a particular security for a medium term (one to two years) or for a longer term and manage the risk through a down cycle.

85. The DMC decided if a loan was “non-performing”. It did not decide the quantum of any provision for impairment. It would review any loan in arrears within the first 12 months of the loan term, loan arrears over 30 days, and any legal action. Arrears reports were then provided to the Board Credit Committee, which proceeded to review on a monthly basis the actions taken by the DMC.
86. Mr Godfrey:
- (a) was given extracts of AASB 139 by Mr Santilla when AASB 139 was introduced;
 - (b) asked Mr Santilla to explain how AASB 139 worked in practice and for confirmation of how to determine a reasonable provision for any loan; and
 - (c) was informed by Mr Santilla that AASB 139 required a degree of judgment to be exercised about whether an impairment provision was required and it was not a question of applying a particular formula.
87. In each quarter during the Relevant Period, Mr Godfrey prepared a document

titled “*Non-performing loans and provisions*” for consideration by the Board (**Provision Report**). The Provision Report contained, amongst other things, a description (in respect of each non-performing loan) of:

- (a) the borrower;
 - (b) the carrying value of the loan;
 - (c) the notional provision for the loan.
88. The second most senior Banksia Financial Group accountant was Julie Hubble (**Ms Hubble**). Ms Hubble reported to Mr Santilla.
89. At the time of the preparation of the 30 June and 31 December financial reports, Mr Godfrey met with Ms Hubble with a view to Mr Godfrey determining what recommendations should be made to the Board regarding suitable provisions for impairment.
90. In these meetings, both Mr Godfrey and Ms Hubble had the latest Provision Report. Ms Hubble had with her and provided to Mr Godfrey a document identifying the impairment provisions for each company in the Banksia Financial Group and the notional attribution of the provision to specific non-performing loans.
91. In the meetings with Ms Hubble, Mr Godfrey decided what the recommended “*notional provision*” for impairment would be for each non-performing loan. During the Relevant Period, Mr Godfrey assessed the quantum of “*notional provision*” using the criteria referred to in paragraph 45 above.
92. Once Mr Godfrey decided on recommendations regarding which loans required a provision and the quantum of that provision, Ms Hubble rateably attributed that provision to the relevant companies in the Banksia Financial Group and adjusted the financial statements accordingly.
93. So, for 30 June 2011:
- (a) the general provisions for impairment held within the financial records of the Banksia Financial Group totalled \$7,666,358;
 - (b) Mr Godfrey determined “notional provisions” against 9 of the 16 non-performing loans which totalled \$6,901,793;
 - (c) Ms Hubble apportioned the \$6,901,793 provision according to the participation of the Banksia Financial Group company in the original loan;
 - (d) the result for BSL was the provision of \$4,146,000 in note 6 to the 2011 Annual Report.
94. For the accounting periods that ended on 30 June and 31 December 2011, the proposed provisions entered into the draft worksheet did not differ materially from the figures that appeared in the Provision Report.
95. In determining the figure that appeared in each Provision Report and the draft worksheet, Mr Godfrey relied in part on discussions with loan managers, and the information provided to the DMC. The employees responsible for the loans informed the DMC of developments concerning each loan identified as “in arrears”. The information included matters such as:

- (a) the value of the land which was security for the loan as stated in any sworn valuation;
 - (b) the value of the land which was secured by mortgage as advised by a relevant real estate agent;
 - (c) sales of any part of the land concerned;
 - (d) the prospect of better recovery by means of further advances and development of the property secured;
 - (e) market conditions (e.g. for farm land and climatic conditions which would materially affect value);
 - (f) recoverability of the loan from other persons such as guarantors, prior valuers, introducing broker and accountants;
 - (g) progress in any legal proceedings;
 - (h) BSL's historic performance of recoveries in respect of non-performing loans; and
 - (i) views in regard to the short term and long term strategies adopted for recovery of the debt.
96. In some cases, particularly where the value of a loan was substantial, Mr Godfrey also relied upon his own physical inspection of relevant security property and discussions he held personally with the principals behind the borrower, who were often also guarantors. In that way, Mr Godfrey gained a personal understanding as to the quality of the security and, in the case of property development projects, the commercial sense of the project.
97. In determining whether a provision should be recognised for a particular loan, Mr Godfrey used the criteria set out in the Policy. In determining the value at which a mortgage investment acquired from SSI should be carried in the accounts of BSL, Mr Godfrey used the same criteria.
98. In particular, the approach adopted by Mr Godfrey and BSL to impairment in respect of non-performing loans was that:
- (a) each loan was assessed individually;
 - (b) where there was evidence of a plan for net enhancement of the value of relevant security property, by the undertaking of development works, it was an acceptable and valid strategy to hold a property that secured a loan for as long as necessary to realise that enhancement in order to achieve a realistic recovery, rather than selling that property in the short term for a lesser value and realising a loss against that loan. The Board was acutely aware that this was a strategy that had been successfully deployed by BSL in the past, resulting in many cases in full recovery of the loan (and also recovery of penalty interest and recovery costs); and
 - (c) it was appropriate, where a security property was not intended to be immediately realised, to take into account a judgement as to possible future change in the market value of the security property (by reason of those proposed development works or otherwise) to determine whether a mortgage investment had suffered an impairment loss.

99. Mr Godfrey and the Board considered that the requirements of the accounting standards in estimating the future cash flows in respect of loans identified as non-performing included the reasonable assessment of not just the security property, but all other potential future cash flows, including potential recovery from guarantors and actions brought against valuers.

Involvement of the Auditor in Preparation of Draft Financial Statements

100. As stated above, RSD completed its audit before the BSL directors passed their resolution about the financial reports. Further relevant factual matters concerning RSD's involvement are set out at paragraphs 287 to 297 below.

Involvement of the A&CGC

101. The involvement of the A&CGC, in determining what the BSL impairment provision would be, was as stated above; namely, it engaged with Mr Sinnott and, after obtaining confirmation from him that nothing was untoward, resolved to recommend to the Board that the financial statements be accepted. Discussion with Mr Sinnott included discussion without management present as well as periodic discussion about the "hold" strategy (described in paragraph 98 above), adoption of accounting standards and the level of provisioning. Mr Sinnott was specifically questioned by members of the A&CGC regarding how he satisfied himself in respect of the audit process for assessing the adequacy of provision for doubtful debts. In response, Mr Sinnott stated that RSD did not simply accept what they were told by BSL's management and that they independently reviewed the loan files. Mr Sinnott was also well aware of the 'hold' strategy being adopted by BSL in relation to some non-performing loans, as this was specifically mentioned by members of the A&CGC in discussions with him. Mr Sinnott at no time expressed any concerns about BSL's use of the 'hold' strategy.

Involvement of the Board Credit Committee

102. The involvement of the Board Credit Committee, in determining what the BSL impairment provision would be, was as indicated in paragraphs 34 to 37 above; namely, that it received the "Non-performing loan and provision" sheet quarterly and detailed reports on individual non-performing loans as the need arose.

BSL Board and Mr Santilla

103. The level of arrears in respect of BSL loans under management, including non-performing loans, as well as the potential for losses to be realised in respect of non-performing loans were discussed at most, if not all, Board meetings.
104. Arrears management was dealt with initially by executive committees, as referred to at 80 to 102 above.
105. The minutes of each Board meeting record that non-performing loans were considered in detail at Board level. The Board spent a significant amount of time during Board meetings receiving updates in respect to loans under management, and discussing recovery processes and assumptions in relation to those specific loans. Board papers were regularly produced and discussed in significant detail by the Board. These Board papers identified each of the non-performing loans and loans with legal action in progress, and included commentary on the current position of those loans.

106. While some efforts were made to move some of the detail in respect to consideration of arrears management from Board meetings to committees, the reasonableness of the recovery processes for non-performing loans and the assumptions behind proposed strategies and provisions were always the subject of robust discussion at Board meetings. Comprehensive discussions of all loans under management continued to take place regularly at Board meetings on approximately a quarterly basis.
107. In the lead-up to the end of each financial and calendar year, the Board received and considered the recommendations from the relevant committees on the level of provisioning to be allocated in respect of specific non-performing loans. During this time, the Board engaged in significantly more detailed discussions and debate regarding those recommendations. These detailed discussions built on the directors' understanding of the particular circumstances of the loans under management based on the regular and on-going Board consideration of those loans. The directors actively questioned the level of provisioning that had been suggested against specific loans. On occasion, these discussions led to increases to provisioning above the levels recommended by the committees. In other circumstances, the directors were satisfied that the level of recommended provisioning was appropriate having regard to their knowledge of the status of the loans including particular circumstances of the loan, and the loan files, and previous discussions of the relevant non-performing loans.
108. As part of the Board papers for every month, the directors of the Banksia Financial Group were given year-to-date financial statements of BSL which showed the impairment provision. Each month Mr Santilla prepared a summary report entitled "Financial Results" on those year-to-date financial statements. That report was included in the Board papers within Mr Godfrey's managing director's report.

