

IN THE MATTER of an Application by the Australian Securities and Investments Commission to the Companies Auditors Disciplinary Board pursuant to section 1292 of the Corporations Act 2001

MATTER NO: 01/QLD17

AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

Applicant

REGINALD LANCE WILLIAMS

Respondent

Note regarding application for review of decision by the Administrative Appeals Tribunal

On 5 December 2018, Mr Williams applied to the Administrative Appeals Tribunal ("AAT") for a review of the Panel's decision in this matter. The AAT placed a temporary stay on the operation and implementation of the Board's decision pursuant to Section 41(2) of the AAT Act. The AAT's stay order lapsed on 26 March 2019 following a [decision of Deputy President McCabe on 19 March 2019](#). Accordingly, the Panel's orders in this decision are now operative. CADB has implemented those orders by arranging publication of its decision in the Government Gazette on 9 April 2019 in accordance with its statutory obligation, publishing this decision on the CADB website and issuing a media release in accordance with the Panel's decision on publicity.

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REGINALD LANCE WILLIAMS

Respondent

DECISION AND REASONS

5 December 2018

Panel:

Maria McCrossin (Panel Chairperson)

Tony Brain

Inge Kindermann

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DECISION AND REASONS

The Application

1. This is an Application under section 1292 of the *Corporations Act 2001* (“the Act”) lodged with the Companies Auditors Disciplinary Board (“the Board”) by the Australian Securities and Investments Commission (“ASIC”) on 4 April 2017. By the Application, ASIC asked the Board to cancel the registration of Mr Reginald Lance Williams (“Mr Williams”) (a registered auditor).

Section 1292(1)(d) of the Act provides:

The Board may, if it is satisfied on an application by ASIC or APRA for a person who is registered as an auditor to be dealt with under this section that, before, at or after the commencement of this section:

...

(d) the person has failed, whether in or outside this jurisdiction, to carry out or perform adequately and properly:

(i) the duties of an auditor; or

(ii) any duties or functions required by an Australian law to be carried out or performed by a registered auditor;

or is otherwise not a fit and proper person to remain registered as an auditor;

by order, cancel, or suspend for a specified period, the registration of the person as an auditor.

Relevant background facts and key documents

2. Mr Williams has been registered continuously as an auditor since 1996. His firm, Williams Partners Independent Audit Specialists (“WPIAS”), a partnership, performed an audit of the financial report of the LM Managed Performance Fund (“LM”) for the 2012 financial year (“2012 LM Audit”). LM was an unregistered managed investment scheme constituted in December 2001. The financial report for LM comprised an annual report from the directors together with the audited consolidated financial statements of LM and its controlled entities for the financial year ending on 30 June 2012 (“2012 LM Financial Statements”). Mr Williams signed an unqualified audit report with respect to the 2012 LM Financial Statements on 7 December 2012 as a partner of WPIAS, and his ASIC registered company auditor number (No. 165400) appeared below his signature (the “2012 LM Audit Opinion”). The 2012 LM Audit was the subject of Contentions 1–7 in ASIC’s Statement of Facts and Contentions¹ (“SOFAC”).
3. It was not in issue that:

¹ ASIC’s Statement of Facts and Contentions dated 24th March 2017 and lodged with the Board on 4 April 2017.

- (a) LM did not need to be registered with ASIC under section 601ED of the Act because the scheme was marketed primarily as a fund to foreign investors and most of the contributors came from outside Australia and therefore fell within section 601ED(2) of the Act.
 - (b) There was no statutory requirement for the 2012 LM Financial Statements to be audited.
4. The manager of LM was LM Investment Management Ltd² (“LMIM”) that was incorporated and domiciled in Australia. Mr Peter Drake was the 100% owner of LMIM and the chief executive officer.
5. The 2012 LM Financial Statements noted the principal activities of LM and its controlled entities as investment in a combination of interest bearing cash investments, property investment and debt structured loans for the purchase and/or development of Australian real property. A second priority loan to Maddison Estate Pty Ltd (ACN 127543980) (“Maddison”) was the major asset reflected in the 2012 LM Financial Statements.
6. The ASIC company extract dated 17 February 2017 recorded Mr Peter Drake as a director of Maddison from 14 September 2007 until 9 January 2015. At the relevant time, Maddison and LM were related entities within paragraph (k) of the definition of ‘related entity’ in section 9 of the Act.³
7. As at 30 June 2012, LM had net assets attributable to unit holders of \$353,156,353 with loans and receivables comprising \$299,570,308 of that amount. The largest loan was to Maddison for \$201,187,254 secured by a second priority mortgage. The loan to Maddison represented 57% of the total net assets of LM and 67% of the total loans and receivables.
8. LMIM's request to WPIAS to perform an audit of the 2012 LM Financial Statements was accepted by a letter dated 1 August 2012 to the Board of Directors of LMIM from WPIAS, signed by Mr Williams as a partner of WPIAS (“the Engagement Letter”).
9. The Engagement Letter included the following statements:
 - (a) Under the heading ‘The Responsibilities of the Auditor’ the letter states:

We will conduct our audit in accordance with the Australian Auditing Standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.
 - (b) Under the heading ‘Reporting’ the letter states:

We will conduct our audit in accordance with Australian Auditing Standards, in order to express an opinion as to whether the financial report presents a true and fair view of the entity's financial position as at 30 June 2012 and its performance for the year ended on that date in accordance with the Australian Accounting Standards (including

² (ACN 077 208 461).

³ ‘A body corporate one of whose directors is also a director of the first mentioned body’.

Australian Accounting Interpretations) and the Corporations Act 2001. The form and content of our report may need to be amended in light of our audit findings.

- (c) Under the heading 'Presentation of Audited Financial Report on the Internet' it was noted:

If the entity intends to publish a hard copy of the audited financial report and auditor's report for members, and to electronically present the audited financial report and auditor's report on its internet website, security and controls over information on the website should be addressed.

- (d) Under the heading 'Other' the letter stated:

The opinion provided for the audit is for the express use of those directly requesting it from Williams Partners Independent Audit Specialists. The audit relates only to the entity and does not provide an opinion on any other entity.

10. Between August 2012 and December 2012, WPIAS carried out the 2012 LM Audit of the 2012 LM Financial Statements on a going concern basis.
11. On 7 December 2012, Mr Williams signed the 2012 LM Audit Opinion (unqualified) which expressed the opinion that the 2012 LM Financial Statements were in accordance with the Act, including:
- (i) giving a true and fair view of LM's financial position as at 30 June 2012 and of its performance for the year ended on that date;
 - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
 - (iii) the financial report also complies with International Financial Reporting Standards as disclosed in Note 2.
12. The 2012 LM Financial Statements (including the Directors' Report signed by Peter Drake on 7 December 2012) recorded the following information and commentary:
- (a) Net profit before distribution to unit holders for 2012 was \$21,361,292.
 - (b) Distributions payable to unit holders during 2012 totalled \$23,167,343.
 - (c) Investments into the funds were termed placements. These could be placed up to a maximum of 5 years. The 3 to 5 year investment terms continued to be an increasing component of the LM's overall holding.
 - (d) In respect of 'Redemptions' it stated: 'The MPF has continued to pay investor redemptions. From a high of just under 40%, fund redemptions now measure at less than 6% of Funds Under Management.'
 - (e) With respect to development progress, it stated: 'A number of development assets are now ready to commence staged construction and pre-sales, with those asset sales expected to generate increased cash flow into the Fund from 2013 onwards.'

(f) It described Maddison as: ‘The anchoring asset of the fund’

(g) That LM had:

Funded and facilitated the successful acquisition and consolidation of 30 sites into one englobo site required for the large 118 hectare residential development approved to 1,458 residential dwellings, ... The total number of residents expected to live at Maddison is approximately 3,500 when complete to current approvals. Development Approvals have been obtained and works commenced with necessary land clearing for Stage 1 completed. Maddison is entering pre-sale stage with civil works now underway on site.

(h) Under the heading ‘Review of Results and Operations’, it referred to the expectation that a wave park was to be incorporated into the development and noted:

Maddison Estate and four other major assets of the fund have attracted substantial offshore construction funding interest with current due diligence in process with two major institutions in USA and Asia.

(i) The auditor's independence declaration on page 15 of the 2012 LM Financial Statements was signed by Mr Williams as ‘Registered Company Auditor No. 165400’.

(j) Net assets attributable to unit holders of \$353,156,353, comprised largely of loans and receivables of some \$299,000,000.

(k) Under the heading ‘Summary of Significant Accounting Policies’ dealing with Basis of Accounting it stated:

This financial report is a general purpose financial report that has been prepared in accordance with ... the requirements of the Corporations Act 2001, which includes applicable Accounting Standards and other authoritative pronouncements of the Australian Accounting Standards Board.

(l) Under the heading ‘Summary of Significant Accounting Policies’ dealing with Loans and Receivables it stated: ‘Loans and receivables are assessed for impairment at each reporting period.’

(m) First mortgages totalling approximately \$30 million and second mortgages of approximately \$220 million.

(n) Director-related entities as special purpose vehicles through which all of the development profit would flow to LM and its investors to ensure the full benefit to LM and its investors and to provide for tax insulation.

(o) During the 2012 year, management fees of \$11,368,182 were expensed to LM and paid to LM Administration Pty Ltd (“LMA”). This represented a significant increase on the previous year’s figure for management fees of \$1,397,727.

(p) In addition, there was a prepayment by LM of \$20,752,639 representing a payment on account of management fees for future work to be performed. The accounts noted that as at the date of the report the balance had been

reduced to \$17.7 million and that the pre-paid management fee would be recovered through LMA's agreement to offset future payable management fees or pursuant to the guarantee from Mr Drake, a Director of LM, that was noted as documented and secured via a letter of undertaking outlining that the full balance would be payable if LMIM or its related entities were sold in part or in full.

- (q) LMA provided administration and fund management services to LM on behalf of LMIM as associate of the Manager.
- (r) The 2012 LM Audit Opinion was dated 7 December 2012. It stated, under the heading 'Auditor's Responsibility':

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards.

...We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

- 13. The basis of the Application was set out in the SOFAC. Details of the 6 contentions pressed in the proceedings are as follows.

The SOFAC Contentions

Contention 1 – Carrying Value, Impairment and Recoverability of loans

- 14. ASIC contended that within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Financial Statements in respect of the carrying value, impairment and recoverability of loans and receivables. Contention 1 comprised 13 Sub-Contentions and 1 Sub-Contention in the alternative with respect to 4 loan receivables referred to in the 2012 LM Financial Statements. Those Sub-Contentions and our conclusions thereon are set out at paragraphs 718–783 hereto.

Contention 2 – Consideration of Going Concern

- 15. ASIC contended that within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Financial Statements regarding consideration of going concern. Contention 2 comprised 9 Sub-Contentions and 1 Sub-Contention in the alternative with respect to consideration of going concern in the 2012 LM Audit. Those Sub-Contentions and our conclusions thereon are set out at paragraphs 921–952 hereto.

Contention 3 – Related party loans

- 16. ASIC contended that within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Financial Statements, regarding the accuracy and disclosure of related party loans in the 2012 LM Financial Statements. Contention 3 comprised 8 Sub-Contentions and 1 Sub-Contention in the alternative with respect to consideration of related party loans in the 2012

LM Audit. Those Sub-Contentions and our conclusions thereon are set out at paragraphs 1036–1079 hereto.

Contention 4 – Management fees

17. ASIC contended that within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Financial Statements, regarding the completeness and accuracy of, and the Manager's rights and obligations to, management fees in the 2012 LM Financial Statements. Contention 4 comprised 9 Sub-Contentions and 1 Sub-Contention in the alternative with respect to consideration of management fees in the 2012 LM Audit. Those Sub-Contentions and our conclusions thereon are set out at paragraphs 1147–1181 hereto.

Contention 5 - Materiality

18. ASIC contended that within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Financial Statements regarding the calculation of materiality in the 2012 LM Audit. Contention 5 comprised 5 Sub-Contentions and 1 Sub-Contention in the alternative with respect to consideration of materiality in the 2012 LM Audit. Those Sub-Contentions and our conclusions thereon are set out at paragraphs 1258–1274 hereto.

Contention 6 – Appropriateness of Audit opinion

19. ASIC contended that within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Financial Statements insofar as he signed an unqualified audit opinion with respect to those accounts. Contention 6 comprised 6 Sub-Contentions and 1 Sub-Contention in the alternative with respect to the appropriateness of the 2012 audit opinion with respect to the 2012 LM Financial Statements. Those Sub-Contentions and our conclusions thereon are set out at paragraphs 1287–1308 hereto.

Contention 7 – Fit and proper person

20. The further alternative contention that Mr Williams is not a fit and proper person to remain registered as an auditor on account of his audit of the 2012 LM Financial Statements, was not pressed by ASIC in the proceedings.

Outline of events between filing the Application and the hearing

21. There were events between the time this Application was filed and heard that we record in this determination because they provide context to the emergence of the “preliminary points” that the Panel of the Board (“Panel”) heard and ruled upon during the hearing.
22. These proceedings were filed with the Board by ASIC on 4 April 2017. On 5 April 2017, the Board sent a notice of the Application to Mr Williams notifying him that disciplinary proceedings had been commenced and providing him with

information about the Board's process for hearing and determining the Application.

23. The Board was notified that Mr Williams was to be represented by Mr Ashley Tiplady of Russells Lawyers in Brisbane. Shortly before the first scheduled pre-hearing conference, Mr Tiplady sought and obtained an adjournment and an extension of time for filing Mr Williams' Response to the SOFAC.
24. The first pre-hearing conference took place on 1 June 2017 (although the Response had not been filed). A timetable for the preparation of evidence was agreed between the parties and the matter was fixed for hearing for 5 days from 4 September – 8 September 2017. Mr Williams was given a further extension of time, to 6 June 2017, to file his Response.
25. Mr Williams filed his Response on 20 June 2017 and the timetable was further varied to provide ASIC with additional time to prepare its evidence following receipt of Mr Williams' Response. The timetable for filing Mr Williams' evidence was however maintained as Mr Williams' solicitor informed the Board that it could still be met as the evidence had been substantially prepared in the course of finalising Mr Williams' Response.
26. After a number of timetable lapses on the part of Mr Williams, the Board was informed that Mr Tiplady was no longer retained as Mr Williams' solicitor.
27. At a teleconference on 26 July 2017, Mr Williams appeared on his own behalf. There were two notable matters raised. First, Mr Williams explained that he had not received notification from his insurers as to whether they would fund legal representation on his behalf in these proceedings (following a notification he said had been made on 2 May 2017). On that basis, he sought an adjournment of the hearing date because he said he was unable to otherwise fund legal representation. The second matter, raised by ASIC, was whether two matters previously raised by Mr Williams' lawyer with ASIC, that had not been addressed in Mr Williams' recently received Response, were to be pressed in the proceedings.
28. With respect to the first matter, the Chairperson informed Mr Williams that the Board was not inclined to vacate the hearing without appropriate cause, although if new legal representatives were appointed by the insurer, Mr Williams could instruct them to make an application for adjournment at the time they were appointed.
29. As to the second matter, a direction was made that if Mr Williams proposed to press preliminary points not addressed in his Response, details were to be provided. The matter was fixed for a further pre-hearing conference on 3 August 2017 in order either to deal with those points or make further directions.
30. By the next pre-hearing conference on 3 August 2017, Mr Robert Nicholls of Prestige Legal and Corporate Services Pty Limited had been instructed by Mr Williams to represent him. Mr Williams did not refer to his insurance arrangements again during the proceedings. Mr Nicholls sought extensions to

the timetable in place, which were accommodated with ASIC's consent. Mr Williams did not seek an adjournment of the hearing.

31. The preliminary points initially submitted to the Board on behalf of Mr Williams concerned the alleged invalidity of the section 30A Notices served by ASIC (by which the documents relied on by ASIC in these proceedings had come into ASIC's possession) and the Board's jurisdiction under section 1292(1)(d) of the Act, to hear a matter not concerned with an audit conducted under Chapter 9 of the Corporations Act.
32. Following a number of pre-hearing applications by the parties arising from timetable lapses, the hearing of the preliminary points and Mr Williams falling ill, the hearing was re-fixed to start on 5 September 2017, first to hear legal submissions from the parties on the preliminary points and, if appropriate, to commence hearing the substantive issues.
33. Mr Williams filed statements of evidence on 4 September 2017, although at that time he did not file a statement on his own behalf.

Respondent's Preliminary Points

34. The preliminary points were initially described by a letter, dated 21 August 2017, to CADB and ASIC in the following terms:

The circumstance that section 30A ASIC Act is not available in respect of activities that are not "audits" as defined for the purposes of the Corporations legislation precludes the possibility that such activity may properly and competently be made the subject of an Application under Sub-Section 1292(1)(d) of the Corporations Act.

As the Respondent understands the position, ASIC acknowledges that there was no requirement in the Corporations Act that required the Fund's accounts to be audited; that is, that the "audit" the subject of:

- (a) The Application, and of
- (b) The notices expressed to have been given pursuant to section 30A ASIC Act dated 21 June 2013 and 11 August 2014,

was not one required by Part 2M of the Corporations Act 2001, nor otherwise required by law. ...

Put another way the power in section 30A of the ASIC Act is ancillary to the possibility of a **competent** Application under section 1292; it does not enlarge the ambit of section 1292. So much is clear from the terms of section 30A itself. The power conferred only

- (a) For the purposes of the ... exercise of any ... functions ...
 - (i) under Chapter 2M and Part 9.2

Part 9.2 is an incidental power or function in respect of the non-performance or mis-performance of a registered auditor of her/his "duties" or functions under Chapter 2M (or some other law)

For the reason identified in 4 above, the Application now before the Board is incompetent, because it does not allege a failure etc. to perform a statutory duty etc.

In the circumstances the notices were not within the power of ASIC to issue.

Being incompetent the Application must be dismissed.

35. Mr Williams' written submissions on the preliminary points were filed on 4 September 2017 and ASIC's submissions in response were filed the following day.
36. The hearing on the preliminary points commenced on 6 September 2017. Mr Terence Lynch SC, instructed by Mr Nicholls, represented Mr Williams and ASIC was represented by Mr Greg McNally SC, instructed by Mr George Boland of ASIC.
37. In his oral submissions Mr Lynch outlined the preliminary points as follows:
 - (a) The ground asserted by ASIC in paragraph 2(i) of its Application, namely that Mr Williams 'has failed to carry out and perform adequately and properly his duties as an auditor' cannot succeed as the audit to which the Application relates was not an audit required to be undertaken for the purposes of the Act (the "not an audit and not an auditor" preliminary point");
 - (b) Further, the ground asserted by ASIC in paragraph 2(ii) of its Application, namely that Mr Williams 'is not a fit and proper person to remain registered as an auditor' is not tenable in circumstances where the particulars alleged in support of this allegation repeat failures in relation to conduct not covered by section 1292(2)(d)(i) of the Act (the "Not Fit and Proper" preliminary point);
 - (c) The entirety of the non-formal evidence is concerned with the conduct of an activity that is not a statutory audit, therefore it was not within the scope of section 1292(2)(d)(i) of the Act and so was not validly obtained by the section 30A notice power exercised by ASIC to obtain documents with respect to the audits performed, because those Notices were ineffective and unlawful (the "section 30A Notice" preliminary point).
38. Mr Lynch submitted that if the above propositions were to succeed, no allegation in the SOFAC would be capable of being established by ASIC because the documents it relied on should not be admissible as evidence in the proceedings because ASIC acted outside its power when it issued the section 30A⁴ notices by which it had come into possession of the documents.
39. Mr Lynch submitted that the preliminary points arose for determination in these proceedings because of Branson J's decision in *Goodman*.⁵ He referred the Panel to page 18 of that judgment where Justice Branson said:

The Board is under a duty to receive, and to consider, any Application by ASIC for a person who is registered as an auditor... and....

⁴ *ASIC Act 2001*.

⁵ *Goodman v Australian Securities Commission* [2004] FCA 1000.

Having received and considered the Application the Board was required to determine whether, were the facts alleged in the Statement established at the hearing, it would seriously consider dealing with the applicant under ss1292(1) or subs 1292(9)....Unless the Board determined that it would in such circumstances seriously consider dealing with the applicant under s1292, the principles of good administration and fair dealing, which are to be found by implication within the statutory framework pursuant to which the Board operates, would dictate that the Board not conduct a hearing on the Application by ASIC.

Based on her Honour's observations, if the propositions that were the subject of the three preliminary points were found to be correct, then the Board should not proceed to conduct a hearing on the Application.

40. There were further submissions then made on Mr Williams' behalf that we discuss below in the context of providing our detailed reasons forming the basis of the ruling delivered to the parties following the hearing on the preliminary points.

Panel's ruling and reasons on Preliminary Points

41. Having adjourned and considered the parties' submissions on the preliminary points overnight, the Panel Chairperson ruled that it was not satisfied that the preliminary points raised provided a sufficient basis for declining to proceed with a merits hearing and it was satisfied that on the basis of the facts alleged in ASIC's SOFAC, were they to be established at a hearing, it would seriously consider dealing with the Respondent under section 1292(1) or (9) of the Act. The parties were informed that the written reasons for the Panel's findings with respect to the preliminary points would be included in the Panel's final determination in this matter.
42. In accordance with the above ruling, the panel sets out its written reasons for the ruling.

Was the Panel conducting the "Goodman Task" when hearing the preliminary points?

43. When the Panel ruled on the preliminary points, it was cognisant of Mr Lynch's submissions with respect to the *Goodman* dictum, set out in paragraph 39 above, as the basis for the consideration the Panel was being asked to undertake.
44. The task to which Branson J referred in *Goodman* (the "Goodman Task") is one undertaken when an Application is received by CADB by the CADB Chairperson⁶ (the "Chair") reviewing the application filed in order to assess the sufficiency of the particulars in support of the contentions in order to be satisfied there is a case for the Respondent to answer. That is to say, that the facts particularised, if established, would cause a Panel to seriously consider dealing with the registered auditor under sections 1292(1) or (9) of the Act. This is an informal process.
45. We note that Branson J further noted in *Goodman* that:⁷

⁶ The CADB Chairperson is responsible under section 1294 of the Act for the conduct of the pre-hearing steps in proceedings.

⁷ *Goodman v Australian Securities Commission* [2004] FCA 1000 [19].

...the Board did not at the time it determined to proceed to a hearing, make a decision that is reviewable under the *ADJR Act* (see *Australian Broadcasting Tribunal v Bond* (1990) 170 CLR 321 at 337; *McLachlan v Australian Securities Commission* (1998) 52 ALD 298 at 305).

46. If, following a review of the application as contemplated by the Goodman Task, the Chairperson held the view that ‘the principles of good administration and fair dealing...would dictate that the Board **not** conduct a hearing on the Application by ASIC’, then this may be dealt with by first providing ASIC (or APRA) with an opportunity (usually at the first pre-hearing conference with the parties) to amend its application with respect to the matters relevantly identified.
47. Following that opportunity being provided, if the Chairperson were to continue to believe that a Panel would not seriously consider dealing with the applicant under section 1292 of the Act on the basis of the contents of the Application, the appropriate course to give effect to that decision would be to dispose of the application by striking out the proceedings. By this process ‘the principles of good administration and fair dealing’ are incorporated in the Board’s process when dealing with applications that are filed.
48. What the Panel was being asked to do by the respondent here was not the Goodman Task as his counsel had submitted. However, the Respondent’s preliminary points, had we been persuaded of their merit, would have resulted in there being no case for Mr Williams to answer and so the result would have been the same, whether or not so characterised. As foreshadowed at the hearing, our written reasons for concluding that the preliminary points advanced by the Respondent did not provide a basis for the Panel not proceeding to hear this Application follow below.

The “not an audit and not an auditor” preliminary point

49. The Respondent's first preliminary point was that the ground asserted in paragraph (2)(i) of the Application that Mr Williams ‘failed to carry out or perform adequately and properly his duties as an auditor’ cannot succeed as a matter of law because the audit to which the allegations related was not an audit required to be undertaken for the purposes of the Act and Mr Williams, acting as the auditor of LM, did not fall within the scope of the meaning of *auditor* for the purposes of section 1292(1)(d)(i) of the Act.
50. Mr Lynch submitted that because registration as an auditor pursuant to section 1280 of the Act is required in order to undertake audits of companies and schemes under Chapter 2M of the Act, the function of such registration must also be limited to performing such statutory audits and section 1292(1)(d)(i) of the Act is properly interpreted as limited to applying to registered auditors performing an audit under Chapter 2M of the Act undertaking statutory functions on the basis of their registration as a company auditor.

51. In support of this argument, Mr Lynch referred the Panel to the decisions in *Bride*⁸ and *Gould*⁹ and submitted that those decisions are binding on the Board.
52. *Bride*¹⁰ was a decision concerning a registered liquidator, who, in relation to a particular company, had been appointed as a receiver. In the context of the question whether as a receiver, he was acting as a de facto liquidator, the decision in *Bride* considered the point at which the duties of a registered liquidator arise by virtue of registration under the Act. The case was concerned with the interpretation of section 1284(1) of the Act and Regulation 9.2.05 as then in force. Relevantly section 1284(1) of the Act provided:
- Where the Commission grants an Application by a person for registration as a liquidator or as a liquidator of a specified body corporate, the person shall lodge and maintain with the Commission a security for due performance of his or her duties as such a liquidator in such form...
53. The reference above to ‘his or her duties as such a liquidator’ in section 1284(1) of the Act, in his Honour’s opinion referred to duties that arise when:
- (a) a person who has been registered as a liquidator is appointed as a liquidator of a company; or
 - (b) a person who has been registered as a liquidator of a specified body corporate is appointed as a liquidator of a specified body corporate.
54. Carr J stated that the fact that the liquidator was not qualified to be appointed as a receiver had he not been registered as a liquidator did not mean that his conduct, after being appointed as a receiver was to be characterised as carrying out his duties as a liquidator. Registration as a liquidator simply provided him with a qualification entitling him to be appointed as a receiver. The legal functions of a receiver on the one hand and a liquidator on the other are separate and distinct.¹¹
55. Carr J also said:¹²
- Parliament has, in the context of cancellation or suspension of the registration of a liquidator distinguished between a person carrying out or performing adequately and properly...the duties of a liquidator as such, as distinct from any duties or functions required by an Australian law to be carried out or performed by a registered liquidator (see 1292(2)(d)). Where Parliament wants to refer to both the duties of a liquidator and other duties required by law to be carried out or performed by a registered liquidator, it refers expressly to two sets of duties.
56. Mr Lynch submitted that the facts in *Bride*¹³ were analogous to this matter. He submitted that the binding effect of *Bride* on this Board was that section 1292(1)(d)(i) of the Act is concerned with the duties entailed in the

⁸ *Bride v Australian Securities Commission* (1997) 143 ALR 523.

⁹ *Gould v Companies Auditors and Liquidators Disciplinary Board and Another* (2009) 71 ACSR 648.

¹⁰ *Bride v Australian Securities Commission* (1997) 143 ALR 523.

¹¹ *Ibid* 527 [35]-[40].

¹² *Ibid*.

¹³ *Bride v Australian Securities Commission* (1997) 143 ALR 523.

appointment as an auditor to undertake an audit required by the Act and section 1292(1)(d)(ii) of the Act is concerned with appointment as an auditor to undertake statutory functions for which qualification as a registered company auditor is required, but which is not a Chapter 2M audit. He said that *Bride*¹⁴ provided the Federal Court's explanation of how section 1292(1)(d)(i) and (ii) of the Act operate. Subsection (1)(d)(i) covers the duties for which a registered company audit qualification is required and subsection (1)(d)(ii) is concerned with the duties undertaken consequent upon appointment.

57. Finally on this point, Mr Lynch referred the Panel to the decision in *Gould*¹⁵, the reasoning in which he submitted was in line with *Bride*. Based on these authorities, Mr Lynch submitted that the allegations that Mr Williams had failed to carry out or perform adequately and properly the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act must be dismissed without a hearing because the Act does not regulate audits except those referred to in Chapter 2M of the Act and the 2012 LM Audit the subject of the SOFAC, not being an audit required by Chapter 2M of the Act meant that Mr Williams was not performing the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act when he performed the 2012 LM Audit.
58. Mr McNally made the following submissions in response:
- (a) He referred the Panel to the distinction drawn in *Dean-Willcocks*¹⁶ between the use of 'registered liquidator' in section 1292(2)(d)(i) of the Act and 'liquidator' in section 1292(2)(d)(ii) of the Act and submitted that the distinction lends support to the argument that the duties of an auditor referred to in section 1292(1)(d)(i) of the Act are not limited to audits of a Chapter 2 company or an audit under Chapter 2M of the Act, but relate to audits generally performed by a registered auditor. The fact that there is no use of the word 'registered' before auditor in section 1292(2)(d)(i) of the Act supports that interpretation. On a reading that takes into account the purpose and object of the Act, that purpose and object is best served if the distinction between 'auditor' in section 1292(2)(d)(i) of the Act and 'registered auditor' in section 1292(2)(d)(ii) of the Act is given some effect so that auditor means the general duties of an auditor and would cover the situation where Mr Williams was purporting to carry out an audit as if it were a Chapter 2M audit as was alleged.
 - (b) With reference to the decision in *Bride*, he pointed to the distinction in language between section 1284(1) of the Act, which was the subject of Carr J's comments in that decision, and section 1292 of the Act and the fact that, in the 2012 LM Audit, Mr Williams was clearly acting as an auditor and not as a de facto auditor.
 - (c) Pointed the Panel to the purpose and object of the regulatory scheme with respect to auditors that ensures only those who are competent as auditors may be registered and safeguards that framework through ASIC's function

¹⁴ *Bride v Australian Securities Commission* (1997) 143 ALR 523.

¹⁵ *Gould v Companies Auditors and Liquidators Disciplinary Board and Another* (2009) 71 ACSR 648.

¹⁶ *Dean-Willcocks v Companies Auditors and Liquidators Disciplinary Board* (2006) ACSR 698.

to bring matters before the Board when it suspects an auditor has not carried out his/her duties adequately and properly or is otherwise not a fit and proper person to remain registered as an auditor. This has its connection with the Act because only persons who remain competent and who are able to adequately and properly carry out their duties as an auditor, should remain registered.

- (d) Referred to a decision of White J¹⁷ in the Supreme Court where his Honour stated:

Section 1(2)(g) of the ASIC Act requires that, in performing its functions and exercising its powers ASIC must strive to take whatever action it can take and is necessary in order to enforce and give effect.

After referring to the facts, White J said further: ‘The ASIC Act is to be interpreted in a way which promotes ASIC's ability to act.’¹⁸

- (e) Pointed to the public’s interest in being protected from a registered auditor who has failed to carry out adequately and properly the duties of an auditor in conducting an audit purporting to be an audit prepared as if it was a Corporations Act audit.
- (f) Referred to the letter of engagement signed by Mr Williams on behalf of WPIAS with respect to the conduct of the 2012 LM Audit which created a contractual obligation to carry out the audit in accordance with the relevant Australian Auditing Standards (“Auditing Standards”) so as to express an opinion as to whether the 2012 LM Financial Statements presented a true and fair view of the entity’s financial position at 30 June 2012 and its performance for the year ended on that date in accordance with the Auditing Standards and the Act submitting that the obligation created therein was sufficient to enliven the Board’s jurisdiction should it be found that the audit, as performed, failed to comply with those requirements.

Panel's views on “not an audit and not an auditor” preliminary point

59. In our view the 2012 LM Audit was an audit falling within the purview of section 1292(1) of the Act and Mr Williams was performing the ‘duties of an auditor’ within the meaning of section 1292(1)(d) when performing the 2012 LM Audit. It follows that the particulars pleaded in support of the allegations in the SOFAC were not insufficient in the respects alleged and, if established by the evidence, the Board’s powers under section 1292(1) and/or (9) of the Act would be enlivened.
60. The reasons for our view are as follows:
- (a) The Panel does not regard itself as bound by the decisions in *Bride*¹⁹ nor *Gould*²⁰ such that the scope of section 1292(1)(d)(i) of the Act is limited

¹⁷ *ASIC v Sigalla (No 2)* (2010) 271 ALR 164.

¹⁸ *Ibid* 175 [33].

¹⁹ *Bride v Australian Securities Commission* (1997) 143 ALR 523.

²⁰ *Gould v Companies Auditors and Liquidators Disciplinary Board and Another* (2009) 71 ACSR 648.

to audits required by the Act to be performed by a registered auditor. Those decisions are distinguishable from the facts in this matter.

- (b) The decision in *Bride*²¹ was concerned with a different section of the Act with similar but not identical language to section 1292(1)(d) that was directed to specific circumstances with respect to a registered liquidator and whether, when appointed as a Receiver, he would be acting as a de facto liquidator. That factual context is not analogous to a consideration of whether Mr Williams, in conducting an audit of a *non*-Chapter 2M company as though it was a Chapter 2M company, was performing the duties of an auditor under section 1292(1)(d)(i) of the Act. The difficulty with Mr Lynch's submission that the decision in *Bride*²² provides an explanation by the Federal Court of how subsections (1)(d)(i) and (1)(d)(ii) of the Act operate is that the decision neither relates to these subsections nor considers the duties of a liquidator in any analogous sense to the circumstances of Mr Williams' performance as a registered auditor of the 2012 LM Audit.
- (c) The Panel was not persuaded by the Respondent's arguments that the decision in *Gould*²³ provides support for the narrow reading of section 1292(1)(d)(i) of the Act for which the Respondent contended. The relevant dictum in that decision was as follows:

Paragraph [2](d)(i) refers to the duties of the office of liquidator occupied by the person. Paragraph [2](d)(ii) refers to the duties or functions of other offices that, under Australian law, may only be carried out or performed by a registered liquidator.

- (d) While before the repeal of subsection (2)(d) the jurisprudence regarding section 1292(1)(d) and (2)(d) of the Act had much in common with respect to a consideration of the respective functions and duties of registered liquidators and registered auditors, it is not in our view correct that the precedent provided by *Gould* with respect to liquidators requires section 1292(1)(d)(i) of the Act to be read so that jurisdiction is conferred on the Board in respect of a registered auditor only if that auditor 'is duly appointed to a particular corporation' (i.e. one requiring the use of a registered auditor under Chapter 2M of the Act). The fact that a liquidator must always be occupying that office when performing duties as a liquidator and cannot otherwise perform duties as a liquidator is a significant point of distinction between auditors and liquidators in a consideration of the operation of section 1292(1)(d) and (2)(d) of the Act. The exercise of simply substituting the word *auditor* for *liquidator* in the relevant dictum in *Gould*²⁴ as Mr Lynch argued in order to support a conclusion that for jurisdiction to arise under section 1292(1)(d)(i) of the Act a registered auditor must first be appointed to a Chapter 2M audit is undermined by that distinction. There are many different types of audits and no *office* of auditor as there is of a liquidator.

²¹ *Bride v Australian Securities Commission* (1997) 143 ALR 523.

²² *Ibid.*

²³ *Gould v Companies Auditors and Liquidators Disciplinary Board and Another* (2009) 71 ACSR 648, 651 [25].

²⁴ *Ibid.*

- (e) The further difficulty in the Respondent's argument was that the narrow interpretation of section 1292(1)(d)(i) of the Act advanced required the words 'Australian law' in section 1292(1)(d)(ii) of the Act to be read as including Australian legislation but excluding the Act. Mr Lynch submitted that the proper approach was to first work out what section 1292(1)(d)(i) of the Act covers and then interpret section 1292(1)(d)(ii) of the Act within that context. This required the reference to Australian law to be interpreted as a reference to statutory duties not including those prescribed by the Act. In our view that is not an interpretation that is consistent with section 15AA of the *Acts Interpretation Act 1901*, particularly given the definition of Australian law in section 9 of the Act,²⁵ nor consistent with the authorities that hold (and which represent precedent that binds the Board) that there are three separate and distinct heads of jurisdiction conferred by section 1292(1)(d) of the Act.²⁶ Further, it is not a reading of section 1292(1)(d) of the Act that in our view takes into account the purpose and object of the Act, which is best served if the distinction between 'auditor' in paragraph (d)(i) and 'registered auditor' in paragraph (d)(ii) is given some effect so that the reference to auditor in paragraph (d)(i) covers the general duties of an auditor and therefore contemplates the circumstance where Mr Williams carried out the 2012 LM Audit *as if* it were a Chapter 2M audit.
- (f) Finally, with respect to the further arguments submitted by Mr Lynch about the limited nature of audits that fall within the purview of section 1292 of the Act and the narrow definition of *auditor* for the purposes of section 1292 of the Act, our view is that those arguments are neither consistent with the authorities to which we were referred nor sustainable on a plain reading of section 1292(1)(d) having regard to the purpose and objects of the Act. In the decision of *Coopers and Lybrand v Australian Securities Commission* (1994)²⁷ the proposition that the Board's functions and powers under section 1292 did not extend to the activities of registered auditors otherwise than in relation to their conduct as company auditors auditing a company within Part 3.7 of the Corporations Law (as it then was) was expressly rejected.

61. For the above reasons we conclude that section 1292 of the Act is not limited in the manner submitted by Mr Lynch with any consequent impact on the sufficiency of ASIC's Application. Indeed, the effect of the arguments urged upon us would be (subject to the relevant facts being established) that Mr Williams as an auditor registered under the Act, assumed responsibility for conducting the 2012 LM Audit on the basis of the terms expressed in the Engagement Letter, including performing the audit in accordance with the relevant auditing standards and the Act, but was not performing any duties as an auditor within the meaning of section 1292(1)(d) of the Act. Such a construction of the words of the subsection would in our view be plainly inconsistent with the purpose and object of the regulatory scheme with respect to auditors

²⁵ Corporations Act definition of Australian law: 'Australian law – means a law of the Commonwealth or of a State or Territory'.

²⁶ *Davies v Australian Securities Commission and another* (1995) 131 ALR 295, 307.

²⁷ 53 FCR 599, 606-607.

contemplated by the Act to which Mr McNally referred in his submissions. In our view, the public is entitled to expect that a registered auditor holding himself out as such will conduct any audit for which he is responsible in a manner that is both consistent with the relevant professional standards then in place, the relevant applicable legislation and any specific representations that the auditor makes as to the manner in which the audit will be performed.

62. Our consideration of whether the matters alleged regarding Mr Williams' conduct of the 2012 LM Audit were duties of an auditor within section 1292(1)(d)(i) of the Act is further considered at paragraph 88 in the context of our discussion of the relevant statutory question under section 1292(1)(d)(i) of the Act.

The "Not Fit and Proper" preliminary point

63. The basis advanced by the Respondent for the second preliminary point was twofold:
- (a) First, that the allegation that Mr Williams is not a fit and proper person to remain registered as an auditor is not tenable in the circumstances where the particulars for that contention, repeat the failures alleged in relation to the first preliminary issue; and
 - (b) Second, that the premise that Mr Williams was vicariously liable for all the particularised conduct alleged in the SOFAC was incorrect.
64. With respect to subparagraph (a), Contention 7 was advanced as an alternative contention by ASIC in the proceedings. With respect to subparagraph (b), Mr Williams did not press the Engagement Partner Response.²⁸ For those reasons, we have not further considered this preliminary point.

"Section 30A Notice" preliminary point

65. The relevant facts which were not in issue between the parties were as follows:
- (a) There were two notices served by ASIC pursuant to its power under section 30A of the ASIC Act ("the Section 30A Notices"). The first was served on 21 June 2013 ("the First Notice") under cover of a letter from ASIC addressed to 'All the partners for the time being of Williams' Partners Independent Audit Specialists' and marked to the attention of Mr Reg Williams. The First Notice stated its purpose as follows: '...ascertaining compliance by the partners...with audit requirements contained in Division 3 of Part 2M.3 and Division 3 of Part 2M.4 of the Corporations Act.'
 - (b) By letter dated 10 July 2013 from WPIAS to ASIC signed by Mr Williams, there were three USB sticks provided to ASIC in response to the First Notice. The letter described the material provided as:

²⁸ See paragraphs 101-118.

All working papers, correspondence and permanent files; all time records for each engagement team member and all invoices, in relation to the audit of the consolidated financial statements of the LM Investment Management Limited, re LM Managed Performance Fund ABN 95595833174.

- (c) The second notice, dated 14 August 2014, was served by letter from ASIC to all of the Partners for the time being of WPIAS (“the Second Notice”). The 14 August letter referred to the First Notice and noted it may have been defective and stated ‘consequently, I enclose a new Notice issued under s30A of the ASIC Act.’ The Second Notice stated its purpose as ‘performing or exercising our functions and powers relating to Division 3 Part 9.2 of the Corporations Act 2001...’.
- (d) By letter dated 9 September 2014 from its Lawyers, WPIAS notified ASIC that in its view the Second Notice was also defective on the basis that LM is not an entity to which audit requirements imposed by the Act apply and the audit that was undertaken was therefore not conducted for the purposes of the Act.