E.2 Proper Application of AASBs

109. Under AASB 139, an impairment loss is incurred in respect of a loan when:
 - (a) there is objective evidence of an impairment that results from one or more events that occurred after initial recognition of the asset;
 - (b) the relevant event or events impact the estimated future cash flows of the asset (or group of assets) in a way that can be reliably measured.
110. Where a loss event has been identified, whilst AASB 139 is not prescriptive it does require the quantum of the loss to be measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. This is necessarily a forward looking exercise as to the expected future cash flows. Where the observable data required to estimate the amount of an impairment loss may be limited or no longer fully relevant, the entity is to use its experienced judgment to estimate the amount of the impairment loss.
111. The Application Guide to AASB 139, although not mandatory, suggested that, once BSL had identified objective evidence of impairment of a collateralised financial asset, the calculation of the present value of that asset reflect the cash flows that may result from foreclosure, less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

112. The proper application of AASB 139 therefore required that, in the event BSL determined that there was objective evidence of impairment of a loan or receivable at a reporting date, BSL was required to recognise a provision equal to the difference between:
- (a) the carrying value of the loan; and
 - (b) the cash flows that may result from the foreclosure, less the costs for obtaining and selling the collateral,
- appropriately discounted to account for the time that it would take to realise the value of that collateral.
113. In respect of the specific loans which are the subject of Section G below, the process that Mr Godfrey and BSL employed to determine the provisions for impairment in the Relevant Period did not comply with the requirements of AASB 139 because that process, variously:
- (a) allowed BSL, in assessing the estimated future cash flows from the security for a loan:
 - i. to assume that the relevant security would, at an undefined future time, realise an amount that was more than its value at the time of the assessment as a result of:
 - A. a future appreciation in its value; and/or
 - B. development or other improvements to the property that BSL might carry out to the property; and/or
 - ii. to have regard to the possible recovery of compensation or damages from valuers, introducers or any parties other than the borrower and any guarantor;
 - (b) by reason of the matters in (a):
 - i. did not involve the assessment of the present value of the estimated future cash flows of the relevant mortgage investments as the equivalent of the cash flows that may result from sale of the security held for that investment; and/or
 - ii. included a measure of guidance used to determine the value of the security held for the relevant loans contingent on future events that should not have been taken into account.
114. Details of the failure to make adequate provisions for impairment of particular loans are set out in Section G below and summarised in the tables at paragraphs 153, 189, 217, and 248.

F. BSL's financial reports in the Relevant Period

115. During the Relevant Period, BSL lodged with ASIC a financial report some time after the end of each reporting period.

F.1 BSL 2011 financial report

116. At a meeting of the Board held on 29 September 2011 attended by Mr Godfrey, Mr Carr, Mr Skewes and Mr Mathison, the directors present:

- (a) adopted the financial statements in the BSL 2011 financial report;
 - (b) resolved to approve the Directors' Declaration in the BSL 2011 financial report;
 - (c) resolved to approve the Directors' Report of BSL for the financial year ended 30 June 2011;
 - (d) authorised Mr Carr and Mr Godfrey to sign the Directors' Declaration and Directors' Report on behalf of the Board.
117. As was the case in previous periods, prior to the Board resolving, on 29 September 2011, to make the declaration required by s 295(4)(d) of the Act, BSL's auditor, RSD provided a letter dated 19 September 2011 to the A&CGC in which RSD said that it would give the financial report in the 2011 Annual Report an unqualified audit opinion. RSD further said that:

As noted in our 2010 audit there remains high levels of arrears which are obviously being closely monitored by [the Banksia Financial Group]. We are satisfied there are no material errors in the provision for losses held based on the security positions.

118. Prior to the Board resolving on 29 September 2011 to make the declaration required by s 295(4)(d) of the Act, the A&CGC met on that day. Mr Sinnott, the partner of RSD responsible for the Banksia Financial Group audit, was present. Minutes were taken of this meeting. Mr Sinnott told the committee that there were no major issues in relation to the audit. A management letter from RSD dated 19 September 2011 relating to the audit of, among others, BSL, for the year ending 30 June 2011 was circulated and noted. Relying upon the fact that Mr Sinnott did not identify any significant issues, the committee resolved that the financial statements in the 2011 Annual Report be accepted and that they be recommended to the Board for approval.
119. On 29 September 2011, Mr Godfrey and Mr Carr, acting as directors of BSL, signed the declaration for the purposes of s 295(1)(c) of the Act to be included in the BSL 2011 financial report, which was in the following terms:

The directors of the company declare that:

1. *the financial statements, comprising the directors' declaration, statement of comprehensive income, statement of financial position, statement of changes in equity, statement of cash flows, a summary of significant accounting policies and other explanatory information, are in accordance with the Corporations Act 2001 and:*
 - (i) *comply with Accounting Standards, which, stated in accounting policy Note 1 to the financial statements includes explicit and unreserved compliance with International Financial Reporting Standards (IFRS); and*
 - (ii) *give a true and fair view of the financial position as at 30 June 2011 and of the performance for the year ended on that date of the company;*
2. *in the directors' opinion there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable.*

This declaration is made in accordance with a Resolution of the Board of Directors.

120. RSD provided the following unqualified report dated 29 September 2011 under s 301 of the Act in respect of the 2011 Annual Report:

- (a) *the financial report of Banksia Securities Limited is in accordance with the Corporations Act 2001, including:*
 - (i) *giving a true and fair view of the company's financial position as at 30 June 2011 and of its performance for the year ended on that date; and*
 - (ii) *complying with Australian Accounting Standard AASB 101: Presentations of Financial Statements and the Corporations Regulations 2001; and*
- (b) *the financial report also complies with International Financial Reporting Standards as disclosed in Note 1.*

121. The BSL 2011 financial report:

- (a) stated in Note 1 to the financial statements, that the financial statements had been prepared in accordance with Australian Accounting Standards, Australian Accounting Interpretations, other authoritative pronouncements of the AASB and the Act;
- (b) stated in Note 6 and in the statement of financial position in the financial statements, that the assets of BSL included Trade and other Receivables of \$498,209,044, which included:

Mortgage investments	\$461,826,926
Less provision for impairment of receivables	<u>\$4,146,000</u>
	<u>\$457,680,926</u>

- (c) stated in Note 24 in the financial statements, that:
 - (i) mortgage investments in the amount of \$84,012,951 were more than 90 days overdue but not impaired;
 - (ii) possession of the security had been taken in respect of mortgage investments totalling \$80.6 million
- (d) further stated in Note 24 in the financial statements, that:

The fair values of financial assets and liabilities are comparable to their carrying values as presented in the statement of financial position. Fair values are those amounts at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair values may be based on information that is estimated or subject to judgement.

122. The mortgage investments referred to in paragraph 121(b) included BSL's interest in five particular mortgage investments, as set out in the following table (2011 Table A).

Loan No	Borrower Name	Carrying Value \$	Impairment \$
MIC0017B/17C/19B	Michelmore, AD & TR	4,489,242	Nil

MIR0012B	Mirage Property Group Pty Ltd	3,142,859	373,000
SOU0045B	South Beach Developments Pty Ltd	3,215,155	Nil

123. In the BSL 2011 financial report, BSL reported:

- (a) a profit before tax of \$3,541,533;
- (b) total issued capital reserves and retained earnings of \$24,061,249.

F.2 BSL 2011-12 half-year financial report

124. At a meeting of the Board held on 23 February 2012 attended by Mr Godfrey, Mr Keating, Mr Carr, Mr Skewes and Mr Mathison, the directors present:

- (a) adopted the financial statements in the BSL 2011-12 half-year financial report;
- (b) resolved to approve the Directors' Declaration in the BSL 2011-12 half-year financial report;
- (c) resolved to approve the Directors' Report of BSL for the half-year ended 31 December 2011;
- (d) authorised Mr Keating and Mr Godfrey to sign the Directors' Declaration and Directors' Report on behalf of the Board.

125. Prior to the Board resolving, on 23 February 2012, to make the declaration required by s 303(4)(d) of the Act, RSD provided a letter dated 14 February 2012 to the A&CGC in which RSD said that it would give the financial report in the 2011-12 half-year financial report an unqualified audit opinion. RSD further said that:

There are no significant issues that we believe are necessary to bring to your attention as part of the half year audits.

126. Prior to the Board resolving, on 23 February 2012, to make the declaration required by s 303(4)(d) of the Act, the A&CGC met on that day. Mr Sinnott was present. Minutes were taken of this meeting. Mr Sinnott told the committee that there were no major issues in relation to the audit. A management letter from RSD dated 14 February 2012 relating to the audit of, among others, BSL, for the half-year ending 31 December 2011 was circulated and noted. Relying upon Mr Sinnott's advice that there were no major issues, the committee resolved that the financial statements in the 2011-12 half-year financial report be accepted and that they be recommended to the Board for approval.

127. On 23 February 2012, Mr Keating and Mr Godfrey, acting as directors of BSL, signed the declaration for the purposes of s 303(1)(c) of the Act to be included in the BSL 2011-12 half-year financial report, which was in the following terms:

The directors of the company declare that:

- 1. *the financial statements, comprising the directors'*

declaration, statement of comprehensive income, statement of financial position, statement of changes in equity, statement of cash flows, a summary of significant accounting policies and other explanatory information, are in accordance with the Corporations Act 2001 and:

- (i) *comply with Accounting Standard AASB 134: Interim Financial Reporting, and International Financial Reporting Standards as stated in accounting policy Note 1 to the financial statements; and*
 - (ii) *give a true and fair view of the financial position as at 31 December 2011 and of the performance for the half-year ended on that date of the company;*
2. *in the directors' opinion there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable.*

This declaration is made in accordance with a Resolution of the Board of Directors.

128. The BSL 2011-12 half-year financial report:

- (a) stated in Note 1 to the financial statements, that the financial statements had been prepared in accordance with Australian Accounting Standards, Australian Accounting Interpretations, other authoritative pronouncements of the AASB and the Act;
- (b) stated in Note 6 and in the statement of financial position in the financial statements, that the assets of BSL included Trade and other Receivables of \$498,337,412, which included:

Mortgage investments	\$476,974,534
Less provision for impairment of receivables	<u>\$4,916,000</u>
	<u>\$472,058,534</u>

129. The mortgage investments referred to in paragraph 128(b) included BSL's interest in six particular mortgage investments, as set out in the following table (2011-12 Table A).

Loan No	Borrower Name	Carrying Value \$	Impairment \$
MIC0017B/17C/19B	Michelmore, AD + TR	4,560,335	605,453
JAV0001B	Java Court Pty Ltd	4,071,418	Nil
MIR0012B	Mirage Property Group Pty Ltd	3,155,686	369,000
SOU0045B	South Beach Developments Pty Ltd	3,238,787	Nil

130. In the BSL 2011-12 half-year financial report, BSL reported:
- (a) a loss before tax of \$487,160;
 - (b) total issued capital reserves and retained earnings of \$22,972,650.

F.3 BSL 2012 financial report

131. By circular resolution dated 27 September 2012, the directors of BSL:

- (a) adopted the financial statements in the BSL 2012 financial report;
- (b) resolved to approve the Directors' Declaration in the BSL 2012 financial report;
- (c) resolved to approve the Directors' Report of BSL for the financial year ended 30 June 2012;
- (d) authorised Mr Keating and Mr Godfrey to sign the Directors' Declaration and Directors' Report on behalf of the Board.

132. Prior to the Board resolving, on 27 September 2012, to make the declaration required by s 295(4)(d) of the Act, RSD provided a letter dated 24 September 2012 to the A&CGC in which RSD said that it would give the financial report in the 2012 Annual Report an unqualified audit opinion. RSD further said that:

Outcome – based on our audit procedures performed we have concluded that the provision for doubtful debts which is based on security positions are not materially misstated in the financial statements of the entities as at 30 June 2012.

133. Prior to the Board resolving, on 27 September 2012, to make the declaration required by s 295(4)(d) of the Act, the A&CGC met on that day. Mr Sinnott was present. Minutes were taken of this meeting. Mr Sinnott told the committee that there were no major issues in relation to the audit. A management letter from RSD dated 24 September 2012 relating to the audit of, among others, BSL, for the year ending 30 June 2012 was circulated and noted. Relying upon the fact that Mr Sinnott did not identify any significant issues, the committee resolved that the financial statements in the 2012 Annual Report be accepted and that they be recommended to the Board for approval.

134. On 27 September 2012, Mr Keating and Mr Godfrey, acting as directors of BSL, signed the declaration for the purposes of s 295(1)(c) of the Act to be included in the BSL 2012 financial report, which was in the following terms:

In accordance with a resolution of the directors of Banksia Securities Limited, the directors of the company declare that:

- 1. *the financial statements and notes, as set out on pages 4 to 26, are in accordance with the Corporations Act 2001 and:*
 - (i) *comply with Australian Accounting Standards, which, as stated in accounting policy Note 1 to the financial statements constitutes compliance with International Financial Reporting Standards (IFRS); and*

(ii) *give a true and fair view of the financial position as at 30 June 2012 and of the performance for the year ended on that date of the company;*

2. *in the directors' opinion there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.*

135. The BSL 2012 financial report:

(a) stated in Note 1 to the financial statements, that the financial statements had been prepared in accordance with Australian Accounting Standards, Australian Accounting Interpretations, other authoritative pronouncements of the AASB and the Act;

(b) stated in Note 6 and in the statement of financial position in the financial statements, that the assets of BSL included Trade and other Receivables of \$538,393,961, which included:

Mortgage investments	\$506,274,803
Less provision for impairment of receivables	<u>\$6,455,000</u>
	<u>\$499,819,803</u>

(c) stated in Note 24 in the financial statements, that:

i. mortgage investments in the amount of \$64,371,698 were more than 90 days overdue but not impaired;

ii possession of the security had been taken in respect of mortgage investments totalling \$74.49 million;

(d) stated in Note 24 in the financial statements, that:

The fair values of financial assets and liabilities are comparable to their carrying values as presented in the statement of financial position. Fair values are those amounts at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair values may be based on information that is estimated or subject to judgment

136. The mortgage investments referred to in paragraph 135(b) included BSL's interest in six particular mortgage investments, as set out in the following table (**2012 Table A**).

Loan No	Borrower Name	Carrying Value \$	Impairment \$
JAV0001B	Java Court Pty Ltd	4,081,067	Nil
MIC0017B/17C/19B	Michelmore, AD & TR	4,557,295	\$1,000,000
MIR0012B	Mirage Property Group Pty Ltd	3,174,773	\$800,000
SOU0045B	South Beach Developments Pty Ltd	3,426,833	Nil

137. In the BSL 2012 financial report, BSL reported:
- (a) a profit before tax of \$306,396;
 - (b) total issued capital reserves and retained earnings of \$24,192,965.

F.4 Underprovided Mortgage Investments

138. The mortgage investments referred to in paragraphs 122, 129, and 136 above (the **Underprovided Mortgage Investments**) are instances in which BSL, in the financial reports lodged during the Relevant Period, failed to recognise any, or any sufficient, provision for impairment, for the reasons set out in paragraph 113 above.

G. Underprovided Mortgage Investments – Facts and Specific Failures

G.1 Loan JAV0001B – Java Court Pty Ltd

139. On or about 26 February 2010, BSL advanced \$3,699,500 (**Java Court Loan**) to Java Court Pty Limited ACN 119 861 344 (**Java Court**).

140. The Java Court Loan:

- (a) had an interest rate at settlement of 9.85%;
- (b) required that interest payments of \$32,033.19 be made on the 20th of each month; and
- (c) included a provision at settlement of \$180,000 to be applied to the loan in the event that Java Court defaulted on payments of interest (**Java Court Interest Provision**).

141. The Java Court Loan was secured by:

- (a) a first mortgage in favour of PCL over apartments situated at Units 41 and 43 – 46, 1245 Burke Road, Kew, Victoria (**Java Court Secured Properties**); and
- (b) guarantees of all monies advanced under the Java Court Loan and provided by:
 - i. Paul Gordon Riggs (**Paul Riggs Guarantee**);
 - ii. David Andrew Riggs (**David Riggs Guarantee**); and
 - iii. Palomine Pty Limited ACN 100 116 738 (**Palomine**)

(collectively the Java Court Guarantors).

142. At the time that the Java Court Loan was advanced, BSL:

- (a) expected that the Java Court Loan would be repaid progressively from the proceeds of the sale of parts of the Java Court Secured Properties;
- (b) required that the Java Court Interest Provision be retained by Java Court in a deposit account with BSL as further security for the Java Court Loan (**Java Court Cash Deposit Account**).

143. On or about 9 February 2010, BSL received from Adrian Graham of WBP Property Group the following valuations of the Java Secured Properties if

they were to be sold at fair value (**February 2010 Java Court Valuations**):

(a)	Unit 41/1245 Burke Road, Kew	\$1,060,000
(b)	Unit 43/1245 Burke Road, Kew	\$1,045,000
(c)	Unit 44/1245 Burke Road, Kew	\$1,060,000
(d)	Unit 45/1245 Burke Road, Kew	\$1,060,000
(e)	Unit 46/1245 Burke Road, Kew	\$1,060,000
	Total	\$5,285,000

144. Before 30 June 2011:

- (a) Interest payments due on at least the following dates were not paid by Java Court:
 - i. 20 August 2010;
 - ii. 20 September 2010;
 - iii. 20 October 2010;
 - iv. 20 November 2010; and
 - v. 20 December 2010;
- (b) BSL approved, on or about 4 October 2010, a release of \$84,564.04 from the Java Court Cash Deposit Account to clear arrears of interest payments;
- (c) Java Court Cash Deposit Account was closed on or about 9 December 2010 with a balance of \$0;
- (d) Java Court failed to make payment of all money advanced pursuant to the Java Court Loan by 13 January 2011 when required to do so by BSL. Accordingly, on or about 13 January 2011, BSL served a notice on Java Court requiring immediate payment of all monies advanced pursuant to the Java Court Loan;
- (e) on or about 2 March 2011, PCL, in its capacity as the registered mortgagee of the Java Court Secured Properties, commenced proceedings in the Supreme Court of Victoria (**Java Court Recovery Proceedings**) against Java Court and the Java Court Guarantors seeking, inter alia, the following relief:
 - i. payment of outstanding amounts due under the Java Court Loan of \$3,787,950.09; and
 - ii. possession of the Java Court Secured Properties;
- (f) on or about 9 June 2011, PCL entered judgment in default of appearance against Java Court in the Java Court Recovery Proceedings for:
 - i. payment of outstanding amounts due under the Java Court Loan of \$3,798,774.93 and interest in the sum of \$136,162.66; and

- ii. possession of the Java Court Secured Properties (**June 2011 Java Court Default Judgment**);
 - (g) no payment was received in satisfaction of the June 2011 Java Court Default Judgment; and
 - (h) Java Court was placed into liquidation on or about 19 May 2011.
145. After 30 June 2011 and before 31 December 2011:
- (a) BSL attempted to sell the Java Court Secured Properties at auction on 26 September 2011 but received no bids;
 - (b) BSL became aware at or about the time of the said auction that there were defects in the building in which the Java Court Secured Properties were located which would have a significant negative impact on their marketability, which were not alluded to in the February 2010 Java Court Valuations. This formed part of a potential claim against the valuer. To this extent, BSL engaged Slater & Gordon to provide legal advice with respect to commencing proceedings against WBP Property Group arising from the February 2010 Java Court Valuations. BSL considered this a viable option to recover any shortfall in relation to the Java Court Loan;
 - (c) Palomine was placed into liquidation on 21 September 2011;
 - (d) BSL became aware that the February 2010 Java Court Valuations were excessive;
 - (e) BSL received from Hollingsworth St Claire a valuation of the Java Court Secured Properties (**August 2011 Java Court Valuation**) of:

Property	2010 Value (\$)	2011 Market value (\$)	2011 Mortgagee sale value (\$)
Unit 41/1245 Burke Rd, Kew	1,060,000	750,000	715,000
Unit 43/1245 Burke Rd, Kew	1,045,000	765,000	725,000
Unit 44/1245 Burke Rd, Kew	1,060,000	765,000	725,000
Unit 45/1245 Burke Rd, Kew	1,060,000	765,000	725,000
Unit 46/1245 Burke Rd, Kew	1,060,000	765,000	725,000
TOTAL	5,285,000	3,810,000	3,615,000

- (f) BSL marketed the Java Court Secured Properties for private sale at \$749,000 each, but none were sold.