Parties’ submissions on Section 30A Notice preliminary point

66. Mr Lynch submitted that:

- (a) The documentary evidence ASIC would need to rely on to make its case in these proceedings had been obtained unlawfully because the section 30A Notices it issued requiring production of the documents were invalid.
- (b) The Panel must consider and make a finding as to the validity of the Notices as a preliminary matter.
- (c) The Panel must consider the lawfulness of the means by which the evidence on which this Application is based was obtained by ASIC because, as a matter of public policy, the conferral of jurisdiction to decide an Application requires the Board to determine all of the issues arising in the course of the Application according to law.

67. ASIC submitted that:

- (a) The Board does not have jurisdiction to determine the validity of a notice issued by ASIC pursuant to section 30A of the ASIC Act (“section 30A Notice”). Section 1292 of the Act sets out the powers of CADB in relation to auditors and those powers do not include jurisdiction to determine the validity of a section 30A Notice.
- (b) While the Panel does not have power to determine the legality of the section 30A Notices, a consideration of the circumstances in which the evidence was obtained may be relevant in relation to the admission of specific evidence in the proceedings and the Respondent would be entitled to raise an objection on the basis that the documents had been obtained pursuant to an invalid notice. In that context the Panel may need to form a view about the likely circumstances in which the evidence was obtained,

including the scope of ASIC's power to issue notices under that section, in order to enable it to have regard to the relevant considerations that weigh in the exercise of its discretion with regard to the admission of the evidence.

68. In response to ASIC's submission, Mr Lynch argued that there was a preliminary matter before the point at which the admissibility of evidence would be considered because an exercise of discretion by the Panel in relation to the admission of evidence would, if the basis of the challenge was to be unlawfulness, require the Panel first to determine whether ASIC had acted unlawfully.

Panel's views and ruling on Section 30A Notice Preliminary Point

69. The decision in *Re Andrew Henry Ralph and Telstra Corporation* [2005] AATA 106 at 23 considered analogous circumstances under different legislation. In that decision Deputy President D G Jarvis held that the AAT did not have jurisdiction to determine the validity of a Notice to produce documents under section 58 of the *Safety Rehabilitation and Compensation Act 1998 (Cth)*, which was for a Court to decide.
70. CADB's jurisdiction does not extend to determining whether ASIC has acted unlawfully with respect to issuing the Section 30A Notices and/or the legality of the relevant Section 30A Notices. These matters do not fall within the scope of the power conferred on the Board by section 1292 of the Act and for that reason we did not regard the Section 30A Notice preliminary point as a matter on which it was open to CADB to rule nor a matter that prevented the Board from proceeding with the Application filed by ASIC.

Further comments on admissibility

71. Although the Board is not bound by the rules of evidence, it may be the case that in the context of ruling whether to admit documentary evidence in the proceedings, consideration of the means by which documents had come in to ASIC's possession might be relevant particularly when the facts suggest an irregularity that would sustain an objection to the admission of the evidence based on public policy grounds.
72. It is not in our view correct and nor does it logically follow that we must as Mr Lynch submitted, rule on the legality of the section 30A Notices in order subsequently to exercise our discretion with respect to the admission or otherwise of documents at the hearing. While in a matter such as this the extent of the documents affected may have practical implications for the conduct of the hearing, that factor should not and does not elevate the issue in the manner suggested.
73. The primary bases advanced as to why the section 30A Notices were allegedly invalid were the same matters the subject of the Respondent's first preliminary point, namely that the nature of the audits the subject of the Notices and Mr Williams' conduct with respect to performing those audits were not matters within the purview of section 1292(1)(d) of the Act, nor therefore properly the subject of a section 30A Notice which, the Respondent argued with respect to

this final point, rendered those Notices invalid. We were not persuaded by the arguments advanced by the Respondent on the first preliminary issue for the reasons we have set out. It follows from our conclusions that the question of the validity of the section 30A Notices also falls away and were those same matters advanced in support of an objection on public policy grounds to the admission of ASIC's documentary evidence, there would be no reason for that question, in the absence of any other relevant considerations, to bear upon the exercise of our discretion in that regard.

Further adjournment after commencement of hearing on substantive issues

74. Following the Panel's ruling on the preliminary issues, Counsel for ASIC proceeded to open ASIC's case. Although Mr Williams was absent due to illness, the Board had foreshadowed it would proceed with Mr McNally's opening as to do so would not prejudice Mr Williams as his legal team were to remain present for the opening and the record would be available to Mr Williams via the transcript. At the conclusion of Mr McNally's opening, the case was adjourned and fixed for further hearing for four days from Monday, 20 November 2017 to allow time for Mr Williams to recover.
75. Late on the evening of Sunday, 19 November 2017, immediately before the hearing was due to recommence the following day, Mr Williams filed a medical certificate and foreshadowed a further adjournment application. Mr Williams represented himself at the hearing the next day. After considering the material, the Panel formed the view there was insufficient information to consider the impact of Mr Williams' incapacity as no objective information had been provided to the Panel. There was a further overnight adjournment to allow Mr Williams an opportunity to provide evidence from his treating physician as to his medical condition.
76. On the basis of the further information provided, the matter was adjourned by consent to March 2018. Mr Williams agreed to provide an interim undertaking that he would refrain from performing any work on company audits until the finalisation of these proceedings before the Board.

Re-commencement of substantive hearing March 2018

Mr Williams now unrepresented

77. Following the adjournment provided to Mr Williams in November 2017, the Panel reconvened in Brisbane on 5 March 2018. Mr Williams was not legally represented at this hearing, even though he had submitted at the November hearing that he would require time following recovery from his illness to brief a lawyer in order to be prepared for the further hearing.
78. Mr Williams requested that Ms Dipenaar be present as his support person at the hearing. ASIC did not object to her presence and the Panel made a direction under section 216(4) of the ASIC Act.
79. As Mr Williams was unrepresented, the Panel, before re-commencing and in order to facilitate conduct of the hearing, outlined the likely sequence of each party's case presentation, provided guidance to Mr Williams on the process for

submission of each party's evidence and summarised the result of what had so far occurred in the proceedings.

80. In the event, the hearing ran for a further five days.
81. We turn now to our reasons for determination of the substantive matters in the proceedings.

The relevant statutory question under section 1292(1)(d)(i) of the Act

82. The first relevant question with respect to our consideration is whether the matters alleged regarding Mr Williams' conduct of the 2012 LM Audit were duties of an auditor within section 1292(1)(d)(i) of the Act.
83. As we have noted, the 2012 LM Audit Opinion that was signed by Mr Williams as the Engagement Partner, represented that the 2012 LM Financial Statements were in accordance with the Act, the Auditing Standards and the Regulations, that they gave a true and fair view of LM's financial position, and were compliant with international financial reporting standards.
84. The Engagement Letter²⁹ formed the contractual basis for the performance by WPIAS of the 2012 LM Audit of the 2012 LM Financial Statements. As already noted, the Engagement Letter stated that the audit would be conducted in accordance with the Act and the Auditing Standards.
85. Relevantly the Engagement Letter also noted:

The objective and scope of the audit

We will conduct our audit in accordance with the Australian Auditing Standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement. An audit involves performing procedures to obtain evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial report.

Reporting

We will conduct our audit in accordance with the Australian Auditing Standards, in order to express an opinion as to whether the financial report presents a true and fair view of the entity's financial position as at 30 June 2012 and its performance for the year ended on that date in accordance with the Australian Accounting Standards (including Australian Accounting Interpretations) and the Corporations Act 2001. The form and content of our report may need to be amended in light of our audit findings.

Presentation of Audited Financial Report on Internet

If the entity intends to publish a hard copy of the audited financial report and auditor's report for members and to electronically present the audited financial report and auditor's report on its internet website, the security and controls over information on the website should be addressed by the entity to maintain the integrity of the data presented. The examination of

²⁹ See paragraphs 8-9.

the controls over the electronic presentation of audited financial information on the entity's website is beyond the scope of the audit of the financial report. Responsibility for the electronic presentation of the financial report on the entity's website is that of the governing body of the entity.

Other

The opinion provided for the audit is for the express use of those directly requesting it from Williams Partners Independent Audit Specialists. The audit relates only to the entity and does not provide an opinion on any other entity.

86. As noted in paragraph 12(k), the 2012 LM Financial Statements noted the report was a general purpose financial report that had been prepared in accordance with the Scheme Constitution and the requirements of the Act.
87. Mr Williams conceded that he was responsible as the WPIAS Engagement Partner on the 2012 LM Audit (the "Engagement Partner"). We discuss this matter further in the context of our consideration of Mr Williams' responses to the SOFAC allegations.³⁰
88. The Contentions set out in the SOFAC characterised the conduct alleged as within section 1292(1)(d)(i) of the Act. That section confers power on the Board 'if it is satisfied on an application...for a person who is registered as an auditor to be dealt with under this section, that...the person... has failed...to carry out or perform adequately and properly...the duties of an auditor.' By contrast, paragraph (d)(ii) refers to 'any duties or functions required by an Australian law to be carried out or performed by a registered company auditor.' Both subsections apply only to auditors registered under the Act. In its decision in *Hill*,³¹ the Board referred to its earlier decision in *Fernandez* that discussed the relevant authorities and expressed the view that the preferable construction to be placed on section 1292(1)(d)(i) was one that included both the statutory duties and the general law duties of an auditor and confirmed the Board's view that the words 'duties of an auditor' under section 1292(1)(d)(i) encompass the general law duties and the statutory duties of an auditor.
89. We are satisfied that Mr Williams was carrying out duties within the meaning of section 1292(1)(d)(i) of the Act. The first six contentions pressed by ASIC referenced various requirements in the Auditing Standards that it was alleged were not performed, or were not performed adequately and properly within the meaning of section 1292(1)(d)(i) of the Act, in the conduct of the 2012 LM Audit. Those standards are issued by the Australian Auditing Standards Board ("AUASB") and apply to audits whether or not they are conducted under the Act.
90. With respect to audits of financial reports conducted under the Act, the Auditing Standards applied because they are issued as legislative instruments under the Act.
91. With respect to audits of financial reports not conducted under the Act, the Accounting and Ethical Standards Board ("APESB") issued a revised APES 210

³⁰ See above n 28.

³¹ Determination of the Board, Matter No 01/NSW14.

in November 2011 that provided that a member was required to comply with the Auditing Standards. APESB is an independent body established in 2006 as an initiative of CPA Australia and Chartered Accountants in Australia and New Zealand (then the Institute of Chartered Accountants in Australia). CPA Australia, Chartered Accountants ANZ and the Institute of Public Accountants are all members of the APESB. The role of APESB is to develop and issue professional and ethical standards in the public interest that apply to members of CPA Australia and the other two Australian accounting bodies. APES 210 required members of those bodies to comply with relevant Auditing and Assurance Standards. The only exception was if legislation or other government authority required a departure from such standards. In such circumstances the member was required to disclose that matter in the member's report. Mr Williams was a member of CPA Australia Ltd when he conducted the 2012 audit and so was required to comply with APES 210 that required compliance with the Auditing Standards.

92. The provisions of the Auditing Standards at the relevant time represented a framework governing the conduct of an audit of a financial report in Australia. They may be categorised within section 1292(2)(d)(i) of the Act as either a statutory duty by virtue of their status as a legislative instrument under the Act or as a general law duty assumed by Mr Williams in this matter by the process outlined in paragraph 91.
93. Mr Williams separately assumed a contractual obligation to perform the 2012 LM Audit in accordance with the Act and the Auditing Standards by the terms of the Engagement Letter.³²
94. For the above reasons, we are satisfied that in this matter, the prevailing provisions of the Auditing Standards and the Act at the relevant time in 2012 governed Mr Williams' performance of the 2012 LM Audit and are appropriate sources from which his obligations when performing that audit arose within the meaning of section 1292(1)(d)(i) of the Act.

The Board's task under section 1292

95. The next relevant question is the nature of the task to be performed by the Board in considering an application under section 1292 of the Act and the question of whether a registered auditor *has failed to carry out or perform adequately and properly, the duties of an auditor*.
96. In the Board's decision in *Walker* that task was explained in the following terms:³³

It is beyond doubt that there are various sources from which an auditor's duties may arise and they include statutory provisions, the general law and codes and standards promulgated by professional bodies. In this case ASIC has framed a number of its contentions as being constituted by a contravention (or a failure to comply with) a specified statutory provision. However, whether there has been a contravention of any particular statutory provision is not a matter relevantly for us to decide. The exercise of our power under s1292 does not turn on our being satisfied as to a legal standard. It may be that the failure to carry out and perform

³² See above n 29.

³³ *ASIC v Walker* (Determination of the Board, Matter No 06/VIC07, 20).

a relevant duty is an offence, however that is not what we are called upon to determine by the terms of s1292. The question for us is the adequacy and propriety of the carrying out or performance of a relevant duty and that is to be judged by the Board by making an evaluative and subjective determination (*Albarran v CALDB* [2006] FCAFC 69 at 45).

It is accepted in the accounting profession (including in the auditing and insolvency sectors) that registered company auditors and registered liquidators have a duty to observe what Campbell J called “proper professional practice” (*Re Vouris* (2003) 47 ACSR 155 at para [100]) and what Branson J called “accepted professional standards” (*Goodman v ASIC* [2004] FCA 1000). The codes and standards promulgated by professional bodies from time to time are widely regarded as being evidence, even if not technical proof, of what are accepted professional standards. This is not to say that those published codes and standards actually constitute duties of a practising accountant (although an auditor is obliged by law to conduct an audit in accordance with auditing standards – s307A(1)) nor is it to say that accepted professional standards are actually defined or confined by the codes and standards any more than they are by obligations created by statute. However it is relevant for us in reaching a view about what proper professional practice requires should be done or not done, to have regard to the published codes and standards.

97. The nature of the task was further discussed by the High Court in *Albarran v Members of the Companies Auditors and Liquidators Disciplinary Board*³⁴ in which the plurality stated (at [18]):

[18] In construing paragraph (d) of s 1292(2), weight must be given to the introductory but controlling words “to carry out or perform adequately and properly”. Of the words “proper” and “adequate” as they appear here, Tamberlin J said in *Dean-Willcocks v Companies Auditors and Liquidators Disciplinary Board* that they invite...the testing of performance against a relevant standard or benchmark of performance. The interpretation advanced for the applicant, in my view, is too narrow in requiring the identification of a specific duty directly imposed by legislation. The level of performance called for is that of “adequacy”. The standard is that the duty must be performed “properly”.

[19] Section 203 of the ASIC Act, in dealing with the composition of the board, requires that it include members appointed by the Minister from panels nominated by professional accountancy bodies. The section also now requires the appointment of “business members” from among persons the Minister is satisfied are suitable as representatives of the business community by reason of qualifications, knowledge or experience in fields including business or commerce, the administration of companies, financial markets, and financial products and financial services.

[20] Against that background, in *Dean-Willcocks*, Tamberlin J went on to observe that paragraph (d)(ii) of s 1292(2):

... is designed to enable a board representative of the commercial and accounting communities to consider whether the function has been adequately and properly carried out. To assess this, it is permissible, in my view, to have regard to the standards operative in the relevant sphere of activity.

[21] That reasoning of Tamberlin J should be accepted as indicative that the function performed by the Board in the present cases was not the ascertainment or enforcement of any existing right or liability in respect of an offence and the punishment for an offence. So, also, should the conclusion expressed by the Full Court in the judgment here under appeal. Their Honours said:

The function of the Board is not, as was submitted, to find (as an exercise of deciding present rights and obligations in the above sense) whether an offence has

³⁴ (2007) 231 CLR 350; [2007] HCA 23.

been committed and, if so, to inflict a punishment therefor. It is, as we have said, to assess whether someone should continue to occupy a statutory position involving skill and probity, in circumstances where (not merely because) the Board is satisfied that the person has failed in the performance of his or her professional duties in the past. Messrs Gould and Albarran say that punishment or a penal or harmful consequence is finally inflicted on the person consequent upon the finding of the committal of an offence prescribed by law. That is not what s 1292(2) says the function of the Board is. It is not, in substance, what the Board does.

[22] This construction of paragraph (d) of s 1292(2) is not qualified or displaced by any considerations flowing from the final words in that paragraph “or is otherwise not a fit and proper person to remain registered as a liquidator.

98. Compliance with the prevailing Auditing Standards requirements in the 2012 LM Audit set or alternatively reflected a relevant professional standard to which the Panel might have regard when evaluating the adequacy and propriety of Mr Williams’ performance of his audit duties under section 1292(1) of the Act.
99. In making our ‘evaluative and subjective determination’³⁵ of the adequacy and propriety of the carrying out or performance of his duties, a relevant general benchmark against which to evaluate the level and sufficiency of Mr Williams’ performance of his duties in this matter would be a reasonably competent registered auditor performing the audit of a similar financial report in similar circumstances at a similar time to Mr Williams’ performance of the 2012 LM Audit. In our view, adequate performance of relevant duties by a reasonably competent registered auditor would be demonstrated by:
- (a) Compliance with current relevant requirements of the Auditing Standards. Those standards, which are principles based, are designed to be applied by an auditor through the exercise of professional judgement³⁶ and an element of the Panel’s assessment of whether there has been adequate performance of this aspect of the auditor’s duties will therefore involve an element of qualitative evaluation.
 - (b) Compliance of the entity’s reporting in its financial statements with relevant applicable legislative requirements and AASB requirements.
 - (c) Performing the audit engagement consistently with any specific representations with respect to its performance made by the auditor by way of, for example, an audit engagement letter.
 - (d) Performing duties in an audit engagement at a standard consistent with the relevant Auditing and Assurance Standards Board (“AUASB”) guidelines, pronouncements and/or bulletins published from time to time.

(“The Relevant Benchmark”)

³⁵ *Albarran v CALDB* [2006] FCAFC 69, 45.

³⁶ AUASB Bulletin (August 2012), page 3.

Threshold matters arising from Mr Williams' Response

100. There were four matters that arose from Mr Williams' Response to the proceedings and his evidence that were repeated with respect to all contentions. They were:
 - (a) The Engagement Partner Response;
 - (b) The Limited Purpose/Limited User response;
 - (c) The WPIAS audit templates – their relevance and evidentiary weight; and
 - (d) The status of the WPIAS Forensic file ("Forensic File") that Mr Williams alleged was part of the WPIAS Audit Engagement File.

The Engagement Partner Response

As the Engagement Partner what was the extent of Mr Williams' responsibility with respect to the 2012 LM Audit?

101. Until the ninth day of the hearing, Mr Williams maintained that, in the context of the quality control framework in place at WPIAS (discussed further in paragraphs 103 and 135–140), the role that he performed and the actions that he took as Engagement Partner on the 2012 LM Audit satisfied his obligation as a registered auditor to carry out his duties adequately and properly within the meaning of section 1292(1)(d)(i) of the Act in the context of the 2012 LM Audit.
102. In his evidence, Mr Williams had said that the quality control framework in place at WPIAS meant that two of the firm's partners shared responsibility as engagement partners on the 2012 LM Audit. In this matter he said he was the Engagement Partner and Ms Blank shared that responsibility in her role as "Lead Engagement Partner". A third registered auditor, Ms Lee-Anne Dipenaar performed the role of "Engagement Quality Control Review Partner". On the basis of those registered auditors each performing a designated role, Mr Williams, in his Response, had asserted that he had adequately performed his role in the 2012 LM Audit and was not otherwise responsible for the performance of other audit work that had been carried out by Ms Blank (the "Engagement Partner Response").
103. While it is not unusual, particularly in a practice with a small number of partners and staff, for there to be more than one partner involved in an audit in a substantial and "hands on" manner as was the case here, the APESB pronouncements and the Auditing Standards in place at the relevant time addressed the matter of responsibility for audit engagements and established a clear framework of responsibility for a single auditor carrying out the role of engagement partner with respect to an audit.
104. APES 320 *Quality Control for Firms* at AUST 2.1(f) set out the definition and expectations of the Engagement Partner as follows:

Engagement Partner means the Partner or other person in the Firm who is responsible for the Engagement and its performance, and the report that is issued on behalf of the Firm, and

who, where required, has the appropriate authority from a professional, legal or regulatory body.

105. *ASA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards* at paragraph 13(d) set out the context in which the terms of Auditor and Engagement Partner are used within the Auditing Standards:

Auditor means the person or persons conducting the audit, usually the engagement partner or other members of the engagement team or, as applicable, the firm. Where an Auditing Standard expressly intends that the engagement partner fulfill a requirement or responsibility, the term “engagement partner” rather than auditor is used.

106. *ASA 220 Quality Control for Audits of Historical Financial Information* at paragraph 7(a) sets out the definition of Engagement Partner and mirrors what is set out in APES 320:

“Engagement partner” means the partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor’s report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

107. *ASA 220.8* sets out the leadership responsibilities for *Quality of Audits* as follows: ‘The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned.’

108. *ASA 220.15-220.22* set out the responsibilities of the engagement partner in relation to:

- (a) Direction, Supervision and Performance of the audit;
- (b) Reviews of the audit documentation;
- (c) Consultation;
- (d) Engagement Quality Control Review; and
- (e) Differences of Opinion.

109. *ASA 220* further provided explanatory information setting out the significant responsibility of the auditor designated with responsibility as Engagement Partner.

110. The relevant audit working papers reference *ASA 220* and recorded Mr Williams’ role in the 2012 LM audit as that of Engagement Partner. Those records outlined the responsibilities of the role consistent with *ASA 220*. For example:

- (a) New Client Entry/Acceptance Form that set out the audit team members and nominated Mr Williams as Engagement Partner.
- (b) Audit Team Planning Meeting AWPAA2. This document recorded a planning meeting that was attended by various audit team members including ‘Mr Williams - Engagement Partner’.

- (c) The Scope and Overall Audit Strategy AWP's AA1.2(c) and (d) that set out various responsibilities of the Engagement Partner and in particular at section 4.1 documented Mr Williams as Engagement Partner and Andrea Blank as Lead Partner. Section 4.2 of AWPAA1.2 stated that the Engagement Partner shall take responsibility for:
 - (i) the direction, supervision and performance of the audit engagement in compliance with the Auditing Standards, relevant ethical requirements, and applicable legal and regulatory requirements; and
 - (ii) the auditor's report being appropriate in the circumstances.
- 111. It was not in issue that Mr Williams had spent 71.70 hours with respect to the performance of the 2012 LM Audit and he had signed both the Engagement Letter and the 2012 LM Audit Opinion.
- 112. Before conceding that he was the Engagement Partner, Mr Williams had argued that section 324AF of the Act expressly permitted joint/shared auditor responsibility. While it is the case that section 324AF(1) used the terminology *lead auditor* and section 324AF(2) included a definition of *review auditor*, those references did not in our view provide a basis for the proposition advanced that joint primary responsibility for an audit was contemplated by the relevant framework. The sections of the Act within which the references to lead auditor and review auditor are to be found are provisions that deal with Auditor Independence and consequent requirements for the rotation of Audit Partners. Those provisions impose obligations on the auditor who is primarily responsible for the conduct of the audit and on the auditor who is in turn responsible for reviewing the audit (often in practice referred to as the Quality Review Partner, or similar nomenclature), to rotate from an audit engagement after a specified time frame. Those statutory provisions are not relevant to a consideration of the responsibility of an auditor nominated as the engagement partner on an audit, which is informed by reference to the relevant Auditing Standards that we have set out in paragraph 105-109.
- 113. On day 9 of the hearing, Mr Williams ultimately admitted that he was the only Engagement Partner for the 2012 LM Audit and as the Engagement Partner he was responsible for the appropriate performance of the 2012 LM Audit in accordance with the relevant Auditing Standards, regardless of who at WPIAS may have performed the audit work the subject of ASIC's allegations. The fact that Ms Blank and Ms Dipenaar were also registered auditors did not alter or diminish Mr Williams' responsibility as the Engagement Partner, for the overall quality and efficacy of the audit work performed in the 2012 LM Audit, nor his duty to ensure that he met the requirements of the Auditing Standards when performing his role as the Engagement Partner on the 2012 LM Audit.
- 114. Following this concession, Mr Williams, during cross-examination, described his responsibility as Engagement Partner as 'looking at material items and key audit work'. He was asked if, when reviewing the work of his team, he would have asked questions such as what costs increases there had been to the various projects. He answered no, because he said he was relying on the expertise and seniority of those doing the work to bring matters to his attention should there

have been such matters. In answer to the question of whether he satisfied himself of whether work had been done or whether his approach was to ask the question of his team whether there was anything they wished to tell him, Mr Williams said that he asked that question of the lead partner. Mr Williams' further evidence in cross-examination was that the extent of the review of others' audit work he undertook depended on who had performed the work and his level of confidence in them.

115. In cross-examination, Mr McNally asked Mr Williams:

So, you say that because you had comfort in people you worked with you didn't delve down any further to see whether or not what they were telling you might be accurate or not?

Mr Williams' response was:

I was relying on the company auditor.

Mr McNally then asked:

If we can put the Maddison Estate to one side for the moment, did you do any checking at all in respect of any other part of the audit or simply rely on trusted employees?

Mr Williams' response was:

No, I - there were other parts as I said, in terms of the key fronting of the file, when we would look at the risk analysis we look at the background to the environment of the MPF, we look at the identified risks and the materiality levels and the approach we were going to take, yes, I was heavily involved in that and the related party loan to Mr Drake, but in terms of the context of loan balances, I focussed on the material balance of 67%.

Mr McNally asked:

And so how do you ensure that members of your team have addressed any inconsistencies in respect of audit evidence?

Mr Williams' response was:

Well, there's a level of seniority and therefore the - and I don't know who did the work but it would have been a combination of Evelyne Kwong and the lead partner. So the expectation is that issues that need to be addressed will be escalated by the right process.

Mr McNally asked:

And so you don't check at all as to whether or not your employees- sorry, not your employees but other persons on the audit team are performing their task properly?

Mr Williams' response was:

I do with the lesser experienced persons, yes. In terms of Maddison work, where work was done by other team members, I certainly reviewed their work.

116. We have included the detailed record of evidence above because in our view, it demonstrates that Mr Williams did not have a proper understanding of the scope of his responsibilities as the Engagement Partner having regard to the auditing standards we have referred to even after he had conceded the point.
117. The reasons we have set out above represent the basis for our view, had we been required to make a finding, that as the Engagement Partner in the 2012 LM Audit, Mr Williams was responsible for the overall quality and sufficiency of the audit work performed and for the audit opinion that was issued. This responsibility was a relevant duty that arose within the meaning of section 1292(1)(d)(i) of the Act. In our view this is a very significant responsibility and inadequate performance of that role has a highly pervasive potential detrimental impact on audit quality.
118. We make one further observation that the fact that Mr Williams advanced this response as an answer to the contentions, even though he ultimately withdrew it, together with the evidence set out above, indicates in our view, having regard to the Relevant Benchmark, that his understanding of the requirements of the relevant Auditing Standards and how they informed the discharge of his professional responsibilities as Engagement Partner with respect to the 2012 LM Audit, was not adequate.

The Limited Purpose/Limited User Response

119. Mr Williams' second common response to the contentions was that, while LMIM did publish the 2012 LM Audit, it did so in circumstances where that report had been prepared for the limited purpose of assisting LMIM in preparing for the registration of LM as a registered managed investment scheme ("MIS") with ASIC (the "Limited Purpose") and for limited users, being the Board of LMIM and shareholders of LMIM (the "Limited Users").
120. Mr Williams said further that the 2012 LM Financial Statements would not be made available to third parties until audited financial statements for LM for 2011, 2012 and 2013 were lodged with ASIC, were the Manager to opt to apply for registration of the scheme in Australia after 30 June 2013.
121. Mr Williams relied on the Limited Users and Limited Purpose, as a basis for asserting that the standard of his performance of the 2012 LM Audit, in the context of those limited users and that limited purpose, was not inappropriate. Mr Williams told the Board that this was a fundamental point and submitted that the approach, scope and methodology taken in an audit is heavily driven by the intended user group, such that the sampling, risk assessment, testing of internal controls and materiality thresholds, may be different. He accepted however that the audit outcome or opinion would not differ as a result.
122. In so far as there was documentary evidence of a Limited Purpose and Limited Users, we were referred to the following records:
 - (a) Document AA1 in the Forensic File noted the purpose of the audit as:

Purpose: The Board of LMIM are considering the option of registering the scheme in Australia, pursuant to the Managed Investments Act 1998, post 30 June 2013. To this end, they have requested (3) three years audited financial statements, in the appropriate form to lodge with ASIC.

- (b) The Engagement Letter (set out in paragraph 85 above) contained the following paragraph:

Presentation of Audited Financial Report on Internet

If the entity intends to publish a hard copy of the audited financial report and auditor's report for members and to electronically present the audited financial report and auditor's report on its internet website, the security and controls over information on the website should be addressed by the entity to maintain the integrity of the data presented. The examination of the controls over the electronic presentation of audited financial information on the entity's website is beyond the scope of the audit of the financial report. Responsibility for the electronic presentation of the financial report on the entity's website is that of the governing body of the entity.

- (c) AWPIB1/2 prepared by Ms Blank in the previous year on 12 November 2011, that noted WPIAS had:

also requested to complete an audit of Maddison Estate Pty Ltd for the period from its incorporation (being 14 September 2007) to 31 December 2011, given the significance of the project, however have been advised by the Board of LMIM this is not considered necessary at this stage, **given our audit report will only be used by the LMIM Board to assist in getting the fund's financial statements ready for lodgement with ASIC.**

- (d) AWPIB1/3 recorded that 'given our audit report will only be used by the LMIM Board to assist in getting the Fund's financial statements ready for lodgement with ASIC, we will reserve the right to amend the report and/or ask the Manager to amend the 2012 financial statements should any significant issues arise from the audit of the Maddison project.'

- (e) The Materiality Program, described in paragraph 1183 noted next to 'select a percentage to be applied' [for materiality] '10% considered an appropriate level given we are reporting internally to management and the Board of LMIM.' This comment was cross-referenced to audit procedure 1.4 which was 'consider relationship between the percentage *and the chosen benchmark*'.

123. Cross examination of Mr Williams relevant to the Limited Purpose/Limited User Response elicited the following evidence:

- (a) When asked why, if the brief was to get LM ready for registration as an MIS one would not conduct the audit on that basis, Mr Williams said he could not answer that question because it was a matter within the discretion of the LMIM Board. Mr Williams agreed that he could have chosen to conduct the audit on that basis.
- (b) Mr Williams did not know that the 2012 LM Audit Opinion might be published on the LM website and did not believe there was any chance that that may happen.

- (c) With reference to the paragraph from the Engagement Letter set out in paragraph 122(b) above, Mr Williams did not believe that a director reading that paragraph would believe they were entitled to publish the audited financial report on the company's website. He said that the paragraph in the Engagement Letter was framed so that 'there would be an availability, if they [the directors] so chose, to put the financial report on the website with secure access for the directors only and members of the company. Which does happen in practice a lot'.
- (d) Mr Williams did not recall on which website the 2012 LM Audit Opinion was published but said it could well have been the LM website.
- (e) In Mr Williams' experience it was not likely, in circumstances where there were applications for finance on foot, that a board would make the LM audit report available to prospective financiers for their consideration.
- (f) Mr Williams maintained that the use of the report was limited to the LMIM Board and referred to paragraph 4 of the Engagement Letter which said:

Other

The opinion provided for the audit is for the express use of those directly requesting it from Williams Partners Independent Audit Specialists. The audit relates only to the entity and does not provide an opinion on any other entity.

- (g) Mr Williams admitted that he believed that the users of the 2012 LM Audit Opinion would include ASIC at the time he signed that report but did not concede that this amounted to ASIC being a prospective user of the report. He said in answer to the question:

Q: So where you previously said, "the only users of the Report would be the Board", do you now wish to add to that "And ASIC"?

A: Well, no, again, as I've said quite clearly...there was no requirement to lodge with ASIC and I think from the discussion with the Board at the time – and I think their words were they wanted to be a good corporate citizen and they wanted to not only give them an application for registration, but to say, "Look, we've had three years worth of audited accounts...we are now ready for statutory reporting if we should go forward".

124. There were inconsistencies in Mr Williams' evidence with respect to Limited Purpose/Limited User. First, while he admitted that the 2011 and 2012 LM Audits were conducted in case LM was to be registered in future as an MIS he was not prepared to admit that ASIC would be a user of the report. His explanation in cross-examination that there was no requirement to lodge the audits with ASIC when applying for registration does not explain why ASIC was not a potential user of the report nor respond to the other documentary evidence that records an intention to provide the LM audits to ASIC in the future such as document AA1 (referred to above), and the note of a planning meeting for the 2012 LM Audit where in response to the question 'Who will see the report', it was written 'LMIM Board (ultimately ASIC)'. Even if it was to be at a point in the future and only in certain circumstances, the evidence in our view supports a conclusion that the prospect of providing the information to ASIC was conveyed to and understood by Mr Williams when he accepted the 2011 and

2012 LM audit engagements and that he knew that the audit reports produced by WPIAS could, in the future, be provided to ASIC.

125. The excerpts from the Engagement Letter that we have set out in paragraph 121(b) above do not in our view make it clear that the report was intended for the limited use and audience for which Mr Williams contended. We find it improbable that if the audit was to be conducted for a limited purpose and for limited users that this fact would not have been directly and specifically dealt with in the Engagement Letter.
126. We also find it improbable that an experienced auditor would not believe it was at least possible, in circumstances where a significant re-financing initiative was in train, that the 2012 LM Audit Opinion would not be possibly useful and relevant and might not be made available to prospective financiers by the Board or by a member of LMIM management.
127. We find it unusual that if the 2012 LM Audit Opinion was not for the sole purpose of gaining registration as an MIS, the audit would not have been conducted as if it were an audit of an MIS.
128. Mr Williams' obligation as the auditor of LM was to apply professional scepticism. The evidence in paragraphs 122-127, in our view, demonstrates that he did not apply professional scepticism to negotiating and documenting the terms of the 2012 LM Audit. If the arrangement with the LMIM Board and management was to confine the use of the 2012 LM Audit in the manner advanced (and there was no independent evidence of this matter), he should have ensured that the documentation clearly and comprehensively reflected details of the limitations and he should have taken steps to ensure that his audit opinion, when finalised, also reflected the terms of the limited purpose and the limited use intended.
129. If the audit was not to be conducted in accordance with the Act and the Auditing Standards, which is the effect of Mr Williams' Limited Purpose/Limited User response, then the Engagement Letter misrepresented the terms of the engagement and to the extent the 2012 LM Audit Report did not refer to or clarify that matter, it did as well.
130. At the relevant time, ASA 706.A9 provided:

A financial report prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such a general purpose financial report meets their financial information needs. Since the auditor's report is intended for specific users, the auditor may consider it necessary in the circumstances to include an Other Matter paragraph, stating that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.

Mr Williams could have used an 'other matter' paragraph, for example, to include clarification or he could have issued a qualified audit report that would have ensured that, if the audit report was used or distributed in a way that was not intended, the unintended user would have been aware of its potential limitations.

131. Based on the above evidence, we have formed the view that it is improbable that the 2012 LM Audit Opinion was prepared for the Limited Users and only for the Limited Purpose.
132. Even if the 2012 LM Audit Opinion was prepared on that basis, the Limited User/Limited Purpose response does not, in our view, provide a legitimate reason for accepting that there was an appropriate basis for Mr Williams not to have performed the audit to the required professional standard. The 2012 LM Audit Opinion signed by Mr Williams expressly states that the 2012 LM Financial Statements comply with the Auditing Standards.
133. To the extent the Limited User/Limited Purpose response was advanced by Mr Williams in answer to ASIC's allegations and contentions, the reasons we have set out above represent the basis for our conclusion that the Limited User/Limited Purpose response was not an answer to the allegations made in these proceedings and did not bear on our view as to whether Mr Williams failed to carry out or perform adequately and properly his duties as an auditor within the meaning of section 1292(1)(d)(i) of the Act.
134. We make a final observation on this response that the fact that Mr Williams advanced it as an answer to the contentions indicates in our view, having regard to the Relevant Benchmark, that his understanding at the time of the requirements of the relevant auditing standards and how they informed the discharge of his professional responsibilities with respect to the 2012 LM Audit was not adequate.

The relevance and weight to be given to WPIAS' audit templates

135. A third threshold matter was Mr Williams' reliance, in support of the adequacy of the audit evidence on the 2012 LM Audit Engagement File ("Audit Engagement File"), on a number of audit records that were template working paper audit programs generated by the proprietary software in use by WPIAS at the time. A number of these documents were initially completed in the planning process (which took place in May 2012) of the audit. They provided a record of the scope of the work that was intended to be performed in the audit by reference to the relevant obligations in the Auditing Standards and the International Standards on Auditing (together the "Relevant Standards"), and which were part of the WPIAS Quality Control Manual. These documents recorded the initials of various members of the WPIAS audit team, including Mr Williams together with the dates they had signed off on various actions having been completed and, in some cases, were cross referenced to other parts of the audit file and/or other audit working papers.
136. By way of example these records included:
 - (a) *AWPAA1 - Audit Plan and Overall Strategy for LM Performance Fund Year End 30 June 2012* (Annexure 3 Response), noted as reviewed by Mr Williams on 22 May 2012, that recorded details of LM and the 'engagement team' and recorded a series of yes/no responses to pre-populated matters such as integrity of client, competence, resources and time to perform audit, the need to maintain compliance with ethical

requirements during the course of the audit by the engagement team, preconditions for an audit and engagement terms.

- (b) *AWPAA2 - Audit Team Planning meeting for LM Performance Fund Year End 30 June 2012 (Annexure 4 Response)*. This document recorded the matters addressed at the audit team planning meeting on 1 May 2012 attended by Mr Williams, Ms Blank, Ms Kwong and Ms Harriden including:

The audit obligations in ASA 200:

- (i) Guidelines for direction, supervision and performance of the audit and noting the objectives for the audit (including Mr Williams as Engagement Partner);
 - (ii) Discussion of the respects in which the 2012 LM Financial Statements may be susceptible to material misstatement, identifying the main issues as misappropriation of assets and overstatement of earnings;
 - (iii) Noting random testing would be used in the sampling approach for the purpose of incorporating an element of unpredictability into the audit procedures to be performed;
 - (iv) Noting the potential influence of Peter Drake as the sole owner and CEO;
 - (v) Noting the risk of reduced objectivity arising from no independent non-executive director; and
 - (vi) Noting the risk of the possibility of profits being manipulated by revising interest rates and discount rates used in the development feasibilities.
- (c) *AWPAA3 - Planning Meeting With Those Charged With Governance, LM Performance Fund Year End 30 June 2012*, initialled by Mr Williams on 22 May 2012.
- (d) *AWPAA4 - Auditor's Responsibility relating to Fraud in an audit of a financial report, LM Performance Fund Year Ended 30 June 2012*, initialled by Mr Williams on 22 May 2012.
- (e) *AWPAA5 - Identifying and Assessing the Risks of a Material Misstatement through understanding the entity and its environment*, initialled by Mr Williams on 22 May 2012.
- (f) *AWPAA5.6 - Identified risks of material misstatements* prepared on 9 May 2012 by Evelyne Kwong and reviewed by Mr Williams on 14 August 2012. It noted the impairment of loans receivable as a significant risk; accuracy, valuation and completeness as the assertions affected; the likelihood of material misstatement as possible and the consequence severe. It further noted follow up action as the review of the loans for

recoverability. It noted LM's internal management controls as not relied on.

137. There were documents referred to and annexed to Mr Williams' Response, including documents identified as AWPAA1.2 - *Scope and Overall Audit Strategy*; AWPXC1 – *Subsequent Events*; AWPAG1 – *Accounting Estimates*; and AWPBC1 – *Forming an Opinion on the Financial Report*.
138. It was not in issue between the parties that the performance of the 2012 LM Audit had been undertaken by the WPIAS audit team pursuant to the firm's processes invoked by them at the apparently appropriate stages pursuant to the requirements set out in the WPIAS Quality Control Manual and utilising the software programme in place at the firm during the relevant time and known as *myworkpapers.com.au*.
139. There were no allegations with respect to the integrity of those audit procedures or that they did not reflect the Relevant Standards.
140. However, the mere fact that these pro-forma documents had been utilised and apparently completed in accordance with WPIAS' quality control processes, in our view, amounts to no more than relevant evidence of what those documents record, for example the risks that were identified, other work papers cross-referenced and who had carried out, checked and/or signed off on various actions. Their existence and the fact that they were based on the firm's apparently accredited audit processes, which was not in issue in these proceedings, does not demonstrate the adequacy of the actions taken by Mr Williams as Engagement Partner for the 2012 LM Audit, an enquiry to be answered by reference to the substantive evidence before us in connection with each of the contentions alleged that will include a consideration of those work papers on the basis of the objective evidence they provide.

Mr Williams' "Forensic File"

141. A fourth threshold matter that arose from Mr Williams' Response to the SOFAC was the status of the Forensic File.
142. This matter arose when Mr Williams' statement of evidence was filed. By way of background, a draft of Mr Williams' statement of evidence had initially been provided to the Board without annexures some time before the final version that included annexures was filed ("Final Statement"). The Final Statement, when filed (by which time Mr Williams was self-represented) was similar to the earlier draft, but included previously unidentified annexures comprising a copy of the whole of the Audit Engagement File as one annexure, what Mr Williams referred to as the Forensic File as a further annexure and the Permanent File. Those files together were substantial – comprising in total approximately 17 lever arch files.
143. Throughout his Final Statement, Mr Williams referred to the Forensic File as well as to the Audit Engagement File, in support of matters addressed in his Final Statement on the basis that the Forensic File was part of the Audit Engagement File.