BSL 2011-12 half-year financial report

146. As at 31 December 2011:
- (a) there was objective evidence of impairment of the Java Court Loan as a result of one or more loss events within the meaning of paragraph 59 of AASB 139; and
 - (b) the estimated future cash flows that BSL could expect to receive from the sale of the remaining 5 units in the Java Court Secured Properties, at the market value in the August 2011 Java Court Valuation, less the expenses of sale, was \$3,691,500;
 - (c) BSL was required to make provision in the BSL 2011-12 half-year financial report for impairment losses on the Java Court Loan of \$451,918.
147. In the BSL 2011-12 half-year financial report, the carrying value of the Java Court Loan was \$4,071,418, with no provision for impairment.
148. Mr Godfrey recommended that no provision for impairment should be made in respect of the Java Court Loan in the BSL 2011-12 half-year financial report. In making that recommendation, he also considered the following matters:
- (a) The guarantors were not bankrupt, and so represented a potential opportunity to recover some of the Java Court Loan.
 - (b) The possibility of recovering any shortfall from WBP Property Group for the February 2010 Java Court Valuations.

BSL 2012 financial report

149. After 31 December 2011 and before 30 June 2012:
- (a) on or about 14 May 2012, PCL entered judgment in default of appearance in the Java Court Recovery Proceedings against Paul Riggs and David Riggs for payment of \$3,797,421.82 and interest of \$605,569.14 (**Riggs Guarantee Amount**);
 - (b) BSL did not receive the Riggs Guarantee Amount;
 - (c) none of the Java Court Secured Properties had been sold.
150. As at 30 June 2012:
- (a) there was objective evidence of impairment of the Java Court Loan as a result of one or more loss events within the meaning of paragraph 59 of AASB 139; and
 - (b) the estimated future cash flows that BSL could expect to receive from the sale of the remaining 5 units in the Java Court Secured Properties, at the market value in the August 2011 Java Court Valuation, less the expenses of sale, was \$3,619,500;
 - (c) BSL was required to make provision in the BSL 2011-12 half-year financial report for impairment losses on the Java Court Loan of \$461,567.
151. In the BSL 2012 financial report, the carrying value of the Java Court Loan

was \$4,081,067, with no provision for impairment.

152. In deciding that no provision should be made in respect of the Java Court Loan, BSL also considered the following matters:
- (a) The guarantors were not bankrupt, and so represented a potential opportunity to recover some of the Java Court Loan.
 - (b) The possibility of an increase in the market value of the Java Court Properties if BSL held on to the Java Court Secured Properties until the market recovered, and then sold the units over time.
153. In summary, the following additional provisioning was required in respect of the Java Court Loan for the relevant financial accounts of BSL:

Accounts	Required additional provision (\$)
June 2011	0
December 2011	451,918
June 2012	461,567

G.2 Loans MIC0017B, MIC0017C, MIC0019B – Andrew and Tania Michelmore

154. On or about:
- (a) 24 April 2008, BSL advanced \$8,150,000 (**First Michelmore Loan**) to Andrew Dean Michelmore (**Michelmore**);
 - (b) 24 April 2008, BSL advanced \$850,000 (**Second Michelmore Loan**) to Michelmore; and
 - (c) 15 October 2008, BSL advanced \$300,000 (**Third Michelmore Loan**) to Michelmore and Tania Reid Michelmore
- (collectively **Michelmore Loans**).
155. By a deed dated 16 June 2008 (**Tranche Priority Deed**), Michelmore and BSL agreed that repayments on the First Michelmore Loan were allocated:
- (a) first, to repayment of \$6,200,000 that was to be repaid at an interest rate of 10.04% (**First Michelmore Tranche**); and
 - (b) secondly, to repayment of \$1,950,000 that was to be repaid at an interest rate of 10.249% (**Second Michelmore Tranche**).
156. In or about September 2009, the Michelmore Loans were increased by \$350,000, which increased the balance of the Michelmore Loans to \$9,160,000, including capitalised arrears.
157. The Michelmore Loans were secured by:
- (a) a first mortgage provided by Michelmore to PCL over:
 - i. farming land on Caves District Road, Joanna, South Australia comprised of the following properties (**Caves District Road Secured Properties**):

Certificate of Title	Property Name
5949/802	Crawford's
5949/806	Koppamurra
5959/291	Carters 1
5959/293	Carters 2
5959/294	Woodlands
5218/012	Allotment 012

- ii. farming land and improvements situated on North Settlement Road, Joanna, South Australia comprised of the following properties (**North Settlement Road Secured Properties**):

Certificate of Title	Property Name
5319/702	Kiama
5528/733	Langes
5823/507	Glensy's Farm

- iii. farming land situated on Braunack's Road, Naracoorte, South Australia comprising the following properties (**Braunack's Road Secured Properties**):

Certificate of Title	Property Name
5592/341	Allotment 439
5813/767	Woodsy's
5588/406	
5588/407	

- (b) a first mortgage provided by Michelmore and Tania Michelmore to PCL over farming land situated on Braunack's Road, Naracoorte, South Australia comprising the property in certificate of title 5947/195 (**Heddle's Block**);
- (c) a first mortgage provided by Tania Michelmore to PCL over farming land located at Braunack's Road, Naracoorte, South Australia comprising the property in certificate of title 5447/800 (**Peter's Block**);
- (collectively **Michelmore Secured Properties**)
- (d) guarantees and indemnities provided by Tania Michelmore on or about 15 October 2008 and 28 April 2009 for the whole of the amount advanced pursuant to the Michelmore Loans.
158. The Third Michelmore Loan was also secured by a guarantee provided by Richard John Burns and Renate Burns and dated 15 October 2008 (**Burns Guarantee**).
159. Western District Valuation Services (**WDVS**) provided a valuation as at 20 March 2008, which valued:
- (a) Braunack's Road Secured Properties at \$1,168,000; and
- (b) North Settlement Road Secured Properties at \$4,200,000.

160. WDVS provided a valuation as at 14 July 2008, which valued:
 - (a) Peter's Block at \$400,000; and
 - (b) Caves District Road Secured Properties at \$7,287,000.
161. On or about 21 October 2008:
 - (a) Allotment 012 was sold;
 - (b) PCL provided a discharge and release of Allotment 012; and
 - (c) Allotment 012 was removed from the Michelmore Secured Properties, and was replaced with Peter's Block.
162. On or about 15 May 2009:
 - (a) the properties in certificates of title 5588/406 and 5588/407 were sold;
 - (b) the amount of \$195,004.85 was repaid to reduce the Second Michelmore Loan;
 - (c) PCL provided a discharge and release of those properties; and
 - (d) the properties were removed from the Michelmore Secured Properties, and replaced with Heddle's Block.
163. WDVS provided a valuation as at 12 October 2009, which valued:
 - (a) Woodsy's property of the Braunack's Road Secured Properties at \$530,000;
 - (b) Heddle's Block at \$574,000;
 - (c) Peter's Block at \$480,000;
 - (d) North Settlement Road Secured Properties at \$3,845,000; and
 - (e) Caves District Road Secured Properties at \$5,960,000.
164. On or about 4 November 2009:
 - (a) Allotment 439 was sold for \$475,000;
 - (b) the amount of \$440,499.49 was repaid to reduce the First Michelmore Loan;
 - (c) PCL provided a discharge and release of Allotment 439; and
 - (d) removed Allotment 439 from the Michelmore Secured Properties.
165. On or about 9 April 2010:
 - (a) Koppamurra was sold.
 - (b) the amount of \$441,719.92 was repaid to reduce the First Michelmore Loan;
 - (c) PCL provided a discharge and release of Koppamurra; and
 - (d) Koppamurra was removed from the Michelmore Secured Properties.

166. One of the Caves District Road Secured Properties was sold, and WDVS provided an updated valuation as at 14 April 2010 and concluded the remaining Caves District Road Secured Properties were valued at \$6,184,000.
167. WDVS valued the North Settlement Road Secured Properties as at 28 April 2010 at \$4,200,000, with the view that market conditions had improved.
168. Michelmore was made bankrupt on or about 16 November 2010.
169. Michelmore failed to make payment of all money advanced pursuant to the Michelmore Loans by 3 January 2010 when required to do so by BSL.
170. Tania Michelmore failed to make payment of all money advanced pursuant to the Michelmore Loans by 15 April 2011 when required to do so by BSL.
171. BSL received valuations of the remaining Michelmore Secured Properties by Graeme D Linke of LMB Linke Pty Limited on or about 2 February 2011 (**February 2011 Michelmore Valuations**).
172. The February 2011 Michelmore Valuations assessed the market value of the remaining Michelmore Secured Properties on a forced sale as follows:
- | | | |
|-----|--|--------------------|
| (a) | Caves District Road Secured Properties | \$3,025,000 |
| (b) | North Settlement Road Secured Properties | \$1,925,000 |
| (c) | Braunack's Road Secured Properties | \$ 350,000 |
| (d) | Heddle's Block | \$ 335,000 |
| (e) | Peter's Block | \$ 285,000 |
| | TOTAL | \$5,920,000 |
173. The February 2011 Michelmore Valuations included a discount of 5–15% off the market value. This discount had to account for factors inherent in forced sales, such as the effect of multiple properties being placed on the market at the same time, saturating the market with inventory of very similar properties in the same area and limited time to market and prepare the property for sale.
174. On or about 18 February 2011:
- (a) the remaining four Caves District Road Properties were sold (for \$3.98 million);
 - (b) the settlement funds remitted to PCL resulted in a principal reduction of \$3,688,417 and
 - (c) PCL provided a discharge and release of the Caves District Road Properties.

BSL 2011 financial report

175. As at 30 June 2011:
- (a) there was objective evidence of impairment of the Michelmore Loans as a result of one or more loss events within the meaning of paragraph 59 of AASB 139;
 - (b) the estimated future cash flows that BSL could expect to receive

from the sale of the remaining Michelmore Secured Properties at the market value of as per the February 2011 Michelmore Valuations (without discount for a forced sale), less the expenses of sale, was \$3,129,525;

- (c) BSL was required to make provision in the BSL 2011 financial report for impairment losses on the Michelmore Loans of at least \$1,359,725.
176. In the BSL 2011 financial report the carrying value of the Michelmore Loans was \$4,489,242, with no provision for impairment.
177. Mr Godfrey recommended that no provision for impairment losses be made in respect of the Michelmore Loans. In making that recommendation, he considered the following matters:
- (a) the possibility of an increase in the market value of the Michelmore Secured Properties if BSL held on until the market recovered;
 - (b) his belief that the guarantor, Tania Michelmore, came from a family of means and had substantial assets, and represented a potential opportunity to recover some of the Michelmore Loans.

BSL 2011-12 half-year financial report

178. On or about 1 August 2011, PCL commenced proceedings against Richard and Renate Burns to enforce the Burns Guarantee (**Burns Proceedings**).
179. By 31 December 2011:
- (a) judgment had not been granted in the Burns Proceedings;
 - (b) BSL could have no reasonable expectation of recovering any amount from the Burns Proceeding before 31 December 2011; and
 - (c) there had been no material change to the value of the Michelmore Secured Properties since 30 June 2011.
180. As at 31 December 2011:
- (a) there was objective evidence of impairment of the Michelmore Loans as a result of one or more loss events within the meaning of paragraph 59 of AASB 139; and
 - (b) the estimated future cash flows that BSL could expect to receive from the sale of the remaining Michelmore Secured Properties at the market value of as per the February 2011 Michelmore Valuations (without discount for a forced sale), less the expenses of sale, was \$3,129,525;
 - (c) BSL was required to make provision in the BSL 2011-12 half-year financial report for impairment losses on the Michelmore Loans of \$1,430,825.
181. In the BSL 2011-12 half-year financial report:
- (a) BSL made provision for impairment losses on the Michelmore Loans of \$605,453;
 - (b) the carrying value of the Michelmore Loans was \$4,560,332 after

deducting that provision.

182. Mr Godfrey recommended that a provision for impairment losses of \$605,453 be made in respect of the Michelmore Loans. In making that recommendation, he considered the matters described in paragraph 177 above.

BSL 2012 financial report

183. On 3 January 2012, PCL, in its capacity as the mortgagee of the Michelmore Secured Properties, commenced proceedings against Tania Michelmore (**Tania Michelmore Proceedings**) seeking orders that:
- (a) judgment be entered against her for \$6,091,862.68, being the outstanding principal and interest payable on the Michelmore Loans;
 - (b) PCL be granted possession of Peter's Block and Heddle's Block.
184. In February 2012, BSL approved the costs of advertising the Kiama and Langes of the North Settlement Road Secured Properties (the dairy properties) for lease. These properties were leased from 1 June 2012 for \$120,000 per annum being provided to BSL, with the property being marketed subject to the lease. Negotiations were on foot for leases for three of the other properties for a combined \$23,000 per annum.
184. BSL recognised that there was a potential loss of up to \$1 million on the Michelmore Loans. This is recorded in the Trust Company Reports dated 10 July 2012 and 10 August 2012, which shows that BSL expected a loss of up to \$1 million.
186. By 30 June 2012:
- (a) judgment had not been granted in the Tania Michelmore Proceedings; and
 - (b) there had been no material change to the value of the Michelmore Secured Properties since 31 December 2011.
187. As at 30 June 2012:
- (a) there was objective evidence of impairment of the Michelmore Loans as a result of one or more loss events within the meaning of paragraph 59 of AASB 139; and
 - (b) the estimated future cash flows that BSL could expect to receive from the sale of the remaining Michelmore Secured Properties at the market value of as per the February 2011 Michelmore Valuations (without discount for a forced sale), less the expenses of sale, was \$3,129,525;
 - (c) BSL was required to make provision in the BSL 2012 financial report for impairment losses on the Michelmore Loans of \$1,427,778.
188. In the BSL 2012 financial report:
- (a) BSL made provision for impairment losses on the Michelmore Loans of \$605,453;
 - (b) the carrying value of the Michelmore Loans was \$4,257,295 after

deduction of that provision.

189. In summary, the following additional provisioning was required in respect of the Michelmores Loans for the relevant financial accounts of BSL:

Accounts	Required additional provision (\$)
June 2011	1,359,725
December 2011	825,372
June 2012	822,325

G.3 Loan MIR0012B - Mirage Property Group Pty Ltd

190. In or about May 2006, SSI advanced \$4,180,000 (**Mirage Loan**) to Mirage Property Group Pty Limited ACN 115 641 784 (**Mirage**) on an 18 month term. The terms of the Mirage Loan provided that an initial amount of \$1,690,000 was to be made available on settlement (13 June 2006) and the balance being made available on a progressive draw down basis.
191. The Mirage Loan was secured by:
- (a) a first mortgage over land situated at 52 West Street, Nambucca Heads, New South Wales (**Mirage Secured Property**);
 - (b) a charge over Mirage; and
 - (c) guarantees provided by Stephen Kenneth Johnson (**Johnson**) and Jean Sarkis Philibossian (**Philibossian**).
192. At the time the Mirage Loan was advanced, Mirage intended to develop the Mirage Secured Property into a residential subdivision (**Mirage Subdivision**).
193. CBRE Australia provided a valuation on or around 7 April 2006 for the Mirage Secured Property, in the amount of:
- (a) \$7,033,000 for the aggregate Gross Realisation Potential of the development upon completion, inclusive of GST;
 - (b) \$6,630,000 for the aggregate Gross Realisation Potential of the development upon completion, exclusive of GST; and
 - (c) \$2,600,000 as is, exclusive of GST.
194. On 28 July 2006, SSI entered into a Deed of Priority with RAB Finance (as second mortgagee), Mirage and the Guarantors (**Deed of Priority**). RAB's mortgage secured an amount of \$150,000.
195. On or around 11 February 2008, SSI approved an increase of \$270,000 to the Mirage Loan, bringing the total of the Mirage Loans up to \$4,450,000. The Deed of Priority was amended so that RAB would receive 15% of the net sale proceeds of any future sale of lots of the Mirage Secured Property.
196. Certificates of title for the first stage of the Mirage Subdivision comprising 12 lots were issued in or about March 2009.
197. On or about 16 July 2009, David Mansfield (**Mirage Liquidator**) of the firm Moore Stevens was appointed as official liquidator of Mirage pursuant to an

order of the Supreme Court of New South Wales.

198. By December 2009, six of the said lots had been sold and removed from the Mirage Secured Property.
199. In or about December 2009, BSL received a valuation for the Mirage Secured Property by KG Dovers of North Coast Valuation Services for the balance of the Mirage Secured Property (**December 2009 Mirage Valuation**).
200. The December 2009 Mirage Valuation:
 - (a) noted that development of Stage 2 of the Mirage Subdivision (33 lots) was physically complete but required council contributions of \$8,022 before they could be sold;
 - (b) valued the balance of the Mirage Secured Property on the basis of a sale “in one line” at \$1,895,000;
 - (c) assessed the average selling price of the lots on an individual basis at \$98,718 (**December 2009 Valuation Average**);
 - (d) considered sale prices for lots in the Mirage Subdivision that occurred prior to undertaking the December 2009 Mirage Valuation, that were, on average, \$110,000 (**December 2009 Historical Average Price**); and
 - (e) informed BSL that in the opinion of the valuer, the sale of all of the lots on an individual basis would take 6 to 10 years.
201. In or around early 2010, SSI considered pursuing an action against the Guarantors. SSI noted that Johnson owned a house in the subdivision valued at around \$320,000, in respect of which he had \$60,000 equity. However, SSI considered that it would not be sensible to pursue any action against Johnson as he was the one generating the sales of the lots of the Mirage Secured Property.
202. Johnson became a bankrupt on or about 25 March 2010.
203. On or about 8 October 2010:
 - (a) two lots of the Mirage Secured Property were under contract and completion was pending;
 - (b) 34 lots of the Mirage Secured Property remained unsold;
 - (c) SSI carried the Mirage Loan at a value of \$3,430,163 after impairment losses of \$1,738,411;
 - (d) the Mirage Loan was transferred from SSI to BSL for consideration of \$3,500,000;
 - (e) BSL initially recognised the Mirage Loan at a value of \$3,500,000, after impairment losses of \$1,600,000 which remained in SSI.

BSL 2011 financial report

204. Before June 2011:
 - (a) BSL had taken possession of the Mirage Secured Property when it was transferred to BSL by the Mirage Liquidator in or about

December 2010;

- (b) SSI, in its capacity as the registered mortgagee of the Mirage Secured Property, commenced proceedings in the Supreme Court of New South Wales against Philibossian to enforce the guarantee provided by Philibossian (**Philibossian Proceeding**);
 - (c) SSI agreed to settle the Philibossian Proceeding on the basis that Philibossian pay to SSI \$136,050 by 15 March 2011.
205. Between on or about 8 October 2010 and 30 June 2011, BSL discharged three lots that were sold and received \$300,000 in reduction of the Mirage Loan.
206. As at 30 June 2011:
- (a) there was objective evidence of impairment of the Mirage Loan as a result of one or more loss events within the meaning of paragraph 59 of AASB 139; and
 - (b) the estimated future cash flows that BSL could expect to receive from the sale of the Mirage Secured Property, less the expenses of sale, was \$2,048,223;
 - (c) BSL was required to make provision in the BSL 2011 financial report for impairment losses on the Mirage Loans of \$1,094,636.
207. In the BSL 2011 financial report:
- (a) BSL made provision for impairment losses on the Mirage Loan of \$373,000;
 - (b) the carrying value of the Mirage Loan was \$3,142,859 after deduction of that provision.
208. Mr Godfrey recommended that a provision for impairment of only \$373,000 be made in respect of the Mirage Loan. In making that recommendation, he considered the following matters:
- (a) his opinion that the Mirage Secured Property was a particularly good property;
 - (b) his opinion that the December 2009 Mirage Valuation did not properly take into account the benefits of the property.