144. We consider below Mr Williams' evidence and arguments that the Forensic File was part of the Audit Engagement File and comprised part of the relevant audit evidence as those terms are normally understood by reference to the relevant standards.
145. *ASA 230 Audit Documentation* deals with the relevant requirements with respect to the audit file documentation. Of particular relevance are the definitions under paragraph 6, which relevantly provided:
- For the purposes of the Australian Auditing Standards, the following terms have the meanings attributed below:
- (a) Audit documentation means the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as "working papers" or "work papers" are also sometimes used).
 - (b) Audit file means one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.
146. At the relevant time, Aus 16.1 of ASA 230 further provided: 'The auditor shall adopt appropriate procedures for maintaining the confidentiality, safe custody, integrity, accessibility and retrievability of the audit documentation.'
147. ASA 230.8 set out the requirements regarding the expectations of the form, content and extent of such *Audit Documentation* as follows:
- The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:
- (a) The nature, timing, and extent of the audit procedures performed to comply with the Australian Auditing Standards and applicable legal and regulatory requirements;
 - (b) The results of the audit procedures performed, and the audit evidence obtained; and
 - (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.
148. It was not in issue between the parties that Mr Williams had not produced to ASIC the Forensic File in response to the Section 30A Notices seeking production of, with respect to the 2011 and 2012 LM audits, 'all working papers, correspondence and permanent files'.
149. Mr Williams informed the Panel during his opening submissions that the Forensic File comprised the records of WPIAS Forensic Consulting Pty Ltd, a separate corporate entity related to WPIAS, which had undertaken work on the instruction of Mr Williams with respect to the 2012 LM Audit. He asserted it was part of the audit documentation.
150. There were three key matters highlighted by relevant evidence in the proceedings, that have lead us to conclude that the Forensic Files were not part of the Audit Engagement File that represented the record of audit documentation that Mr Williams was required to keep in accordance with the provisions of the relevant standards that we have set out.

151. First, it seems improbable that, at the time of receiving the Section 30A Notices Mr Williams regarded the 2012 Audit Engagement File as including the Forensic File, because he did not produce it, nor refer to its existence in his response to ASIC. It is reasonable to assume that as a registered auditor, Mr Williams was fully aware of his obligations with respect to the audit documentation prescribed by the Auditing Standards that we have referred to, as well as the significance of ensuring proper compliance with a Section 30A Notice. In our view, it is improbable that at the time he was served with the Section 30A Notices, Mr Williams did not turn his mind to ensuring full compliance with the notices by the production of all documentation that he regarded as audit documentation within the meaning of the standards to which we have referred.
152. The second key matter in our view was that Aus 16.1 of ASA 230 required the auditor to prepare audit documentation so that an experienced auditor with no previous connection to the audit would understand what procedures were undertaken and the results of those procedures. Leaving aside the obvious physical separation between the Audit Engagement File and the Forensic File, it was clear too from the evidence that the documentation on the Forensic File was mostly not cross-referenced to the Audit Engagement File work papers in a way that would enable information on the Forensic File to be read as forming part of the audit documentation so that ‘an experienced auditor with no previous connection to the audit would be able to understand what procedures were undertaken and the results of those procedures’.
153. By way of example, we refer to AWPIB10, which was the lead work paper on the Audit Engagement File documenting the testing and investigation carried out with respect to the Maddison Loan Receivable (the “Maddison Loan Lead AWP”) that we have discussed in more detail in the context of our consideration of Contention One. This AWP did not cross-reference any of the work on the Forensic File that Mr Williams referred us to as audit work done with respect to the Maddison Loan receivable.
154. Third, Mr Swanborough, who was responsible for conducting a significant amount of the work contained on the Forensic File, was not identified as a member of the WPIAS Audit Engagement team in any of the audit planning work papers that referred to the composition of that team. The only reference to Mr Swanborough was contained in Appendix IV of the 2012 LM Audit Closing Report, prepared for LMIM, dated 1 March 2013. In a table under the heading ‘Independence’ which listed ‘Senior Team Members’ and set out when a rotation would take place, Mr Swanborough was noted as a ‘Senior Forensic Accountant.’ This was not a role envisaged by the WPIAS Audit Programme and in our view this fact, and the fact that Mr Swanborough was not otherwise identified as part of the Audit Engagement team for the 2012 LM Audit in any of the work papers on the Audit Engagement File supports a conclusion that the Forensic File was neither intended, nor did, form part of the Audit Engagement File.
155. Having regard to the three matters discussed above, our view is that it is neither consistent with the weight of the evidence nor with the requirements of the relevant auditing standards, to regard the Forensic File as part of the WPIAS Audit Engagement File with respect to the 2012 LM Audit.

156. Notwithstanding our conclusion that the work evidenced by the records we were referred to on the Forensic File was not part of the Audit Engagement File, that work was nevertheless potentially relevant to the question of the sufficiency of the performance of the 2012 LM Audit.
157. In the context of concluding our findings on the contentions alleged, we have therefore taken into account the substance of any particular documents on the Forensic File to which Mr Williams specifically referred us, as well as to documents on the Audit Engagement File, to which he made specific reference.
158. A final general point with regard to the documentary evidence from the Forensic File is that in the context of these proceedings ASIC reviewed the contents of that file following receipt of Mr Williams' Final Statement. ASIC's evidence referred to specific documents within the Forensic Files to which ASIC considered it relevant to draw the Panel's attention. Consistent with the approach outlined in the preceding paragraph, we have also considered those documents to the extent they were relevant to our deliberation with respect to any of the specific contentions.

Other threshold matters

Mr Rea's evidence

159. In support of the SOFAC allegations, ASIC tendered statements from Mr Rea that were admitted into evidence. To the extent ASIC's case relied upon an absence of documentation on the WPIAS Audit Engagement File, Mr Rea's evidence was that the allegations were based on his review of the files produced by WPIAS pursuant to the Section 30A Notices from ASIC requiring production of the audit files of WPIAS with respect to the 2011 and 2012 LM Audits. Mr Rea was cross-examined by Mr Williams on his statements at some length during the proceedings. Mr Rea is a Chartered Accountant. He worked in the audit division of Price Waterhouse Coopers for six years, and has been an officer of ASIC since 2005, where his duties have included reviewing audits conducted by registered company auditors to ensure compliance with the Auditing Standards and the Act.
160. Mr Rea was responsible for the conduct of the investigation into the 2012 LM Audit and for drafting the SOFAC with respect to this Application.
161. In our view, Mr Rea was appropriately qualified and experienced to conduct a review of WPIAS' 2011 and 2012 LM Audit Engagement Files to assess compliance with the Auditing Standards and the Act.
162. We accept Mr Rea's evidence with regard to the manner in which he conducted the review of those files.

Professional Scepticism

163. At the time of the 2012 LM Audit, ASA 200.15 provided that the auditor shall plan and perform an audit with professional scepticism recognising that circumstances may exist that cause the financial report to be materially misstated.

164. The question of whether appropriate professional scepticism was applied by Mr Williams and his audit team in the 2012 LM Audit was a question raised for our consideration by the pleadings with respect to numerous allegations the subject of Contentions 1–5.
165. As a further threshold matter we have therefore set out our views on the concept of professional scepticism as referred to in the Auditing Standards and matters that are relevant to its appropriate application and demonstration in the performance of an audit. We have referred to the views we set out here in support of our conclusions on whether Mr Williams exercised appropriate professional scepticism in the conduct of the 2012 LM Audit in the various contexts that matter has been alleged in Contentions 1–5.
166. In an AUASB Bulletin issued in August 2012 that was entitled *Professional Scepticism in an Audit of a Financial Report* (the “AUASB Bulletin”), the critical importance of the consistent application of professional scepticism to the performance of high quality audits was discussed.
167. In our view the relevance of the guidance that was provided by the AUASB Bulletin on how to approach applying professional scepticism appropriately in various contexts is particularly pertinent to our consideration of whether Mr Williams met an appropriate professional standard when applying that concept in the various aspects of the 2012 LM Audit given the temporal connection between publication of that guidance and the conduct of that audit.
168. By way of context, the AUASB Bulletin noted that the inspection programs conducted by ASIC had raised concerns about whether professional scepticism was being applied properly in auditing practice and noted that ASIC’s findings had provoked questions about whether auditors respond appropriately to unreliable audit evidence, whether they seek to corroborate evidence rather than challenge it and whether audit working papers adequately demonstrate a record of how professional scepticism has been applied. The key areas of audit judgement highlighted by the AUASB Bulletin where the level of professional scepticism exercised or evidenced in the audit files needed improvement included fair value measurement of assets, impairment calculations, and going concern assessments.
169. The AUASB Bulletin went on to say that the need for professional scepticism in an audit:
- ...cannot be overemphasised. Scepticism is an essential attitude that enhances the auditor’s ability to exercise professional judgement in identifying and responding to conditions that may indicate possible misstatement. Professional scepticism includes a critical assessment of audit evidence. It also means remaining alert for evidence that contradicts other audit evidence or that brings into question the reliability of information obtained from management and those charged with governance. The consistent application of professional scepticism is imperative for auditors to draw appropriate conclusions in the conduct of their work. **The AUASB takes this opportunity to emphasise to both auditors and others, the important and fundamental role that professional scepticism has to play in audits of financial reports.**
170. The AUASB Bulletin then proceeded over a further five pages to provide an in-depth view of what was involved in applying appropriate professional scepticism

at the time starting with the definition in ASA 200 – ‘an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.’ It noted that professional scepticism:

- (a) Is fundamentally a mindset, largely applied by being alert, particularly to conditions that may indicate error or fraud and for circumstances that suggest the need for audit procedures in addition to those required by the Auditing Standards.
- (b) Is inseparably linked to the fundamental ethical principles of objectivity and auditor independence and an inescapable element of professional judgement and without professional scepticism, the auditor does not challenge or remain alert to inconsistencies and circumstances that indicate actual or potential misstatements or fraud.
- (c) Includes a critical assessment of audit evidence which comprises the information that supports and corroborates management’s assertions and any information that contradicts such assertions and, in this context, applying professional scepticism would involve questioning and considering the sufficiency and appropriateness of the audit evidence obtained in the light of the known circumstances. Where there is doubt, the Auditing Standards require that the auditor further investigate and determine what modifications or additions to audit procedures are necessary to resolve the matter.
- (d) Is particularly important when considering the risks of material misstatement due to fraud and noted that ASA 240 placed special emphasis on professional scepticism and requires the auditor to investigate further where conditions identified during the audit cause the auditor to believe that a document may not be authentic or may have been modified. It further noted the specific reference in ASA 240 to professional scepticism requiring an ongoing questioning of whether information and audit evidence obtained by the auditor suggests that a material misstatement due to fraud may exist, including considering the reliability of information to be used as audit evidence and the controls over its preparation.
- (e) In terms of the requirement in ASA 200.15 to plan and perform the audit with professional scepticism, areas of focus for the auditor included (but were not limited to):
 - (i) Accepting the engagement – integrity of owners, management and directors;
 - (ii) Identifying and assessing risks of misstatement - initial risk assessment procedures and revisions to initial assessments and planned audit procedures resulting from audit findings;
 - (iii) Designing the nature, timing and extent of audit procedures, for example when considering areas of higher risk; planning and performing substantive analytical procedures - evaluating the

reliability of data, investigating fluctuations or relationships that are inconsistent with expectations; and

- (iv) Forming and expressing an opinion - concluding whether reasonable assurance has been obtained, deciding on the right form of opinion and evaluating whether fair presentation has been achieved.
 - (f) Is particularly important in evaluating the reasonableness of significant assumptions used by management for accounting estimates, going concern assessments, related party relationships, consideration of laws and regulations and the use of specialists.
 - (g) Is demonstrated by discussions with management and those charged with governance, client staff and the audit team and the documentation of key points of those discussions as required by the Auditing Standards. Key areas where audit documentation should reflect that professional scepticism has been appropriately applied include: discussions among the engagement team; significant decisions regarding the susceptibility of the financial statements to material misstatement; identified non-compliance with laws or regulations; the basis for the auditor's conclusions on accounting estimates and any indicators of possible management bias; identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, including how the inconsistency was addressed; the basis of the auditor's conclusions on the reasonableness of areas of subjective judgements; the use of experts; and communications with client management and their staff.
 - (h) Finally, the AUASB Bulletin focused on the importance of the Engagement Partner's role in communicating the importance of applying appropriate professional scepticism in the performance of an audit and underscored the importance of quality as an essential focus in the performance of audit engagements to all members of an audit engagement team.
171. The guidance on the concept of professional scepticism and its application provided by the AUASB Bulletin at the time Mr Williams was carrying out the 2012 LM Audit underscored the importance that must be placed by auditors on ensuring the appropriate application of professional scepticism in an audit of a financial report, and provided comprehensive commentary on how to apply and record its application effectively. Mr Williams should have been aware of the contents of the AUASB Bulletin. The Relevant Benchmark we have formulated in paragraph 99 therefore includes reference to the contents of the AUASB Bulletin as representing an appropriate pronouncement on professional scepticism against which relevant aspects of Mr Williams' performance of the 2012 LM Audit may be evaluated.
172. We turn now to a consideration of each of the relevant contentions in this application.

CONTENTION 1 CARRYING VALUE, IMPAIRMENT, RECOVERABILITY OF RECEIVABLES

Relevant background and introductory comments

173. Contention One related to the sufficiency of the audit work done by WPIAS in connection with the carrying value, impairment and recoverability of loans and receivables (summarised in the table below) recorded in the 2012 LM Financial Statements. It comprised 14 Sub-Contentions.³⁷
174. As at 30 June 2012, LM's consolidated statement of financial position disclosed a loans and receivables balance of \$299,570,308. The total of this balance represented 79.5% of LM's total assets. The loan to Maddison Estate Pty Ltd ("Maddison Loan") comprised over two thirds of the total loan balance.
175. The loans the subject of Contention One were summarised in AWPIB2 as follows:³⁸

Loan	30 June 2012 (\$)	30 June 2011 (\$)	Testing completed
Maddison Estate Pty Ltd ("Maddison Loan")	201,187,254	128,301,729	Carrying value, Recoverability, Impairment, Security
Aalto Apartments Pty Ltd ("Aalto Loan")	1,187,082	0	Carrying value, Recoverability, Impairment
AIIS ("AIIS Loan")	15,249,821	14,574,322	Carrying value, Recoverability, Impairment
LM Capalaba Pty Ltd ("LMC Loan")	14,968,213	9,610,476	Carrying value, Recoverability, Impairment
Peter Drake ("Drake Loan")	16,911,196	15,226,499	Carrying value, Recoverability, Impairment, Security
Ekard Property Trust ("Ekard Loan")	2,995,270	2,896,698	Not selected for testing

176. Overall, materiality for the 2012 LM Financial Statements was set at 10% of the total net assets (approximately \$35.3 million).
177. Note 2(c)(ii)(a) of the 2012 LM Financial Statements was entitled *Allowance for impairment loss on loans and receivables*. It stated:
- (a) The Scheme determines whether loans are impaired on an ongoing basis. This requires an estimation of the value of future cash flows through an "on completion" valuation of the property based on an "as is" valuation; and
 - (b) A provision for impairment was raised totalling \$23.4 million against 6 loans, which is based on current market assessments of recoverability of these loans. There has been no impact on unit price as this provision has been allowed for against the general

³⁷ Details of Contention One Sub-Contentions are set out from paragraph 718-781.

³⁸ Contention One considered Aalto/AIIS and Drake/Ekard Loans together.

earnings of the fund. The exit strategy on these loans will result in no impact on unit price as they are fully provisioned...

178. It was not in issue that Mr Williams adopted a largely substantive audit approach in relation to the impairment of loans receivable and did not rely on LM's internal controls.
179. Contention One which grouped the Aalto/AIIS Loans and the Drake/Ekard Loans together, advanced four separate sets of allegations with respect to the Maddison Loan, the Aalto/AIIS Loans, the LMC Loan and the Drake/Ekard Loans. Our approach to setting out our reasons and conclusions with respect to Contention One has been to first deal with the consideration of and our findings with respect to these allegations.
180. We then consider the Sub-Contentions advanced on the basis of our findings with respect to the loan allegations in order to form our overall conclusion on whether we are satisfied that Contention One has been established.

Mr Williams' Responses to Contention One

Complete Response

181. Mr Williams denied all of the Sub-Contentions in Contention One, to the extent they were made with respect to any of the loans, on a number of bases.
182. The Engagement Partner Response³⁹ was pleaded as a complete Response to Contention One as well as a response to various specific allegations in Contention One.
183. As we have noted, Mr Williams admitted that he was the Engagement Partner on the 2012 LM Audit and we refer to and repeat our discussion and conclusions at paragraphs 101-118. In our discussion of the allegations we have noted the matters to which Mr Williams made this response. In a number of instances the Engagement Partner Response was Mr Williams' only response to an allegation. The admission that he was the Engagement Partner in the 2012 LM Audit was significant.

Specific Responses

184. We deal with Mr Williams' further specific responses to the allegations made with respect to the various loans in Contention One within our discussion of each of those loans.

Maddison Loan

185. The following further facts relevant to the Maddison Loan were not in issue between the parties:
 - (a) Maddison was incorporated on 14 September 2007. Peter Charles Drake was the director and secretary of Maddison and its sole shareholder was LM Coomera Holdings Pty Ltd. Maddison was the developer of a

³⁹ See above n 28.

residential dwelling project on the Gold Coast at Pimpana (near Coomera) known as the “Maddison Development”.

- (b) LM loaned funds to Maddison to finance the Maddison Development. The site for the Maddison Development had been purchased at a cost of \$76 million. Maddison controlled the owner of the site, Coomera Ridge Pty Ltd, pursuant to a contractual arrangement.
- (c) The balance of the Maddison Loan was \$95,817,590 on 30 June 2010, \$128,301,729 on 30 June 2011 and \$201,187,254 as at 30 June 2012. The loan balance as at 30 June 2012 included \$100,000,000 of capitalised interest. There was discretion vested in LMIM to vary the interest rate charged on the loan. The rate current in the 2012 year was 25% per annum. Note 12 to the 2012 LM Financial Statements included a disclosure (at page 22) noting that LM was able to periodically assess the interest rate of loans made to Special Purpose Vehicles (“SPVs”) enabling the LM to extract all of the financial benefit of the SPVs from the underlying asset.
- (d) The directors in their report that was included as part of the 2012 LM Financial Statements described the Maddison Loan as LM’s ‘anchoring asset’.
- (e) Maddison was not subject to audit and had not been audited in any year between the 2007 and the 2012 financial years (inclusive).
- (f) LM and Maddison were related parties because Mr Peter Drake was the sole director and sole beneficial owner of Maddison and also the 100% owner and director of LM’s Manager, LMIM.
- (g) On 24 July 2012, WPIAS received from LMIM an updated report on the Maddison Development based on information that was presented at a meeting convened by LMIM and held at its offices on 17 July 2012 attended by Ms Blank and Mr Williams (“Maddison Feasibility”).
- (h) AWPIB10A1, which was the 2012 Maddison Feasibility (“Maddison Feasibility”), contained forecasts of projected sales, costs, and overall returns for the Maddison Development. It included information on the number of lots proposed and with current council approval. The projected returns assumed sales and revenue escalation of 50% in each of 2013 and 2014, 30% in 2015 and 15% in 2016. By contrast, the escalation rates in the previous year’s feasibility for the Maddison Development had been 7%, 15%, 8% and 8% respectively for the 2013, 2014, 2015 and 2016 years. AWPIB10A1 is described more fully and discussed in the context of the Second and Third Maddison Loan Allegation.
- (i) As at 25 July 2012, no construction work had commenced on the Maddison development, no plans of subdivision had been registered and none of the proposed housing lots had been sold, although a development approval had been procured and land clearing had taken place with respect to Stage 1 of the development.

- (j) The Maddison Loan was a second ranking exposure to the Maddison Development. Maddison had a loan facility with Suncorp Metway Ltd (“Suncorp”) secured by a first mortgage over the site (“The Suncorp Facility”). The Suncorp Facility had been varied, amended or restated on various occasions since 21 January 2008. By 2011, Suncorp was reducing its exposure to the development. An AWP dated 21st November 2011 had noted the first mortgage priority as \$37,000,000. By 30 June 2012, the loan was \$22,046,134 and Suncorp had agreed to extend the loan facility to 31 March 2013, conditional upon an amortised pay down to \$18 million by that date.
- (k) By letter dated 26 November 2012, First Wall St Capital Partners LLC (“First Wall St”) confirmed its interest, subject to satisfactory due diligence, to provide funding for up to 5 projects including the Maddison Development. This included a specific priority funding payment of USD 22,000,000 for payout of the Suncorp Facility. The letter specified two conditions ‘to assessing this priority and our continuation of due diligence’. Both conditions referred to Suncorp. The first was ‘Suncorp Bank confirm in writing, by 30 November, that the extension has been approved to March 31 2013, on all current standard loan terms’ and the second condition was that ‘Suncorp Bank unconditionally allow Maddison Estate Pty Ltd to immediately commence civil works on the site and shall execute all consents within 5 business days as requested by LM to facilitate the approvals and all works relevant to the timely development of the site’.
- (l) When Mr Williams signed the 2012 LM Audit Opinion on 7 December 2012, no significant construction work had commenced on the Maddison Development (only some tree clearing had taken place) and no lots had been sold.
- (m) The client representation letter from LMIM to Mr Williams dated 7 December 2012 stated:
- We confirm we will appoint Williams Partners Independent Audit Specialists to complete an audit of Maddison Estate Pty Ltd for the period from inception to 31 December 2012, to be completed by 31 March 2013.
- (n) On 19 December 2012, Mr Williams sent a letter to Mr Drake in his capacity as a Director of Maddison confirming WPIAS’ acceptance of the engagement to audit the financial reports of Maddison between 2007 and 31 December 2012 and *for the conduct of those audits to be concluded by 31 March 2013*. Mr Drake signed this letter on 16 January 2013.

Maddison Loan – Audit work papers

Lead audit work paper for Maddison Loan

186. AWPIB/10 was the lead AWP for the Maddison Loan for the 2012 LM Audit. It was noted as prepared by Ms Blank on 7 August 2012, updated by Ms Blank on 28 September 2012 and reviewed by Mr Williams on 15 November 2012. Assessed risk by assertion was recorded as follows: ‘Existence and occurrence

(EO) low; completeness(C) low; Valuation and Measurement (VM) Medium; Rights and Obligations (RO) Medium; Disclosure (D) Low’.

187. The audit procedures recorded in AWPIB/10 as selected to address the relevant audit risks were in most cases cross-referenced to other AWP’s as follows:

1. Inspect entity Records and enquire of management [etc.] to identify all loans receivable. Ref: I1
2. Create a schedule of loans receivable classified by type including secured, unsecured, current, non-current and those to related parties. Trace balances to the general ledger. Ref:I1
3. Determine whether the use of external confirmation is necessary to obtain sufficient appropriate audit evidence with regard to loans receivable. If so complete relevant audit program. IB.1 Ref: NCN
4. Obtain an understanding of the nature and extent of related party transactions. Evaluate the business rationale of significant related party transactions vouching to supporting documentation. IB10A+
5. Inspect loan documentation to confirm loans were authorised and terms of the loans have been adhered. Ref:IB10D
6. Where a decision has been made to make a new loan, or increase an existing loan, consider whether Section 180(2) of the Corporations Act 2001 relating to a business judgement being made in the best interests of the company has been complied with, particularly in relation to related party loans (e.g.: was the loan made on an arms’ length basis, market interest rates, security held, etc.). Ref:IB10D
7. Determine the recoverability of the loans receivable. As a minimum make enquiry of the entity’s management as to the recoverability of the loans and also review the financial statements of the loan recipient. Determine whether additional procedures are required to confirm the recoverability of each loan. Ref:IB10A+
8. Ensure interest has been completely and accurately recognised and correctly accrued in accordance with the terms of the loan agreements. Ref: IB10B
9. Inspect documentation to confirm the appropriate authorisation of all loans written off throughout the year. Ref: N/A
10. For loan(s) exposed to foreign currency, determine the existence of conditions or events which could have a material impact on the value of the loan(s). Ensure any required reporting requirements have been adhered to and that any foreign exchange gains or losses have been calculated in accordance with Australian Accounting Standards. Ref: N/A
11. Review loans receivable for:
 - a. Impairment Ref:IB10A+
 - b. Classification Ref:N/A
 - c. Measurement, including the effective interest rate method where necessary. Ref: IB10A+

188. AWPIB10 recorded the following conclusion:

In our opinion sufficient appropriate audit evidence has been obtained to materially meet the stated audit objective (that objective as also stated on this work paper being “to reduce the assessed risks by assertion to an acceptably low level”). That was followed by a typed note: “We have requested to complete a full scope audit of Maddison Estate Pty Ltd for the period of its inception to 31 December 2012 to obtain further support for this loan. Refer signed client representation letter and engagement letter filed at IB10M. Underneath this there was a final handwritten note as follows: “NB: Subsequent to year end & the feasibility we have reviewed, we understand the lot numbers have increased due to the addition of ~1000 units around the wave pool.

189. AWPIB10/1 was attached and listed documents that had been received, and included two sets of calculations referred to as ‘Summary from Feasibility’ and ‘Gross Profit Review’.

Other significant audit work papers for Maddison Loan

AWPIB10A + (Spreadsheet)

190. AWPIB10A+ ‘Maddison Estate’ was located on the Audit Engagement File. It was noted as prepared by Ms Blank on 8 August 2012 and reviewed by Mr Williams on 15 November 2012.
191. AWPIB10A comprised a sizeable A3 print-out of an Excel spreadsheet.
192. AWPIB10 identified AWPIB10A as supporting work papers for 3 of the audit procedures being:
- (a) Procedure 4: Obtain an understanding of the nature and extent of related party transactions. Evaluate the business rationale of significant related party transactions, vouching to supporting documentation.

(It was not clear to the Panel how 1B10A+ supported the audit procedure set out in (a) above).

- (b) Procedure 7: Determine the recoverability of the loans receivable; and
- (c) Procedure 11(a) Review loans receivable for impairment.

We would expect the audit work undertaken for Procedures 7 and 11(a) to be similar in many respects.

193. AWPIB10A/4 records totals of calculations made in the spreadsheet. It shows balances that comprise totals of expected net cash flow for the Maddison project (\$513,933,391) and compares these amounts to the loan balance at 30 June 2012 (\$201,187,254) then records a calculation that adds in estimated additional drawdowns (\$51,740,644). It recorded an amount of \$261,005,493 next to a description called ‘Buffer’. The word ‘ok’ is typed next to this total.
194. AWPIB10A/4 appears to record a conclusion that, based on the calculations made, there was sufficient expected future cash flow from the Maddison Development to cover the loan balance to Maddison as at 30 June 2012. A sales target of 63.7% to cover costs was also recorded in this document.

195. The purpose of the work papers that comprise AWPIB10A+, the assumptions that were used, what audit work was actually undertaken to verify the assumptions as being reasonable or otherwise, or what testing of the calculations and formulae used within the spreadsheet was carried out were not clear from the record of AWPIB10A+. There was no narrative recorded on AWPIB10A as to how it was used to audit the Maddison Loan balance.
196. Based on these observations our view is that the contents of AWPIB10A+ did not conform to the requirements of ASA 230,⁴⁰ with respect to audit documentation that must be retained. Those requirements are self-explanatory.
197. We have discussed the contents of AWPIB10A/4 further in paragraphs 303 and 304.

AWPIB1/2

198. AWPIB1/2 was a memo prepared by Ms Blank on 12 November 2011, that noted WPIAS had:

...also requested to complete an audit of Maddison Estate Pty Ltd for the period from its incorporation (being 14 September 2007) to 31 December 2011, given the significance of the project, however have been advised by the Board of LMIM this is not considered necessary at this stage, given our audit report will only be used by the LMIM Board to assist in getting the fund's financial statements ready for lodgement with ASIC.

AWPIB1/3

199. Prepared by Ms Blank, AWPIB1/3 was entitled *Maddison Loan Summary* and is dated 29 November 2012. It was initialled by Mr Williams on 7 December 2012. This document included the following points (not extracted in full):
- (a) In relation to Carrying Value that the audit testing completed included inter alia:
- (i) Reviewed loan statement;
 - (ii) Agreed opening balance to prior year work paper;
 - (iii) Sample testing of drawdowns;
 - (iv) Agreed interest rate to loan agreements and test checked calculations.
- (b) In relation to Recoverability:
- (a) That WPIAS had conducted a high level review of project feasibility, that costs agreed to the external costs estimates, a contingency has been included and costs have been escalated over time;
 - (b) that starting sales values appear comparable to current sales prices in the area;

⁴⁰ See paragraphs 145-147.

- (c) that LMIM had included a high escalation of sales values based on the completion of various facilities such as swimming pools, a wave park and the Coomera town centre;
 - (d) the end sales values (in 7 years' time) appear comparable to high end estates such as Sanctuary Cove. The Gold Coast property market appears to be at the bottom of the market (2012 considered a base year);
 - (e) two immediate risks being the refinancing of the Suncorp loan facility and development of the project at the planned rate;
 - (f) WPIAS' had again requested to audit Maddison by 31 March 2013;
 - (g) an independent external valuation of the project would be obtained by the Manager before 31 March 2013;
 - (h) that WPIAS' review of the Maddison feasibility was limited to a reasonability review to assess recoverability of the loan in the long term;
- (c) It noted:
- (i) 'Given our audit report will only be used by the LMIM Board to assist in getting the Fund's financial statements ready for lodgement with ASIC, we will reserve the right to amend the report and/or ask the Manager to amend the 2012 financial statements should any significant issues arise from the audit of the Maddison project.'
 - (ii) That four *what-if* scenarios with respect to the Maddison Loan had been performed by changing one of several assumptions in each scenario to assess the amount available for repayment of the loan under different conditions. During cross-examination, Mr Williams agreed that it would have been more prudent to change more than one variable in each scenario when doing this analysis.
 - (iii) That a review for indicators of impairment had taken place, by assessing the likelihood of the loan defaulting and recorded the conclusion that there were nil impairment indicators noted at year-end date and up to 7 December 2012. Immediately following this conclusion was a note of WPIAS' recommendation that the 'Manager continually monitor the project for indicators that may arise such as the external funding and projected sales (once sales programme has commenced) (including market conditions and associated determinants e.g.: demand/supply/cost of finance)'.
 - (iv) That a review of the security documents in relation to the Maddison Development had been undertaken and that registered mortgages to Suncorp and LM Coomera Pty Ltd were in place in respect of the property held by Coomera Ridge Pty Ltd. Coomera Ridge Pty Ltd was a registered chargee/trustee of Maddison (controlled by Maddison via contractual rights) and not subject to audit.

AWPIB10B

200. The handwritten notations on the LM loan statement for Maddison dated 13 August 2012 indicated performance of audit work to agree to opening balance to prior year working papers; reconciled interest rate with loan agreements and identified loan calculations selected for audit testing.

AWPBE1

201. This document is described and discussed in the Fifth Maddison Loan Allegation in paragraph 311.

AWPBC1

202. AWPBC1 entitled *Forming an Opinion on the Financial Report* was cross referenced in Forensic AA1. AWPBC1 is a template produced by the WPIAS auditing program software and lists various requirements in the Auditing Standards in relation to drawing final conclusions based on the audit work performed, including consideration of the form of audit opinion to be issued, that have been ticked. AWPBC1 is described in paragraphs 438-441.
203. We refer to and repeat our views with respect to the template working papers.⁴¹ In general terms, our view is that to the extent Mr Williams relied on AWPBC1 as evidence of the consideration and analysis that lead to the conclusion that an unmodified audit opinion was appropriate, the contents of AWPBC1 did not reflect an appropriate basis for that conclusion.

Further documents relevant to Maddison Loan Allegations on Audit Engagement File

204. The Maddison Feasibility received from LMIM on 24 July 2012 that contained forecasts of projected sales, costs, and overall returns for the Maddison Development and is described in paragraphs 263-267.
205. Other documentation such as the copy of an email from Grant Fischer (LMIM) to Andrea Blank that set out the text of an article in the Australian Financial Review newspaper dated 24 October 2012 about the Maddison Development that Mr Fischer described in his email to her attaching it as 'balanced and factual'. Content of this article, such as the harsh climate for Gold Coast housing estates prevailing at the time, the ambitious nature of the project when land sales in the Gold Coast were at record lows, the view of some property executives that the site could be worth as little as \$30 million, the 'heat' being on LM to successfully launch its flagship project and tie down a funding partner, and another developer in a better area of Pimpana having just 123 lots under contract after 2 years of sales, called into question other information in the Audit Engagement File. The article also noted that LM's latest update said that, of its \$379.3 million of assets at the end of September (2012), it held a \$217.1 million loan to Maddison. We note the requirement in ASA 500.11 that if audit evidence from one source is inconsistent with that obtained from another, the auditor is required to determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any,

⁴¹ See paragraphs 135-140.

on other aspects of the audit. There should have been some audit evidence on the Audit Engagement File directed to this requirement with respect to the contents of this article and its apparent inconsistency with other audit evidence.

206. There were also a number of legal agreements (“Agreements”) in relation to the Maddison Estate loan including:
- (a) A copy of a loan agreement between LM Coomera Pty Ltd and LMIM;
 - (b) Fixed and floating charge agreement between Coomera Ridge Pty Ltd and LM Coomera Pty Ltd;
 - (c) Deed of cross charge between LM Coomera Pty Ltd and CRDC Pty Ltd;
 - (d) Legal report to LM Coomera Pty Ltd regarding Coomera Joint Venture; and
 - (e) Development Management Agreement side deed between LM Coomera Pty Ltd, CRDC Pty Ltd, Young Land Project Management Pty Ltd and Suncorp-Metway Limited.

*Summary of audit procedures performed evidenced by AWP*s

207. We are satisfied, and ASIC accepted, that the AWP
- s on the Audit Engagement File show that the audit team performed the following procedures with respect to the Maddison Loan:
- (a) Compared the carrying value of the loan to the recoverable amount of the Maddison Development based on LMIM’s Maddison Feasibility;
 - (b) Performed testing on the loan statement to ensure the transactions during the year were correct and appropriately accounted for, including agreeing the opening balance to prior year working papers;
 - (c) Performed a sample testing of drawdowns, agreed on the interest rate to loan agreements and test-checked calculations;
 - (d) Conducted a high level review of the Maddison Feasibility and noted that it used high escalation rates and the immediate risk posed was the refinancing of the Suncorp Facility followed by the development of the project at the planned rate;
 - (e) Performed a what-if sensitivity analysis to determine recoverability of the Maddison Loan by changing certain assumptions in the Maddison Feasibility (changing one variable at a time);
 - (f) Reviewed registered mortgage encumbrances;
 - (g) Reviewed for indicators of impairment noted at year-end and up to 7 December 2012; and
 - (h) Reviewed the Agreements.

Documents relied on by Mr Williams that were not on the Audit Engagement File

208. Mr Williams' evidence was that he had personally performed relevant and significant aspects of the audit work for the Maddison Loan, some of which was recorded on the Forensic File. In our view, his performance of the work personally is of limited relevance given his overarching responsibility for the 2012 LM Audit as the Engagement Partner.⁴²
209. Mr Williams' Response said that the further documents on the Forensic File, prepared contemporaneously and for use in the 2012 LM Audit, more closely examined the Maddison financial position and rendered the audit evidence sufficient and appropriate to support the conclusion that there was no objective audit evidence requiring impairment of the Maddison Loan as at 30 June 2012.
210. Our conclusion⁴³ was that work recorded on the Forensic File and not contained and appropriately cross-referenced on the Audit Engagement File did not constitute audit evidence as it did not conform to the requirements of ASA 230.⁴⁴ We have nevertheless considered documents on the Forensic File with respect to the Maddison Loan that Mr Williams drew to the Panel's attention, given the significance of that receivable to the 2012 LM Audit and evidence those documents provide as to work that was done (although not recorded as audit evidence). Our observations with respect to those documents are as follows.

IB10/2 "The Swanborough Report"

211. The "Swanborough Report" is not specifically referred to in the lead AWP for the Maddison Loan receivable. The Swanborough Report was authored by Mr Swanborough of WPIAS Forensic Consulting Pty Ltd. The document has notations of what appear to be file references. The first is 138 and the second is *IB10/2*. The report carries the handwritten initials AB and the date 28 September 2012.
212. The opening paragraph of the Swanborough Report states: 'The following analysis aims to assess whether the loan to the Maddison Estate project is impaired by assessing the likelihood of the firm defaulting on the loan.'
213. The Swanborough Report considered the possible impairment of the Maddison Loan by assessing the likelihood of default. The Swanborough Report set out three elements that (it noted) determined the default probability of an entity (value of assets, asset risk, leverage) and referred to various models for performing default risk assessments. The Swanborough Report recorded a conclusion that default on the loan in the 12 months to 31 December 2013 was unlikely.
214. A matter of dispute between the parties was whether a copy of the Swanborough Report was located on the Audit Engagement File. It was not in issue a copy was located on the Forensic File. ASIC asserted that the Swanborough Report was not part of the Audit Engagement File because it had not been produced pursuant

⁴² See above n 28.

⁴³ See paragraphs 141-158.

⁴⁴ See above n 40.

to the Section 30A Notices to which we have previously referred. Mr Williams' Response to the SOFAC referred to the Swanborough Report (identified as AWPIB10/2) as being one of a number of additional work papers contained on the Forensic File. Mr Williams' oral evidence at the hearing was that a copy of the Swanborough Report was also a record on the Audit Engagement File.

215. Mr Rea's evidence was that he had conducted a review of the documents produced by WPIAS pursuant to the Section 30A Notices and the Swanborough Report was not amongst the documents produced, although subsequently he had become aware of the Swanborough Report as a result of its production to ASIC in a different context. Mr Rea's evidence was corroborated by documentary evidence of ASIC's record keeping system, that was consistent with a conclusion that the Swanborough Report had not been included in the documentation produced in response to the Section 30A Notices that were issued to WPIAS, but had been produced to ASIC subsequently in a different context.
216. Mr Williams' evidence that the Swanborough Report was recorded on both files was not consistent with either the objective evidence that the report was not produced to ASIC pursuant to the Section 30A Notices, or with Mr Williams' Response that identified the Swanborough Report as located on the Forensic File. It is improbable that Mr Williams' Response would have identified the Swanborough Report as located on the Forensic File without also referring to it as an Audit Engagement File record, had there also been a copy located there. The evidence that the Swanborough Report was not cross-referenced in the lead AWP for Maddison was also inconsistent with it having been included on the Audit Engagement File record, and particularly unusual given the emphasis Mr Williams has placed on its relevance in these proceedings.
217. Having regard to the inconsistencies in Mr Williams' evidence and the objective evidence that we have referred to, we are not prepared to conclude as a matter of evidence that a copy of the Swanborough Report was on the Audit Engagement File at the time the 2012 LM Audit was concluded. We do not therefore regard it as constituting part of the audit evidence for the 2012 LM Audit within the meaning of ASA 230 ("Finding on Location of Swanborough Report").
218. We have discussed the contents of the Swanborough Report further in paragraph 258(c).

Forensic AA1

219. This was a WPIAS Forensic Consulting Pty Ltd work paper located on the Forensic File ("Forensic AA1"). We note there was an AWP on the Audit Engagement File also identified as AA1 that was a template document of the nature we have described and discussed in paragraphs 135-140. Forensic AA1 carried the initials 'RW' beside the words 'Reviewed by' with the date '7/12/2012'. The initials 'RW' also appeared beside the words 'Prepared/Updated by:' and there were two further dates noted, '20/9/12' and '9/12/12'. Forensic AA1 appears to be notes of a briefing meeting between Mr Williams and Mr Swanborough and was headed 'LM Managed Performance Fund: Background'.

220. Forensic AA1 recorded commentary on the current status of LM. Under 'Reporting Framework', this document said:

The MPF is an unregistered Scheme with no statutory or constitutional requirement for audit. Whilst the audit report is for internal purposes only, i.e. Board and shareholders of LMIM, LMIM have requested the audit of the MPF Financial Statements be audited as if it were a Corporations Act 2001 audit and in accordance with Australian Auditing Standards so that what is ultimately lodged with ASIC, if at all, will be in the appropriate format. The financial statements template will be based upon their other registered schemes. No unit holders of MPF will be given the audit report nor your report on the Maddison project.

221. Forensic AA1 then set out the potential risks for investors in LM that had been identified by the LM information memorandum and under 'General Risks' noted four, being:

- (a) LM may become insolvent – against which it was noted that it was not a trading entity and did not incur normal trading liabilities.
- (b) LMIM might be unable to raise further investment monies for completion of the project, against which it was noted:

LM is able to quarantine all cash flows at any time. Provided there are adequate reserves to cover landholding costs e.g.: land tax, rates etc. and appropriate support and cooperation from the external debt provider, the impact of delays in development activity due to economic factors could be mitigated/managed. LMIM is in negotiations with several groups to source the requisite funding and/or exit a number of projects including this project.