BSL 2011-12 financial report

209. By 31 December 2011, there had been no material change in the value of the Mirage Secured Property.
210. As at 31 December 2011:
- (a) there was objective evidence of impairment of the Mirage Loan as a result of one or more loss events within the meaning of paragraph 59 of AASB 139; and
 - (b) the estimated future cash flows that BSL could expect to receive from the sale of the Mirage Secured Property, less the expenses of sale, was \$2,048,223;

- (c) BSL was required to make provision in the BSL 2011-12 half-year financial report for impairment losses on the Mirage Loans of \$1,107,463.
211. In the BSL 2011-12 half-year financial report:
- (a) BSL made provision for impairment losses on the Mirage Loan of \$373,000;
 - (b) the carrying value of the Mirage Loan was \$3,155,686 after deduction of that provision.
212. Mr Godfrey recommended that a provision for impairment of only \$367,000 be made in respect of the Mirage Loan. In making that recommendation, he considered the matters described in paragraph 208.

BSL 2012 financial report

213. On or about 2 May 2012, BSL received advice from Ray White Nambucca Valley that the realisable value of the remaining lots in the Mirage Secured Property in the then current market ranged from \$30,000 - \$70,000 (**May 2012 Mirage Valuation**).
214. On 28 May 2012, Mr Neale sent an email to Mr Godfrey that attached a copy of the May 2012 Mirage Valuation. On 29 May 2012, Mr Godfrey sent an email to Mr Santilla, in which Mr Godfrey instructed Mr Santilla the security held for the Mirage Loan had now been assessed as having inadequate value to continue to support any loan balance.
215. As at 30 June 2012:
- (a) there was objective evidence of impairment of the Mirage Loan as a result of one or more loss events within the meaning of paragraph 59 of AASB 139; and
 - (b) the estimated future cash flows that BSL could expect to receive from the sale of the Mirage Secured Property, less the expenses of sale, was \$1,158,582;
 - (c) BSL was required to make provision in the BSL 2012 financial report for impairment losses on the Mirage Loans of \$2,016,271.
216. In the BSL 2012 financial report:
- (a) BSL made provision for impairment losses on the Mirage Loan of \$367,000;
 - (b) the carrying value of the Mirage Loan was \$3,174,773 after deduction of that provision.
217. In summary, the following additional provisioning was required in respect of the Mirage Loan for the relevant financial accounts of BSL:

Accounts	Required additional provision (\$)
June 2011	721,636
December 2011	738,463
June 2012	1,649,271

G.4 Loan SOU0045B – South Beach Developments Pty Ltd

218. On or about 31 July 2007, SSI advanced \$3,997,500 (**South Beach Loan**) to South Beach Developments Pty Limited ACN 010 214 776 (**South Beach**).
219. The South Beach Loan:
- (a) had a term of 6 months and matured on or about 31 January 2008;
 - (b) required only that interest be paid during its term, with the principal of the loan repayable upon maturity; and
 - (c) was secured by:
 - i. a first registered mortgage over vacant land situated at 23-25 Sims Esplanade, Yorkey's Knob, Queensland (**South Beach Secured Property**);
 - ii. a third registered mortgage over land situated at 21 Sims Esplanade, Yorkey's Knob, Queensland (**Sims Esplanade**);
 - iii. collateral security, being a registered second mortgage over land situated at 17 Bayswater Road, Potts Point, New South Wales (**Bayswater Road**);
 - iv. a charge over South Beach; and
 - v. a guarantee provided by Alister Toma (**Toma**) and Toma Services Pty Ltd.
220. Cairns Regional Valuers provided a valuation of the South Beach Secured Property dated 5 June 2007 with a high value of \$6,150,000 and a low value of \$4,000,000.
221. On 19 June 2008, Toma Services Pty Ltd, a guarantor, had receivers and managers appointed to it.
222. On 7 July 2008, Grant Dene Sparks and Raymond William Richards of the firm PPB Advisory were appointed as receivers and managers of South Beach.
223. In July 2008:
- (a) Colliers provided a valuation of the South Beach Secured Property with a high value of \$4,500,000 and a low value of \$3,500,000; and
 - (b) CBRE Australia provided a valuation of the South Beach Secured Property with a high value of \$5,000,000 and a low value of \$4,500,000.
224. On or about 22 August 2008, Terry Grant Van Der Velde and David Michael Stimpson (**South Beach Liquidators**) of the firm SV Partners were appointed as joint and several liquidators of South Beach pursuant to an order of the Supreme Court of Queensland.
225. By in or about August 2008, SSI had taken possession of the South Beach Secured Property.
226. Herron Todd White provided a valuation of the South Beach Secured Property dated 29 February 2009 of \$4,500,000.

227. CBRE Australia provided a valuation of the South Beach Secured Property dated 14 April 2009 with a high value of \$2,500,000 and a low value of \$2,000,000
228. On 13 July 2009, Armstrong Wily was appointed controlling trustee of the estate of the guarantor, Alister Toma, under s 188 (of Part X) of the *Bankruptcy Act 1966* (Cth).
229. On or about 14 August 2009:
- (a) the first mortgagee of Bayswater Road entered into an agreement to sell Bayswater Road for \$4,400,000;
 - (b) the amount required to discharge the first mortgage was approximately \$6,900,000; and
 - (c) BSL recovered \$0 pursuant to its second registered mortgage over that property.
230. On or about 28 August 2009:
- (a) the sale of Sims Esplanade settled for \$540,000; and
 - (b) the settlement proceeds were insufficient to discharge the first mortgage over Sims Esplanade; and
 - (c) BSL recovered \$0 pursuant to its third registered mortgage over that property.
231. On or about 1 September 2009, Toma became bankrupt.
232. On or about 30 September 2009, BSL received a valuation by Neil V Teaves of Asset Advance of the South Beach Secured Property (**September 2009 South Beach Valuation**).
233. The September 2009 South Beach Valuation assessed the value of the South Beach Secured Property without improvements at \$2,350,000 fair market value and \$1,700,000 for a forced sale.
234. On or about 30 September 2010:
- (a) the South Beach Loan had an outstanding balance of \$4,730,872;
 - (b) SSI carried the South Beach Loan at a value of \$3,243,280 after impairment losses of \$1,530,872;
 - (c) the South Beach Loan was transferred from SSI to BSL;
 - (d) BSL initially recognised the South Beach Loan at a value of \$3,200,000.
235. Cairns Regional Council provided a valuation of the South Beach Secured Property dated 1 October 2010 of \$2,500,000.

BSL 2011 financial report

236. On or about 6 June 2011, BSL received a valuation of the South Beach Secured Property of no more than \$1,024,907 (**June 2011 South Beach Valuation**).
237. The June 2011 South Beach Valuation:

- (a) was provided to BSL as part of a marketing and sales proposal for the South Beach Secured Property prepared by Ray White Real Estate;
 - (b) was an assessment of the fair value of the South Beach Secured Property without improvements; and
 - (c) provided the following range of values for the South Beach Secured Property:
 - i. Low \$878,841
 - ii. Median \$900,000 - \$1,000,000
 - iii. High \$1,024,907
238. Before 30 June 2011, BSL was holding the South Beach Secured Property in order to develop and sell the property.
239. As at 30 June 2011:
- (a) there was objective evidence of impairment of the South Beach Loan as a result of one or more loss events within the meaning of paragraph 59 of AASB 139; and
 - (b) the estimated future cash flows that BSL could expect to receive from the sale of the South Beach Secured Property, less the expenses of sale, was \$974,156;
 - (c) BSL was required to make provision in the BSL 2011 financial report for impairment losses on the South Beach Loan of \$2,241,000.
240. In the BSL 2011 financial report the carrying value of the South Beach Loan was \$3,215,156, with no provision for impairment:
241. Mr Godfrey recommended that no provision be made in respect of the South Beach Loan. In making that recommendation, he considered the following matters:
- (a) The South Beach Secured Property was a 14,386 square metre parcel land on the beach situated in a prime location of Yorkeys Knob. There was a council reserve parkland between it and the beach, and any development would have views over Trinity Bay from the first floor and above.
 - (b) During the Relevant Period, demand for development property, particularly in regional Australia, was extraordinarily subdued due to the financial state of many developers and the withdrawal of funding sources for new developments. Furthermore, it was well recognised that periods of non-existent demand for Queensland coastal development property are followed by a progressive resurgence and return to solid demand.
 - (c) An increase in the market value of the South Beach Secured Property if BSL held on until the market recovered.

BSL 2011-12 half-year financial report

242. As at 31 December 2011:
- (a) there was objective evidence of impairment of the South Beach Loan as a result of one or more loss events within the meaning of paragraph 59 of AASB 139; and
 - (b) the estimated future cash flows that BSL could expect to receive from the sale of the South Beach Secured Property, less the expenses of sale, was \$974,000;
 - (c) BSL was required to make provision in the BSL 2011-12 half-year financial report for impairment losses on the South Beach Loan of \$2,264,787.
243. In the BSL 2011-12 half-year financial report the carrying value of the South Beach Loan was \$3,238,787, with no provision for impairment:
244. Mr Godfrey recommended that no provision be made in respect of the South Beach Loan. In making that recommendation he considered the matters referred to in paragraph 241.

BSL 2012 financial report

245. Prior to completion of the BSL 2012 financial report the Cairns Regional Council valued the South Beach Secured Property at \$1,500,000 as at 30 June 2011.
246. By reason of the facts set out in paragraphs 225 to 234, and 238, as at 30 June 2012:
- (a) there was objective evidence of impairment of the South Beach Loan as a result of one or more loss events within the meaning of paragraph 59 of AASB 139;
 - (b) the estimated future cash flows that BSL could expect to receive from the sale of the South Beach Secured Property, less the expenses of sale, was \$1,425,000;
 - (c) BSL was required to make provision in the BSL 2012 financial report for impairment losses on the South Beach Loan of \$1,821,883.
247. In the BSL 2012 financial report the carrying value of the South Beach Loan was \$3,215,156, with no provision for impairment:
248. In summary, the following additional provisioning was required in respect of the South Beach Loan for the relevant financial accounts of BSL:

Accounts	Minimum required additional provision (\$)
June 2011	2,241,156
December 2011	2,264,787
June 2012	1,821,883

H. Effect on the BSL financial statements of Mr Godfrey's failure to ensure that proper provisions for impairment were recognised against the Underprovided Mortgage Investments

249. As the consequence of the failures set out in Section G above, the financial reports of BSL prepared in the Relevant Period did not comply with the accounting standards, or contain a true and fair view of the financial position of BSL because:

- (a) the quantum of the provision for impairment recognised against loans and receivables was less than it ought to have been; and
- (b) as the result of (a):
 - i. the carrying value of loans and receivables;
 - ii. profit before tax; and
 - iii. total issued capital, reserves and retained earnings,
 were each overstated by no less than the quantum of the provisions for impairment that ought to have been recognised against the Underprovided Mortgage Investments in each of the financial reports.

H.1 BSL 2011 financial report

250. The provision made by BSL in the BSL 2011 financial report for impairment of the five mortgage investments referred to in 2011 Table A was materially less than the provision that BSL was required by AASB 139 to make in respect of those mortgage investments, as set out in the following table (**2011 Table B**).

Loan No	Borrower Name	Provision Made \$	Additional Provision Required \$
MIC0017B/17C /19B	Michelmore, AD & TR	nil	\$1,359,725
MIR0012B	Mirage Property Group Pty Ltd	373,000	721,636
SOU0045B	South Beach Developments Pty Ltd	nil	2,241,156
TOTAL:			4,322,517

251. By reason of the facts in 2011 Table B, in contravention of s 296(1) of the Act, the BSL 2011 financial report did not comply with AASB 139.

252. If the BSL 2011 financial report had complied with AASB 139:

- (a) BSL would have reported a loss before tax of \$1,217,764 as opposed to the profit before tax of \$3,541,533 in fact reported;
- (b) BSL would have reported total issued capital, reserves and retained earnings of as little as \$21,035,487, as opposed to the amount in fact reported of \$24,061,249.

253. By reason of the foregoing facts, in contravention of s 297 of the Act, the

BSL 2011 financial report did not show a true and fair view of the financial position of BSL.

H.2 BSL 2011-12 half-year financial report

254. The provision made by BSL in the BSL 2011-12 half-year financial report for impairment of the six mortgage investments referred to in 2011-12 Table A was materially less than the provision that BSL was required by AASB 139 to make in respect of those mortgage investments, as set out in the following table (2011-12 Table B).

Loan No	Borrower Name	Provision Made \$	Minimum Additional Provision Required \$
JAV0001B	Java Court Pty Ltd	nil	451,918
MIC0017B/17C /19B	Michelmore, AD & TR	605,453	825,372
MIR0012B	Mirage Property Group Pty Ltd	369,000	738,463
SOU0045B	South Beach Developments Pty Ltd	nil	2,264,787
TOTAL:			4,280,540

255. By reason of the facts in 2011-12 Table B, in contravention of s 304 of the Act, the BSL 2011-12 half-year financial report did not comply with AASB 139.
256. If the BSL 2011-12 half-year financial report had complied with AASB 139:
- (a) BSL would have reported a loss before tax of \$4,767,700 as opposed to the loss before tax of \$487.160 in fact reported;
 - (b) BSL would have reported total issued capital, reserves and retained earnings of as little as \$18,692,109, as opposed to the amount in fact reported of \$22,972,650.
257. By reason of the foregoing facts, in contravention of s 305 of the Act, the BSL 2011-12 half-year financial report did not show a true and fair view of the financial position of BSL.

H.3 BSL 2012 Financial Report

258. The provision made by BSL in the BSL 2012 financial report for impairment of the six mortgage investments referred to in 2012 Table A was materially less than the provision that BSL was required by AASB 139 to make in respect of those mortgage investments as set out in the following table (2012 Table B).

Loan No	Borrower Name	Provision made \$	Additional Provision Required \$
JAV0001B	Java Court Pty Ltd	nil	461,567
MIC0017B/17C	Michelmore, AD &	605,453	822,325

/19B	TR		
MIR0012B	Mirage Property Group Pty Ltd	367,000	1,649,271
SOU0045B	South Beach Developments Pty Ltd	nil	1,821,883
<hr/>			
TOTAL:			4,755,046
<hr/>			

259. By reason of the facts in 2012 Table B, in contravention of s 296(1) of the Act, the BSL 2012 financial report did not comply with AASB 139.

260. If the BSL 2012 financial report had complied with AASB 139:

- (a) BSL would have reported a loss before tax of \$4,448,650 as opposed to the profit before tax of \$306,395 in fact reported;
- (b) BSL would have reported total issued capital, reserves and retained earnings of \$20,864,433 as opposed to the amount in fact reported of \$24,192,965.

261. By reason of the foregoing facts, in contravention of s 297 of the Act, the BSL 2012 financial report did not show a true and fair view of the financial position of BSL.

I. Breaches

262. At all times during the Relevant Period, Mr Godfrey considered that in:

- (a) undertaking the process of determining provisions for impairment; and
- (b) participating in resolutions of the directors of BSL to approve the financial statements prepared during the Relevant Period,

he applied a proper understanding of the AASB 139.

263. During the Relevant Period, Mr Godfrey did not understand that the proper application of AASB 139 required that he adopt the process set out in paragraphs 109 to 112 above. As a result, Mr Godfrey did not have, and failed to obtain, a proper understanding of the requirements of AASB 139 as it applied to the determination of:

- (a) the value at which a loan or receivable was to be recognised on the balance sheet of BSL; and
- (b) whether or not there was objective evidence that a loan or receivable was impaired; and, if so,
- (c) the proper quantum of any provision for impairment;

264. Because that was the case, he failed during the Relevant Period to take all reasonable steps to secure compliance by BSL with the accounting standards, as set out in paragraph 113 above, in respect of the loans set out in Section G above.

265. By reason of those failures, Mr Godfrey breached s 344 of the Act in relation to the:

- (a) BSL 2011 financial report;

- (b) BSL 2011-12 half-year financial report; and
- (c) BSL 2012 financial report.

J. Seriousness of Breaches

266. The following considerations reflect on the seriousness of the breaches by Mr Godfrey.
267. Mr Godfrey was:
- (a) in respect of the accounting period ended 30 June 2011 and 31 December 2011, the managing director of the Banksia Financial Group and BSL and had primary responsibility for determining the appropriate provision for impairment of loans and receivables recognised on the balance sheet of BSL; and
 - (b) in respect of the accounts for the period ended 30 June 2012:
 - i. involved in the determination of the provisions for bad and doubtful debts in that he prepared a draft of proposed provisions for impairment before handing over his executive responsibilities to Mr Shaw;
 - ii. otherwise, a non-executive director of BSL and a signatory to those accounts.
268. The proper performance of the task of providing for bad and doubtful debts was of critical importance to BSL because:
- (a) loans and receivables comprised by far the preponderance of BSL's assets;
 - (b) BSL was thinly capitalised, having at all times in the Relevant Period a debt to equity ratio of at least 25:1 and a substantial change in the amount of impairment of mortgage investments was capable of having a significant impact on BSL's solvency;
 - (c) the value and marketability of many of the properties securing mortgage investments by BSL and SSI was significantly adversely impacted by the global financial crisis which commenced in late 2008; and
 - (d) BSL was a significant borrower of money from the public, and it can be inferred that at least to some degree (directly or indirectly) investors in BSL's debentures relied upon the accuracy of the financial accounts contained in its prospectuses.
269. The failures by Mr Godfrey resulted in an overstatement of the profit before tax, and the total issued capital reserves and retained earnings in each of the financial reports referred to in this statement.
270. Correcting for those mis-statements in issued capital, reserves and retained earnings, results in an increase in BSL's debt to equity ratio in the:
- (a) BSL 2011 financial report from 26.2 to 30.0;
 - (b) BSL 2011-12 half-year financial report from 27.5 to 34.1; and
 - (c) BSL 2012 financial report from 27.6 to 32.0.