- (c) Adequate external funding for continued development of the project cannot be sourced. The comments in subparagraph (b) above were referenced to this risk with a further statement: 'Limit of loan increased to \$280 million, expiring 30 June 2013. Suncorp facility expires 31 March 2013.'
- (d) The development projects do not proceed as planned e.g. delays in approvals, escalation rates not being achieved. The comments in subparagraph (b) were referenced to this risk.

222. Finally, Forensic AA1 referenced document BC1⁴⁵ in the Audit Engagement File and recorded:

Discussed with lead partner on 7 December 2012 whether there were any significant audit matters to note. Nil matters noted: unmodified audit report on MPF prepared. 2012 Audit Report issued by EY for LMIM was unmodified.

223. While Forensic AA1 reflects an understanding by Mr Williams of risks that had been identified, it is not evidence of any testing or investigation that was carried out.

224. Insofar as it expressed conclusions (e.g. Provided there are adequate reserves to cover landholding costs (e.g. land tax, rates etc...) and appropriate support and cooperation from the external debt provider, the impact of delays in development activity due to economic factors could be mitigated/managed), those conclusions

⁴⁵ "Forming an opinion on the Financial Report" described in paragraphs 438-441.

do not vouch for the reliability of the information (from the 2012 LM Financial Statements) on which they were based. Even if Forensic AA1 had been part of the Audit Engagement File, our view is that it was not appropriate audit evidence as contemplated by ASA 200.17, that required the auditor *to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.*

Forensic A1

225. This document was headed *LM Managed Performance Fund: Carry forward points to note* and was also located on the Forensic File.
226. Mr Williams relied on this document as demonstrating the investigation he had undertaken with respect to the Maddison Loan that enabled him to identify the risks this document identified. Forensic A1 noted carry forward points to be considered on the proposed audit of Maddison Estate as follows:
1. **Maddison Estate Pty Ltd.** Two major assets as at 30 June 2012 are the project dev. costs re Maddison Estate project and loan to Peter Drake of \$7,971, 843. In the books of the MPF, there is a secured loan (charge over LMA and Century Star Investments) of \$16, 911,196 to Peter Drake. Appears the security as at 30 September 2012 is sufficient to cover the aforementioned secured loan, on a Net Asset backing basis, but is not sufficient to cover the unsecured loan from Maddison Estate Pty Ltd (noting it has reduced from the balance outstanding as at 30 June 2011 of 10,409,752. Deficiency at 30/09/2012: \$7,639,335. **Consider need for impairment during Maddison audit.**
 2. **Maddison Estate Pty Ltd.** Two major loans payable as at 30 June 2012 are the loans from MPF and Suncorp of \$22, 046, 134. Suncorp facility expires March 2013. LMIM launched (Oct 2012) a special purpose offer to raise \$30 million from offshore investors (at 10 %) to take out Suncorp, if required. **Consider results of the offer during the Maddison audit.**
 3. **Note carry forward points** and assess as project progresses/approvals obtained, particularly pre-sales in June 2013 quarter and whether the project is being developed in line with feasibility timeline/forecasts. **Review actual v. forecast for 6 months ending 31/12/12 during Maddison audit.**
 4. **Loan limit: increased to \$280 million.** Majority of increase to cover book interest of 25% (payable to MPF) + loan re-est fee (3.5%). Note: Peter Drake excluded from Credit Committee decision vote. New concepts added (wave pool, swim school, volleyball facility + central park theme).
 5. **Probability of loan default.** Analysis was carried out using the dev feasibility model prepared by the PAM division. Cost inputs and sale values were reviewed during the audit process. Notwithstanding, it was assumed that the underlying assumptions were, at least, highly inaccurate, particularly escalation rates. Monte Carlo simulation was used to create 100,000 different budgets based on 100,000 unique combinations of input assumptions. A sufficiently large number of the "budgets" resulted in the project being profitable to give confidence it was viable. However, this alone did not take complete account of the riskiness of the debt i.e. an indication of the probability that the loan will default at various times during the life of the project. The risk of default was then determined using the Merton risky debt model and Black & Cox premature default model. Each of the models assumed that the project was a call option with a strike price equivalent to the face value of the debt and a spot price equivalent to the discounted cashflows from the project. **No likely default in 12 months to 31/12/13**

but need to track actual performance against budget, at least every 6 months, for indicator/(s) of an increase in probability of default.

6. **Standard residential subdivision model.** Analysis was carried out, using Estatemaster, adopting a lower risk option for the land being a standard residential subdivision. 2 scenarios assessed re cost of capital (7.5% + 25%). Escalation rates for costs were 3% pa and lot prices 3% increasing to 5% pa after 2013. Costs to complete (over 5 years) were estimated at: subdivn \$30m + 5% contingency; stat fees: \$37M and holding costs of \$357,000 plus GST pa (+ pre-sales commissions/finance charges/interest). Project timeline ended May 2027. Other straight line “what-if” scenarios prepared including using preliminary median price per m2 for vacant land on the Gold Coast of \$437. **In various scenarios, the principal, as a minimum, is capable of being repaid.**
7. **Subsequent events:** material (increment) changes to loan from MPF post 30/06/2012 relate to applied interest (monthly accrual) and monthly dev management fee. Balance sheet changes between 30/06/2012 and 30/09/2012 (in MPF):
 - 7.1 Cash: current liabilities ratio increased from 1.42 to 3.10.
 - 7.2 Cash assets increased from \$17, 287, 936 to \$18, 956, 861.
 - 7.3 Current liabilities decreased from \$12,189,594 to \$6,116,104.
 - 7.4 Mortgage loan receivable increased by \$19, 252, 361.
 - 7.5 Investor funds increased by \$23, 812, 015.
 - 7.6 Distributions paid were \$6,985, 243.

Review December 2012 quarter financial statements (MPF) for any material (adverse) changes during Maddison audit.

227. Forensic A1 demonstrates consideration by Mr Williams of the likelihood of default on the Maddison Loan occurring in the period to 31 December 2013 (for example, the references to the Swanborough Report and the performance of the Merton risky debt modelling). Forensic A1 was not dated, nor recorded or referenced on the Audit Engagement File. It contained several references to reviews/action necessary following an audit of Maddison such as:
 - (a) Consider need for impairment during the Maddison audit.
 - (b) LMIM launched (Oct 2012) a special purpose offer to raise \$30m from offshore investors (at 10%) to take out Suncorp, if required. Consider results of the offer during Maddison audit.
 - (c) Note carry forward points and assess as project progresses/approvals obtained, particularly pre-sales in the June 2013 quarter and whether the project is being developed in line with feasibility timeline/forecast. Review actual v. forecast for 6 months ending 31/12/12 during Maddison audit.
 - (d) No likely default in 12 months to 31/12/13 but need to track actual performance against budget, at least every 6 months, for indicator(s) of increase in probability of default.
 - (e) In various scenarios, the principal, as a minimum, is capable of being repaid.
 - (f) Review December 2012 quarter financial statements (MPF) for any material (adverse)

changes during the Maddison audit.

228. In our view, Forensic A1 does not add to the sum of evidence supporting the view concluded by Mr Williams in the 2012 LM Audit on the recoverability of the Maddison Loan or add weight to a conclusion on whether the audit evidence reduced audit risk to an acceptably low level. Indeed, the document is objective evidence of specific matters that should have been the subject of appropriate audit procedures before the 2012 LM Audit was signed, but were not.
229. Even had this document been part of the Audit Engagement File, our view is that it was not appropriate audit evidence as contemplated by ASA 200.17 that required the auditor to ‘obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor’s opinion.’

Forensic AA2

230. Forensic AA2 on the Forensic File dated 7 December 2012 was headed *LM Performance Fund: Summary Procedures (Maddison Estate)*. This document noted action points including:
- obtain and Review 30 June 2011 and 30 June 2012 financial statements for Maddison Estate Pty Ltd;
 - obtain and review current development feasibility model/inputs;
 - obtain and review current funding limit details for 2012/2013;
 - complete assessment of probability of loan default;: DCF/Monte Carlo
 - assessment of whether a standard res subdivision could repay the non interest component of the loan;
 - complete “what-if” scenarios capping escalation rates + sales price+ base subdiv (extract from audit file; Review);
 - subsequent information including the most recent quarterly financial report.
231. Against each point was a reference (presumably) to other parts of the Forensic File recording the work that was carried out.
232. The *carry forward* action point noted in Forensic AA2 referenced Forensic A1, which we have discussed in paragraphs 225-229 and we refer to and repeat those comments. The carry forward points noted in Forensic AA2 were further matters that should have been the subject of audit procedures prior to concluding the 2012 LM Audit and about which Mr Williams should have had appropriate audit evidence before he drew his conclusions on which the 2012 LM Audit Opinion was based.
233. In our view, Forensic AA2 does not assist Mr Williams. It is not audit evidence regarding the recoverability of the Maddison Loan, nor did it provide or add to the weight of the evidence that was available as a basis for a conclusion on whether audit risk had been reduced to an acceptably low level.

Mr Williams' common response to all Maddison Loan allegations – "The Subsequent Maddison Audit"

234. With respect to every Maddison Loan allegation, Mr Williams' response was that WPIAS had reserved the right to alter or reissue the 2012 LM Audit Opinion, as permitted by ASA 560.14,⁴⁶ once WPIAS had undertaken a full scope audit of Maddison to be commenced in January 2013 and completed by 31 March 2013 (the "Subsequent Maddison Audit"). We have considered and set out our views first on the merits of Mr Williams' response based on the Subsequent Maddison Audit because of its general significance to our conclusions on Contention One with respect to the Maddison Loan receivable.

Subsequent Maddison Audit – relevant documentary evidence

235. The *Maddison Loan Summary* (AWPIB1/2) included the following statement:

Given our audit report will only be used by the LMIM board to assist in getting the fund's financial statements ready for lodgement with ASIC, we will reserve the right to amend our report and/or ask the Manager to amend the 2012 financial statements should any significant issues arise from the audit of the Maddison Project.

236. The WPIAS 2012 Audit Closing Report for the LM Audit ("Closing Report") (p10) stated as follows:

We issued an unqualified audit opinion on the financial statements of the Fund as at 30 June 2012. As part of our Client Continuation Assessment Procedures, we again requested the right to undertake a full scope audit of Maddison Estate Pty Ltd, representing the Fund's largest loan receivable balance. This right was granted on 16 January 2013 with a self imposed deadline of 31 March 2013. Should we be unable to complete this engagement [the audit of Maddison Estate Pty Ltd] by 31 March 2013 and/or should our additional examinations identify any significant findings, we reserve the right to alter and re-issue our 2012 audit report.

237. The client representation letter from LMIM to Mr Williams dated 7 December 2012 said: 'We confirm we will appoint Williams Partners Independent Audit Specialists to complete an audit of Maddison Estate Pty Ltd for the period from inception to 31 December 2012, to be completed by 31 March 2013.'

238. The letter of engagement for the Maddison audit was dated 19 December 2012 and signed by Mr Peter Drake on 16 January 2013.

239. In a letter dated 22 March 2013 from WPIAS to ASIC, Mr Williams wrote:

...as previously advised, given the significance of the loan from MPF to Maddison Estate Pty Ltd, it was a requirement of our continuation to act as auditor of MPF that we complete a full scope audit of Maddison Estate Pty Ltd, from its commencement, being 14 September 2007, to 31 December 2012, and completing same by 31 March 2013. We had commenced this engagement on 18 January, but now are unable to complete the subject engagement by our designated due date of 31 March 2013.

Given the aforementioned, our internal continuation procedures have resulted in WPIAS resigning as auditor for both engagements effective immediately.

⁴⁶ See paragraph 240.

Relevant Auditing Standards

240. ASA 560 provides, relevantly:

ASA 560.2 A financial report may be affected by certain events that occur after the date of the financial report.

It states that ordinarily, there are two types of events:

- (a) Those that provide evidence of conditions that existed at the date of the financial report; and
- (b) Those that provide evidence of conditions that arose after the date of the financial report.

ASA 560.14 After the financial report has been issued, the auditor has no obligation to perform any audit procedures regarding such financial report. However, if after the financial report has been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:

- (a) Discuss the matter with management and, where appropriate, those charged with governance;
- (b) Determine whether the financial report needs amendment and; if so,
- (c) Enquire how management intends to address the matter in the financial report.

241. ASA 700.41 states:

The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial report, including evidence that:

- (a) All the statements that comprise the financial report, including the related notes, have been prepared; and
- (b) Those with the recognised authority have asserted that they have taken responsibility for the financial report.

Panel Finding on Subsequent Maddison Audit Response

242. The words of ASA 560 do not contemplate a mechanism for permitting the issue of an unqualified audit opinion on the basis that it could be amended if necessary following the audit of another entity. Rather, it provides a means for dealing with a fact or facts that become known to an auditor following the completion of an audit which fact or facts may have caused the auditor to amend the report, had they been known at the date of the auditor's report. ASA 560 is directed to dealing with unanticipated matters that emerge following the conclusion of an audit, that are relevant to the audit period.

243. That interpretation of ASA 560 is consistent with and reinforced by paragraph 41 of ASA 700, which unambiguously contemplates that signing an audit opinion represents that an audit is complete. That is to say, that at the time

of signing that audit opinion, the auditor has obtained sufficient appropriate audit evidence with respect to matters relevantly the subject of the audit, and any matters of significant uncertainty have been adequately and appropriately dealt with and are reflected in the audit conclusions reached.

244. In our view the comment we have referred to in AWPIB1/2 above, ‘Given our audit report will only be used by the LMIM board to assist in getting the fund’s financial statements ready for lodgement with ASIC, we will reserve the right to amend our report and/or ask the Manager to amend the 2012 financial statements should any significant issues arise from the audit of the Maddison Project’ recognised that a subsequent audit of Maddison was irregular insofar as it was being justified on the Limited User/Limited Purpose response basis and we refer to and repeat our conclusions on the Limited User/Limited Purpose Response.⁴⁷
245. Further, the statement in the Closing Report – ‘Should we be unable to complete this engagement [the audit of Maddison Estate Pty Ltd] by 31 March 2013 **and/or** (emphasis added) should our additional examinations identify any significant findings, we reserve the right to alter and re-issue our 2012 audit report’ – acknowledges that the only circumstance in which the unqualified 2012 LM Audit Opinion would **not** need to be re-visited would be if the planned audit of Maddison proceeded, was concluded by 31 March 2013 **and** did not identify any significant findings.
246. Mr Williams’ obligation as LM’s appointed auditor was to ensure that any matters of significant uncertainty were reflected in the 2012 LM Audit Opinion. ASA 700 specifically provides that ‘The auditor’s report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor’s opinion on the financial report...’.
247. In terms of the 2012 LM Audit, the matters about which Mr Williams intended on obtaining assurance by performing the Subsequent Maddison Audit were in our view matters about which there was significant uncertainty in terms of the 2012 LM Audit. Forensic A1⁴⁸ recorded these matters as follows:
- (a) Consider need for impairment during the Maddison audit.
 - (b) LMIM launched (Oct 2012) a special purpose offer to raise \$30m from offshore investors (at 10% to take out Suncorp, if required). Consider results of the offer during Maddison audit.
 - (c) Note carry forward points and assess as project progresses/approvals obtained, particularly pre-sales in the June 2013 quarter and whether the project is being developed in line with feasibility timeline/forecast. Review actual v. forecast for 6 months ending 31/12/12 during Maddison audit.
 - (d) No likely default in 12 months to 31/12/13 but need to track actual performance against budget, at least every 6 months, for indicator(s) of increase in probability of default.

⁴⁷ See paragraphs 119-134.

⁴⁸ Described in paragraphs 225-229.

- (e) In various scenarios, the principal, as a minimum, is capable of being repaid. Review December 2012 quarter financial statements (MPF) for any material (adverse) changes during the Maddison audit.
248. ASA 200.17 required the auditor to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and to obtain reasonable assurance to enable the auditor to draw reasonable conclusions on which to base an audit opinion. Mr Williams was aware when he signed the 2012 LM Audit, that the above matters required further clarification. They were matters about which he did not have sufficient appropriate audit evidence to support an audit conclusion with respect to the Maddison Loan receivable in the 2012 LM Financial Statements. ASA 560 did not provide a mechanism for allowing him to sign the audit opinion without qualification, based on the Subsequent Maddison Audit.
249. For these reasons, we have formed the view that Mr Williams should not have signed an unqualified audit opinion with respect to the 2012 LM Financial Statements as the Subsequent Maddison Audit was not an option that was properly available under the relevant auditing standards to which we have referred to deal with the matters he had identified in Forensic A1 as matters for review/action with respect to the Maddison Loan receivable in the 2012 LM Financial Statements, and about which the evidence shows he did not have sufficient appropriate audit evidence to support the recoverability of that loan and nor, therefore the 2012 LM Audit Opinion in accordance with the requirements of the Auditing Standards (“Finding on the Subsequent Maddison Audit Response”).
250. Because it may be relevant to our consideration of whether and what sanction may be appropriate, we record our observation that the interpretation of ASA 560 on which Mr Williams’ Subsequent Maddison Audit response relied demonstrates, in our view, a quite fundamental misunderstanding on Mr Williams’ part, of the scope, purpose and meaning of ASA 560, as well as of the requirements set out in ASA 200.17, ASA 230 and ASA 700. It also demonstrates in our view that the audit was not performed with appropriate professional scepticism as required by ASA 200.15.
251. The Panel’s Finding on the Subsequent Maddison Audit Response bears upon the Maddison Loan Sub-Allegations and we refer to it further below in the context of our findings on those matters.

Mr Williams’ specific responses to the Maddison Loan Sub-Allegations

252. In the alternative to the Subsequent Maddison Audit Response, Mr Williams relied on the existence of specific documentary evidence to deny the Maddison Loan allegations.
253. While the significance of the Panel’s Finding on the Subsequent Maddison Audit Response diminishes the relevance of Mr Williams’ further specific responses to the Maddison Loan Allegations, we have nevertheless considered and set out below our comments and findings on these further responses in the context of our consideration of those allegations.

Maddison Loan Allegations/Specific Responses/Findings

254. There were nine allegations made with respect to the Maddison Loan in Contention One as follows:

First Maddison Loan Allegation

255. The first allegation with respect to Maddison was that as Coomera Ridge Pty Ltd (“CRPL”), a registered chargee/trustee of Maddison (controlled by Maddison via contractual rights) and Maddison had not been audited, a reasonably competent auditor would, at the minimum, have identified the following concerns about the reliability of audit evidence obtained in relation to the Maddison Estate loan:

- (a) That it was not sufficient and appropriate to provide support for the conclusion in the lead audit work paper that stated ‘In our opinion sufficient appropriate audit evidence has been obtained to materially meet the stated audit objective (that objective stated in this work paper to be “to reduce the assessed risks by assertion to an acceptably low level”)’ on which the auditor's opinion would be based;
- (b) That the level of audit evidence was not sufficient to support the carrying value of the Maddison Loan; and
- (c) That as a result of (a) and (b) above, the auditor needed additional evidence to support the carrying value of the loan or have regard to the obligation under *ASA 705 Modifications to the Opinion in the Independent Auditors Report*.

256. In his Response, Mr Williams said that neither CRPL or Maddison were required to be audited pursuant either to the standards or legislation. This was not in issue between the parties. In our view, the fact that neither entity had been audited was a matter that should have increased the level of professional scepticism applied by Mr Williams to the audit evidence with respect to the Maddison Loan in accordance with his obligation to exercise appropriate professional scepticism.⁴⁹

257. Mr Williams denied these allegations and relied on:

- (a) The Engagement Partner Response that was not pressed. We refer to and repeat our comments in paragraphs 101-118 with respect to the responsibility of the Engagement Partner for an audit.
- (b) The Subsequent Maddison Audit Response. We refer to and repeat our comments and the Finding on the Subsequent Maddison Audit Response.⁵⁰
- (c) *Substantial working papers* on the Forensic File including IB10/2, the Swanborough Report that he had partly prepared and reviewed, to assert that the audit evidence was appropriate and sufficient to support the conclusion that there was no objective evidence requiring the impairment

⁴⁹ ASA 200.15.

⁵⁰ See paragraphs 242-251.

of the Maddison Loan as at 30 June 2012 and at the date of sign off, no additional evidence was required in relation to assessing whether the Maddison Loan was impaired.

258. With respect to response (c) above, we refer to:

- (a) Our conclusion on the Forensic File documents⁵¹ and our Finding on Location of the Swanborough Report⁵² as the basis for our view that the Swanborough report was not part of the audit evidence and so was not audit evidence supporting the conclusion that there was no objective evidence requiring the impairment of the Maddison Estate Loan as at 30 June 2012.
- (b) The Finding on the Subsequent Maddison Audit⁵³ that causes us to conclude further that even if the evidence on the Forensic File was part of the Audit Engagement File, it would not have been appropriate and sufficient audit evidence because of the matters that were specifically not addressed on the basis they would be in the Subsequent Maddison Audit.
- (c) The Swanborough Report⁵⁴ and note Mr Williams' evidence that the objective of the modelling analysis performed in the Swanborough Report was to test the likelihood of a default occurring in the following 12 months. ASIC submitted that an audit analysis of the recoverability of a loan receivable is not demonstrated by testing the likelihood of a default occurring in the following 12 months. Rather, evidence supporting the recoverability of the loan would have been relevant and there was no audit evidence addressing that matter. We agree. Even had the Swanborough Report been on the Audit Engagement File, it would not in our view have provided audit evidence of the recoverability of the Maddison Loan.

Panel Finding on First Maddison Loan Allegation

259. Based on the matters we have referred to above and in particular the Finding on the Subsequent Maddison Audit Response,⁵⁵ and having regard to the Relevant Benchmark,⁵⁶ our view is that a reasonably competent registered auditor would not have concluded that the audit evidence was sufficient and appropriate to provide support for the conclusions in the lead Maddison AWP (AWPIB/10) that sufficient appropriate audit evidence had been obtained 'to materially meet the stated audit objective' and 'to reduce the assessed risks by assertion to an acceptably low level' which conclusions would ultimately form part of the basis for the 2012 LM Audit Opinion; nor that the audit evidence was sufficient to support the carrying value of the Maddison Loan.

260. In the circumstances a reasonably competent registered auditor would either have conducted further investigations to obtain additional appropriate audit

⁵¹ See above n 43.

⁵² See paragraphs 211-218.

⁵³ See paragraphs 242-251.

⁵⁴ See above n 52.

⁵⁵ See above n 53.

⁵⁶ See paragraph 99.

evidence and/or appropriately reflect the insufficiency of the audit evidence in the audit opinion issued in accordance with the requirements of ASA 705 *Modifications to the Opinion in the Independent Auditors Report*.

261. We are satisfied that the First Maddison Loan allegation has been established.

Second and Third Maddison Loan Allegations – facts not in issue

262. The second and Third Maddison Loan Allegations concerned the Maddison Feasibility (AWPIB10A1).

263. It was not in issue that for the year ended 30 June 2012, the Maddison Feasibility prepared and provided to WPIAS by LMIM:

(a) Presented the forecast gross profit of the Maddison Development as \$513,933,391, LM's opening loan balance as \$201,187,254 and additional projected loan drawdowns as \$51,740,644, representing a buffer of \$261,005,493 between the forecast gross profit and the anticipated loan balance for the relevant period.

(b) Calculated the *Sales required* figure of \$549,224,649 by adding LM's opening loan balance of \$201,187,254 to the forecast of total costs to complete of \$348,037,395. The *required sales figure* of \$549,224,649 was then divided into the projected sales of \$861,970,786 and expressed as a percentage of the overall sales target to cover costs, which was 63.7%.

(c) Was based on input data that included a forecast of *sales and rental revenue escalation*. For the cashflow period of 2013, the rate of escalation of the forecast sale price (compounded monthly), increased by 50% per residential lot and further increases of 50% and 30% were projected for 2014 and 2015 respectively.

264. The input data for the 2011 feasibility for the Maddison development (dated August 2011) ("2011 Maddison Feasibility") had used forecast escalation rates of 7% for July 2013, 15% for July 2014 and 8% for July 2015.

265. The assumptions and input data used in the 2012 LM Audit had the effect of significantly uplifting the gross revenues of the project compared to the 2011 Maddison Feasibility and therefore, the amount available for recovery of the loan which had also increased significantly.

Second Maddison Loan Allegation

266. It was alleged that in the circumstances of the loan continuing to accrue capitalised interest at 25%, with respect to a relatively early stage project in respect of which construction had not commenced, no revenues were being generated, and no lots had been sold, that Mr Williams did not show a sufficient level of professional scepticism in his assessment and use of the Maddison Feasibility in the 2012 LM Audit.

Mr Williams' Response to Second Maddison Loan Allegation and Panel comments

267. Mr Williams' Response raised five specific matters.

First Specific Response to Second Maddison Loan Allegation

268. Mr Williams acknowledged that the high escalation rates in the Maddison Feasibility would raise significant concerns and he relied on the additional work undertaken by WPIAS recorded in the Forensic File and on the basis of that work denied there was insufficient professional scepticism shown in the assessment and use of the Maddison Feasibility.

269. We have described and set out our comments with respect to the other Forensic File documents relevant to the Maddison Loan to which Mr Williams referred under the heading 'Documents relied on by Mr Williams that were not on the Audit Engagement File' at paragraphs 208–233. We refer to and repeat our comments with respect to those documents in addition to the further discussion below.

270. In Forensic A1 under the heading '**Probability of loan default**' it was recorded:

Analysis was carried out using the development feasibility model prepared by PAM division. Cost inputs and sale values were reviewed during the audit process. Notwithstanding, it was assumed that the underlying assumptions were, at least, highly inaccurate, particularly escalation rates. Monte Carlo simulation was used to create 100,000 different budgets based on 100,000 unique combinations of input assumptions. A sufficiently large number of the "budgets" resulted in the project being profitable to give confidence that it was viable. However, this alone did not take complete account of the riskiness of the debt i.e. an indication of the probability that the loan will default at various times during the life of the project. The risk of default was then determined using the Merton risky debt model and Black and Cox premature default model. Each of the models assumed that the project was a call option with a strike price equivalent to the face value of the debt and a spot price equivalent to the discounted cashflows from the project. **No likely default in 12 months to 31/12/13 but need to track actual performance against budget, at least every six months, for indicator/s of an increase in probability of default.**

271. While the modelling referred to is recorded as having been conducted on the basis that the escalation rates were highly inaccurate, that does not in our view demonstrate that, in terms of the audit evidence, an appropriate level of professional scepticism as contemplated by ASA 200.15. In the circumstances and having regard to the importance of demonstrating appropriate professional scepticism in performance of the audit procedures, our view is that there should have been further investigation of the basis of the projections with management.

272. In any event, to the extent there was further analysis done on the Maddison Feasibility, this information was not included as evidence on the Audit Engagement File. Even had it been:

- (a) There was no explanation recorded as to how the Monte Carlo simulation had taken into account the very high escalation rates that had been used in the Maddison Feasibility which in our view would have been necessary to validate the relevance of the modelling performed.

(b) It would not address or overcome the difficulty with regard to the insufficiency of the audit work and the audit evidence with respect to the Maddison Loan receivable that was the subject of the Subsequent Maddison Audit response and we refer to and repeat our Finding on the Subsequent Maddison Audit Response.⁵⁷ The impact of this finding undermines the value as audit evidence of much of the audit work performed with respect to the Maddison Loan in terms of providing appropriate support for the audit conclusion reached because that analysis could not adequately address the gap created by the relevant matters Mr Williams had identified and that were not dealt with in the 2012 LM Audit before the 2012 LM Audit Opinion was issued.

273. In our view the approach adopted by Mr Williams in the 2012 LM Audit that formed the basis of the Subsequent Maddison Audit response further supports a conclusion that insufficient appropriate professional scepticism was applied in the 2012 LM Audit with respect to the audit of the Maddison Loan receivable. We refer to and repeat our comments on professional scepticism.⁵⁸ The fact that the requests to conduct an audit of Maddison had not been acceded to by LMIM should have heightened Mr Williams' professional scepticism, and responding by adopting the Subsequent Maddison Audit as a solution showed inappropriate professional scepticism, having regard to the Relevant Benchmark.⁵⁹

Second Specific Response to Second Maddison Loan Allegation

274. Mr Williams said that LMIM had complete discretion on the interest rate to be charged on the loan and that it was LMIM's intention to periodically assess the interest rate to be charged to enable LM to extract all of the financial benefits that the SPV received from the SPV's contractual participating interest in the underlying asset to maximise the tax benefit to LM investors and in the circumstances, said it was not a given that interest would continue to accrue at 25% per annum.

275. Note 12 to the 2012 LM Financial Statements included a disclosure noting LM's ability to periodically assess the interest rate of the loan, hence enabling it to extract all of the financial benefits. Interest at the time was being charged at 25%.

276. While we accept that discretion was available, there was no evidence on the Audit Engagement File that any enquiries were made to verify and obtain details of how the rate that was being charged enabled LM to extract the financial benefit as set out in the accounts nor whether LM intended to or in what circumstances it would consider varying the interest rate and/or the timeframe for that to occur.

277. In our view, these matters were relevant to an evaluation of the recoverability of the Maddison Loan receivable, about which there should have been audit procedures and audit evidence. The reference made by Mr Williams to Note 12 in the 2012 LM Financial Statements did not provide such evidence.

⁵⁷ See above n 53.

⁵⁸ See paragraphs 163-171.

⁵⁹ See above n 56.

Third Specific Response to Second Maddison Loan Allegation

278. Mr Williams said that there was no indication that the project would not go ahead, that the evidence was that the project had progressed as planned, and that it is reasonable for projects of this nature to incur the financing costs prior to commencement of production and revenue.
279. We accept that is not unusual for projects such as the Maddison Development to incur financing costs prior to the commencement of production and revenue.
280. The fact that there may not have been any indication that the project would not go ahead, which was not recorded on the Audit Engagement File in any event, does not demonstrate diligence in the performance of the audit and nor does it constitute audit evidence, nor that an appropriate level of professional scepticism was being applied having regard to our comments on professional scepticism and the guidelines contained in the AUASB Bulletin that we have discussed.⁶⁰
281. There was no evidence of audit procedures having been performed, nor any audit evidence about whether project development timelines were being met and whether future projections were achievable. It was noted in *Forensic AI* that the project development timeline was a matter to be followed up in the Subsequent Maddison Audit and we refer to and repeat our comments in paragraph 273. Even if the evidence on the Forensic File had been part of the Audit Engagement File, it would not have been appropriate and sufficient audit evidence in terms of the requirements of the auditing standards because of the matters that were specifically not addressed on the basis they would be dealt with in the Subsequent Maddison Audit.

Fourth Specific Response to Second Maddison Loan Allegation

282. Mr Williams said that the Maddison Feasibility was reviewed, but not relied upon solely in assessing the recoverability of the Maddison Loan.
283. Although Mr Williams had undertaken further analysis with respect to the Maddison Loan, that evidence was not part of the Audit Engagement File and was not appropriately reflected in the documents that comprised the audit evidence with respect to the Maddison Loan that were on the Audit Engagement File. The Maddison Feasibility was a significant part of the audit evidence for the Maddison Loan and the Audit Engagement File did not highlight the limitations of the document so as to sufficiently contextualise it as part of the audit record.
284. We accept that the Maddison Feasibility was not relied upon solely in assessing the recoverability of the Maddison Loan. Whether or not that was the case does not overcome the above matters nor address the impact of the Panel's Finding on the Subsequent Maddison Audit Response.⁶¹

⁶⁰ See paragraph 166-170.

⁶¹ See above n 53.

Fifth Specific Response to Second Maddison Loan Allegation

285. Reliance upon the Engagement Partner Response that was not pressed. We refer to and repeat our comments with respect to the responsibilities of the Engagement Partner.⁶²

Panel Finding on Second Maddison Loan Allegation

286. The Second Maddison Loan Allegation was that in the circumstances of the loan continuing to accrue capitalised interest at 25%, with respect to a relatively early stage project where construction had not commenced, no revenues were being generated, and no lots had been sold, that Mr Williams did not show a sufficient level of professional scepticism in his assessment and use of the Maddison Feasibility in the 2012 LM Audit.

287. A review of the Maddison Feasibility was recorded in AWPIB1/3 *Maddison Loan Summary*. It was noted that it was limited to a reasonability review to assess the recoverability of the loan in the long term. Page 12 of the Maddison Feasibility includes handwritten commentary (in relation to the escalation rates referred to) as follows:

- a. 2012 prices appear reasonable.
- b. Escalations based on expected property price increases and additional facilities being made available.

288. The basis for the conclusions noted in the preceding paragraph was not documented on the Audit Engagement File.

289. Even though Mr Williams during cross-examination agreed with respect to the Maddison Feasibility that the escalation rates used were “*optimistic*” that there was a “*huge disparity*” between the rates that had been used in 2011 and those used in 2012 and admitted that the escalation rates were a “*red flag*”, the record of the review of the Maddison Feasibility did not evidence any testing of or reasons for the appropriateness of the escalation rates used by management.

290. There was no other audit evidence, such as independent data on future projections for the real estate market in the area that supported the escalation rates in the Maddison Feasibility or evidence of whether those rates were in line with current market conditions, particularly as they were significantly higher than those applied in the previous year. Indeed, the text of the AFR article on the Audit Engagement File that we have referred to⁶³ noted the ‘current harsh climate for Gold Coast housing estates... the ambitious project at this time ... when land sales in the Gold Coast are at record lows...and [another developer] better located elsewhere in Pimpana having 123 lots under contract at the end of ... two years of sales.’ The contents of this article apparently contradicted the high escalation rates that had been used. In our view, there should have been audit evidence that reconciled or contextualised the contents of the AFR article and the escalation rates in the Maddison Feasibility, having regard to the

⁶² See above n 28.

⁶³ See paragraph 205.

requirement in ASA 500.11 and the obligation to exercise professional scepticism in ASA 200.15, particularly in circumstances where management had described the article as ‘Balanced and factual’.

291. We also refer to and repeat our comments and views regarding AWPBE1.⁶⁴
292. In addition to the matters we have already commented on in the context of Mr Williams’ responses to this allegation that were all factors that should have resulted in Mr Williams applying heightened professional scepticism, he was responsible for ensuring the quality of the 2012 LM Audit in circumstances where he knew that he did not have audited accounts with respect to Maddison and so should have ensured appropriate investigation and testing was designed and performed to take account of that.
293. There was no audit evidence that any of the information set forth by management in the Maddison Feasibility was independently verified by the WPIAS Audit team and there was no basis recorded for the conclusions noted.
294. Having regard to the Relevant Benchmark,⁶⁵ our view is that Mr Williams failed to apply appropriate professional scepticism to the assessment and use of the Maddison Feasibility in the 2012 LM Audit. We refer to and repeat our comments on appropriate professional scepticism at the time of the 2012 LM Audit.⁶⁶
295. We are satisfied that the Second Maddison Loan Allegation has been established.

Third Maddison Loan Allegation

296. It was alleged that the Audit Engagement File did not contain evidence that Mr Williams had applied appropriate professional scepticism to the significant increases in estimated sales prices referred to in the Maddison Feasibility.
297. A reasonably competent auditor would have:
- (a) initially considered the significant increases in forecast sales escalation rate of 50% and 30% as unrealistic and performed additional audit procedures to obtain sufficient appropriate audit evidence to support a realistic level of escalation rate, such as request/obtain additional evidence from the Manager supporting the escalation rates and obtain evidence from similar property developments which have been completed to see if the escalation rates adopted by the Manager are reasonable when compared to the market; and
 - (b) identified that listings of comparable house prices based on 2012 sales prices were merely supporting the current sales values and not the future escalation rate.

⁶⁴ See paragraph 311.

⁶⁵ See above n 56.

⁶⁶ See above n 58.

Mr Williams' Response and Panel comments – Third Maddison Loan Allegation

298. In response to the Third Maddison Loan Allegation, Mr Williams:

- (a) Relied on the Engagement Partner Response that was not pressed.
- (b) Admitted that the listing of comparable house sales in Coomera (Qld) was used to support the 2012 sale prices.

We note that the evidence on the Audit Engagement File of the 2012 property sale prices in Coomera does not provide evidence that supports the escalation rates that were used in the Maddison Feasibility for the subsequent years.

- (c) Said that additional WPIAS forensic work that assessed the increased sale rates was performed that evidenced appropriate professional scepticism and otherwise denied the allegations.

With respect to this final response, we refer to and repeat our comments in paragraph 272 in the context of the Second Maddison Loan Allegation.

Panel Finding on Third Maddison Loan Allegation

299. We refer to and repeat our comments with regard to our finding on the Second Maddison Loan Allegation above, our comments with respect to Mr Williams' Responses on the Second Maddison Loan Allegation and our comments with respect to Mr Williams' responses to this allegation. Based on those matters, we are satisfied that the Third Maddison Loan Allegation has been established.

Fourth Maddison Loan Allegation

300. The Fourth Maddison Loan Allegation was that the Audit Engagement File did not contain sufficient appropriate audit evidence outlining consideration of events that occurred subsequent to year end up until the date of the 2012 LM Audit report (i.e. from 1 July 2012 to 7 December 2012) such as whether there were additional drawdowns made to the Maddison Loan and whether the Maddison Estate Development continued to progress in accordance with the Maddison Feasibility.

Mr Williams' Response and Panel comments and findings

301. Mr Williams denied that these matters were not considered and that sufficient appropriate audit evidence was not obtained. Mr Williams:

- (a) relied upon the Engagement Partner Response that was not pressed; and
- (b) said the matters were considered at AWP 1B10A/4 and in additional work papers on the Forensic File.

302. We have described document IB10A+ in paragraphs 190–197 and we refer to and repeat our comments with respect to IB10A+.

303. AWPIB10A/4 of IB10A+ records totals of calculations made in the spreadsheet. It shows expected net cash flow for the Maddison project (\$513,933,391) compared to the loan balance at 30 June 2012 (\$201,187,254) and recorded a calculation that added in estimated additional drawdowns (\$51,740,644). It recorded an amount of \$261,005,493 described as *Buffer*. The word 'ok' is typed next to this total. This appears to be recording a conclusion based on those calculations that there was sufficient expected future cash flow to cover the loan balance at 30 June 2012. It also recorded a sales target to cover costs of 63.7%.
304. While AWPIB10A/4 appears to evidence consideration of whether cashflow projections post 30 June 2012 would be sufficient to service the loan and estimated future additional drawdowns, there is no information included that supports the reasonableness of, or basis of, the projections and estimated drawdowns on which the conclusion was apparently drawn. AWPIB10A/4 does not demonstrate that there had been any investigation or evaluation of events that had actually occurred between 30 June 2012 and when the audit report was signed. We note that Mr Rea accepted that there was consideration of additional drawdowns evidenced by IB10A/4. In his evidence, he noted this consideration was in the context of the review of the Maddison Feasibility rather than in the context of considering events subsequent to year-end. In our view this is a relevant distinction.
305. We have discussed the XC subsequent event documentation further in Contention 2.⁶⁷
306. The document *Forensic AI* located on the Forensic File also referred to subsequent events as follows:
7. **Subsequent events:** material (increment) changes to loan from MPF post 30/06/2012 relate to applied interest (monthly accrual) and monthly dev management fee. Balance sheet changes between 30/06/2012 and 30/09/2012 (in MPF):
 - 7.1 Cash: current liabilities ratio increased from 1.42 to 3.10
 - 7.2 Cash assets increased from \$17, 287, 936 to \$18, 956, 861
 - 7.3 Current liabilities decreased from \$12,189,594 to \$6,116,104
 - 7.4 Mortgage loan receivable increased by \$19, 252, 361
 - 7.5 Investor funds increased by \$23, 812, 015
 - 7.6 Distributions paid were \$6, 895, 243
- Review December 2012 quarter financial statements (MPF) for any material (adverse) changes during Maddison audit.**
307. While *Forensic AI* demonstrated some consideration by Mr Williams of the likelihood of default on the Maddison Loan occurring in the period to 31/12/13 (for example, the references to the Swanborough Report and the performance of the Merton risky debt modelling) it was not dated, nor recorded or referenced on the Audit Engagement File and in our view for the reasons we have already set

⁶⁷ See paragraphs 806-811.

out with respect to the Forensic File documents, was not audit evidence. Even had it been on the Audit Engagement File, we note that it referred to subsequently reviewing LM's December 2012 quarter financial statements in the Subsequent Maddison Audit and we refer to and repeat our Finding on the Subsequent Maddison Audit Response.⁶⁸

308. We are satisfied that the Audit Engagement File did not contain sufficient appropriate audit evidence outlining WPIAS' consideration of events that occurred subsequent to year end up until the date the 2012 LM Audit Opinion was signed (i.e. from 1 July 2012 to 7 December 2012) such as whether there were additional drawdowns made to the Maddison Loan and whether the development continued to progress in accordance with the Maddison Feasibility.
309. We find the Fourth Maddison Loan Allegation has been established.

Fifth Maddison Loan Allegation

310. The Fifth Maddison Loan Allegation was that there was no evidence in the Audit Engagement File that the checks or monitoring referred to in AWPBE1 had been carried out for the 2012 LM Audit.
311. AWPBE1 was noted as prepared by *RLW* on 13 November 2012 and reviewed on 22 November 2012 by *AB* and *LD* and was identified as 'Points forward to note/action (during Maddison audit or next interim + on-going) from review of Maddison Estate feasibility' and included the following comments:

Sales:

- (a) Escalation on GR for land appears optimistic, with starting prices of \$235-\$385k compared with ending prices average \$700k in 5 years: **need to monitor**
- (b) Escalation on GR for apartments appears optimistic with starting average of \$384k compared with ending price average of \$680k (will depend upon size of apartment etc). Current sales values per apartment based upon \$ per s/m compared to current market: **need to monitor** page 1, ASIC
- (c) Review projected sales rate per month in both land and apartments to reaffirm that the actual settlement rate is achievable for both: **need to monitor**
- (d) Check land value for GST margin scheme calculation purposes. GST margin on values with escalation do not appear to match current sales prices margin calculation (\$83m v \$45m): **check**
- (e) Appears recoverability of non-residential assets (Aqua Centre etc) based upon cost to build, not projected revenue: **check**

Costs:

- (a) Determine land purchase price for revised feasibility models + land transaction costs (stamp duty, legals etc): **check**
- (b) Determine whether all costs to date have been included and reconciled back to accounting system/job cost reports: **check**

⁶⁸ See above n 53.

- (c) Determine whether costs associated with construction civils have been allocated across the stages correctly ie is the timing correct based upon the works required for different stages? Eg stage 8 is \$9m and stages 9-11 are under \$1m each: **check**
- (d) Review QS report for build cost for apartments and cost per s/m per apartment building + do the apartment build costs allow for all relevant builders prelim costs: **check**
- (e) Determine whether there is any allowance for defects/rectification work in the build costs for apartments:
- (f) Aquatic Centre build cost is \$1m more than its sale value (before taking into account consultants, civils, etc) ... **check**
- (g) Review infrastructure charges against current PIP charges from GCCC (under stat fess): **check**
- (h) Review costs projection vs actual, especially if the sales rate is not met. Additional holding costs would need to be forecast: **need to monitor**
- (i) Re-calculate finance costs based upon new assumption of GR escalation to cover costs each month and to take into account peak debt position and associated line fees: **check**
- (j) No interest calculated on the Suncorp loan although there are fees included in finance charges to take the facility limit up to \$65m: **check**

Mr Williams' Response and Panel comments

312. Mr Williams Response was that:

- (a) The issues were identified for addressing in the Subsequent Maddison Audit.

We refer to and repeat our comments and Finding on the Subsequent Maddison Audit Response⁶⁹ that form the basis for our view that this response does not provide an appropriate answer to this allegation.

- (b) These were issues that would have been investigated in the 2013 interim testing and were documented on the AWP as points for next year.

Whether the issues would have been so investigated does not answer the allegation made that there was no evidence on the Audit Engagement File that the checks or monitoring referred to in AWPBE1 had been carried out for the 2012 LM Audit.

- (c) These matters did not require addressing prior to signing off on the 2012 LM Audit Opinion.

We refer to and repeat our comments and Finding on the Subsequent Maddison Audit Response⁷⁰ which forms the basis for our view that these matters should have been addressed prior to issuing the 2012 LM Audit Opinion.

⁶⁹ See above n 53.

⁷⁰ Ibid.

- (d) If WPIAS had been unable to complete the Maddison audit by 31 March 2013, or through additional examination had identified significant findings, WPIAS had reserved the right to alter or reissue the 2012 report (noting it had been commissioned for the Limited Purpose and was delivered to the Limited Users).

We refer to and repeat our comments and Finding on the Subsequent Maddison Audit Response⁷¹ which forms the basis for our view that this response does not provide an answer to this allegation.

- (e) Mr Williams relied upon the Engagement Partner Response⁷² that was not pressed.

Panel Findings on the Fifth Maddison Loan Allegation

313. There was no Audit Engagement File evidence with respect to the matters noted to *check* in AWPBE1 and this is consistent with the documentary record of AWPBE1, the subject of which was noted to be *Points forward to note/action (during Maddison audit or next interim + on-going) from review of Maddison Estate feasibility*. The matters in respect of which *check* was recorded had not been the subject of audit investigations because Mr Williams was intending to deal with these issues either when he performed the Subsequent Maddison Audit or ‘next interim + ongoing’.
314. Based on our comments above, including our comments with respect to Mr Williams’ responses in paragraph 312, we are satisfied that the Fifth Maddison Loan Allegation that there was no evidence in the Audit Engagement File that the checks or monitoring referred to in AWPBE1 had been carried out for the 2012 LM Audit has been established.

Sixth Maddison Loan Allegation

315. The Sixth Maddison Loan Allegation was that Mr Williams did not obtain sufficient appropriate audit evidence to address either the recoverability of the Maddison Loan or whether the loan value had been appropriately accounted for in the 2012 LM Financial Statements in accordance with AASB 139 (*Financial Instruments: Recognition and Measurement*).
316. AASB 139 imposed an obligation on the entity (LM) to assess at the end of each reporting period, relevantly, whether any objective evidence existed that a financial asset was impaired and, if any such evidence does exist, the entity shall, for financial assets carried at amortised cost, apply paragraph 63 to determine the amount of any impairment loss. Paragraph 63 provided that where ‘there is objective evidence that an impairment loss on loans and receivables...[had] been incurred, the amount of [that] loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows...discounted at the financial asset’s original effective interest rate.’ Paragraph 63 provided further that ‘[t]he carrying amount of the asset shall be reduced either directly or through use of an allowance account’ and ‘[t]he

⁷¹ Ibid.

⁷² See above n 28.

amount of the loss shall be recognised in profit or loss.’ In the context of auditing a loan receivable, the disclosures made by an entity in its financial report in this regard is a matter within the scope of the auditor’s responsibility.

317. The Sixth Maddison Loan Allegation comprised Sub-Allegations (a)-(v). We deal with each of those Sub-Allegations, Mr Williams Response and the Panel’s comments and conclusions as follows:

Sub-Allegation 6(a)

Why the Maddison Loan increased by \$28,385,804 during the financial year ended 30 June 2012 as a result of capitalised interest and why the monies were not used to progress the development.

318. Mr Williams’ Response was that this was not a matter about which audit procedures and audit evidence was required on the basis that capitalised interest is a non-cash item and, as such, would not have been available to spend to progress the development.
319. While capitalised interest is a non-cash item, and it is not unusual for interest to be capitalised in the early stages of real estate development projects, these were nevertheless matters about which, in the context of an audit evaluation of the recoverability of the Maddison Loan by LM and whether the loan value had been appropriately accounted for by LM in its financial statements in accordance with its obligation pursuant to AASB 139, Mr Williams needed to ensure there would be, via the implementation of appropriate and comprehensive audit procedures, appropriate and sufficient audit evidence on which to base an audit conclusion in the 2012 LM Audit.
320. In our view, the objective of audit enquiries in this regard would have been to confirm that in the context of the purpose and size of the Maddison Loan, it was appropriate to be capitalising the interest insofar as it was not unacceptably increasing the likelihood of impairment of the loan. This could involve, for example investigating development progress by reference to comparing timeline projections and evaluating actual progress. If progress was not evident, it may have meant that the increased exposure to the Maddison Development that would arise from capitalised interest over the corresponding period was relevant to consider in terms of possible impairment and whether it had been appropriately accounted for by LM in terms of the requirement in AASB 139 and therefore a matter that should have been investigated in the 2012 LM Audit and about which there should have been audit evidence.
321. While there was audit evidence that the interest rate had been agreed and the calculations had been test checked, there was no audit evidence that any enquiries had been made about the matters we have set out directly above.
322. We are therefore satisfied that Sub-Allegation (a) was a matter relevant to evaluating the recoverability of the Maddison Loan and/or whether the value of the Maddison Loan had been appropriately accounted for in the 2012 LM Financial Statements in accordance with AASB 139 and that that there was no sufficient and appropriate audit evidence that demonstrated these matters had been properly investigated and evaluated.

323. In our view, having regard to the Relevant Benchmark,⁷³ a reasonably competent auditor in the circumstances of the 2012 LM Audit, would have performed audit procedures to obtain sufficient and appropriate audit evidence with respect to these matters in order to demonstrate that there was appropriate consideration given to assessing the recoverability of the Maddison Loan receivable and to LM's assessment of impairment of the Maddison Loan (having regard to the requirements of AASB 139).
324. We find the Maddison Loan allegation 6(a) established.

Sub-Allegation 6(b)

Why approximately half of the loan balance represented capitalised interest (\$100 million).

325. Mr Williams stated that LMIM had complete discretion available with regard to the interest rate to be charged on the loan, that there was no indication that the Maddison Development would not proceed, and that the project had progressed as planned.
326. Note 12 to the 2012 LM Financial Statements included a disclosure noting that LM was able to periodically assess the interest rate of the loan that enabled LM to extract all of the financial benefit. Interest in that year was being charged at 25%.
327. There was no evidence on the Audit Engagement File that any enquiries were made to verify and obtain details of how the interest rate being charged enabled LM to extract 'all of the financial benefit' as noted.
328. The capitalised interest sum was high as a proportion of the overall loan sum and, as we have discussed in the context of Sub-Allegation (a), was in the absence of evidence to the contrary, an indication of possible of impairment. Note 12 to the 2012 LM Financial Statements did not address whether the discretion available to adjust the interest rate extended to interest payments already capitalised.
329. There was no evidence in these proceedings of audit procedures having been performed, nor audit evidence about, whether project development timelines had been met or whether future projections with respect to the progress of the Maddison Development were achievable. The fact that there was no indication that the Maddison Development would not proceed would not have been sufficient in terms of ASA 200.17, even if there had been audit evidence of this matter to demonstrate a proper evaluation of the recoverability of the Maddison Loan receivable and LM's assessment of the impairment of the Maddison Loan (having regard to the requirements of AASB 139).
330. In our view, having regard to the Relevant Benchmark,⁷⁴ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed audit procedures to obtain sufficient and appropriate audit evidence with respect to these matters in order to demonstrate that there was appropriate consideration

⁷³ See above n 56.

⁷⁴ Ibid.

given to assessing the recoverability of the Maddison Loan receivable and to LM's assessment of the impairment of the Maddison Loan (having regard to the requirements of AASB 139).

331. We find the Maddison Loan Allegation 6(b) established.

Sub-Allegation 6(c)

Why the interest of 25% p.a. was higher than industry interest rates and therefore why the loan amount continued to increase despite the fact that the value of the property and/or development may/may not increase by a similar amount.

332. There was no evidence on the Audit Engagement File with respect to Sub-Allegation (c).

333. Mr Williams referred to the Manager's discretion to vary the interest rate in answer to this Sub-Allegation and made the point that it was not assumed that interest would continue to accrue at 25% p.a.

334. We refer to and repeat our comments and views with respect to Sub-Allegation (b) which form the basis of our conclusion that, having regard to the Relevant Benchmark,⁷⁵ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed audit procedures to obtain sufficient and appropriate audit evidence with respect to these matters in order to demonstrate that there was appropriate consideration given to assessing the recoverability of the Maddison Loan receivable and to LM's assessment of the impairment of the Maddison Loan (having regard to the requirements of AASB 139).

335. We find Maddison Loan Sub-Allegation 6(c) established.

Sub-Allegation 6(d)

Why the developer had not obtained finance for the construction of the development.

336. Mr Williams' response was that 'The Manager was, at the date of sign off for the 2012 financial statements in due diligence with respect to obtaining finance with a number of parties...it was reasonable that finance was not obtained because it was not unreasonable to accept that the due diligence process would exceed the 11 days between the date of the letter from First Wall Street Capital Partners (a potential funder) and the date of sign off of the Audit Report' and that 'Suncorp had, as at the date of the sign off of the financial statements, confirmed in writing that its loan facility would be extended to 31 March 2013'.

337. ASIC submitted that the letter from First Wall Street Capital Partners dated 26 November 2012 ("the Letter"):

- (a) was a letter of intention only conditional upon due diligence being completed; and
- (b) expressed two pre-conditions:

⁷⁵ Ibid.

- (a) first, that Suncorp must confirm in writing by 30 November that it had approved an extension to 31 March 2013 on all current standard loan terms; and
 - (b) second, that Suncorp would unconditionally allow Maddison to immediately commence civil works on the site and execute all consents required within 5 business days.
338. There was audit evidence in relation to the extension of the Suncorp Facility (see our comments below), but no audit evidence about whether the second pre-condition set out in the Letter had been met. While we agree with Mr Williams' response that it was not unreasonable to expect that the due diligence process would exceed the 11 days between the Letter and the 2012 LM Audit Opinion, that response falls away without any evidence in relation to satisfaction of the second immediate precondition referred to in the Letter.
339. In our view, the fact that due diligence was still to be conducted by a potential financier (which would be required to stand in the shoes of an existing financier) within the relatively short period of under four months, is a significant indicator of uncertainty with respect to the re-financing arrangements in train that required further investigation in the 2012 LM Audit, especially given the context of the significance of the Maddison Loan receivable to LM and the potential impact, if refinancing of the Suncorp Facility could not proceed in the (relatively short) timeframe available.
340. As to Mr Williams' response regarding the extension of the Suncorp Facility, AWPIB10K to which he referred, is an email between Suncorp and Mr Grant Fisher of LMIM dated 29 November 2012 that confirmed Suncorp had obtained credit approval for a loan extension to March 2013. In the email, Suncorp stated that its credit approval 'remains subject to satisfactory documentation. We will provide a further update on Monday with regards to documentation timing and initial thoughts with regards to reviewing the Phase 1 bulk earth works (one of the conditions of approval)'.
341. AWPIB10K was not, in our view, sufficient appropriate audit evidence that an extension of the Suncorp Facility had been concluded. There should have been audit evidence of further investigation by the auditor as to the terms on which the extension of the Suncorp Facility was proposed and the achievability of the other matters referred to in the email to Mr Fischer before Mr Williams signed the 2012 LM Audit Opinion.
342. In our view, it would have been appropriate to obtain further details of the existing and proposed financing arrangements, including why the Suncorp Facility was being refinanced, the likelihood of the potential new financier proceeding, why development finance was not yet in place, and the potential impact of delay or failure of the refinancing that was anticipated, as all of these matters were relevant to evaluating the recoverability of the Maddison Loan and/or whether the loan value had been appropriately accounted for in the 2012 LM Financial Statements in accordance with AASB 139. There should also have been audit evidence about whether the second pre-condition set out in the Letter had been met.

343. There was no audit evidence on the Audit Engagement File that these matters had been properly investigated and evaluated.
344. In our view, having regard to the Relevant Benchmark,⁷⁶ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed audit procedures to obtain sufficient and appropriate audit evidence with respect to these matters in order to demonstrate that there was appropriate consideration given to assessing the recoverability of the Maddison Loan receivable and to LM's assessment of the impairment of the Maddison Loan (having regard to the requirements of AASB 139).
345. We find Maddison Loan Sub-Allegation 6(d) established.

Sub-Allegation 6(e)

Whether it was likely additional finance would be obtained with reference to the value of the property on an 'as is' basis, which was not evidenced on the engagement file, compared to the value of the outstanding debt.

346. Mr Williams' Response was that:

...the additional finance being obtained was not being sought on an "as is" basis but rather for construction finance and for the costs to complete the project. Accordingly, the value of any outstanding debt would be recovered on completion of the project as a whole.

347. The additional finance being sought was based on the *on-completion* value of the development and we accept that this is not unusual. However, from the perspective of LM as an existing second priority lender to the development, the inherent risk of finance or sufficient finance not being procured (for example, if increased funding was required for the project due to an unforeseen delay or a budget overrun) was high, particularly because significant cash flow would not be generated by the development until it reached the final stages.
348. The question therefore of the *as is* value of the property and its relationship to the amount of additional finance being obtained was in our view a relevant audit question for exploration in terms of the recoverability of the loan receivable and whether the loan value had been appropriately accounted for in the 2012 LM Financial Statements.
349. There was no audit evidence on the Audit Engagement File that these matters had been properly investigated and evaluated.
350. In our view, having regard to the Relevant Benchmark,⁷⁷ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed audit procedures to obtain sufficient and appropriate audit evidence with respect to these matters in order to demonstrate that there was appropriate consideration given to assessing the recoverability of the Maddison Loan receivable and to LM's assessment of impairment of the Maddison Loan (having regard to the requirements of AASB 139).
351. We find Maddison Loan Sub-Allegation 6(e) established.

⁷⁶ Ibid.

⁷⁷ Ibid.

Sub-Allegation 6(f)

Why approvals had not been obtained for the majority of the proposed development sites and why there was no evidence of pre-sales.

352. Mr Williams' Response was that:

In circumstances where the entire project had gained preliminary approval and the first stage of 150 lots had been approved, there was no reason to believe that the second approval for 250 lots would not be obtained.

353. There was no substantive audit evidence that supported Mr Williams' assertion. The development timeline is often a matter dependent on such things as council development approvals that are matters critically relevant to the financial risk profile of the development and also therefore relevant to the audit assessment of the recoverability of a loan receivable in respect of such a project and a consideration of the appropriateness of how it has been accounted for in terms of AASB 139.

354. In the 2012 LM Audit, this was particularly evident against the backdrop of the risks inherent in the early stages of the Maddison Development, the significant future capital requirement, the evidence of current uncertainty regarding short and longer term financing, the lack of written evidence of Council's commitment to approving further development, the evidence of the general economic environment and the lack of evidence of pre-sales, all of which were matters that should have been considered, if appropriate professional scepticism, and proper diligence was applied in the 2012 LM Audit.

355. There was no audit evidence on the Audit Engagement File that these matters had been properly investigated and evaluated.

356. In our view, having regard to the Relevant Benchmark,⁷⁸ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed audit procedures to obtain sufficient and appropriate audit evidence with respect to these matters in order to demonstrate that there was appropriate consideration given to assessing the recoverability of the Maddison Loan receivable and to LM's assessment of impairment of the Maddison Loan (having regard to the requirements of AASB 139).

357. We find Maddison Loan allegation 6(f) established.

Sub-Allegation 6(g)

The relevance of the concerns raised in the AFR article dated 24 October 2012 in relation to the value of the property development.

358. Mr Williams' Response was that:

No reliance was placed on the article and the work performed in relation to the impairment of the loan (incl. the WPIAS Forensic Work) did not identify any objective evidence of the need for any such impairment.

⁷⁸ Ibid.

359. We have described the contents of the AFR article⁷⁹ and already noted that, in our view, it should have been cross-referenced to audit work relied on and appropriate narrative included to address the apparent inconsistencies in order to show that appropriate professional scepticism, in accordance with ASA 200.15, was being applied to the information obtained in the audit.
360. We refer to and repeat our comments on the importance of applying appropriate professional scepticism in an audit.⁸⁰
361. The fact that no reliance was placed on the article is beside the point. Applying professional scepticism requires a critical assessment of not only information that supports management's assertions, but also of any information that contradicts those assertions and would have been consistent with satisfying the requirement in ASA 230.11.
362. There was no audit evidence that this article was considered in the 2012 LM Audit.
363. In our view, having regard to the Relevant Benchmark,⁸¹ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed audit procedures to obtain sufficient and appropriate audit evidence with respect to these matters in order to demonstrate that there was appropriate consideration given to assessing the recoverability of the Maddison Loan receivable and to LM's assessment of impairment of the Maddison Loan (having regard to the requirements of AASB 139).
364. We find Maddison Loan Sub-Allegation 6(g) has been established.

Sub-Allegation 6(h)

Why LM had a second mortgage over the Maddison property and, as the project was still in pre-development stage, whether Maddison was paying all the interest on the Suncorp Facility as if all that interest was not being paid this would result in the loan capital increasing and reducing LM's claims on any security the property provided.

365. Mr Williams' Response was that:

...whilst Suncorp did hold the first mortgage over the real property, the balance of the Suncorp loan as at 30 June 2011 was \$36,196,944.96 which had been reduced to \$22,046,134.26 by 30 June 2012. In those circumstances interest and principal was being repaid and accordingly interest was not increasing on the Suncorp loan nor was the loan balance increasing. Consequently, LM's claims on the security held in the property were increasing and not reducing in value.

366. The documentary evidence Mr Williams referred to (AWPIB10K) corroborated his response to the second leg of this Sub-Allegation. We agree that the reduction in the loan principal was a factor that ameliorated some of LM's risk exposure to the Suncorp Facility. However, AWPIB10K did not address the issue of why LM's loan to Maddison was subordinate.

⁷⁹ See paragraph 290 and above n 63.

⁸⁰ See above n 58.

⁸¹ See above n 56.

367. In our view, given the range of risks and uncertainties inherent in the Maddison Development, financing arrangements that we have described in paragraph 354 and their potential impact on the recoverability of LM's loan to Maddison, and its significance as an asset to LM, there should have been heightened professional scepticism applied in the performance of the 2012 LM Audit that reflected this heightened risk profile that was reflected by additional audit evidence that demonstrated that sufficient information had been sought from management, its reliability appropriately evaluated and the basis for the audit conclusion with respect to the significance of that audit evidence. We refer to and repeat our comments on the importance of applying appropriate professional scepticism to the quality of an audit.⁸²
368. In our view, having regard to the Relevant Benchmark⁸³, a reasonably competent auditor in the circumstances of the 2012 LM Audit applying an appropriate level of professional scepticism would have performed an assessment of the impact of LM being a second priority lender to Maddison as this was clearly relevant to the recoverability of the loan and whether it had been appropriately accounted for in accordance with AASB139.
369. With respect to AWPIB10K, which is a copy of a loan account statement from Suncorp for the month of June 2012 showing an opening and closing balance, two payments into the account reducing the loan balance and the monthly interest charge, with three ticks recorded on it in handwriting, a reasonably competent auditor, in the circumstances of the 2012 LM Audit, would have retained audit evidence that included explanatory commentary about the purpose of this document, a reference to the nature and objectives of the audit work undertaken with respect to it and the conclusions drawn as to its relevance with respect to the audit of the Maddison Loan receivable.
370. There was no audit evidence that either matter was considered in the 2012 LM Audit.
371. We find that Maddison Loan Sub-Allegation 6(h) has been established.

Sub-Allegation 6(i)

Why the AWP detailing the first mortgage security was brought forward from the prior year so that any change to the first mortgage security in the current (2012) year from that of the 2011 year had not been considered.

372. Mr Williams' Response was that 'changes during the year 1 July 2011 to 30 June 2011' were noted on the AWPs and referenced supporting documents. Further, the loan statement detailing all the transactions from 1 July 2011 to 30 June 2012 were obtained (AWPIB10B) and in those circumstances all charges were considered.
373. Although less significant to the audit of the Maddison Loan receivable, our views with respect to this issue are similar to those expressed in Sub-Allegation 6(h).

⁸² See above n 58.

⁸³ See above n 56.

374. The AWP's demonstrated evidence of some consideration of the Suncorp loan at 30 June 2012. In our view, having regard to the requirements with respect to audit evidence set out in ASA 230, the AWP that dealt with the first mortgage security for the 2012 year should have recorded the outstanding amount with respect to that loan as at 30 June 2012.
375. The audit evidence to which Mr Williams referred supports the view that, although the AWP from the prior year had been carried forward and reflected a different loan amount, that did not affect the audit work that was done and for this reason we are not satisfied that Sub-Allegation (i) has been established.

Sub-Allegation 6(j)

Why the Suncorp loan facility in relation to the development was to be re-financed.

376. Mr Williams' Response was:

...the balance of the Suncorp loan had been reduced (from \$36m to \$22m) in line with the repayment terms of the loan, risk of refinance of the Suncorp loan was not a direct risk to LM, but rather to Maddison. Evidence of the progress of refinance had been obtained and the Suncorp loan facility had been fully disclosed in the 30 June 2012 financial statements. In these circumstances, there was no requirement to investigate the reasons for Suncorp requesting its loan facility to be refinanced.

377. For the reasons we have referred to in Sub-Allegation 6(e), we do not think it is correct that the refinancing of the Suncorp Facility was not a direct risk to LM. In our view, it was a significant risk and Mr Williams should have enquired as to why the Suncorp Facility was being refinanced. If, for example, those enquiries had revealed concerns about Maddison's future capacity to service the loan or a breach of the loan covenants, such evidence would have alerted the auditor to heightened risk regarding the continued viability of the project and consequently, the potential recoverability of the Maddison Loan. We refer to our comments in Sub-Allegations 6(d) and 6(f) that are also relevant to this Sub-Allegation.
378. There was no audit evidence on the Audit Engagement File that these matters had been properly investigated and evaluated.
379. In our view, having regard to the Relevant Benchmark,⁸⁴ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed audit procedures to obtain sufficient and appropriate audit evidence with respect to these matters in order to demonstrate that there was appropriate consideration given to assessing the recoverability of the Maddison Loan receivable and to LM's assessment of impairment of the Maddison Loan (having regard to the requirements of AASB 139).
380. We find that Maddison Loan Sub-Allegation 6(j) has been established.

Sub-Allegation 6(k)

Why the Suncorp facility refinancing was not completed at 7 December 2012 despite correspondence with a number of other lenders, including FWS, Carlton and Ashe Morgan Intuitive Capital.

⁸⁴ See above n 56.

381. Mr Williams relied on his previous responses.
382. We refer to and repeat our comments with respect to Sub-Allegation 6(d).
383. There was no audit evidence on the Audit Engagement File that these matters had been properly investigated and evaluated.
384. In our view, having regard to the Relevant Benchmark,⁸⁵ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed audit procedures to obtain sufficient and appropriate audit evidence with respect to these matters in order to demonstrate that there was appropriate consideration given to assessing the recoverability of the Maddison Loan receivable and to LM's assessment of impairment of the Maddison Loan (having regard to the requirements of AASB 139).
385. We find that Maddison Loan Sub-Allegation 6(k) has been established

Sub-Allegation 6(l)

Whether the assumptions regarding the increase in estimated sales referred to in the Maddison Feasibility were unreasonable.

386. We refer to and repeat our comments and finding with respect to the Second Maddison Loan Allegation in paragraphs 286–295.
387. There was no audit evidence on the Audit Engagement File that this matter was investigated with LM management or properly evaluated.
388. In our view, having regard to the Relevant Benchmark,⁸⁶ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed audit procedures to obtain sufficient and appropriate audit evidence about the reasonableness of the assumptions regarding the increase in estimated sales referred to in the Maddison Feasibility. This matter was relevant to evaluating the financial viability of the project and therefore the recoverability of the Maddison Loan and/or whether the loan value had been appropriately accounted for in the 2012 LM Financial Statements in accordance with AASB 139.
389. We find that Maddison Loan Sub-Allegation 6(l) has been established.

Sub-Allegation 6(m)

Whether project development timelines had been met, whether future timelines were achievable, potential impact of delays on the total costs of the Maddison Estate project and/or result on the loan balance and impairment.

390. Mr Williams' Response referred to further work performed that was recorded within the Forensic File although we were not referred to any specific documents, but note the Swanborough Report.
391. We refer to and repeat our comments and conclusion with respect to the Forensic File documents.⁸⁷ Even if that documentation had been on the audit file, it would

⁸⁵ Ibid.

⁸⁶ Ibid.

⁸⁷ See above n 43.

not in our view have been sufficient audit evidence as the Forensic File records were not cross-referenced clearly and consistently to other material nor did they clearly and consistently identify the aspects of the audit they were designed to address.

392. In our view, having regard to the Relevant Benchmark⁸⁸, Mr Williams should have obtained further information about whether project development timelines had been met, whether future timelines were achievable, the potential impact of delays on the total costs of the Maddison Development as these matters were relevant important feed-ins to the identification of the potential risks to recoverability of the Maddison Loan at 30 June 2012 and/or whether the loan value had been appropriately accounted for in the 2012 LM Financial Statements in accordance with AASB 139.
393. There was no audit evidence on the Audit Engagement File that these matters had been sufficiently or properly investigated with LMIM management or properly addressed by the audit procedures performed in the 2012 LM Audit.
394. In our view, having regard to the Relevant Benchmark,⁸⁹ a reasonably competent auditor in the circumstances of the 2012 LM Audit, would have performed audit procedures to obtain sufficient and appropriate audit evidence about whether project development timelines had been met, whether future timelines were achievable and the potential impact of delays on the total costs of the Maddison Development project as these matters were relevant important feed-ins to the identification of the potential risks to recoverability of the Maddison Loan at 30 June 2012 and/or whether the loan value had been appropriately accounted for in the 2012 LM Financial Statements in accordance with AASB 139.
395. We find that Maddison Loan Sub-Allegation 6(m) has been established.

Sub-Allegation 6(n)

Whether the information contained in the goldcoast.com.au article dated 5 August 2012 impacted Mr Williams assessment of the projected results of the project and if the estimated feasibility was accurate.

396. Mr Williams' response was that 'no reliance was placed upon the article but rather the work performed in relation to any impairment to the loan did not identify any objective evidence of the need for any impairment.'
397. We refer to and repeat our comments with respect to Maddison Loan Sub-Allegation 6(g).
398. There was no audit evidence that this article was considered in the 2012 LM Audit.
399. In our view, having regard to the Relevant Benchmark,⁹⁰ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed audit procedures to obtain sufficient and appropriate audit evidence with respect to

⁸⁸ See above n 56.

⁸⁹ Ibid.

⁹⁰ Ibid.

these matters in order to demonstrate that there was appropriate consideration given to assessing the recoverability of the Maddison Loan receivable and to LM's assessment of impairment of the Maddison Loan (having regard to the requirements of AASB 139).

400. We find Maddison Loan Sub-Allegation 6(n) has been established.

Sub-Allegation 6(o)

Why Maddison and CRPL, as related parties, had not been audited.

401. While audited accounts of a related party entity would have been desirable, the fact that those entities had not been audited did not mean that sufficient appropriate audit evidence in relation to the recoverability of the Maddison Loan receivable, and the accounting treatment under AASB 139 could not have been obtained via other means if the audit procedures had been designed to take account of the unaudited status of those two related entities.

402. For this reason, we do not think that the matters the subject of this Sub-Allegation were necessarily relevant to the recoverability of the Maddison Loan receivable and the accounting treatment under AASB 139, the more pertinent question being what audit planning and procedures were necessary to provide sufficient and appropriate audit evidence in order to have satisfied ASA 200.17 and ASA 500.6 in circumstances where there were related entity accounts that were unaudited.

403. We are not satisfied that this Sub-Allegation has been established.

Sub-Allegation 6(p)

Why the security value and outstanding loan balance amounts provided by LM to Mr Williams were exactly the same and whether the basis for determining the security value was appropriate based on the nature of and current status of the development of the land.

404. We refer to and repeat our reasons and findings with respect to the Ninth Maddison Loan Allegation at paragraphs 460–472 and also repeat and note Mr Williams' responses and our comments with respect to the that allegation.

405. In our view, having regard to the Relevant Benchmark,⁹¹ the fact that the loan balance and the security value of the property were the same was a matter that a reasonably competent auditor in the circumstances of the 2012 LM Audit, exercising appropriate professional scepticism, would have recognised may have indicated a risk of loan impairment. The fact there was no margin available should have signalled heightened risk and so investigation with respect to the status of the project and the budget projections, for example, were indicated. We refer to and repeat our comments on the importance of applying appropriate professional scepticism in an audit.⁹²

406. We find Maddison Loan Sub-Allegation 6(p) has been established.

⁹¹ Ibid.

⁹² See above n 58.

Sub-Allegation 6(q)

Why the request to audit Maddison Estate was not granted and why an independent external valuation of the project was not undertaken for the period ended 30 June 2012.

407. Mr Williams relied on his previous responses with respect to this Sub-Allegation.
408. We refer to and repeat our comments and Finding on the Subsequent Maddison Audit Response.⁹³ We also refer to our discussion in Sub-Allegation 6(o) above.
409. There was evidence of requests from WPIAS to LMIM management to audit Maddison in 2011 and 2012 that were apparently declined.
410. The Subsequent Maddison Audit response was not an appropriate solution to dealing with the unaudited status of Maddison in the context of the 2012 LM Audit.
411. However, as we have noted in Sub-Allegation (o), the fact that those entities had not been audited did not mean it was not possible to obtain sufficient appropriate audit evidence if appropriate audit procedures were designed and planned.
412. An independent external valuation of the project for the period ended 30 June 2012 would have been an important aspect of those alternative procedures.
413. The audit evidence on the Audit Engagement File about why the requests to conduct an audit of Maddison were declined was related to the Limited Purpose/Limited User response and we refer to and repeat our comments and findings with respect to that response.⁹⁴
414. There was no evidence that other audit procedures were considered to obtain reasonable assurance about those matters that would have been addressed by the Subsequent Maddison Audit.
415. In our view, having regard to the Relevant Benchmark,⁹⁵ a reasonably competent auditor in the circumstances of the 2012 LM Audit, would have recognised that the Subsequent Maddison Audit response was not a proper means of addressing the unaudited status of Maddison in the terms of appropriately addressing the Maddison Loan receivable in the 2012 LM Audit and would have considered what audit procedures were necessary in order to seek to obtain reasonable assurance about those matters that could also have been addressed by an audit of Maddison.
416. We find that Maddison Loan Sub-Allegation 6(q) has been established.

Sub-Allegation 6(r)

Whether pre-sales targets for the Maddison Development had been met.

⁹³ See above n 53.

⁹⁴ See above n 47.

⁹⁵ See above n 56.

417. Mr Williams Response was that such matters were considered, and sufficient audit evidence was obtained.

418. We refer to and repeat our comments with respect to Sub-Allegation 6(l).

419. We find that Maddison Loan Sub-Allegation 6(r) has been established.

Sub-Allegation 6(s)

Whether senior debt refinancing had been obtained.

420. Mr Williams Response was that such matters were considered and sufficient audit evidence was obtained.

421. We refer to and repeat our comments with respect to Sub-Allegation 6(k).

422. We find that Sub-Allegation 6(s) has been established.

Sub-Allegation 6(t)

Whether construction contracts had been entered into.

423. Mr Williams Response was that such matters were considered, and sufficient audit evidence was obtained.

424. In our view, having regard to the Relevant Benchmark,⁹⁶ a reasonably competent auditor in the circumstances of the 2012 LM Audit, would have performed audit procedures to obtain sufficient and appropriate audit evidence that included evidence of consideration of whether any construction had commenced or contracted to commence during the year and subsequent to year end up to the date of signing the 2012 LM Audit Opinion. These matters were relevant because of their potential to impact cost projections and in order to consider and obtain appropriate assurance about current cost and profit projections and the rate at which the development was progressing. These were matters relevant to the assessment of whether the loan was appropriately accounted for in accordance with AASB 139, and evaluating the recoverability of the Maddison Loan receivable and LM's assessment of impairment of the Maddison Loan receivable.

425. There was no audit evidence of this matter having been considered in the 2012 LM Audit.

426. We find that Maddison Loan Sub-Allegation 6(t) has been established.

Sub-Allegation 6(u)

Whether the timelines of the project from inception were achievable.

427. Mr Williams' Response was that such matters were considered and sufficient audit evidence obtained.

428. We refer to and repeat our comments with respect to Sub-Allegation 6(m).

429. We find that Sub-Allegation 6(u) has been established.

⁹⁶ Ibid.

Sub-Allegation 6(v)

Whether the developer had a successful track record in relation to any previous developments

430. Mr Williams' Response was that such matters were considered and sufficient audit evidence obtained.
431. AWPIB13F noted: 'The LM Group has a long track record of profitability with a sound business model, backed by a guarantor with a strong net asset position and net income position'. However, this memo contained a handwritten notation at the top 'subsequently received in Feb 13' and could not therefore have been audit evidence that Mr Williams had taken into account when forming his audit opinion with respect to the 2012 LM Financial Statements.
432. In our view, having regard to the Relevant Benchmark,⁹⁷ a reasonably competent auditor in the circumstances of the 2012 LM Audit, would have obtained, prior to finalising the 2012 LM Audit and expressing the 2012 LM Audit Opinion, further information about this matter because evidence of whether the LM group had a track record of successful property developments could have provided assurance about the developer's capacity and experience which was relevant to the audit risk assessment of the likelihood of completion of the Maddison Development and the ultimate recoverability of the loan and so was a matter relevant to consider in the audit evaluation of the Maddison Loan receivable and whether it had been appropriately accounted for in accordance with AASB 139.
433. We find that Maddison Loan Sub-Allegation 6(v) has been established.

Finding on Sixth Maddison Loan Allegation

434. Based on our findings above, that, with the exception of Maddison Loan Sub-Allegations 6(o) and 6(i) the Sub-Allegations the subject of the Sixth Maddison Loan Allegation have been established, we are satisfied to the extent of our findings with respect to Sub-Allegations (a)–(v), that a reasonably competent auditor in the circumstances of the 2012 LM Audit would have attended to and retained sufficient appropriate audit evidence with respect to the matters the subject of these Sub-Allegations in order to address the recoverability of the Maddison Loan or whether the loan value had been appropriately accounted for in the 2012 LM Financial Statements in accordance with AASB 139.

Seventh Maddison Loan Allegation

435. The Seventh Maddison Loan Allegation referred to the notation in the Maddison Loan summary, AWPIB1/3 (described in paragraph 199) that noted the WPIAS request to complete an audit of Maddison by 31 March 2013. It was alleged that a reasonably competent auditor, rather than reserving the right to amend the 2012 LM Audit Opinion, would have withdrawn from the audit or disclaimed the opinion in accordance with ASA 705.13(b) and ASA 705.9.

⁹⁷ Ibid.

436. ASA 705 sets out the framework for identifying when to withdraw from, qualify or disclaim an audit opinion. ASA 705 relevantly provides:

705.7 The auditor shall express a qualified opinion when:

- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial report; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial report of undetected misstatements, if any, could be material but not pervasive.

705.09 The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial report of undetected misstatements, if any, could be both material and pervasive.

705.13 If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (a) If the auditor concludes that the possible effects on the financial report of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (b) If the auditor concludes that the possible effects on the financial report of undetected misstatements, if any, could be both material and pervasive, so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
 - (i) withdraw from the audit where practicable and possible under the applicable law or regulation; or
 - (ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial report.

437. We have considered Mr Williams' specific responses to the seventh Maddison Loan allegation in the context of our consideration of the Subsequent Maddison Audit response.⁹⁸

438. Mr Williams also referred to AWPBC1 in direct response to this allegation [which was repeated as Sub-Contention 1(m)]. AWPBC1 is a template produced by the Firm's auditing program software entitled *Forming an Opinion on the Financial Report* and lists various requirements from the auditing standards in relation to drawing final conclusions based on the audit work performed, including consideration of the form of audit opinion to be issued. We refer to and repeat our general view on the relevance of AWPBC1 set out in paragraph 203.

439. The first page of AWPBC1 section 1 sets out 11 questions relating to audit file completion and accounting preparation. For example, whether sufficient appropriate audit evidence has been obtained and whether information presented in the financial report is relevant, reliable, comparable and understandable.

⁹⁸ See above n 53.

These questions provide for marking a Yes/No option. In addition, there is an empty box next to each option. Each question was marked as a 'Yes' response and each box had been ticked.

Section 2 of the AWP commences:

2. Conclude based on the responses to section 1 above whether the financial report has been prepared, in all material respects, in accordance with the applicable financial reporting frameworks.

And follows with: 'If conclusion is yes then express an unmodified opinion'. Next to this line a box had been ticked and there was a handwritten notation 'Yes – unmodified'. The remainder of this work paper (two and a half pages) template refers to a series of considerations, consistent with the relevant auditing standards, including audit completion, modified opinions and going concern. There is a handwritten 'N/A' next to each step listed.

440. The answers recorded in AWPBC1 were not consistent with the audit evidence, as they did not reflect the significant matters of uncertainty identified and noted, including those matters the subject of the Subsequent Maddison Audit response.⁹⁹ Had this template been completed having appropriate regard to those matters of uncertainty it would not have led to the conclusion that an unmodified audit opinion was appropriate.
441. Although AWPBC1 appears to appropriately reflect ASA 705, it has not been completed in a manner that appropriately reflects either the scope or content of the relevant audit evidence.
442. We also refer to and repeat our comments with respect to the template generated documents that were used by WPIAS in the 2012 LM Audit¹⁰⁰ and we refer to and repeat our comments and finding with respect to the Subsequent Maddison Audit response.¹⁰¹
443. The auditor's duty to properly carry out the requirements in the auditing standards to identify and act on facts or circumstances that may require withdrawing from, disclaiming or qualifying an audit opinion is one of utmost significance that relies on the appropriate exercise of professional judgement by the auditor recognising the public trust and confidence that resides in the office. It is a judgement that requires consideration of a range of factors including:
- (a) A proper appraisal of the relevance, significance, sufficiency and appropriateness of the audit evidence obtained having regard to the requirements and obligations prescribed in the auditing standards and (where relevant) the accounting standards. This must include consideration of whether the audit procedures initially planned and scoped continue to be sufficient to meet those objectives throughout the audit and in circumstances where information emerges that was either not anticipated or which indicates the need for additional audit procedures, the auditor

⁹⁹ Ibid.