271. At all times in the Relevant Period, the trustee of the debenture holders' interest in BSL was the Trustee.
272. There were terms of the trust deed entered into between BSL and the Trustee to the effect that:
- (a) BSL would not issue debentures if its total external liabilities (**Total External Liabilities**) would, by reason of the issue of those debentures, exceed 97% of its total tangible assets (**Total Tangible Assets**) (cl 8.01) (**Capital Adequacy Ratio**);
 - (b) Total Tangible Assets was to be calculated in accordance with generally accepted accounting principles and was not to include amounts, inter alia, of provision for depreciation and bad and doubtful debts (cl 8.02);
 - (c) Total External Liabilities were defined as the aggregate as disclosed in the last audited financial report of BSL of all secured and unsecured liabilities.
273. In or about September 2010, BSL changed its policy regarding the calculation of its Total Tangible Assets for the purposes of the trust deed to add back to the value of loans and receivables the value of impairment losses recognised on those assets.
274. On each of the reporting dates in the Relevant Period, BSL's Capital Adequacy Ratio calculated in accordance with that decision was as follows:

Date	Ratio	Total Tangible Asset	Total External Liabilities
30 June 2011	96.21%	\$655,925,363	\$631,098,389
31 December 2011	96.31%	\$662,022,903	\$637,597,810
30 June 2012	96.18%	\$693,307,972	\$666,818,527

275. The calculation for the purposes of determining the Capital Adequacy Ratio on each of the reporting dates in the Relevant Period, prior to the decision in paragraph 273 to add back the value of impairment losses, and taking into account the assets and liabilities actually reported in the financial statements issued during the Relevant Period, would have resulted in the following Capital Adequacy Ratios:

Date	Ratio	Total Tangible Asset	Total External Liabilities
30 June 2011	96.83%	\$651,779,363	\$631,098,389
31 December 2011	97.03%	\$657,106,903	\$637,597,810
30 June 2012	97.08%	\$686,852,972	\$666,818,527

276. Taking account only of the Underprovided Mortgage Investments, and the consequential reduction in the value of the total tangible assets, the ratio reported in each of the financial statements issued during the Relevant Period ought to have been up to the following:

Date	Ratio	Total Tangible Asset	Total External Liabilities
30 June 2011	97.47%	\$647,456,846	\$631,098,389
31 December 2011	97.67%	\$652,826,363	\$637,597,810
30 June 2012	97.76%	\$682,097,926	\$666,818,527

277. At all times during the Relevant Period, BSL was required by:
- (a) s 709 of the Act to prepare a prospectus for the offer of debentures;
 - (b) s 710 of the Act to include in the prospectus all information that investors and their professional advisors would reasonably require to make an informed assessment of the assets and liabilities, financial position and performance, profits and losses and prospects of BSL; and
 - (c) s 728 of the Act to refrain from offering securities under a prospectus if there is a misleading or deceptive statement in the prospectus.
278. On or about 17 October 2011, BSL issued prospectus number 18 for term and at call investments (**2011 Prospectus**).
279. The 2011 Prospectus:
- (a) stated in the synopsis that at 30 June 2011:
 - i. the surplus of assets over liabilities of BSL was \$24.06 million; and
 - ii. profit after income tax expenses was \$1.86 million;
 - (b) stated that its equity ratio was 3.6%;
 - (c) stated in its explanation of the equity ratio that it has made provision in its accounts for impairment of receivables and impairment of loans and receivables which at 30 June 2011 was \$4,146,000.
280. Those statements in the 2011 Prospectus were misleading or deceptive because the reduction in the value of the assets reported in the BSL 2011 financial report set out at paragraph 252 above meant that:
- (a) at 30 June 2011:
 - i. the true surplus of assets over liabilities of BSL was \$21.04 million;
 - ii. the true profit after income tax expense was a loss of \$1.22 million; and
 - iii. the true equity ratio was 3.2%;
 - (b) BSL's provision for impairment as at 30 June 2011 was inadequate and ought to have been an amount of \$8,468,517.
281. The misleading or deceptive statements in the 2011 Prospectus:
- (a) were based upon the BSL 2011 financial report;

- (b) would not have been made but for Mr Godfrey's failure to take all reasonable steps to secure compliance with parts 2M.2 and 2M.3 of the Act.

282. The 2011 Prospectus remained current until 25 October 2012.
283. Between 17 October 2011 and 25 October 2012, BSL borrowed an amount of about \$40 million from the public pursuant to applications made under the 2011 Prospectus. A significant amount of this investment was rolled over from investments made with BML. It is not possible to say how many, if any, of those investments would have been made if the BSL 2011 financial report (as reflected in the 2011 Prospectus) was not misleading or deceptive in the manner outlined in paragraph above.
284. The persons who subscribed for debentures issued by BSL under the 2011 Prospectus have suffered losses that the Receivers and Managers appointed to BSL on 25 October 2012 assessed to be 17 cents in the dollar.

K. OTHER MATTERS

K.1 Losses Limited

285. To date each debenture holder has been paid at least 80 cents in each dollar invested in a debenture.

K.2 No Dishonesty

286. In respect of the provision for impairment, Mr Godfrey acted honestly throughout the Relevant Period in relation to his compliance with the Act and did not profit in any way from any understatement of impairment of BSL's loans.

K.3 Failings by BSL's Auditor

287. In January 2009 BSL engaged RSD as BSL's independent audit firm for the year ending 30 June 2009, replacing Maxwell Brown and Mountjoy in accordance with BSL's A&CGC and Board policies on auditor rotation and independence. RSD continued to act as BSL's auditor thereafter.
288. RSD's audit plans specifically noted that additional audit emphasis would be placed on provisioning, including a review of the provisioning process and assessment of the adequacy of provisions held in BSL.
289. RSD issued unqualified audit reports which expressly stated, amongst other things, "we are satisfied that there are no material errors in the provision for losses held based on the security position". This provided significant comfort to the Board that their independent review of the financial statements prepared by management and the discussions in relation to provisioning at Board level were validated by independent professional auditors who had specifically reviewed the provisioning process and the adequacy of BSL's provisions.
290. In its Audit Plans issued to BSL each year, RSD stated:

The current economic and environmental climate will result in us completing additional procedures in relation to the adequacy of the specific provision held.

We will assess the adequacy of the provision and the impact on

customers' ability to repay their loans given current Australian economic factors and the mix of the loan portfolio.

We will review the provisioning process to ensure that specific provisioning is conducted in accordance with regulatory requirements and specifically:

- *processes to, on a timely basis, identify exposures where recovery is considered doubtful;*
- *valuation of security held; and*
- *impact of credit crisis, drought, water availability and other issues ...*

... we believe the audit risk profile for the Banksia Financial Group is 'Moderate'. Our assessment notes that the Banksia Financial Group has strong systems and procedures in place, with staff having excellent experience and knowledge of the business.

291. As referred to above, Mr Sinnott, the lead auditor and principal of RSD, attended A&CGC meetings, during which discussions took place regarding “[l]oan parameters, valuations, impairment and arrears” and Banksia’s files were noted by Mr Sinnott as providing “sufficient explanation and a realistic assessment of provisions”. Mr Sinnott specifically informed the A&CGC that he had reviewed BSL’s provisions and non-performing loans. A&CGC members inquired of Mr Sinnott whether the financial reports complied with the accounting standards, which Mr Sinnott confirmed was the case. The ‘hold’ strategy was also discussed within the A&CGC when considering provisioning and arrears, while Mr Sinnott was present.
292. The independent chairs of the A&CGC (Ian Evans and subsequently Mike Hall), both of whom were professional auditors, were involved in reviewing the provisions that were applied by BSL. Mr Hall received a copy of all the Board financial papers relating to loan arrears and provisions. The Board took great comfort in Mr Hall’s leadership of the A&CGC, particularly given his knowledge of the business from his previous role as BSL’s auditor, and the audit process and requirements (including requirements under the accounting standards).
293. In considering the level of provisions when approving the financial statements, the A&CGC’s area of focus was directed to RSD’s consideration of the reasonableness of the recommendations of management and the robustness of BSL’s systems and processes, rather than canvassing once again the detailed discussions concerning recoverability and assumptions in respect of particular non-performing loans that had already been undertaken at Board level. Notwithstanding this, there were on occasion detailed discussions at A&CGC meetings on specific elements of loan arrears and/or provisions.
294. From the A&CGC’s point of view, it was important that the auditor was testing not only the procedures adopted by BSL’s management when considering provisioning, but also the actual level of the provisions being put forward. To that end, the A&CGC met with Mr Sinnott to consider each of RSD’s audit reports and discussed with him the specifics of the audit and, in particular, the processes he adopted. Mr Sinnott wrote to the A&CGC summarising RSD’s audit procedures, identifying a very thorough and

comprehensive review of Banksia's mortgage loans including specific confirmation that RSD had "[r]eviewed and assessed current provisions for doubtful debts held on loans". RSD repeatedly confirmed that the audit process included not only a review of all loans under administration but a review of the specific recovery actions and assumptions and the agreed level of provision in respect of those loans.

295. Representatives of the A&CGC directly asked Mr Sinnott during an A&CGC meeting whether RSD undertook its own independent review of the level of provisioning in BSL. Mr Sinnott responded by confirming that this was the case and that RSD did not just adopt the position put by management. Mr Sinnott indicated that the audit had included a separate assessment of the files and a determination of the provisioning involved and its reasonableness.
296. During A&CGC meetings, members of the committee raised with Mr Sinnott the issue of whether BSL's financial reports complied with applicable accounting standards, which Mr Sinnott confirmed they were compliant. The A&CGC also discussed with Mr Sinnott other work he had undertaken, including seeking confirmation that he had signed off on any relevant Trustee certificates as to capital adequacy under BSL's Trust Deed. The A&CGC members also ensured that they met with Mr Sinnott in the absence of management representatives, so that there was an opportunity for any issues of concern to be raised by either Mr Sinnott or the committee members.
297. After investigation by ASIC, the performance of the audits of the financial statements in the Relevant Reports ultimately resulted in Mr Sinnott giving enforceable undertakings to ASIC under s 93AA of the ASIC Act, including an undertaking that for five years he not perform any duty or function which requires registration as an auditor under the Act.

K.4 Co-operation with ASIC

298. Mr Godfrey has cooperated fully with ASIC in its investigation in relation to his possible contravention of the Act.

K.5 Compensation to investors

299. The collapse of BSL has resulted in litigation in the Supreme Court of Victoria against, among many others, Mr Godfrey, as follows:
- (a) Proceedings No. SCI 2012 7185 – class action on behalf of the persons who invested under a prospectus issued by BSL;
 - (b) Proceeding No. [SCI 2014 5875] – claim brought by BSL (under the control of the Special Purpose Liquidators).
300. On or about 12 April 2016, confidential terms of settlement were agreed between the plaintiffs in the above proceedings and some of the defendants, including Mr Godfrey, whereby those defendants agreed to (and since have done so) pay compensation to the plaintiffs and were released from all claims.
301. On 26 August 2016, the Honourable Justice Robson made orders whereby, in effect, the Court:
- (a) approved of the settlement, for the purposes of the rules governing class actions; and

- (b) authorised the Special Purpose Liquidators to proceed with the settlement.

23 June 2017