¹⁰⁰ See above n 41.

¹⁰¹ See above n 53.

must be satisfied that such matters have been identified and appropriately responded to before the audit evidence would be sufficient to properly inform his audit conclusion.

(b) What the auditing standards required of the auditor in terms of his audit conclusion having regard to the matters in (a).

444. Based on our comments above and our finding on the Subsequent Maddison Audit response¹⁰² and having regard to the Relevant Benchmark,¹⁰³ we are satisfied that a reasonably competent auditor, in the circumstances of the 2012 LM Audit would have withdrawn from the audit or disclaimed the opinion in accordance with ASA 705.13(b) and 705.9.

445. We are satisfied that the seventh Maddison Loan allegation has been established.

Eighth Maddison Loan Allegation

446. The Eighth Maddison Loan Allegation with respect to the Maddison Loan concerned the *what if* scenarios recorded in AWPIB1/3 (paragraph 199).

447. These were recorded in that AWP as follows:

(a) *Option 1: Sales escalation rate capped at 5%*

(a) *Sales income = \$551m*

(b) *Costs to complete (current estimated cost) = \$352m*

(c) *Recoverable balance = \$199m (current loan value of \$201m)*

(b) *Option 2: Sales escalation rate capped at 7.5% per year*

(a) *Sales income = \$590m*

(b) *Costs to complete (current estimated cost) = \$352m*

Recoverable balance = \$238m (current loan value of \$201m) balance available for additional cost increases if necessary

(c) *Option 3: Land & apartment values capped at \$500k*

Sales income = \$675m

Costs to complete (current estimated cost) = \$352m

Recoverable balance = \$323m (current loan value of \$201m) balance available for additional cost increases if necessary

(d) *Option 4: Base sub-division*

¹⁰² Ibid.

¹⁰³ See above n 56.

Land purchased = 1,055,617

Assume 50% of land developed = 527,808 square metres

Sales income = \$230m

Current loan balance = \$201m

Balance available of \$30m for additional costs to complete sub-division

448. The scenarios changed one different assumption in each scenario. In option 1, the result was slightly below the loan balance and options 2 and 4 were only between \$30m and \$38m above the loan balance. Therefore in one of the scenarios the loan was impaired and in two other scenarios there was a relatively small buffer between the current loan amount and the projected balance available from which the loan could be repaid.

Details of the Eighth Maddison Loan Allegation

449. ASIC alleged that Mr Williams did not display an appropriate level of professional scepticism when performing the *what-if* scenarios because the various assumptions that could impact the outcomes of a feasibility study were not taken into account by changing just one assumption at a time to show a possible outcome. This was particularly so against a backdrop of the Maddison Loan accruing interest at 25%, the fact no construction work had commenced and no lots had been sold. The various assumptions that could impact outcomes included the projections used for sales, sales escalation rates, costs and returns as well as the cost base, the number of lots approved in comparison to the number of lots proposed, development progress against forecast timeline and the Internal Rate of Return applied.
450. ASIC alleged that a reasonably competent auditor would perform sensitivities that changed more than one assumption at a time to show a possible outcome and that if Mr Williams had adjusted more than one assumption in the *what if* scenarios in AWPIB1/3 there may have been an impairment.

Mr Williams Response and Panel comments

451. Mr Williams First Response was that Mrs Blank performed the *what-if* scenarios and sensitivities and he repeated and relied on the Engagement Partner Response.
452. The Engagement Partner Response was not pressed. We refer to our comments with respect to Mr Williams' responsibility as the Engagement Partner.¹⁰⁴
453. Mr Williams' second response was that the sensitivities were but one element of the assessment of impairment of that loan that was undertaken and that additional work was performed in reviewing the recoverability of the Maddison Loan being the WPIAS Forensic Work, which work was reviewed and utilised in the audit.

¹⁰⁴ See above n 28.

454. We refer to and repeat our comments and finding with respect to the Forensic File documents¹⁰⁵ and note these documents were not part of the audit evidence.
455. Even had the additional work to which Mr Williams referred us been part of the audit evidence on recoverability of the Maddison Loan receivable, there remained those matters relevant to an assessment of its recoverability that Mr Williams intended to investigate as part of the Subsequent Maddison Audit and we refer to and repeat our comments and finding on the Subsequent Maddison Audit response¹⁰⁶ that would lead us nevertheless to conclude that the audit evidence is not sufficient and appropriate.
456. During cross-examination, Mr Williams agreed that it would have been prudent to change more than one variable in each scenario when doing the analysis recorded in AWPIB1/3.

Panel Findings on the Eighth Maddison Loan Allegation

457. In our view, based on our comments above and having regard to the Relevant Benchmark,¹⁰⁷ we are satisfied that a reasonably competent auditor, in the circumstances of the 2012 LM Audit would have performed sensitivities that changed more than one assumption at a time to show a possible outcome.
458. Based on our comments above we are also satisfied that the evidence of the analysis performed does not demonstrate that Mr Williams applied appropriate professional scepticism when performing the *what-if* scenarios. We refer to and repeat our comments on the importance of applying appropriate professional scepticism in an audit.¹⁰⁸
459. We are satisfied that the Eighth Maddison Loan Allegation has been established.

Ninth Maddison Loan Allegation

460. The Ninth Maddison Loan Allegation referred to the LM *Loan Balance Report with Security Values Impairment* dated 30 June 2012 that recorded both the Maddison Loan balance and security value ascribed to it as \$201,187,253.81, which resulted in a nil impairment.
461. It was alleged that, when auditing the impairment of loans, a reasonably competent auditor in Mr Williams' position would have applied a level of professional scepticism to those amounts being shown as equal, but there was nothing to show that Mr Williams had done so.

Mr Williams' Response and Panel's comments and findings

462. Mr Williams' Response denied there was a failure to apply appropriate professional scepticism on four bases.

¹⁰⁵ See above n43.

¹⁰⁶ See above n53.

¹⁰⁷ See above n56.

¹⁰⁸ See above n58.

463. The first was the Engagement Partner Response. This response was not pressed. We refer to and repeat our comments with respect to Mr Williams' responsibility as the Engagement Partner.¹⁰⁹
464. The second was that the security value used by the Manager was a minimum value. There is no audit evidence that supports this assertion.
465. Mr Williams' third response was that the Manager determined whether the loans were impaired on an ongoing basis and this required an estimation of the value of future cash flows through an *on-completion* valuation. The loan balance as at 30 June 2012 compared to the estimation of the value of future cash flows noted a buffer (refer AWP 1B 10A/4).
466. We have described AWPIB10A/4 in paragraphs 193 and 194. While AWPIB10A/4 appears to evidence consideration of cashflow projections post 30 June 2012 and whether they would be sufficient to service the loan and a forecast of future additional drawdowns, there is no information included in the record that addresses the reasonableness of the basis of the projections and forecast of drawdowns and in our view no record of that type of evidence to support the content of AWPIB10A/4 is consistent with insufficient appropriate professional scepticism having been applied to the analysis having regard to our comments on applying appropriate professional scepticism in an audit.¹¹⁰
467. In any event, AWPIB10A/4 does not refer to or cross reference the *LM Loan Balance Report with Security Values Impairment* dated 30 June 2012 that recorded both the Maddison Loan balance and security value ascribed to it as \$201,187,253.81 that resulted in a nil impairment, which is the document the subject of this allegation.
468. Mr Williams' final response was that in any event, additional work was performed in assessing impairment being the work recorded on the Forensic File. We refer to and repeat our comments and with respect to the Forensic File documents¹¹¹ on which our view that they were not audit evidence is based.

Panel Finding on the Ninth Maddison Loan Allegation

469. There was no audit evidence of investigation or testing of the information in the *LM MPF Loan Balance Report with Security Values Impairment* dated 30 June 2012 that recorded both the Maddison Loan balance and security value ascribed to it as \$201,187,253.81, and that resulted in a nil impairment.
470. If there was audit work performed with respect to this document, it should have been cross-referenced and recorded on the Audit Engagement File.
471. In our view, having regard to the Relevant Benchmark,¹¹² the fact that the loan balance and the security value of the property were the same was a matter that a reasonably competent auditor in the circumstances of the 2012 LM Audit,

¹⁰⁹ See above n28.

¹¹⁰ See above n58.

¹¹¹ See above n43.

¹¹² See above n 56.

exercising appropriate professional scepticism, would have recognised may have indicated a risk of loan impairment. The fact there was no margin available should have signalled heightened risk and so investigation with respect to the status of the project and the budget projections, for example, were indicated. We refer to and repeat our comments on the importance of applying appropriate professional scepticism in an audit.¹¹³

472. For these reasons we have formed the view that the Ninth Maddison Loan Allegation has been established.

Aalto/AIIS Loan

Background facts

473. AIIS Ltd (“AIIS”) owned land in Phillip, ACT (the “Property”). AIIS purchased the Property in January 2005 for \$2,900,000. On 19 January 2005, LMIM loaned AIIS \$1,140,000 to fund the purchase and development of the Property. This was a second ranking loan facility.
474. Aalto Apartments Pty Ltd (“Aalto”) was the developer of the Property. The proposed development comprised 278 apartments. Development approval had been obtained and construction was due to commence in 2013. There had been pre-sales amounting to approximately \$17 million by 30 June 2012.
475. Aalto was also a related party of LMIM because Mr Drake was a director and shareholder of both LMIM and Aalto.
476. The Aalto/AIIS loan balance shown in the 2012 LM Financial Statements was \$24,608,244 (Note 12 (page 23)).
477. The 2012 LM Financial Statements included the following related party disclosures regarding Aalto/AIIS:
- (a) Aggregate amount receivable from related party Aalto \$24,608,244; and
 - (b) Aalto:
 - this entity represents a financial asset to the scheme based on the contractual right to receive cash. This receivable is contingent on certain events and the entity is a related party. AIIS Pty Ltd will be the actual recipient of the cash proceeds, which is a wholly owned entity of the scheme. The scheme also holds a second mortgage security over the real property assets of AIIS Pty Ltd. The Manager is currently in due diligence discussions and has received a conditional letter of interest from an offshore financier overall including the assessment of payout of the facility with the first income mortgage fund and financing the full construction of the project to completion.
478. The difference of approximately \$8,000,000 between the related party loan disclosure of \$24,608,244 and the total of the Aalto and AIIS loans of \$16,436,903 was a loan to Aalto by LM First Mortgage Income Fund (“LMFIF”).

¹¹³ See above n 56.

479. AWPIB2 noted that the principal balance of loans from LM to Aalto was \$16,436,903 (comprising AIIS \$15,249,821 and Aalto \$1,187,082).

Aalto/AIIS Relevant Audit Working Papers

AWPIB4 Lead Audit Work Paper

480. The lead AWP for the AIIS/Aalto loan was AWPIB4. It set out the audit procedures selected to address the risk of this loan and was the same template document as the lead AWP for the Maddison Loan. AWPIB4 noted the conclusion that sufficient appropriate audit evidence had been obtained to materially meet the stated audit objective.

481. AWPIB4 was noted as prepared by AB on 10 October 2012 and reviewed by RW on 13 November 2012. It further recorded the following:

- (a) Assessed risk by assertion was recorded as follows: ‘Existence and occurrence (EO) low; completeness(C) low; Valuation and Measurement’. We note that this was the same for all of the loans the subject of Contention One.
- (b) ‘Documents received and reviewed IB4A Feasibility; IB4A.1 Input data for feasibility; IB4B Valuation 12 April 2012; IB4C PKF advise [sic] of Accounting for Land Availability Agreement; IB4E1 Company search Aalto Apartments; IB4E.2 Company search AIIS; IB4F loan agreements and variations; IB4G Loan snapshot; IB4H Project overview, landscape designs etc.; IB4I Transaction Report (0/07/11-30/06/2012); IB4J title search.’
- (c) On the second page there were two headings *Summary from feasibility* and *Gross Profit Review IB10A.1*. The *Summary from feasibility* referred to the ‘LM MIF loan’ of \$8,209,841 and noted ‘buffer’ \$3,278,781 ‘ok’.
- (d) The gross profit review set out various costs and revenues, noting they agreed to costs estimates and/or appeared reasonable and that the gross sales revenue of \$144,005,810 had been *reviewed against valuation*. There were a number of items such as land holding costs and miscellaneous that had *imm* noted next to them that we assume were items judged by the auditor to be immaterial.

Further Relevant Audit Work Papers

482. AWPIB2 that noted that the principal balance of loans from LM to Aalto as at 30 June 2012 was \$16,436,903 (comprising AIIS \$15,249,821 and Aalto \$1,187,082) and that the testing completed was *Carrying value, Recoverability and Impairment*.

483. AWPIB4G1B9 (prepared by LMIM) entitled “*Loan Snapshot*” dated 21 November 2011 re:AIIS that recorded the following information:

- (a) An interest rate of 12%, with handwritten notations ‘10%-12%’ (indistinct ‘23/8/2010’)

- (b) sector classification of the loan as *Pre-development Land* with handwritten notations ‘Purchase and development land described Block 1, Section 22, District/Division of Phillip, Volume 1541, Folio 73 ACT’; and
 - (c) the lender’s priority is second mortgage with the handwritten notation ‘1B4G/26’.
484. AWPIB3/6 entitled LM MPF Loan Balance Report as at 30 June 2012 with security values impairment (*Aalto loan balance report*) that recorded a total debt with respect to Aalto and AAIS of \$16,436,902.97 and the security value assigned to the debt as \$19,833,306 (indicating no impairment).
485. AWPIB4A headed *AIIS Discounted Cash Flow* (“AIIS Discounted Cash Flow”) which recorded a net cash flow of \$19,833,306 and receivable asset of the same amount (the security value used and referred to in IB3/6). IB4A is discussed further below in the context of the First Aalto/AIIS Loan Allegation.
486. A valuation prepared by Jones Lang LaSalle (“JLL”) on behalf of LMIM dated 12 April 2012 (IB4B). It was stated to be a valuation report for the Manager re Aalto, Block 1 Section 22, Division of Phillip (“The JLL Valuation”). The JLL Valuation noted the following information (including but not limited to):
- (a) The valuation assessment was on a Current Market Value – *as is* basis. *Market Value* was defined as:

The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.
 - (b) The proprietor of the land was AAIS.
 - (c) ‘With regard to benchmarking the property against a profit and risk it would be expected to be in a range between 20-25% given the size, nature and term of the development.’
 - (d) Estimated net development profit was \$22,868,136.
 - (e) The “*As Is – DA Approved*” *Current Market Land Value* was \$8,500,000.
 - (f) The “*As if Complete*” *Gross Realisations Value (GST inc)* of \$141,615,800.
487. AWPIB4H entitled *Aalto Feasibility Summary for Carlton Group* (“Carlton Feasibility”) was undated and prepared by LMIM for the purpose of external funding. The Carlton Feasibility was a feasibility summary with respect to the Aalto development. It was based on full repayment of loan principal and interest by August 2015. It estimated gross net realisations from the development of \$126.095 million and, after costs, the sum of \$10.683 million as the repayment sum to LM as second mortgagee. Based on the Carlton Feasibility, the refinancing by an organisation by the name of the Carlton Group, had it proceeded, indicated a potential shortfall of approximately \$14 million to LM

based on the loan balance of \$24,608,244 that was disclosed in the 2012 LM Financial Statements.

488. LMIM document entitled Loan Statement dated 20 July 2012 that included the handwritten notation ‘As part of the restructure of AIIS at 30/6/11 (refer Land Availability Agreement), no interest applies to the AIIS loan. IB43/11’.
489. AWPIB41.8 Document entitled *Development Feasibility Model, Aalto Apartments Estate Master Licensed to:LM Investment Management Ltd* dated 29 November 2011 for time span July 11–May 15 that showed a net development profit of \$26,495,774. (“Aalto Development Feasibility”).
490. AWPIB4H.2 *Macro Development Programme* re: AIIS (“Macro Development Programme”) dated 29 July 2011, noted the following tasks:
 - (a) *Construction contract* start date of 3 August 2012 and finish date of 27 September 2012;
 - (b) *A construction start date* of 1 January 2013 and a finish date of 30 December 2014;
 - (c) *Pre-sales (65% of total sales)* start date of 30 September 2011 and finish date of 27 September 2012; and
 - (d) *Senior debt financing* start date of 3 September 2012 and finish date of 28 December 2012.

Aalto/AIIS Loan Allegations/Specific Responses/Findings

491. There were three allegations made with respect to the Aalto/AIIS loan allegation.

First Aalto/AIIS Loan Allegation

492. It was alleged that with respect to the Macro Development Programme (AWPIB4H2), the Audit Engagement File did not evidence any enquiry or supporting evidence demonstrating that Mr Williams had applied appropriate professional scepticism to evaluating the project’s progress against the milestones recorded in July 2011 to determine whether progress was on track.
493. Mr Williams’ Response was that AWP 1B4H2 and AWP 1B 4H1/68 were AWPs carried forward from the 2011 files and AWP 1B4A AIIS Discounted Cash Flow (paragraph 485) had the updated time frame and said that in these circumstances a sufficient degree of professional scepticism was demonstrated and there was no requirement to make the enquiries alleged in respect of previous time frames as they were updated in the updated feasibility (“AIIS Discounted Cash Flow”).

Panel finding on First Aalto/AIIS Loan Allegation

494. The AIIS Discounted Cash Flow (AWPIB4A) was cross-referenced in the lead audit workpaper (AWPIB4) against the audit procedures ‘Determine the recoverability of the loans receivable’ and ‘Obtain an understanding of the nature

and extent of related party transactions. Evaluate the business rationale of significant related party transactions, vouching to supporting documentation' and described in AWPIB4 as 'Feasibility'. There is no other information as to what the AIIS Discounted Cash Flow was used for and no conclusion or comment recorded on it, nor is it clear who authored the document.

495. AIIS Discounted Cash Flow records outflows and inflows expected to occur over the life of the Aalto property development. It states that it has been agreed to the JLL Valuation. While it is clear the JLL Valuation and the AIIS Discounted Cash Flow refer to the same development, the values used in those documents are not the same.
496. The period covered by AIIS Discounted Cash Flow is from July 2012 to May 2015 – presumably on the basis that it was expected that all apartments would be sold by May 2015. There is a handwritten note stating that the loan repayment of \$12,975,874 is 'expected April 2015 (at end of project)' that corresponds with the period covered by the cashflow. There is a further handwritten note stating that 'additional external funding required from May 2013'. This point is then further referenced to Maddison Loan documents which deal with potential further financing that was being sought.
497. While the AIIS Discounted Cash Flow does incorporate an updated timeframe, it is not audit evidence that the timelines and projections for the previous year that were used in IB4H2 had been evaluated against the updated information.
498. That evaluation was one that in our view would have been relevant to a consideration of possible impairment of the Aalto/AIIS loan because delay to the project of any nature, impacting as it would on the timing of future cashflow generation and completion of the project was potentially significant to the risk profile of recoverability of the loan, particularly given the loan was a second ranking exposure.
499. In our view, evidence of some comparison between the projections from the previous year and the updated projections used in the AIIS Discounted Cash Flow (that were presumably based on information provided by LMIM) would have demonstrated professional scepticism recognising that circumstances may have existed that caused the financial report to be materially misstated, in accordance with ASA 200.15.
500. There was no audit evidence that with respect to the Macro Development Programme (AWPIB4H2), there had been any enquiries in the audit directed to evaluating the project's progress against the milestones recorded in the previous year to determine whether progress was on track.
501. We refer to and repeat our comments with respect to the importance of applying professional scepticism appropriately in an audit¹¹⁴ and we are satisfied that the absence of audit evidence outlined is consistent with insufficient professional scepticism having been applied to the actual progress that had taken place since the forecasts in AWPIB4H2.

¹¹⁴ See above n 58.

502. We are satisfied that the First Aalto/AIIS Loan allegation has been established.

Second Aalto/AIIS Loan Allegation

503. The Second Aalto/AIIS Loan Allegation comprised five Sub-Allegations that the Audit Engagement file did not contain sufficient appropriate audit evidence.

Sub-Allegation 2(a)

Supporting the value of sales in the Carlton Feasibility.

504. Mr Williams Responses were that this matter was not brought to his attention by Ms Blank and he relied upon the Engagement Partner Response and the Carlton Feasibility was not used in the assessment of the impairment of the loan.

505. Mr Williams' first response was not pressed and we refer to and repeat our comments on the responsibilities of the Engagement partner.¹¹⁵ It follows from our conclusions that Mr Williams' responsibility for the proper conduct of the audit meant that he was responsible to ensure that his process of supervision of the audit team would not result in relevant matters being overlooked by him or not otherwise dealt with properly in the context of the audit.

506. Mr Williams' second response does not answer this allegation as it does not address its factual basis, which was whether there was sufficient appropriate audit evidence supporting the value of the sales figures used in the Carlton Feasibility. There was no evidence that supported Mr Williams' assertion that the Carlton Feasibility was not used in the assessment of the impairment of the loan. The Carlton Feasibility (AWPIB4H) was noted in the lead AWPIB4, as having been received and reviewed. In our view it is reasonable to expect that a notation such as the one in the lead AWP that the Carlton Feasibility had been received and reviewed would mean that the document had been read and to the extent that it highlighted anomolous or inconsistent information, that further investigation had been undertaken to clarify the information and appropriate audit evidence retained.

507. The gross sales revenue used in the Carlton Feasibility was \$144.005 million. This figure was noted as 'agreed to the valuation' in IB4A. The reference to valuation in IB4A noted IB4B, the JLL Valuation. It recorded an '*As if Complete* Gross Realisations Value (GST inc)' of \$141,615,800. This sum corresponded to the 'Total Sales Revenue' figure in the document entitled 'Summary of Project Returns' which was annexed to the JLL Valuation. The Summary of Project Returns included the identification 'Estate Master Development Feasibility' and at the bottom right corner there was the file notation 'File EM_Aalto Apartments - April 2011.emdf Date of Report 27/04/2012 10.50am.' recorded. The Summary of Project Returns appeared to be an updated version of IB41.9 and a document prepared by and provided by LMIM to JLL.

508. The audit documentation referred to in the sub-paragraph does not demonstrate that the WPIAS audit programme had tested, investigated further or properly reviewed the documents supporting the value of the sales figures in the Carlton Feasibility. Indeed, the JLL Valuation was \$2,389,200 less than the figure used

¹¹⁵ See above n 58.

in the Carlton Feasibility. Further, it is evident from the cross referencing that the *As if Complete* valuation in the JLL Valuation that the sales figure in the Carlton Feasibility was checked against, was based on a figure that had been provided to JLL by LMIM.

Panel finding on Sub-Allegation 2(a) of Second Aalto/AIIS Loan Allegation

509. The Carlton Feasibility and the JLL Valuation contained inconsistent information that was also unclear.
510. For the above reasons, we are satisfied that there was no audit evidence that supported the value of sales used in the Carlton Feasibility.
511. We are satisfied that Sub-Allegation 2(a) has been established.

Sub-Allegation 2(b)

Evaluating the competence and capabilities of JLL and evaluating the appropriateness of the work performed by JLL as audit evidence.

512. Mr Williams Response was that the Manager determined whether loans were impaired on an ongoing basis, which required an estimation of the valuation of future cash flows through an “on completion” valuation. The loan balance as at 30 June 2012 compared to the estimation of the value of future cash flows did not note a deficiency (refer AWPIB4 and AWPIB4A). The loan was not repayable as at 30 June 2012 and accordingly there was no deficiency as at 30 June 2012. In these circumstances, the JLL Valuation was only part of the supporting documentation provided by the Manager to WPIAS and whilst reviewed in assessing the recoverability of the loan by Mrs Blank, no direct reliance was placed on the report. Accordingly, it was not considered necessary to assess the competence and capabilities of JLL, being a well-known and reputable valuation firm.
513. To the extent Mr Williams’ Response addressed the factual issue of whether there was sufficient appropriate audit evidence evaluating the competence and capabilities of JLL, it indicated that this was not done and we have discussed further the responsibilities of this obligation at (c) of the third Aalto/AIIS allegation below.
514. There was no audit record evidencing that the appropriateness of the work performed by JLL had been evaluated, such as for example narration or notes of review of the JLL Valuation on the Audit Engagement File. The JLL Valuation was noted in the lead audit workpaper as having been received and reviewed.
515. Based on our further comments in Sub-Allegation 2(c) of the Third Aalto/AIIS Loan Allegation below, our view is that there should have been such audit evidence in order to satisfy the requirements of ASA 200.15 and 200.17 and ASA 500.7.
516. We are satisfied that Sub-Allegation 2(b) has been established.

Sub-Allegation 2(c)

Considering the impact on the recoverability of the loan amount of \$24,608,244 that was disclosed in the 2012 LM Financial Statements.

517. The relevant facts that were not disputed are as follows:

- (a) The Aalto/AIIS loan balance shown in the 2012 LM Financial Statements was \$24,608,244.
- (b) This comprised the LM loan balances of \$15,249,820.97 with respect to AIIS Ltd and \$1,187,082.97 with respect to Aalto Apartments Pty Ltd and the sum of \$8,209,841 representing a loan to AIIS from LM First Mortgage Income Fund (“LMFMIF”). As per Note 11(b) to the 2012 LM Financial Statements, the loan of \$8,209,841 from LMFFIF to AIIS (“LMFMIF Loan”) held the senior debt position to LM’s security.
- (c) The lead AWP for the AIIS/Aalto loan (IB4) referred only to the loan balances of \$15,249,820.97 and \$1,187,082.97. On the second page of that work paper under the heading *Summary from feasibility* an additional amount of \$8,209,841 described as ‘LM MIF’ loan had been noted.
- (d) Mr Williams’ evidence was that in accordance with the 2012 Financial Statements at Note 12, the loan balance in respect of Aalto amounting to \$24,608,244 consisted of the balance in AIIS of \$23,421,162 (AWPDG2) and the balance in LM Aalto Apartments of \$1,187,082 (AWPIB2). He said that the security values were referenced in AWPIB 3/6 which was the document entitled *Loan Balance Report with security values and impairment* and the impairment reflected in AWPIB2 was taken from AWPIB3/6. AWPIB 3/6 noted a loan balance of \$15,249,821 for AIIS and \$1,187,082.00 for Aalto and nil impairment.
- (e) Mr Williams’ said further that the AWPs were for LM as a standalone entity, and on that basis there was no impairment, that he had reviewed AWPIB2 and AWPIB4 both of which had been prepared by the lead partner and based on his review had concluded that there was no impairment. He said that the additional loan in the books of AIIS that increased the loan on consolidation to \$24,608,244 was not brought to his attention (although we note it had been referred to in AWPIB4 albeit in the context of the *Summary from feasibility*).
- (f) Mr Rea’s evidence acknowledged that on the basis the 2012 LM Financial Statements was a consolidated financial report there was no anomaly with respect to the amounts of the loans, but if Mr Williams’ was signing the audit on that basis, the impairment testing should have been performed on a consolidated entity basis. It was not in issue that the LMMIF Loan was eliminated on consolidation, but that the loan disclosed in the 2012 LM Financial Statements for the Aalto/AIIS development was \$24,608,244 and this was the relevant balance for the consideration of impairment, in the audit.

- (g) Mr Williams' evidence further noted that the increase in the loan was in part due to the accounting treatment resulting from the land availability agreement and to fund construction of the project and referred to AWPIB4C and DG6 carried over from the 2011 LM Audit file.
- (h) ASIC accepted that the land availability agreement had been documented on the audit file when considering this loan but said that this did not change the fact that with respect to Aalto/AIIS, AWPIB3/6 recorded a security value of \$19,833,306 against loans of \$16,436,902 when the loan value should have reflected the full security value of \$24,608,244 that was disclosed in the 2012 LM Financial Statements. On the basis of that security value, the Aalto/AIIS loan was impaired and there was insufficient appropriate audit evidence in relation to the carrying value of this loan.
518. Mr Williams' first response to Sub-Allegation 2(c) was that he relied on the security value for Aalto/AIIS loan that had been provided to WPIAS and the impairment reflected by WPIAS in AWP1B was taken from that information ("R56 Response").
519. In our view this does not answer Sub-Allegation 2(c). It is evident from Mr Williams' response that the security values that were provided by LMIM were not cross-checked in the audit with the disclosures in the 2012 LM Financial Statements.
520. Mr Williams' second response was that the audit work papers were for LM as a stand alone entity and on this basis there was no impairment.
521. In our view Mr Williams' second response also does not answer Sub-Allegation 2(c), the AWP's must support the financial statements being audited and in the 2012 LM Audit these were the consolidated balances (and we have deliberately not used the term *consolidated financial statements* as to be such they should have recorded both the parent entity balances and the consolidated balances and the 2012 LM Financial Statements recorded only the consolidated balances).
522. Further, Mr Williams' second response does not overcome the difficulty of no audit evidence of any testing or consideration of the higher consolidated Aalto/AIIS loan balance, that should have been considered. The result was that Aalto/AIIS's ability to repay the additional liability represented by the LMFMI Loan, which had priority to LM's loan balances, was not taken into account in the audit when assessing the recoverability of the loan and the availability of sufficient security.
523. Mr Williams' third response was that Mrs Blank did not bring to his attention the additional loan in the books of AIIS that would increase the loan on consolidation to \$24,608,244.00 and relied on the Engagement Partner Response.
524. The Engagement Partner Response was not pressed in the proceedings. We refer to our comments on the responsibilities of the Engagement Partner¹¹⁶ in an audit,

¹¹⁶ Ibid.

which form the basis for our view that the fact the additional loan was not brought to Mr Williams' attention does not answer the allegation.

525. It is clear from the audit evidence that the receivable amount that was considered with respect to the Aalto/AIIS loan was \$16,436,902, not the full security value of \$24,608,244 disclosed in the 2012 LM Financial Statements. As the accounts had been prepared on a consolidated basis the audit testing that was performed should have been undertaken with respect to the full security value of \$24,608,244.
526. We are satisfied that there was no audit evidence considering the impact on the recoverability of the loan amount of \$24,608,244 and that Sub-Allegation 2(c) has been established.

Sub-Allegation 2(d)

Evaluating the impact on the audit approach of the inconsistent values to support the carrying value of the loan receivable \$10.683 million in the Carlton Feasibility, \$19,833,306 in the AIIS Discounted Cash Flow and \$26,495,774 in the Aalto Development Feasibility.

527. In various respects, the documents the subject of this allegation as well as the JLL Valuation contained different and apparently inconsistent balances to which we have referred. There was no audit evidence of any comparative evaluation of any of the audit evidence relating to the current value of the property nor clarification of the relevance or linkage of any of these documents to the audit objectives and audit conclusion with respect to the Aalto/AIIS loan.
528. With respect to this allegation, Mr Williams repeated the R56 Response discussed in paragraph 518 that does not address the subject of this allegation.
529. We are satisfied that there was no audit evidence evaluating the impact of the audit approach of the inconsistent values to support the carrying value of the loan receivable as set out.
530. We are satisfied that Sub-Allegation 2(d) has been established.

Sub-Allegation 2(e)

The differences in valuation between the JLL Valuation of \$141,615,800 valuation [the Gross Sales Revenue of \$144,005,000 referred to in the Carlton Feasibility.]

531. We refer to and repeat our comments in the context of Aalto/AIIS Sub-Allegation 2(a) with respect to the Carlton Feasibility and the JLL Valuation. There was no audit evidence that indicated that the WPIAS audit programme had identified the differences between the figures, or investigated further or properly reviewed the documents supporting the values in either the Carlton Feasibility or the JLL Valuation.
532. Mr Williams' Response to this allegation was based on the Engagement Partner Response and that he could not have been expected to require more audit evidence in respect of the variance in circumstances where Mrs Blank did not bring the variance to his attention.

533. The Engagement Partner Response was not pressed in the proceedings. We refer to our comments on the responsibilities of the Engagement Partner¹¹⁷ in an audit that form the basis of our view that it was Mr Williams responsibility to identify the need for more audit evidence in respect of the variance.
534. We are satisfied there was no audit evidence that reconciled the differences in valuation between the \$141,615,800 in the JLL Valuation and the Gross Sales Revenue of \$144,005,000 referred to in the Carlton Feasibility.
535. We are satisfied that Sub-Allegation 2(e) has been established.

Third Aalto/AIIS loan allegation

Panel Finding on Third Aalto/AIIS Loan Allegation

536. The Third Aalto/AIIS Loan Allegation advanced ten matters it was alleged a reasonably competent auditor, in the circumstances of the 2012 LM Audit, would have identified and/or addressed with respect to the recoverability of the Aalto/AIIS loan. Our comments with respect to each of the ten Sub-Allegations are made having regard to the Relevant Benchmark.¹¹⁸ Together with our comments below they form the basis of our conclusion that the Third Aalto/AIIS loan allegation has been established. The ten matters alleged were as follows:

Sub-Allegation 3(a)

How and why (as at 30 June 2012), the initial debt of \$1,140,000 on the property (January 2005) had increased to \$24,608,244, despite construction not commencing and no evidence of pre-sales and/or construction finance having been obtained;

537. This allegation was based on the Macro Development Programme timeline dated 29 July 2011 (IB4H2) described above in paragraph 490 which noted various task milestones.
538. In response to this allegation, Mr Williams said that the increase in the loan was in part due to the accounting treatment resulting from the land availability agreement and the requirement to fund the construction project and referred to AWPIB4C and DG6-2011 Audit. It was not in issue that the land availability agreement had been documented on the audit file when considering this loan. Regardless, in our view a reasonably competent auditor would have identified that further audit work was required to satisfy the obligation to ensure there was sufficient scrutiny of the available security as part of the assessment of the recoverability of the loan receivable.
539. In our view appropriate scrutiny of the available security for and recoverability of the Aalto/AIIS loan receivable in the audit would have included consideration of the reasons for the increase in debt, and one means of conducting such an assessment would have been to compare progress of the development against the timeline in IB4H2.

¹¹⁷ Ibid.

¹¹⁸ See above n 56.

540. We are satisfied that Sub-Allegation 3(a) has been established.

Sub-Allegation 3(b)

Why the \$24,608,244 loan balance was greater than the security value noted in AWPIB3/6, LMMPF Loan Balance Report, the AIIS Discounted Cash Flow and the JLL Valuation and whether the basis for the security value was appropriate given the nature of and current status of the development of the land.

541. We refer to and repeat our comments and findings in Aalto/AIIS Sub-Allegations 2(d) and (2)(e) that together with our comments in paragraph 536 form the basis for our view that a reasonably competent auditor would have identified and addressed this matter.

542. Mr Williams' Response was the R56 Response described in paragraph 518 and we refer to and repeat our comments with respect to that response.

543. We are satisfied that Sub-Allegation 3(b) has been established.

Sub-Allegation 3(c)

Performed an assessment of the competence and capabilities of JLL LaSalle and evaluated the appropriateness of this work as audit evidence.

544. We refer to and repeat our comments and findings with respect to Aalto/AIIS Sub-Allegation 2(b) that together with our comments in paragraph 536 form the basis for our view that a reasonably competent auditor would have identified and addressed this matter.

545. ASA 500.8 stated:

If the information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

- (a) Evaluate the competence, capabilities and objectivity of that expert;
- (b) Obtain an understanding of the work of that expert; and
- (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

546. Mr Williams' Response was that because there was no deficiency between the on-completion valuation and the Aalto/AIIS loan, that there was no requirement to perform an assessment of the competence and capabilities of JLL or evaluate the appropriateness of their work as audit evidence. In our view that matter is not a relevant consideration with respect to this allegation as the assessment of their competence and capabilities was required by ASA 500.8.

547. JLL was a reputable property valuation firm at the time and we agree that this was a relevant consideration with respect to the extent of audit work/audit evidence required to support a conclusion that the valuation was reliable.

548. The fact though, that JLL was well known and reputable did not in our view absolve Mr Williams from responsibility nevertheless to ensure that appropriate

and sufficient audit work was done, and to retain audit evidence, in order to satisfy the requirements of ASA 500.8.

549. Examples of the type of audit evidence we would expect to have been retained on the Audit Engagement File would include; a record of the purpose of the report, by whom it was commissioned and the context of that commission, evidence that the information and assumptions in the valuation were consistent with other audit evidence and the financial balances in the relevant financial statements and consideration of the independence of the firm performing valuation. We would also expect the auditor's conclusion on the appropriateness of the valuation recorded in the audit evidence.
550. While we do not disagree that the *on completion* value for the development was relevant as asserted by Mr Williams, the bases of the assumptions used in the JLL Valuation were critical to the relevance and reliability of the conclusions it recorded and in order to obtain reasonable assurance we would expect there to have been audit evidence that these assumptions had been identified and, at least, their source verified.
551. There is no audit evidence that there was an evaluation of assumptions used in the JLL Valuation in the context of assessing the recoverability of the loan.
552. Based on our comments on this Sub-Allegation together with our comments in paragraph 536 we are satisfied that a reasonably competent auditor would have identified and addressed this matter.
553. We are satisfied that Sub-Allegation 3(c) has been established.

Sub-Allegation 3(d)

Why the potential buyout and refinancing would result in a shortfall for LM.

554. This allegation was based on the Carlton Feasibility that noted \$10.863 million as the repayment to LM, which would have been a potential shortfall of approximately \$14 million to LM on its loans, based on the loan balance in the 2012 LM Financial Statements.
555. We refer to and repeat our comments on the Carlton Feasibility in Aalto Sub-Allegation 2(a) and the structure of the Aalto AIIS loans in Aalto/AIIS Sub-Allegation 2(c).
556. The audit work performed by WPIAS should have been sufficient to identify the various loan structures, their consequent potential demands on assets and the potential impact on the recoverability and valuation of the loans. Having regard to the requirements of the Auditing Standards, a reasonably competent auditor would, in our view, have clearly identified the apparent inconsistency of the potential shortfall identified in the Carlton Feasibility, having regard to the obligation to exercise appropriate professional scepticism, and performed further audit investigation and clarification before the audit of this loan receivable was finalised.
557. There is no audit evidence of that audit work having been performed.

558. Based on our comments on this Sub-Allegation together with our comments in paragraph 536 we are satisfied that a reasonably competent auditor would have identified and addressed this matter.
559. We are satisfied that Sub-Allegation 3(d) has been established.

Sub-Allegation 3(e)

The impact of the lender's priority being as a second mortgagee.

560. Mr Williams response to this Sub-Allegation was that he was not aware of the LMFMI Loan, although the matter was considered at AWPIB4A which noted the payout of the LMFMI Loan. We do not regard AWPIB4A, the AIIS Discounted Cash Flow (that Mr Williams referred to as the updated feasibility) that we have already described and discussed at paragraphs 494-497 as sufficient appropriate audit evidence of the impact of the lender's priority being a second mortgage in relation to the loan. Mr Williams admitted that he was not aware of the LMFMI Loan and the audit evidence is consistent that loan not having been taken into account in the impairment of the Aalto/AIIS receivable in the audit. The fact that the existence of the LMFMI Loan was referred to in another audit document is not audit evidence that this matter was properly considered.
561. We refer to and repeat our comments and findings with respect to Aalto/AIIS Sub-Allegation 2(c).
562. There was no audit evidence that this matter was properly considered. The audit work did not consider the full amount of the Aalto/AIIS receivable disclosed in the accounts because Mr Williams said that the audit work was performed on the basis of LM as a single entity even though the audit was performed on the basis of the consolidated position.
563. Based on the above matters and having regard to our comments in paragraph 536 a reasonably competent auditor would have identified and addressed this matter in the audit.
564. We are satisfied that Sub-Allegation 3(e) has been established.

Sub-Allegation 3(f)

The status of milestones in relation to the development that were due for completion subsequent to year end and prior to signing the 2012 LM Audit Opinion.

565. Mr Williams said that AWPIB4H2 and AWPIB4H1/68 were AWP's carried forward from the 2011 files and that the updated feasibility¹¹⁹ had the updated time frame and that in these circumstances a sufficient degree of professional scepticism was shown and there was no requirement to make the enquiries alleged in respect of the old time frames as they had been updated in the later feasibility study/report.
566. We refer to and repeat our comments and findings on the First Aalto/AIIS Loan Allegation at paragraphs 494-502 that address Mr Williams' response.

¹¹⁹ This is the "AIIS Discounted Cash Flow" described in paragraphs 494-497.

567. By way of further comment, AWPIB4A would not in our view meet the requirement set out in ASA 230.8:

The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor having no previous connection with the audit to understand:

- (a) The nature, timing and extent of the audit procedures performed in order to comply with the Australian Auditing Standards and applicable legal and regulatory requirements;
- (b) The results of the audit procedures performed, and the audit evidence obtained; and
- (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.

568. Based on the above matters and having regard to our comments in paragraph 536 we are satisfied a reasonably competent auditor would have identified and addressed this matter and ensured it was evident from the Audit Engagement File record that audit work had been performed that showed understanding on the auditor's part of the current status of and progress that had been made with respect to the development, both at year end and as part of a subsequent events review prior to signing the audit opinion.

Sub-Allegation 3(g)

The impact of inconsistent values to support the carrying value of the loan receivable \$10.683 million in the Aalto feasibility for Carlton Group, \$19,833,306 in the AIIS Discounted Cash Flow and \$24,495,774 in the Aalto Development Feasibility had on the audit approach and audit evidence.

569. We refer to and repeat the comments and findings we have already made in Sub-Allegations 2(a), 2(d) and 2(e) (that include our views on Mr Williams' responses to this allegation) and our comments in paragraph 536 that form the basis for our view that a reasonably competent auditor would have identified that there were inconsistencies and would have performed audit procedures directed to resolving the reasons for those differences in order to conclude what value was appropriate to consider to support the carrying value of the AIIS/Aalto Loan receivable.

570. We are satisfied Sub-Allegation 3(g) has been established.

Sub-Allegation 3(h)

Whether the value of the loan was appropriately accounted for in accordance with AASB 139.

571. Mr Williams repeated the R56 Response with respect to this allegation, discussed in paragraph 518 that does not address the subject of this allegation.

572. We refer to and repeat our comments with respect to AASB 139 in paragraph 316.

573. There was no audit evidence with respect to this matter.

574. We are satisfied that a reasonably competent auditor would have considered this matter.

575. We are satisfied that Sub-Allegation has been established.

Sub-Allegation 3(i)

Whether a financier would be likely to provide additional funding in circumstances where the debt on the property is \$24,608,244 and the value of the property 'as is' is \$8,500,000.

576. Mr Williams repeated the R56 Response with respect to this allegation, discussed in paragraph 518 that does not address the subject of this allegation.

577. Mr Williams said further that the JLW Valuation also included an 'as if complete' valuation of \$141,615,800 and noted 'particularly in circumstances where the finance for construction of the project and feasibility supported the payment of the construction costs.'

578. We accept that a financier to a development project would have regard to the expected *on completion* value of the development, as well as to the likelihood of the project succeeding and the track record of a developer.

579. Having regard to our comments in paragraph 536, we are satisfied that a reasonably competent auditor would have considered the likelihood of the developer procuring additional funding in circumstances where the current debt significantly exceeds the *as is* valuation as relevant, because these risk factors that impact the auditor's determination of the recoverability/and impairment provisioning with respect to the loan.

Sub-Allegation 3(j)

In the absence of obtaining further appropriate audit evidence in relation to the valuation on an 'as is' basis by JLL of \$8,500,000 and the loan balance of \$24,608,244) and the difference between the security value of \$19,833,306 and the loan balance of \$24,608,244, Mr Williams should have raised with the entity the possibility of impairment of the loan, or the possibility of writing down the loan.

580. Mr Williams repeated the R56 Response with respect to this allegation, discussed in paragraph 518 that does not address the subject of this allegation.

581. He said further that reliance on an *as is* valuation of \$8,500,000 is erroneous in funding a development of this nature and in any event the shortfall of \$4,774,938 was not material to the net assets attributable to unit holders of \$353,156,353 as at 30 June 2012 (being 1.35%) ("57 Response").

582. In our view neither response answers this allegation for the reasons we have already set out.

583. As we have said there was insufficient audit evidence to support the conclusions that were drawn with respect to the recoverability and impairment status of the Aalto/AIIS loan. Certainly, the figures in the audit evidence, and in particular the difference between the security value of \$19,833,306 disclosed in the accounts and the loan balance of \$24,608,244, do not support the conclusion that was drawn that the loan was not impaired. In our view, having regard to the audit evidence we have discussed, a reasonably competent auditor on the basis he could not obtain further evidence in the audit would have raised with the entity

the possibility of impairment of the loan, or the possibility of writing down the loan.

584. We are satisfied that Sub-Allegation 3(j) has been established.

LM Capalaba Loan

Background facts

585. LM Capalaba Pty Ltd (“LMC”) was a further special purpose vehicle.

586. The LM 2012 Financial Statements disclosed a loan to LMC of \$14,968,213 (“LMC Loan”) as at 30 June 2012.

587. Between 30 June 2011 and 30 June 2012, the LMC Loan balance increased by \$5,357,737.

LMC - Relevant Audit Working Papers

588. The lead AWP for the LMC Loan, AWPIB14 (“AWPIB14”), recorded the audit procedures selected to address the risk of this loan and was the same template document as the Maddison and Aalto/AIIS Loan AWPs.

589. AWPIB14 noted a conclusion that sufficient appropriate audit evidence had been obtained to materially meet the stated audit objective. AWPIB14 was noted as prepared by *AB* on 7/08/2012 and reviewed by *RW* on 08/10/12. It further recorded the following:

Assessed risk by assertion was recorded as follows: Existence and occurrence (EO) low; completeness(C) low; Valuation and Measurement (VM) Medium; Rights and Obligations (RO) Medium; Disclosure (D) Low.

Documents received and reviewed IB14A Feasibility; IB14A.1 Input data for feasibility; IB14.A2 Project Details/Overview; IB14A.3GMP Group January 2012 Report; IB14A4 GMP Group Project Status and Cashflow Update; IB14A5 GMP Group Project Status and Cashflow Update-Consultant’s fees; IBA14A6 GMP Group-Hutchinsons Builders Contract sum; IB14A7 Landsbury’s Valuation Report; IB14A8 Pricing and Escalations ;IB14A9 Rhodes Capalaba Market Update June 2011

IB14B Loan Transaction Report (1 July 2011-30 June 2012 and testing documents); IB14D Joint Venture Agreement; IB14E PKF Margin Scheme; IB14F Marketing and Sales agreement; IB14G PAMDA Agreement; IB14H Sales Remuneration Agreement; IB14I Residential Property prospects; IB14I RP Data Information; IB14K Company Search

590. There was a further heading ‘Summary from feasibility’ and ‘Gross Profit Review IB14A.1’. The gross profit review set out various costs and revenues, noting they agreed to costs estimates and/or appeared reasonable and that the gross sales revenue of \$138,655,274 had been ‘reviewed’. There were a number of items such as land holding costs and financing costs that had ‘imm’ noted next to them.

591. AWPIB3/6 entitled *LM MPF Loan Balance Report with Security Values Impairment 30-Jun-12* that noted the *security value* for LMC was \$14,977,179 compared to a loan balance of \$14,968,213.

592. AWPIB141 *Cash-Flow LM Capalaba & Balmoral Commodities* which referred to:
- (a) *Gross Sales Revenue* of \$138,655,274;
 - (b) *Nil Land and Acquisition costs*; and
 - (c) *Loan 2 - Senior Debt* of \$70,850,419
(“LMC Cashflow”).
593. AWPIB14A8 entitled *Pricing and Escalations* that recorded:
- (a) 20 out of the 54 units (37%) in *Building A* were sold; and
 - (b) 6 out of the 44 units (14%) in *Building B* were sold.
594. AWPIB14A1 *Development Feasibility Model* with respect to the Capalaba site, dated 9 August 2012, prepared for LMIM that included the following information under *Summary of Project Returns (Rhodes – Capalaba)*:
- (a) *Total Sales Revenue* of \$138,655,274; and
 - (b) *Management Rights* of \$2,229,668.
(“Development Feasibility Model”)
595. AWPIB14B LMIM’s loan statement dated 20 July 2012 re: LMC noted:
- (a) an interest rate of 25% p.a.;
 - (b) the balance of the LMC’s loan as at 30 June 2011 as \$9,610,476; and
 - (c) the total loan amount increased by an interest component of \$2,168,284.
596. A valuation report conducted at LMIM’s request by Landsburys Independent Property Advisory Services (“Landsburys”) of property at *Rhodes, 56-58 Mount Cotton Street, Capalaba QLD 4157*, dated 15 March 2011. The report highlighted (including but not limited to) the following:
- (a) Proposed development comprises a residential apartment project consisting of 6 buildings over 6 levels comprising 271 residential units and basement/at grade car parking for 341 vehicles;
 - (b) Gross Realisation Potential for the proposed development, As if Complete, assuming individual sale on an individual lot basis and subject to the assumptions/conditions contained herein is \$116,825,000; and
 - (c) Current market value with Vacant Possession and Development Approval subject to the assumptions/conditions contained herein is \$11,000,000.
(“Landsbury’s Valuation”)

597. A report prepared by Management dated January 2012 that analysed the current costs of and provided an updated budget for the project which was entitled, *Rhodes 56-58 Mt Cotton Road Capalaba Monthly Report No. 08*. (“GMP Report”). The table at page 1 of the report noted some significant variations in relation to development costs in relation to the project compared to the original budget. The summary of financial costs in the report highlighted that:
- (a) *Professional Fees* had increased by \$589,999;
 - (b) *Stage 2* construction costs had increased by \$1,000,000; and
 - (c) *Council/QFRS Fees* invoiced to date were \$198,380 against a revised budget of \$71,507.
598. A letter dated 8 June 2012, from GMP to LMIM re: *Project Status and Cashflow Update* that advised inter alia that the construction of *Buildings A and B* would commence in September 2012.
599. There were also copies of invoices, statements and agreements evidencing the costs incurred on the project.

Contention One LMC allegations/responses/findings

First LMC Loan Allegation

600. It was not in issue that at LMIM’s request Landsburys provided the Landsbury Valuation that referred to the matters set out at paragraph 596.
601. It was alleged that the Audit Engagement File did not contain sufficient appropriate audit evidence with respect to the:
- (a) apparent deficiency of \$3,968,213 revealed by the Landsbury’s Valuation current market value of \$11,000,000 and the LMC loan of \$14,968,213 (“LMC Loan Sub-Allegation 1(a)”); and
 - (b) assessment of the competence and capabilities of Landsbury’s in order to evaluate the appropriateness of the Landsbury Valuation as audit evidence (“LMC Loan Sub-Allegation 1(b)”).

LMC Loan Sub-Allegation 1(a)

602. Mr Williams relied on the Engagement Partner Response, that was not pressed.
603. Mr Williams further Response to Sub-Allegation 1(a) was that LMIM determined whether loans were impaired on an ongoing basis, which required an estimation of the value of future cash flows that had been done by obtaining an *on completion* valuation. The loan balance at 30 June 2012 compared to the estimation of future cash flows did not reveal a deficiency. The loan was not repayable at 30 June 2012 and accordingly there was no deficiency at 30 June 2012.
604. We do not disagree that the *on completion* value of the development was relevant. However, the bases of the assumptions applied in the Landsbury

Valuation were important and there should have been audit evidence that these assumptions had been identified and reviewed in order to obtain reasonable assurance.

605. While there is audit evidence that items such as the gross sales revenue in the Cashflow Report (AWPIB141) and the Development Feasibility Model (AWPIB14A1) were reconciled, there was no audit evidence that the Landsbury Valuation had been assessed to determine whether or how it impacted variables relevant to the recoverability of the LMC Loan.
606. The mere fact that the *on completion* value and the loan amount did not reveal a deficiency does not answer this Sub-Allegation.
607. The fact that there was an apparent deficiency of \$3,968,213 between the *as is* value of the property and the LMC Loan amount should have been the catalyst for further investigation to obtain assurance that the progress of the development was on track and to identify and assess any risks posed to the progress of the project because to the extent they existed they may have had a bearing on the recoverability of the loan at a point before completion of the project that would have been relevant to evaluate in the context of the audit of this loan receivable.
608. The audit evidence did not address the matter the subject of Sub-Allegation 1(a) and this is consistent with Mr Williams' response that this matter was not necessary to consider in the 2012 LM Audit.
609. We are satisfied LMC Loan Sub-Allegation 1(a) has been established.

LMC Loan Sub-Allegation 1(b)

610. The Landsbury's Valuation was located on the Audit Engagement File and had been noted as reviewed. There was no evidence to indicate it was not relied on as part of the audit evidence.
611. Mr Williams' first response to this Sub-Allegation was the Engagement Partner Response that was not pressed. In the context of this response he said that while his responsibility as Engagement Partner did not extend to seeking sufficient further audit evidence on the competence and capability of Landsbury's, he noted that the Landsbury Valuation used a unit selling price to arrive at its gross sales revenue figure that was comparable to the RP sales data obtained and recorded in AWP1B14J.
612. The Engagement Partner Response was not pressed. For completeness, we refer to our comments on the Engagement Partner Response¹²⁰ as the basis for our view that Mr Williams' responsibility as Engagement Partner did extend to ensuring that audit evidence on the competence and capability of Landsbury's was obtained as this was an obligation imposed by the Auditing Standards.
613. With respect to Mr Williams' assertion that the unit selling price of \$511,463 used in the Landsbury Valuation to arrive at the gross sales revenue figure was comparable to the RP sales data obtained we note that the RP data recorded sales

¹²⁰ See above n 28.

values in the range of \$279,000 to \$930,000. There was no audit evidence that the RP Sales Data was used in the audit to evaluate the reasonableness of the gross sales revenue in the Landsbury Valuation. There was no audit evidence of other evaluation of the reasonableness of the sum of \$511,463 used in the Landsbury Valuation, for example by reference to the type and size of the dwellings to be constructed.

614. Mr Williams further response to this allegation was that the Landsbury Valuation, which was dated 15 March 2011 and was not therefore current at the time of the 2012 LM Audit, was only one of a number of supporting documents provided by LMIM with respect to the LMC loan. He said that although it was reviewed, no direct reliance was placed on it and accordingly, it was not considered necessary to assess the competence and capabilities of Landsbury. Mr Williams' response confirms that such evaluation was not undertaken and is consistent with the absence of any audit evidence.
615. Sub-Allegation 1(b) was a factual allegation that there was no audit evidence that an assessment of the competence and capabilities of Landsbury's in order to evaluate the appropriateness of the Landsbury Valuation as audit evidence had taken place.
616. Based on our comments above we are satisfied that Sub-Allegation 1(b) has been established.
617. We are satisfied the First LMC Loan Allegation has been established.

Second LMC Loan Allegation

618. AWPIB141 *LMC Cashflow* described at paragraph 592 referred to:
 - (a) *Gross Sales Revenue* of \$138,655,274;
 - (b) *Nil Land and Acquisition costs*; and
 - (c) *Loan 2 - Senior Debt* of \$70,850,419.
619. The Second LMC Loan Allegation was that there should have been audit evidence showing Mr Williams had adequately considered:
 - (a) the nil land and Acquisition Costs;
 - (b) the identity of the financial institution with the senior debt; and
 - (c) whether delay could impact the senior debt and therefore potentially impact the recoverability of LM's loan.
620. Mr Williams admitted the allegations. He said that the land was already owned by LMC and relied on the Engagement Partner Response and asserted that he was not required to seek additional evidence or consider these matters. We refer

to and repeat our comments on the Engagement Partner Response¹²¹ that was not pressed.

621. We are satisfied that there was no documentation on the Audit Engagement File that addressed the three matters the subject of the Second LMC Loan Allegation.
622. We are satisfied that these were matters that were relevant to assessing the recoverability of the LMC Loan about which there should have been audit evidence.
623. We are satisfied that the Second LMC Loan Allegation has been established.

Third LMC Loan Allegation

624. The Third LMC Loan Allegation was that, in relation to the Development Feasibility Model AWP1B4A1 described in paragraph 594 there was no audit evidence in the Audit Engagement file that Mr Williams had:
 - (a) Adequately identified and/or considered that document; and/or
 - (b) Assessed the difference between the gross sales revenue of \$138,655,274 referred to in that summary and the gross realisation potential of \$116,825,000 referred to in the Landsbury Valuation; and/or
 - (c) Identified what the sum of \$2,229,668 for management rights referred to in that document represented and whether it was appropriate to be included in sales revenue.
625. Mr Williams relied on the Engagement Partner Response¹²² and asserted that his duties as Engagement Partner did not extend to:
 - (a) seeking sufficient further audit evidence on the amounts referred to in the *Summary of Returns Rhodes Capalaba*, and repeated that the Landsbury Valuation (AWP1B14A(1)) used a unit selling price to arrive at its gross sales revenue figure that was comparable to the RP sales data obtained; or
 - (b) considering aspects of the Summary of Project Returns in the document entitled 'Development Feasibility Model'.
626. We refer to and repeat our comments on the Engagement Partner Response¹²³ that was not pressed and our comments with respect to the relevance of the RP sales data in paragraph 613 that form the basis of our view that these matters do not answer this allegation.
627. There was no evidence on the Audit Engagement File that demonstrated the matters set out in (a), (b) or (c) in paragraph 624 had been considered. These were matters that were relevant to assessing the recoverability of the LMC Loan and which on their face were apparently anomalous and inconsistent about which

¹²¹ Ibid.

¹²² Ibid.

¹²³ Ibid.

further investigation should have been undertaken and audit evidence obtained. We refer to and repeat our comments on the importance of applying appropriate professional scepticism in an audit and its importance to audit quality.¹²⁴

628. We are satisfied that the Third LMC Loan Allegation has been established.

Fourth LMC Loan Allegation

629. The Fourth LMC Loan Allegation was that there was no audit evidence to indicate that Mr Williams had considered and addressed the analysis of the project contained in the GMP Report¹²⁵ that highlighted cost increases in professional fees, construction costs and council fees, besides those items having been circled in the copy of the document in the Audit Engagement File.

630. Mr Williams repeated and relied on the Engagement Partner Response, said that his role did not require him to address these matters and in any event the GMP Report was only part of the supporting documentation from LMIM and whilst reviewed in assessing recoverability of the loan, no direct reliance was placed on the report, and accordingly no further work was required in respect of the report. We refer to and repeat our comments with respect to the Engagement Partner Response¹²⁶ (that was not pressed) that form the basis for our view that the first two elements of this response do not answer this allegation.

631. As to the third element of Mr Williams' Response, we note that AWPIB14 notes the GMP Report as received and reviewed. The table at page 1 of the GMP Report noted some significant variations in development costs for the project compared to the original budget including an increase of \$1,000,000 in stage 2 construction costs, an increase in Professional Fees of \$589,999 and council/QFRS Fees invoiced were \$198,380 against a revised budget of \$71,507.

632. In our view, the contents of the GMP report did require further audit assessment because the information it contained was information that suggested that costs had exceeded initial projections which was a matter that required assessment and investigation in the 2012 LM Audit because of its potential to impact the overall financial viability of the development project which was relevant to the consideration of the recoverability of the LMC Loan.

633. We are satisfied that the audit evidence did not indicate that the figures circled in the GMP Report had been considered or that the analysis of the project contained in the GMP Report had been otherwise considered in the 2012 LM Audit.

634. We are satisfied that the Fourth LMC Loan Allegation has been established.

Fifth LMC Loan Allegation

635. The Fifth LMC Loan Allegation was that there was no evidence on the Audit Engagement File that Mr Williams undertook any additional work with respect

¹²⁴ See above n 58.

¹²⁵ See paragraph 597.

¹²⁶ See above n 28.

to the security value of \$14,977,179 noted in AWPIB3/6 LM MPF Loan Balance Report dated 30 June 2012 when the loan balance of \$14,968,213 indicated a shortfall of security and was inconsistent with the Landsbury Valuation.

636. The factual matter to which this allegation is directed is that the Landsbury's *as is* valuation was some \$3.9 million less than the security value attributed to LMC by the Loan Balance Report provided by LMIM. Based on the relevant LMC audit documentation, we are satisfied that there was no evidence on the Audit Engagement File that Mr Williams had undertaken any additional work with respect to the security value of LMC.
637. Mr Williams repeated and relied on the Engagement Partner Response and admitted that he did not undertake any additional work with respect to the security value of \$14,977,179 noted in the LM MPF Loan Balance Report dated 30 June 2012. He said that the Landsbury Valuation was an *as is* current valuation with vacant possession as at 15 March 2011, that was a different basis to the *on completion* valuation used by LMIM to determine impairment of the loan balance. The *on completion* valuation was based on the estimation of the value of future cash flows at 30 June 2012 and did not reveal a deficiency.
638. We refer to and repeat our comments on the Engagement Partner Response¹²⁷ and our further comments in paragraph 612. Based on those comments, our view is that the above responses with respect to the scope of Mr Williams' role and responsibility as the Engagement partner do not answer the allegation.
639. As to Mr Williams' further response to this allegation the fact that the *on completion* value did not reveal a deficiency, this matter does not answer this allegation. The fact that there was an apparent deficiency of \$3,968,213 between the *as is* value of the property and the LMC Loan amount should have been a catalyst for further investigation to obtain assurance that the progress of the development was on track and to identify and assess any risks posed to the progress of the project as such risks, if there were any, were relevant to assessing the recoverability of the loan at a point before completion of the project, which was a relevant consideration in the audit.
640. We are satisfied that there was no audit evidence that there was audit work performed with respect to the security value of \$14,977,179 noted in the LM MPF Loan Balance Report dated 30 June 2012 in the 2012 LM Audit.
641. We refer to and repeat our comments on the application of professional scepticism in an audit and its importance to audit quality.¹²⁸ In our view these matters were relevant and the audit evidence should have provided clarity either about the audit work performed or the basis for concluding the apparent shortfall did not present a risk to recoverability of the LMC Loan or did not give rise to the need to review impairment of the loan.
642. We are satisfied that the Fifth LMC Loan Allegation has been established.

¹²⁷ See above n 28.

¹²⁸ See above n 58.

Sixth LMC Loan Allegation

643. The Sixth LMC Loan allegation comprised two Sub-Allegations. The first was that there was not sufficient appropriate audit evidence to demonstrate that Mr Williams had applied a sufficient level of professional scepticism regarding the costs estimates and cash flow forecasts and the loan and/or the recoverability of the loan and the second Sub-Allegation was that the audit working papers did not consider whether the project was progressing in line with expectations, both in terms of costs incurred and the stage of development for the year to 30 June 2012 and between year end at 30 June 2012 and the date of the 2012 LM Audit Opinion.
644. With respect to the first Sub-Allegation, Mr Williams relied on all of the responses we have discussed in the context of the previous LMC Loan findings and denied that he had not considered costs estimates and cash flow forecasts or the recoverability of the LMC Loan and we refer to our consideration of those responses in the context of the first five LMC Loan allegations.
645. We refer to our findings with respect to LMC loan allegations (1)-(5). In our view the inconsistencies evident in that documentation, the lack of satisfactory explanation or narrative on the Audit Engagement File, particularly with regard to the apparent inconsistencies, and matters such as the cost increases referred to in the GMP Report together with Mr Williams' response that it was not his responsibility in the audit to review certain of the matters the subject of the allegations, support the view that Mr Williams did not apply an appropriate level of professional scepticism in the 2012 LM Audit with respect to the recoverability of the LMC Loan and the costs estimates and cash flow forecasts.
646. Our comments¹²⁹ on the application of professional scepticism in an audit and its importance to audit quality provide context about the importance of this responsibility and the standard that was to be reasonably expected at the time of the 2012 LM Audit. That standard of performance required appropriate scrutiny of the information that was provided by management and where there were anomalies or apparent inconsistencies the audit evidence should have been clear that such matters had been identified and resolved.
647. We are satisfied that on the basis of our findings with respect to the first five LMC Loan Allegations that these anomalies and inconsistencies were not identified in nor their resolution clarified by, the audit evidence in the 2012 LM Audit.
648. We are satisfied the first Sub-Allegation has been established.
649. With respect to the second Sub-Allegation, Mr Williams denied that the audit working papers did not consider whether the project was progressing in line with expectations, both in terms of costs incurred and the stage of development for the year to 30 June 2012 and between year end at 30 June 2012 and the date of the 2012 LM Audit Report and with respect to the latter, he on AWPXC1 to AWPXC5 in the Forensic File.

¹²⁹ Ibid.

650. He said further that his role as Engagement Partner on the audit did not require him to seek the additional evidence or consider the matters detailed. We refer to and repeat our comments on the Engagement Partner Response in paragraph 612. Based on those comments our view is that these matters were within the scope of Mr Williams' role and responsibility as the Engagement partner.
651. AWPXC1 – AWPXC5 to which Mr Williams referred in his response to this allegation do not contain any substantive consideration of subsequent events with respect to whether the LMC project was progressing in line with expectations, both in terms of costs incurred and the stage of development between 1 July 2012 and the date of the 2012 LM Audit. AWPXC1 – AWPXC5 are template documents of the nature we have earlier discussed.¹³⁰
652. We are satisfied, based on our earlier comments as to the relevance of project forecasts and timelines to the audit assessment of recoverability of the loan receivables, that the matters the subject of the second Sub-Allegation were relevant considerations in the 2012 LM Audit.
653. Based on our comments above and our findings with respect to the first five LMC Loan Allegations, we are satisfied that the Audit Engagement File did not include adequate audit evidence that Mr Williams had considered whether the project was progressing in line with expectations, both in terms of costs incurred and the stage of development at year end 30 June 2012 and from 30 June 2012 to the date of the 2012 LM Audit Opinion was signed on 7 December 2012 and that this was a matter relevant to recoverability of the loan receivable.

Seventh LMC Loan Allegation.

654. There were a further 16 matters proposed in the Seventh LMC Loan Allegation that it was alleged a reasonably competent auditor would have identified and/or addressed with respect to recoverability of the LMC Loan. These allegations were based on the inconsistencies apparent in the audit evidence to which we have referred above and other matters that by reference to the requirements of the Auditing Standards, a reasonably competent auditor would have performed. They were similar in nature to the matters the subject of the Sixth Maddison Loan Allegation and the Third Aalto/AIIS Loan Allegation that we have fully considered.
655. While we agree that the series of matters raised in the SOFAC about what a reasonably competent auditor should have done with respect to the audit of the LMC loan may be relevant matters in the context of our task of considering the level of performance by Mr Williams of his duties as an auditor, they are amongst the range of matters that the Panel, as an expert Tribunal, may also inform itself. In our view the findings we have already made with respect to the first six LMC Loan Allegations provide a sufficient factual basis on which to form our view on whether the Contention One Sub-Contentions made with respect to the LMC Loan have been established.

¹³⁰ See above n 41.

656. Our findings on those Sub-Contentions are based on our findings with respect to the First –Sixth LMC Loan Allegations.

Drake Loan

657. At 30 June 2012, LM had loan receivables, as noted in the 2012 LM Financial Statements of:
- (a) \$16,911,196 from Mr Drake (director of LMIM and LM); and
 - (b) \$2,995,270 from the Ekard Property Trust.

Relevant Audit Working Papers

658. The lead AWP for the Drake loan (“AWPIB13”) set out the audit procedures selected to address the risk of this loan and was the same template document used for the previous loans we have considered.
659. AWPIB13 noted a conclusion that sufficient appropriate audit evidence had been obtained to materially meet the stated audit objective. IB13 was noted as prepared by *AB* on 10/10/2012 and reviewed by *RW* on 15/11/12. It further recorded the following:
- (a) Assessed risk by assertion was recorded as follows: ‘Existence and occurrence (EO) low; completeness(C) low; Valuation and Measurement (VM) Medium; Rights and Obligations (RO) Medium; Disclosure (D) Low’ (this was the same as the previous three loans).
 - (b) ‘Documents received (we note other lead audit work papers we have considered said “**received and reviewed**”) IB13A Loan transaction report (1 July 2011 to 30 June 2012; IB13B Loan Snapshot; IB13C Loan Agreements and Variations; IB13D Assessment of Capitalisation of Projected Future Earnings; IB13E LMIM company search; IB13F Asset and liability Statement and Serviceability Memo.’
 - (c) There was a handwritten notation next to *I3F* in AWPIB13 that said ‘subsequently received for completeness’.
 - (d) The typed note under documents received (taken from the notes to the 2012 LM Financial Statements) was as follows:

Note 12(ii)

As at 30 June 2012 the fund had a loan receivable of \$16,911,196 (2011: \$15,226,499) from Peter Charles Drake, a director of the Manager. The loan is secured by a charge over LM Administration Ltd in its own right and as trustee for the Ekhard Property Trust, and by a charge over Century Star Investments. Century Star Investments is a shareholder of LMIM with a 50% stakeholding. An external report from an independent firm 1 November 2012 assessed this security holding at \$54 million (50% of assessed total of \$107m). Interest on this loan is fully serviced monthly.

- (e) There followed a further note which said:

Operating EBIT of these two entities combined was \$11,000,000 EBIT profit for the year ended 30 June 2012 (2011: \$7.1 million). Operating EBIT forecast of these entities for the 2013 financial year is forecast at \$8.8 million.

660. AWPIB13A *LMIM Loan summary Peter Charles Drake* dated 20/07/2012 that noted:
- (a) An increase in the loan during the year that included \$1,876,833 of interest;
 - (b) A reduction in the loan of \$1,400,944; and
 - (c) That 'monthly interest payments are being made since December '11'.
661. AWPIB13B *Loan Snapshot* dated 21 November 2011 re *Peter C Drake* included the following items:
- (a) the interest rate is 17% with the handwritten notation, 'interest rate per loan agreement 16% IB13a/16';
 - (b) the loan is a 'business loan, no real estate security';
 - (c) LMA as trustee for Ekard Property Trust (IB13a/17) noted as first guarantor and Century Star Investments as second guarantor; and
 - (d) the *Serviceability file* location is Gold Coast with the CFO.
662. AWPIB13C *Loan agreement Peter Charles Drake and LMIM* dated 04/05/07. The schedule records:
- (a) loan amount \$12,000,000;
 - (b) interest higher rate 20%; and
 - (c) interest lower rate 16%.
663. AWPIB13F LMIM memo entitled *Managed Performance Fund/Peter Charles Drake, Related Party Loan* dated 12 February 2013, from Dan Longan of LM to Shelley Chalmers. This memo contained a handwritten notation at the top 'subsequently received in Feb 13' and attached a statement of assets and liabilities of Peter Charles Drake. The memo:
- (a) noted the loan was signed off as serviceable because Mr Drake had a personal net asset position of \$95 million; and
 - (b) stated 'the LM Group has a long track record of profitability with a sound business model, backed by a guarantor with a strong net asset position and net income position.'
664. AWPR4, the report entitled *Assessment of Capitalisation of Projected Future Earnings* dated November 2012 ("BStar Report") prepared by BStar Pty Ltd at the request of the CEO of the LM Group. The report noted the following information (including but not limited to):

- (a) *Projected Future Earnings* [used in their Capitalisation of Projected Future Earnings method]:

We have been asked to use a figure of \$11m to represent a level of pre tax Future Projected Earnings.

Note: As stated elsewhere in this document we have not tested whether this is a reasonable or appropriate figure for these purposes. We have relied on management's opinion that this figure represents a level of projected future earnings that the Business considers it can sustain.

- (b) The record of instructions in the BStar Report said 'This report is a capitalisation of future earnings that relies heavily on two variables provided to us that we have not tested and is not intended to represent a valuation'. The report further stated 'The users of this document are encouraged to conduct their own testing, verification and/or audit before relying on the contents of this document' and further 'Nothing in this document constitutes a valuation.'

Other Evidence

665. Mr Williams said in his evidence that Ms Blank had looked at the BStar Report but he thought she was confused that it was a valuation report. During cross-examination he accepted that it was clear from the notation on the lead audit working paper AWPIB13 that Ms Blank had relied on the BStar Report in forming a view that there was sufficient audit evidence with respect to the Drake loan.
666. Mr Williams maintained in his evidence that the BStar Report had a 'certain amount of relevance.'
667. He said he had been concerned though and carried out further procedures with respect to the Drake receivable as a result. He agreed that there was nothing in the Audit Engagement File evidencing that extra work and that an auditor reviewing the Audit Engagement File would not know that other work had been done.
668. Mr Williams said that the further work he carried out was recorded on the Forensic File and he referred us to I4/3. That document recorded that when the Drake loans that were owed to LM and to Maddison were taken into account, there was a deficiency overall of approximately \$7 million. Mr Williams explained it in his evidence as follows:

But I adopted a different method of analysing whether the secured loan from the MPF was covered. And based on my calculations – and I looked at the net assets of both LM Investment Management Ltd and also LMA, which obviously he was a beneficiary of - the loan from the MPF to Mr Drake was covered. What wasn't covered was the loan ultimately from Maddison Estate to Mr Drake, even though it was being paid down - and the evidence was on the file - at that point when we signed off there was a deficiency of just over \$7m in terms of coverage, of security. So that was a flag for us to be checked going forward, that that continued to be paid down.

669. AWPI4/3 noted that the LMC Loan was secured. Mr Williams said it was secured via a guarantee provided by Mr Drake. During cross-examination,

Mr Williams said that he had reviewed Mr Drake's assets and liabilities in LMA and LMIM because that was the subject of the guarantee. Mr Williams did not make any enquiry as to Mr Drake's total assets and liabilities. Mr Williams agreed that for the guarantee to have any effect that Mr Drake would have to have had assets available to be called upon. Mr Williams said that the fact the guarantee may have been worth nothing was flagged on the Forensic File (that was not part of the Audit Engagement File) however this was not apparent on the face of the document to which he had referred.

670. Mr Williams confirmed that as the Engagement Partner he had read AWPIB13 (the lead AWP for the Drake Loan) and was content for it to be placed on the Audit Engagement File. He said he did not see a need to qualify the note at 12(ii) on AWPIB13 that referred to the BStar Report because he had knowledge of the other work he had done (i.e. the work recorded in I4/3 on the Forensic File) and thought that was adequate. When asked if he agreed he should have documented the work he had done so that it could be read together with AWPIB13 he said 'the files were the files. We had two sets of files that we referred to.....I did a net asset procedure which was an additional procedure to what Ms Blank had done and, ...my focus when it came to loans was on the material loan balance'.

Drake Loan allegations, responses and findings

First Drake Loan Allegation

671. The First Drake Loan Allegation was that there was insufficient appropriate audit evidence in the Audit Engagement File to demonstrate that Mr Williams had applied an appropriate level of professional scepticism to and/or assessed whether:
- (a) the figure of \$11 million used as the projected future earnings figure in the BStar Report was reasonable; and
 - (b) the audit procedures performed on the BStar Report, referred to in AWPIB13 were appropriate for audit purposes; and
 - (c) the BStar Report had been prepared by someone with the appropriate experience and expertise and was reliable.
672. Mr Williams made four responses to this allegation.
673. First, he denied that there was insufficient audit evidence. This was based on the audit work he performed that was retained on the Forensic File. We refer to and repeat our comments and conclusion on the Forensic File documents¹³¹ and we note the work on the Forensic File to which Mr Williams referred was not cross-referenced in AWPIB13. We do not regard these records as audit evidence. Further the work recorded on the Forensic File did not directly address content of the BStar Report.
674. The second was the Engagement Partner Response that was not pressed.

¹³¹ See above n 43.

675. The third response was that a sufficient level of professional scepticism was applied when assessing the matters detailed in circumstances where the conclusion was reached based upon the audit team's review of:
- (a) the actual 2012 consolidated result of \$11,238,858.00;
 - (b) the LMIM 30 June 2012 audited Financial Report; and
 - (c) the LMA Financial Report for the year ended 30 June 2011.
676. If the basis of Mr Williams' response in paragraph 675(a) was to justify the reasonableness of the \$11,000,000 figure used in the BStar Report by reference to the overall profit before tax recorded in LMIM Financial Statements, there should have been appropriate and sufficient audit evidence of the performance of audit work that supported the appropriateness of that figure for use as the basis for future projected earnings in the BStar Report in order to demonstrate appropriate professional scepticism had been applied.
677. With respect to Mr Williams' assertion in his third response that there had been a review of the LMIM 30 June 2012 audited Financial Report, we note there was no audit evidence with respect to that review. In our view there should have been audit evidence of the review of the LMIM Financial Statements that demonstrated a thorough understanding had been gained of the flow of funds, the likely generation of future cash flows, encumbrances and liens on any assets from other parties and control within the ownership structure (for example just because Century Star Investments was a shareholder of LMIM with a 50% shareholding would not automatically entitle Century Star Investments to ready access to 50% of LMIM's assets).
678. As to the third sub-paragraph of Mr Williams' third response, the Panel was not referred to the LMA Financial Report for the year ended 30 June 2011 and we could not find that document in the Audit Engagement File, nor audit evidence with respect to its review.
679. In the absence of any audit evidence as to what analysis was performed in the 2012 LM Audit with respect to the documents the subject of the third response our view is that this response does not answer the allegation made.
680. Mr Williams' fourth response to this allegation was that the author of the BStar Report, Mr Grant Bloxham was:
- (a) a well-known expert in the accounting industry in Australia; and
 - (b) considered a competent and capable expert by his peers.

This comment was noted on the Forensic File document referred to above.

681. Mr Williams' evidence on this matter was that the author of the BStar Report was a well-known expert in the accounting industry in Australia, particularly in South East Qld where the BStar head office was located, who was considered by his peers to be more than competent and capable. Mr Williams said that he knew

Mr Bloxham, the founder and CEO of BStar Ltd personally, and while the BStar Report was noteworthy, it was not a valuation report.

682. We do not think this response provides a basis to assert that appropriate professional scepticism was applied to the matters the subject of the first allegation with respect to the Drake loan. In any event, neither the consideration of Mr Bloxham's competence and capabilities, nor identification of the BStar Report as other than a valuation, was recorded on the Audit Engagement File.
683. Even if the BStar Report was not a valuation report, we agree with Mr Rea's assessment that it would be considered work from a management expert and, pursuant to ASA 500.8, an auditor was required to evaluate the competence, capabilities and objectivity of the expert, and an understanding of the work of the expert and the appropriateness of the expert. There was no audit evidence that this had occurred.

Panel comments and finding on the First Drake Loan Allegation

684. There were three factual matters that the first Drake loan allegation referred to as the basis for alleging that there was insufficient appropriate audit evidence in the Audit Engagement file to demonstrate that Mr Williams had applied an appropriate level of professional scepticism to assessing whether:
- (a) the figure of \$11 million used as the projected future earnings figure in the BStar Report was reasonable;
 - (b) the audit procedures performed on the BStar Report that was referred to in the lead audit paper were appropriate for audit purposes; and
 - (c) the BStar Report had been prepared by someone with the appropriate experience and expertise and was reliable.
685. With respect to the first factual matter, we refer to and repeat our comments at paragraphs 676 and 677 and based on those matters we are satisfied that there was no audit evidence to demonstrate that Mr Williams had applied an appropriate level of professional scepticism to assessing whether the projected future earnings figure in the BStar Report was reasonable.
686. As to the second factual matter, Mr Williams' evidence was that the BStar Report was considered, noting it was not a valuation report per se but a report capitalising pre-tax projected future business earnings, based on two main variables being:
- (a) projected future earnings of \$11 million; and
 - (b) the earnings multiplier of 9.75.
687. As we have noted, to the extent Mr Williams performed additional audit work, it was not recorded on the Audit Engagement File, it was not cross-referenced in AWPIB13 and it did not lead to any amendments or additions to the other audit file evidence on the Drake Loan receivable.

688. In our view, particularly based on Mr Williams' evidence that the BStar Report was not a valuation, and had he been displaying appropriate professional scepticism in the conduct of the audit, he would have reconciled the work that he had done with the other audit work that was performed and retained on the Audit Engagement File and cross-referenced in AWPIB13, so as to ensure the audit file evidence placed the BStar Report into appropriate perspective and was consistent and sufficient to support the conclusion that was drawn.
689. However, this was not the result of the work Mr Williams gave evidence about having performed and regardless of whether Ms Blank's characterisation of the BStar Report as a valuation was mistaken, the report was one of the main documents comprising the audit evidence.
690. Further, in terms of the *flag* to which Mr Williams referred in his evidence, we would expect, having regard to the Relevant Benchmark¹³² that a reasonably competent auditor exercising appropriate professional scepticism would consider the impact the \$7 million deficiency in coverage might have on the audit conclusions regarding recoverability of the loans.
691. As to the third aspect of the allegation, as we have noted in paragraph 683 the Auditing Standards specified that audit evidence was required to demonstrate a proper evaluation of the credentials of the management expert and this did not occur, apparently on the basis, according to Mr Williams' evidence, of his personal acquaintance with Mr Bloxham. The various caveats documented in the BStar Report are matters the impact (or appropriate resolution/clarification) of which we would expect a reasonably competent auditor to have clearly explained in the audit evidence and the evidence supports the conclusion that this did not occur.
692. Based on our comments above we are satisfied that there was insufficient appropriate audit evidence in the Audit Engagement File to demonstrate that Mr Williams had applied an appropriate level of professional scepticism to the matters the subject of the First Drake Loan Allegation.
693. We find that the First Drake Loan Allegation has been established.

Second Drake Loan allegation

694. The Second Drake loan allegation was that there was insufficient appropriate audit evidence on the Audit Engagement File to demonstrate that Mr Williams had applied an appropriate level of professional scepticism to assessing:
- (a) the purpose of the Drake loan;
 - (b) the ramifications of this loan being a related party transaction; and/or
 - (c) the terms, conditions and size of the loan.
695. Mr Williams denied this allegation on the two bases.

¹³² See above n 56.

696. The first basis was the Limited Users Response, because the Limited Users were aware of the loan and were involved in its approval, including the terms, conditions and quantum.
697. We refer to and repeat our reasons and finding with respect to the Limited User/Limited Purpose Response.¹³³ We are satisfied that this response does not provide a valid basis for denying this allegation.
698. The second response to this allegation was that the purpose of the loan was not relevant for audit purposes.
699. In our view the fact that Mr Drake was a related party, the quantum of the loan and the fact that there was an overall deficiency of assets in Maddison and LMIM to cover the Drake loan should have been matters that heightened scepticism in the 2012 LM Audit that resulted in further investigation and additional scrutiny of the management information provided with respect to the Drake Loan.
700. Turning now to the substance of the allegation, it is relevant to bear in mind the provisions of ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*, paragraph 8 sets out that when obtaining reasonable assurance, the auditor is responsible for maintaining professional scepticism throughout the audit, considering the potential for management override of controls and recognising the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.
- ASA 240.10 refers to the objectives of the auditor as being:
- (a) To identify and assess the risks of material misstatement of the financial report due to fraud;
 - (b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
 - (c) To respond appropriately to fraud or suspected fraud identified during the audit.
701. In our view, the three matters the subject of the Second Drake Loan Allegation were all matters that as well as being relevant to the recoverability of the Drake Loan were relevant to a proper consideration by the auditor of the responsibilities referred to in ASA 240 in the 2012 LM Audit.
702. Mr Drake was the Chairman and Chief Executive Officer of LMIM which was the Manager of LM. Related party circumstances such as were evidenced by these facts should have prompted heightened professional scepticism on the part of the auditor because of the risk posed by the related party having governance responsibility and being in a position to override management controls in circumstances where there were no non-executive directors. Beyond noting the related party status, there was no audit evidence that heightened professional scepticism was applied. There was no audit evidence about the purpose of the

¹³³ See above n 56.

loan, even though these matters were highly relevant to the potential recoverability of the loan by LM.

703. The *Serviceability Memo for Managed Performance Fund/Peter Charles Drake – related party loan* was not prepared until February 2013 and so was not a document that evidenced information on which Mr Williams’ audit conclusion had been based. We would expect there to have been audit evidence of the contents of that memo and details of the the assets that were available to support the security for the loans, which would have included Mr Drake’s assets that were available to Mr Williams before he signed the 2012 LM Audit.
704. Mr Drake’s multi-faceted involvement in the LM Group, his financial involvement, and his dual role of Chairperson and Chief Executive Officer demanded in our view significantly heightened professional scepticism applied to the performance of the 2012 LM Audit in order to satisfy the requirements of ASA 240 because these matters should have been regarded as indicia that could increase the incentive for material misstatement of the financial report due to fraud.
705. We also refer to and repeat our comments on the importance of applying appropriate professional scepticism in an audit.¹³⁴
706. We are satisfied that there was no audit evidence that demonstrated appropriate professional scepticism had been applied to the matters the subject of this allegation. As well as being being satisfied on the basis of the audit evidence we have discussed, this was also evident from Mr Williams’ Responses, that demonstrated that he did not consider it necessary to apply professional scepticism in the circumstances of the 2012 LM Audit, which in our view in the context of all of the circumstances we have discussed, was misguided, particularly had he appropriately considered all of the matters we have referred to in our discussion of this allegation, which in our view should have caused increased professional scepticism to have been applied.
707. We are satisfied that the Second Drake Loan Allegation has been established.

Third Drake Loan Allegation

708. The Third Drake Loan Allegation was that at the date Mr Williams signed the 2012 Audit Report for LM, there was insufficient appropriate audit evidence on the Audit Engagement File to:
- (a) support the carrying value of the Drake loan; and
 - (b) demonstrate the Drake Loan had been appropriately accounted for in accordance with AASB 139 *Financial Instruments: Recognition and Measurement* insofar as:
 - (i) The Audit Engagement File did not include an assessment of the assumptions used in the valuation of LM e.g. BStar Pty Ltd was asked to use \$11 million for future earnings; and it did not include

¹³⁴ See above n 58.

an assessment of the validity of the valuation for audit purposes and an assessment of the expert's competence and experience;

- (ii) There was no evidence that Mr Williams applied a level of professional scepticism so as to understand the purpose of the loan; and
- (iii) the *Serviceability Memo for Managed Performance Fund/Peter Charles Drake – related party loan* was not obtained by Mr Williams until approximately two months after the Auditor's Report was signed.

709. Mr Williams denied this allegation on the basis of the responses he made to the first two Drake Loan Allegations and with respect to (c) above said that ASA 230 provides: 'The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the audit report.'

710. In our view there was insufficient appropriate audit evidence with respect to the matters particularised in this allegation and we refer to our findings in the First and Second Drake Loan Allegations in this regard.

711. It was implicit in Mr Williams' prosecution of the Limited Purpose/Limited Users Response as the primary ground of his response to the Drake Loan allegations that his view was that such evidence was not necessary in the context of this audit. We refer to and repeat our reasons and finding on the Limited Purpose/Limited User Response¹³⁵ that form the basis for our view that Mr Williams did not have a proper basis for not carefully considering the matters highlighted by the Drake Loan Allegations as they were matters that the Auditing Standards required him and/or were relevant to assessing the risks of recoverability of the Drake Loan and whether the loan had been properly accounted for under AUASB 139. As we have said, the related party nature of the transaction was such that heightened professional scepticism should have been applied.

712. With respect to the document *Serviceability Memo for Managed Performance Fund/Peter Charles Drake – related party loan* – this document was not prepared until February 2013.

713. Mr Williams relied on ASA 230.14 that provided:

The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on timely basis after the date of the audit report.

714. ASIC referred in its final submissions to ASA 230.A22 which provided explanation with respect to paragraph 14 and stated:

The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.

¹³⁵ See above n 47.

715. Paragraph A22 also noted that changes may be made to audit documentation and provided an example of documenting audit evidence that the auditor had obtained, discussed and agreed with the relevant members of the audit engagement team before the date of the auditor's report.
716. As this Memo was created by LM on 12 February 2013, it could not have been obtained, discussed and agreed upon before the 202 LM Audit report was signed on 7 December 2012 and in our view the document's inclusion on the audit file did not fall within the purview of ASA 230.14 as asserted by Mr Williams.
717. We are satisfied that the third Drake loan allegation has been established.

Sub-Contentions – Findings

718. We now turn to consider whether the Contention One Sub-Contentions, to the extent they were made with respect to the four loans we have discussed, have been established based on our findings on the facts and allegations we have already set out.

Sub-Contention 1(a)

Failure to obtain sufficient appropriate audit evidence to support the recoverability of loans and receivables.

719. At the relevant time:

- (a) ASA 500.1 stated that ASA 500 explains what constitutes audit evidence in an audit of a financial report, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.
- (b) ASA 500.6 provided: 'The auditor shall design and perform audit procedures, that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.'
- (c) Relevant definitions contained in ASA 500.5 included:
 - (b) Appropriateness (of audit evidence): 'means the measure of the quality of the audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.'
 - (e) Sufficiency (of audit evidence): 'means the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.'
 - (c) Audit evidence: 'means the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the

accounting records underlying the financial report and other information.’

720. Mr Williams said that Sub-Contention (a) was considered at AWPAA1.2. We refer to and repeat our comments with respect to the template-generated documents that were used by WPIAS in the 2012 LM Audit.¹³⁶
721. The references in the template generated documents such as AWPAA1.2 to matters about which the Engagement Partner must take responsibility and how the audit is to be documented do not constitute appropriate or sufficient audit evidence that the relevant audit procedures were performed.
722. We refer to the Relevant Benchmark.¹³⁷ Based on our comments and findings with respect to:
- (a) The First, Fourth and Fifth Maddison Loan Allegations and Sub-Allegations (a)-(h), (j)-(n) and (p)-(v) of the Sixth Maddison Loan Allegation;
 - (b) The Second and Third Aalto/AIIS Loan Allegations;
 - (c) Sub-Allegation 1(a) of the First and the Second, Third, Fourth, Fifth and Sixth LMC Loan Allegations; and
 - (d) The First, Second and Third Drake Loan Allegations.

Our view is that Mr Williams’ level of performance of his duties relevant to demonstrating that the requirements of ASA 500 had been met in the 2012 LM Audit was not adequate.

723. We refer to and repeat our comments about the nature of the Board’s task under section 1292 of the Act¹³⁸ and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 1(a) has been established.

Sub-Contention 1(b)

Failure to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level ASA 200.17.

724. At the relevant time, ASA 200 set out standards with respect to overall objectives of the Independent Auditor and requirements with respect to the conduct of an audit in accordance with the Auditing Standards. ASA 200.17 provided:

To obtain reasonable assurance, the auditor shall obtain appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor’s opinion.

¹³⁶ See above n41.

¹³⁷ See above n 56.

¹³⁸ See paragraphs 95-99.

725. For the audit procedures to be appropriate for the purpose of obtaining sufficient appropriate audit evidence they were required to result in information that was relevant and reliable, accurate and complete and sufficiently precise and detailed for the auditor's purpose.
726. Mr Williams said that Sub-Contention 1(b) was considered 'throughout the AWP Objectives and Conclusions'.
727. The auditor's duty to properly exercise professional judgement when forming conclusions in an audit must in our view involve having a reasonable basis for those conclusions having regard to the range of requirements in the relevant Auditing Standards. An AWP record of audit objectives does not demonstrate the proper discharge of that duty. The document to which Mr Williams referred was a template of the nature we have already discussed.¹³⁹ We would expect a document such as this to reflect the requirements of the Auditing Standards (then prevailing), as that is their purpose. To the extent that it recorded audit conclusions, those conclusions do not represent appropriate and sufficient audit evidence unless they include or include reference to other audit evidence demonstrating support for the basis of the conclusion recorded, as that reflects the requirements of the relevant standards. For those reasons the AWP Audit Objectives and Conclusion did not in our view demonstrate that appropriate audit evidence had been obtained to obtain reasonable assurance in terms of the requirement in ASA 200.17.
728. We refer to the Relevant Benchmark.¹⁴⁰ Based on our comments and findings with respect to the:
- (a) First, Third and Fourth Maddison Loan Allegation and Sub-Allegations (a)-(h), (j)-(n) and (p)-(v) of the Sixth Maddison Loan Allegation;
 - (b) Second and Third Aalto/AIIS Loan Allegations;
 - (c) First, Second, Third, Fourth, Fifth and Sixth LMC Loan Allegations; and
 - (d) First, Second and Third Drake Loan Allegations.

Our view is that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of ASA 200.17 had been met in the 2012 LM Audit was not adequate.

729. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act¹⁴¹ and based on the matters referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 1(b) has been established.

¹³⁹ See above n41.

¹⁴⁰ See above n 56.

¹⁴¹ See above n 138.

Sub-Contention 1(c) and Sub-Contention 1(l)

Failure to adequately assess the reliability and relevance of information to be used as audit evidence to support loans and receivables and whether that evidence was sufficiently reliable, precise and complete for use in supporting the conclusions on which the audit opinion was based.

730. At the relevant time:

(a) ASA 500.7 provided: ‘When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.’

(b) ASA 500.9 provided:

When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor’s purposes, including as necessary in the circumstances:

- (a) Obtaining audit evidence about the accuracy and completeness of the information; and
- (b) Evaluating whether the information is sufficiently precise and detailed for the auditor’s purposes.

(c) The explanatory material with respect to ASA 500 included the following relevant information:

A5: The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

A31: The reliability of information to be used as audit evidence is influenced by its source and its nature. Recognising there are important exceptions, the following generalisations about the reliability of audit evidence may be useful:

- (a) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- (b) The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- (c) Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example enquiry about the application of a control).
- (d) Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- (e) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

731. Mr Williams said that Sub-Contention (c) was considered at AWPAA1 which was the template document headed *Audit Plan and Overall Strategy*. We refer to and repeat our comments with respect to the template-generated documents that were used by WPIAS in the 2012 LM Audit.¹⁴² AWPAA1 does not demonstrate the consideration of the impact of subsequent events on the carrying value of loans and receivables in accordance with ASA 560.6 and 560.7.

732. We refer to the Relevant Benchmark.¹⁴³ Based on our comments and findings with respect to the:

- (a) Second, Third, Fifth, Seventh, Eighth and Ninth Maddison Loan Allegations;
- (b) First, Second and Third Aalto/AIIS Loan Allegations;
- (c) First, Second, Third, Fourth, Fifth and Sixth LMC Loan Allegations; and
- (d) First, Second, and Third Drake Loan Allegations.

Our view is that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of ASA 500.7 and 500.9 had been met in the 2012 LM Audit, was not adequate.

733. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act¹⁴⁴ and based on the matters we have set out in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d) of the Act and we are satisfied that Sub-Contention 1(c) and 1(l) have been established.

Sub-Contention 1(d)

Failure to consider the impacts of subsequent events on the carrying value of the loans and receivables.

734. At the relevant time:

- (a) ASA 560.6 required an auditor to perform audit procedures to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial report and the date of the auditor's report that require adjustment of, or disclosure in, the financial report have been identified.
- (b) ASA 560.7 required an auditor to perform the procedures so that they cover the relevant period and take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, including the following:
 - (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified;

¹⁴² See above n 41.

¹⁴³ See above n 56.

¹⁴⁴ See above n 138.

- (b) Enquiring of management and, where appropriate, those charged with governance, as to whether any subsequent events have occurred which might affect the financial report;
- (c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial report and enquiring about matters discussed at any such meetings for which minutes are not yet available;
- (d) Reading the entity's latest subsequent interim financial report.

735. Mr Williams said that Sub-Contention 1(d) was considered at AWPXC1 which was the template document headed *Subsequent Events*. We refer to and repeat our comments with respect to the template-generated documents that were used by WPIAS in the 2012 LM Audit.¹⁴⁵ AWPXC1 does not contain any substantive consideration of the impacts of subsequent events on the carrying value of the loans and receivables and does not provide a record that demonstrates that any of the procedures identified in ASA 560.6 and 560.7 had been carried out.

736. We refer to the Relevant Benchmark.¹⁴⁶ Based on our comments and findings with respect to the Fourth Maddison Loan Allegation. Our view is that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of ASA 560.6 and 560.7 had been met in the 2012 LM Audit, was not adequate.

737. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act¹⁴⁷ and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d) of the Act and we are satisfied that Sub-Contention 1(d) has been established.

738. The SOFAC also made this Sub-Contention with respect to all loans and referred to paragraph 138(c) of the SOFAC. The SOFAC did not include a paragraph 138(c) and we have not therefore considered whether this Sub-Contention has been established with respect to all loans.

Sub-Contention 1(e)

Failure to adequately understand management's estimates in relation to the recoverability of loans and receivables and data on which it was calculated.

Sub-Contention 1(f)

Failure to adequately respond to risks of material misstatements with respect to loans and receivables.

Sub-Contention 1(g)

Failure to adequately evaluate whether accounting estimates relating to loans and receivables were reasonable.

739. At the relevant time:

¹⁴⁵ See above n41.

¹⁴⁶ See above n 56.

¹⁴⁷ See above n 138.

- (a) ASA 540.8 required an auditor to obtain an understanding of a range of matters to provide a basis for the identification and assessment of the risks of material misstatements for accounting estimates.
- (b) ASA 540.12 required an auditor to determine, based on the assessed risks of material misstatement, whether management had appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate, and whether the methods for making the accounting estimates (and any changes) were appropriate and had been applied consistently.
- (c) ASA 540.13 provided:

In responding to the assessed risks of material misstatement, as required by ASA 330, the auditor shall undertake one or more of the following, taking account of the nature of the nature of the accounting estimate:

- (a) Determine whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate;
- (b) Test how management made the accounting estimate and the data on which it is based...;
- (c) Test the operating effectiveness of the controls over how management made the accounting estimate, together with appropriate substantive procedures;
- (d) Develop a point estimate or a range to evaluate management's point estimate...

- (d) ASA 540.18 provided:

The auditor shall evaluate, based on the audit evidence, whether the accounting estimates in the financial report are either reasonable in the context of the applicable financial reporting framework or are misstated.

- (e) ASA 540.21 provided:

The auditor shall review the judgements and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias. Indicators of possible management bias do not themselves constitute misstatements for the purpose of drawing conclusions on the reasonableness of individual accounting estimates.”

- (f) ASA 540 Aus 23.1 provided:

The auditor's evaluation of any indicators of possible management bias in making accounting estimates, including whether the circumstances giving rise to the indicators of bias represent a risk of material misstatement due to fraud.

740. Mr Williams said that the requirements in ASA 540 were considered in AWPAG1.

741. AWPAG1 is a system generated template document of the nature we have discussed¹⁴⁸ entitled *Accounting Estimate*. The document lists various audit steps. Similar to the other audit programmes, there is a box at the side of each

¹⁴⁸ See above n 41.

step for use to indicate whether the step has been completed. The document is three pages in length and every box has been ticked as completed. Some of the audit steps in the work paper, which (as we would expect) reflected the requirements of the then prevailing Auditing Standards, noted references to particular audit work papers, although many referenced a whole section of the Audit Engagement File.

742. The relevant Audit procedure recorded in AWPAGI with respect to these Sub-Contentions was (c). It stated:

How management makes the accounting estimates, and an understanding of the data on which they are based, including (i) the method, including where applicable the model, used in making the accounting estimates (ii) relevant controls (iii) whether management has used an expert (iv) the assumptions underlying the accounting estimates (v) whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why and (vi) whether and if so, how management has assessed the effect of estimation uncertainty.

743. There was a tick recorded for this audit procedure in the ‘completed’ column, and nothing recorded under the ‘ref’ column or in the ‘comments’ column.
744. The purpose of a program such as the framework reflected in AWPAG1, was to draw together, by cross-referencing and appropriate narrative, the audit evidence that demonstrated the evaluation that had taken place and that appropriate professional scepticism had been applied to the information gained in the consideration leading to a conclusion. AWPAG1 did not demonstrate this with respect to accounting estimates and is not audit evidence demonstrating Mr Williams appropriately or sufficiently considered the matters that were relevant to an adequate understanding of management’s estimates in relation to the recoverability of loans and receivables and the data on which it was calculated.
745. We refer to the Relevant Benchmark.¹⁴⁹ Based on our comments and findings with respect to the:
- (a) First, Second, Third, Fifth, Seventh and Ninth Maddison Loan Allegations;
 - (b) First, Second and Third Aalto/AIIS Loan Allegations;
 - (c) First, Second, Third, Fourth and Fifth LMC Loan Allegations; and
 - (d) First, Second and Third Drake Loan Allegations.

Our view is that Mr Williams’ level of performance of his duties relevant to demonstrating that the requirements of ASA 560.6 and 560.7 had been met in the 2012 LM Audit, was not adequate.

746. We refer to and repeat our comments in paragraphs 102–107 about the nature of the Board’s task under section 1292 of the Act¹⁵⁰ and based on the matters we have referred to in the preceding paragraph we are satisfied that Mr Williams

¹⁴⁹ See above n 56.

¹⁵⁰ See above n 138.

has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d) of the Act and we are satisfied that Sub-Contention 1(e), (f) and (g) have been established.

Sub-Contention 1(h)

Failure to identify and evaluate any indicators of possible management bias in making accounting estimates.

747. ASA 500.9 is set out in Sub-Contention 1(c).
748. ASA 540.21, 540.23 and ASA 540 Aus 23.1 are set out in Sub-Contention 1(e) above.
749. Mr Williams said that the requirements in ASA 540 were considered in AWPAG1.
750. We refer to and repeat our comments with respect to AWPAG1 referred to in our consideration of Sub-Contentions 1(e), (f) and (g) above.
751. Audit step 5 of AWPAG1 addressed Indicators of Possible Management Bias. It stated:
- Review the judgements and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias. Indicators of possible management bias do not themselves constitute misstatements for the purpose of drawing conclusions on the reasonableness of individual accounting estimates.
752. Step 5 has been marked as completed and a reference to IB is noted beside it. IB is not a specific AWP, but apparently a reference to the entire *Loans Receivable* section of the Audit Engagement File. Using AWPIB10, the lead audit work paper for the Maddison Loan receivable (and hence within the reference to IB noted above) as an example, we note there is no step referencing indicators of possible management bias. While AWPAG1 references management bias and cross referred to the Loans Receivable section of the file, there is no evidence of any specific audit work within AWPIB10 pertaining to the investigation or assessment of the possibility of management bias with respect to the Maddison Loan.
753. We have also considered the documentation with respect to the planning components of the Audit Engagement File, which identified risks that were relevant indicators for management bias. Two examples from Document AA1.1 that was entitled Client Acceptance and Continuance were step 1.9: ‘Consider the integrity of the principal owners, key management and those charged with governance of the entity (as per ASA 220.A8)’. The response that was recorded beside that step: ‘Note the Sydney Morning Herald article ‘The Scarlet Pimpernel of Funds Management’ 17.05.12 and the company’s response. Whilst Grant Fischer and Eryn Vannucci (née Wilson) remain, level of risk acceptable.’ Second, beside step 1.10 the comment ‘Grant Fischer resigned as Executive Director Finance in August 2012, however will remain as contract CFO to December 2012’ and the further comment ‘Reg Williams met with Grant Fischer in October 2012, and was advised there are no reasons to be concerned.’

754. The proper purpose of a program such as that contemplated by AWPAG1 should have been to direct attention in the design and performance of audit procedures to areas such as those referred to, and which had indeed been noted in the planning documents, in order to seek to identify audit evidence that allows a basis for the conclusion in the audit. There was no audit evidence on the Audit Engagement File, in terms of the Maddison Loan, the fund's *anchoring asset*, that any structured evaluation had occurred as to whether those indicators of management bias might be relevant to the accounting estimates and a proper consideration of whether there had been a material misstatement.
755. Even had the conclusion been that the indicators for management bias did not have a relevant impact, we would expect to see evidence of that evaluation in line with ASA 540 Aus. 23.1 and a basis for the conclusion drawn. There was no audit evidence to this effect.
756. Further, the comments referred to in AWPAG1 indicate to us that the absence of follow up and consideration additional to that evidenced by the comments recorded, there was insufficient professional scepticism applied to that information that may have led to the failure to identify and properly evaluate other indicators of possible management bias. We have discussed the importance of demonstrating appropriate professional scepticism throughout an audit and the details of the guidance provided to auditors at the time as to the professional standard in this regard.¹⁵¹
757. We refer to the Relevant Benchmark.¹⁵² Based on our comments and findings with respect to the:
- (a) Third and Fifth Maddison Loan Allegations;
 - (b) First, Second and Third Aalto/AIIS Loan Allegations;
 - (c) First, Second, Third, Fourth, Fifth and Sixth LMC Loan Allegations; and
 - (d) Third Drake Loan Allegation.

Our view is that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of ASA 500.9 and ASA 540 had been met in the 2012 LM Audit, was not adequate.

758. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act¹⁵³ and based on the matters we have referred to in the preceding paragraph we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d) of the Act and we are satisfied that Sub-Contention 1(h) has been established.

¹⁵¹ See above n 58.

¹⁵² See above n 56.

¹⁵³ See above n 138.

Sub-Contention 1(i)

Aalto/AIIS - Failure to evaluate the competence and capabilities of a management expert, obtain an understanding of the work performed by the expert and to evaluate the appropriateness of that expert's work as audit evidence.

759. At the relevant time, ASA 500.8 provided:

If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes: (Ref: Para. A34-A36)

- a. Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para. A37-A43)
- b. Obtain an understanding of the work of that expert; and (Ref: Para. A44-A47)
- c. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para. A48)

760. Mr Williams said that the requirements in ASA 540 were considered in AWPAA1. AWPAA1 was the template document headed *Audit Plan and Overall Strategy*. We refer to and repeat our comments with respect to the template-generated documents that were used by WPIAS in the 2012 LM Audit.¹⁵⁴ AWPAA1 does not demonstrate audit evidence of the evaluation of the competence and capabilities of a management expert or an understanding of the work performed by the expert or an evaluation of the appropriateness of that expert's work as audit evidence.

761. We refer to the Relevant Benchmark.¹⁵⁵ Based on our comments and findings with respect to:

- (a) Sub-Allegation (b) of the Second and Sub-Allegation (c) of the Third Aalto/AIIS Loan Allegations;
- (b) Sub-Allegation (a) of the First LMC Loan Allegation; and
- (c) the First and Third Drake Loan Allegation

Our view is that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of ASA 500.8 had been met in the 2012 LM Audit, was not adequate.

762. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act¹⁵⁶ and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d) of the Act and we are satisfied that Sub-Contention 1(i) has been established.

¹⁵⁴ See above n 41

¹⁵⁵ See above n 56.

¹⁵⁶ See above n 138.

Sub-Contention 1(j)

Failure to document how inconsistencies between identified information and the final conclusion were addressed.

763. The standard of audit documentation required by ASA 230.8 is such that it should have been evident (to another experienced auditor) from the file:

The nature, timing and extent of the audit procedures performed to comply with the Australian Auditing Standards and applicable legal and regulatory requirements (Para A6-7) and (b) The results of the audit procedures performed, and the audit evidence obtained; and (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions...(Paragraph A8-11).

764. ASA 500.11 at the time provided that ‘if audit evidence obtained from one source is inconsistent with that obtained from another...the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.’

765. Mr Williams said that the requirements in ASA 230.8 and ASA 500.11 were considered in AWPAA1.2. We refer to and repeat our comments with respect to the template-generated documents that were used by WPIAS in the 2012 LM Audit.¹⁵⁷ The references in the template generated documents such as AWPAA1.2 to matters about which the engagement partner should take responsibility and how the audit should be documented is not sufficient appropriate audit evidence that the Audit Engagement File was in fact documented in accordance with the relevant requirements as a result of appropriate audit procedures having been performed.

766. We refer to the Relevant Benchmark.¹⁵⁸ Based on our comments and findings with respect to the:

- (a) Fourth, Fifth, Seventh and Ninth Maddison Loan Allegations;
- (b) First, Second and Third Aalto/AIIS Loan Allegations; and
- (c) First and Fifth LMC Loan Allegations,

Our view is that Mr Williams’ level of performance of his duties relevant to demonstrating that the requirements of ASA 230.8 and ASA 500.11 had been met in the 2012 LM Audit, was not adequate.

767. We refer to and repeat our comments in paragraphs 102–107 about the nature of the Board’s task under section 1292 of the Act¹⁵⁹ and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor and we are satisfied that Sub-Contention 1(j) has been established.

¹⁵⁷ See above n41.

¹⁵⁸ See above n 56.

¹⁵⁹ See above n 138.

Sub-Contention 1(k)

Failure to display an appropriate level of professional scepticism.

768. ASA 200.15 provided that the Auditor shall plan and perform an audit with professional scepticism recognising that circumstances may exist that cause the financial report to be materially misstated.
769. Mr Williams said that the requirements in ASA 230.15 were considered in AWPAA1.2. We refer to and repeat our comments with respect to the template-generated documents that were used by WPIAS in the 2012 LM Audit.¹⁶⁰ The references in the template generated documents such as AA1.2 to matters about which the engagement partner should take responsibility and how the audit should be documented is not sufficient or appropriate audit evidence that appropriate professional scepticism was applied in the performance of the audit.
770. We refer to the Relevant Benchmark.¹⁶¹ Based on our comments and findings with respect to the:
- (a) First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth and Ninth Maddison Loan Allegation;
 - (b) First, Second and Third Aalto/AIIS Loan Allegations;
 - (c) First, Second, Third, Fourth, Fifth and Sixth LMC Loan Allegations;
 - (d) First, Second and Third Drake Loan Allegations.

Our view is that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of ASA 200.15 had been met in the 2012 LM Audit, was not adequate.

771. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act¹⁶² and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d) of the Act and we are satisfied that Sub-Contention 1(k) has been established.

Sub-Contention 1(m)

In the absence of auditing Maddison Estate, failure to either withdraw from, disclaim or qualify the LM audit opinion: ASA 705.13(b), 705.9, 705.13(a) and 705.7.

772. ASA 705 sets out the framework for identifying when to withdraw from, qualify or disclaim an audit opinion.
773. ASA 705 relevantly provides:

705.7 The auditor shall express a qualified opinion when:

¹⁶⁰ See above n 41.

¹⁶¹ See above n 56.

¹⁶² See above n 138.

- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial report; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial report of undetected misstatements, if any, could be material but not pervasive.

The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial report of undetected misstatements, if any, could be both material and pervasive.

705.13 If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (a) If the auditor concludes that the possible effects on the financial report of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (b) If the auditor concludes that the possible effects on the financial report of undetected misstatements, if any, could be both material and pervasive, so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
 - (i) withdraw from the audit where practicable and possible under the applicable law or regulation; or
 - (ii) if withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial report.

774. Mr Williams said this contention was considered in AWPBC1. This is a template produced by the Firm's auditing program software entitled *Forming an Opinion on the Financial Report* and lists various requirements from Auditing Standards in relation to drawing final conclusions based on the audit work performed, including consideration of the form of audit opinion to be issued. We have already considered AWPBC1 in detail in the Seventh Maddison Loan Allegation.¹⁶³

775. The first page of this AWP section 1 sets out 11 questions relating to audit file completion and accounting preparation. For example, whether sufficient appropriate audit evidence has been obtained and whether information presented in the financial report is relevant, reliable, comparable and understandable. These questions provide for marking a *Yes/No* option. In addition, there is an empty box next to each option. Each question was marked as a *Yes* response and each box had been ticked.

776. Section 2 of the AWP commences:

2. Conclude based on the responses to section 1 above whether the financial report has been prepared, in all material respects, in accordance with the applicable financial reporting frameworks.

¹⁶³ See paragraphs 438-441.

And follows with:

‘If conclusion is yes then express an unmodified opinion’. Next to this line a box had been ticked and there was a handwritten notation ‘Yes – unmodified’. The remainder of this work paper (two and a half pages) template refers to a series of considerations, consistent with the relevant auditing standards, including audit completion, modified opinions and going concern. There is a handwritten *N/A* next to each step listed.

777. The answers recorded in this document were not consistent with the audit evidence in significant respects as they did not reflect the significant matters of uncertainty identified and noted, including those matters the subject of the Subsequent Maddison Audit Response.¹⁶⁴ Had this template been completed having appropriate regard to the matters of uncertainty identified for follow up in the Subsequent Maddison Audit, it would not have led to the conclusion that an unmodified audit opinion with respect to the 2012 LM Financial Statements, was appropriate.
778. Although AWPBC1 appears to appropriately reflect ASA 705, it has not been completed in a manner that appropriately reflects the relevant audit evidence. We refer to and repeat our comments with respect to the template generated documents that were used by WPIAS in the 2012 LM Audit.¹⁶⁵
779. We refer to the Relevant Benchmark.¹⁶⁶ Based on our comments and findings with respect to the First, Fifth, Sixth, Seventh, Eighth and Ninth Maddison Loan Allegations and our finding on the Subsequent Maddison Audit, our view is that Mr Williams’ level of performance of his duties relevant to demonstrating that the requirements of ASA 705.13(b), 705.9, 705.13(a), 705.7 had been met in the 2012 LM Audit, was not adequate.
780. We refer to and repeat our comments in about the nature of the Board’s task under section 1292 of the Act¹⁶⁷ and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor and we are satisfied that Sub-Contention 1(m) has been established.

Sub-Contention 1(n)

781. Sub-Contention 1(n) was put in the alternative to Sub-Contention 1(a) – (m). On the basis that we have found Sub-Contentions 1(a) – (m) established, we have not considered Sub-Contention 1(n).

Panel’s Conclusion with respect to Contention One

782. Based on our findings on each of the Contention One Sub-Contentions we are satisfied that, within the meaning of sub section 1292(1)(d)(i) of the Act,

¹⁶⁴ See above n 53.

¹⁶⁵ See above n 41.

¹⁶⁶ See above n 56.

¹⁶⁷ See above n 138.

Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor.

783. We are satisfied that Contention One has been established

CONTENTION 2 – AUDIT EVALUATION OF GOING CONCERN ASSESSMENT

784. ASIC contends that within the meaning of subsection 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Financial Statements in connection with the evaluation of management’s assessment of going concern. It was not in issue that the 2012 LM Financial Statements were prepared on the assumption that LM was a going concern and that the 2012 LM Audit Opinion was issued on an unmodified basis.

785. Mr Williams denied the allegations in Contention 2 and asserted a number of responses and referred to a number of documents that he submitted demonstrated there had been appropriate consideration of going concern in the 2012 LM Audit. We have considered his responses and described and discussed the documents to which he referred us in this determination.

ASA 570 – Relevant provisions

786. ASA 570 dealt with the auditor’s responsibilities in the audit of a financial report with respect to management’s use of the going concern assumption when preparing a financial report. Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future.¹⁶⁸

787. ASA 570 provided that management’s assessment of the entity’s ability to continue as a going concern involves making a judgement at a particular time, about inherently uncertain future outcomes of events or conditions and referred to three matters relevant to that judgement as follows:

- (a) The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future it is due to occur.
- (b) The size and complexity of the entity, the nature and condition of the business and the degree to which it is affected by external factors will affect the judgement regarding the outcome of events or conditions.
- (c) Any judgement about the future is based on information available at the time at which the judgement is made. Subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made.¹⁶⁹

¹⁶⁸ ASA 570.1 and 570.2.

¹⁶⁹ ASA 570.5.

788. ASA 570 described the responsibilities of the auditor as being to obtain sufficient appropriate audit evidence about the appropriateness of management’s use of the going concern assumption in the preparation and presentation of the financial report and to conclude whether there was a material uncertainty about the entity’s ability to continue as a going concern. This audit responsibility existed even if the financial reporting framework used in the preparation of the financial report did not include an explicit requirement for management to make a specific assessment of the entity’s ability to continue as a going concern.¹⁷⁰
789. When conducting relevant risk assessment procedures, ASA 570 provided that the auditor must consider whether there were events or conditions that could cast significant doubt on the entity’s ability to continue as a going concern and must determine whether management had already performed a preliminary assessment of the entity’s ability to continue as a going concern.¹⁷¹ If management had made a preliminary assessment, the auditor’s obligation was to discuss that assessment with management and determine whether any events had been identified that individually or collectively, might cast significant doubt on the entity’s ability to continue as a going concern. If there were such events, the auditor was required to make enquiry about the management plan to address those events or conditions. If no preliminary management assessment had been performed, the auditor’s obligation was to discuss the basis for the use of the going concern assumption and inquire of management whether events had occurred that individually or collectively might cast significant doubt on the entity’s ability to continue as a going concern.¹⁷²
790. ASA 570 further provided that the auditor was to remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.¹⁷³ Finally, it set out the requirements for evaluating management’s assessment, additional procedures to be performed if events or conditions existed that might cast doubt on the entity’s ability to continue as a going concern and the requirements for audit conclusions and reporting.¹⁷⁴

Documents referred to by parties on the Audit Engagement File

“Going Concern” AWP’s AF1, AF2, AF3 and Going Concern Summary

791. The Audit Engagement File contained the following audit documents specifically relevant to going concern:
- (a) AWPAF1 - *Going Concern Programme* was the lead audit workpaper (“AWPAF1”);
 - (b) AWPAF2 - *Going Concern Checklist* (“AWPAF2”);

¹⁷⁰ ASA 570.6.

¹⁷¹ ASA 570.10.

¹⁷² ASA 570.10(a) and (b).

¹⁷³ ASA 570.11.

¹⁷⁴ ASA 570.16 and 570.17.

- (c) *Going Concern Summary* (noted as prepared on 29/11/2012 by AB and reviewed by LD on 3 December 2012) (“Going Concern Summary”); and
- (d) AWPAF3 - *MPF Loan Cashflow (forecast)* (“AWPAF3”).

AWPAF1 - Going Concern Programme

792. AWPAF1 was prepared on 29/8/2012 by AB and (correctly) set out the audit objectives as being to obtain appropriate audit evidence regarding the appropriateness of management’s use of the going concern assumption in the preparation of the financial report and to conclude, based on the audit evidence obtained, whether a material uncertainty existed relating to events or conditions that may have cast significant doubt on the entity’s ability to continue as a going concern and to determine the implications for the auditor’s report (“The Going Concern Audit Assessment”). There were a number of audit procedures listed under the headings: *Risk Assessment Procedures and Related Activities; Evaluating Management’s Assessment; Additional Audit Procedures When Events or Conditions are Identified; Audit Conclusions and Reporting; and Use of Going Concern Assumption Appropriate but a Material Uncertainty Exists*. AWPAF1 recorded that all steps under the first two headings noted above had been completed.

793. Under the first heading *Risk Assessment Procedures and Related Activities* in AWPAF1 there were references recorded to AWPs AA5.6 and AA3. We note AA5.6 and AA3 were template audit planning documents of the nature described in paragraphs 135 - 140 and we refer to and repeat our comments therein on the relevance and weight to be given to these documents.

794. In the ‘comments’ section of AWPAF1 there were notations referring to ‘cashflow’, ‘reliance on new investor funds’, and ‘refinancing of loans/new finance to complete projects (*refer IB*).’

795. Under the 2nd heading *Evaluating Management’s Assessment* in AWPAF1 the reference recorded was to AWPAF3 and the comments noted were ‘Audit Report to be issued by 31/12/2012, 2013 interim testing Y/B, next audit to be completed by 30/09/2013.’

796. Against each of the final 3 headings in AWPAF1 namely whether events or conditions were identified that may cast significant doubt on the entity’s ability to continue as a going concern; whether a material uncertainty existed; and the use of going concern assumption being appropriate but a material uncertainty existing the notation recorded was ‘nil noted’.

797. The conclusion noted in AWPAF1 was ‘In our opinion sufficient appropriate audit evidence has been obtained to materially meet the stated audit objective.’

AWPAF2 - Going Concern Checklist

798. AWPAF2 noted the initials RW with the date 7/12/12 and included the following notations against various boxes that had been checked as follows:

- (a) 'yes' with respect to the operating indicator 'concentration of risk in a limited number of products or projects' with a handwritten notation 'high level of investment in Maddison Project (long term project) IB2';
- (b) 'NA' with respect to the financial indicator 'Lack of sustainable operating profits or cash flows from core business activities' with a handwritten notation stating '*as above, reliance on new investor funds';
- (c) 'No' with respect to the financial indicator 'high gearing or net liability position' and the handwritten notation 'positive net asset position, high level of reliance on investor funds - properties still in development phase';
- (d) 'No' with respect to the financial indicator 'Fixed term borrowings approaching maturity, without realistic prospects of renewal or repayment'. The last 7 words had been underlined and a handwritten notation included said 'Suncorp facility (Maddison) requiring refinancing IB10';
- (e) 'No' with respect to the financial indicator 'Difficulty complying with the terms of loan agreements or the need to restructure debt' and 'yes' with respect to the financial indicator 'need to seek new sources or methods of financing or to dispose of substantial assets'. There was a handwritten note beside these two indicators comprising a bracket and the words 'need to refinance Suncorp facility';
- (f) 'Yes' with respect to the financial indicator 'Negative operating cash flows indicated by historical or prospective financial reports' and the handwritten notation 'As above reliance on new investor funds';
- (g) 'Yes' with respect to the 'other' indicator 'Failure of other MIS's on the Gold Coast'; and
- (h) All of the boxes under the heading 'Mitigating factors' were marked 'yes' and there were handwritten notations as follows:

Capability of delaying additional spending in projects/varying projects to suit cash flow; Fund has entered into DD discussions with various funding bodies; as per "Asset factors" above; History + regular new investments, ability to reduce distributions levels as required (+redemption payouts).

"Going Concern Summary"

- 799. Another document that Mr Williams relied on was the *Going Concern Summary*. This document was headed 'Risks identified on AF1 and AF2'. It was noted as prepared on 29/11/2012, which was the same date as AWPAF2 and was initialled by Mr Williams on 7/12/12.
- 800. The *Going Concern Summary* contained narrative with regard to the risks in connection with the going concern assumption that had been identified at the outset of the audit. It was not a record of analysis of what had been done in terms of dealing with each of those risks in the performance of the audit. For example, with respect to the risk *high level of reliance on new investor funds* in the *Going*

Concern Summary, the projection for new investor funds (in 2013) was almost 50% higher than the previous year (2012) when in the prior year (2011) the actual increase in new investor funds was less than 10%. The commentary noted in the *Going Concern Summary* was ‘History of increasing levels of new investor funds received each year (notwithstanding GFC). New funds are received from overseas investors, and with the increasing number of overseas financial advisors, this is budgeted to continue to increase’. That narrative did not provide insight into whether any independent investigation had been conducted by the auditor into whether there were increasing numbers of overseas financial advisers or any analysis of what impact variations to management’s view about expected investment inflows might have. The importance to LM of continuing investment inflows should have caused Mr Williams to carefully scrutinise this management projection and in our view the audit evidence should have demonstrated analysis of the risks identified, particularly given the nature and stage of the current development projects to which LM was exposed and the inherent uncertainties involved in future forecasts.

801. The conclusion in the *Going Concern Summary* was ‘Based on the audit evidence we have sighted and the discretionary power of the Manager that allows it to control cash outflows, we are of the opinion that no material uncertainty exists that casts significant doubt on the Fund’s ability to continue as a going concern.’
802. ASIC submitted that in drawing this conclusion Mr Williams relied too heavily on LM’s ability to influence its cash outflows rather than considering the more appropriate matter of LM’s ability to generate cash inflows from its receivables. Mr Williams’ Response, evidenced in the conclusion recorded in the *Going Concern Summary*, was that the Manager had complete discretion in relation to the cash flow management of LM, including the ability to suspend unit holder redemptions, vary loan terms including higher interest rates, vary loan repayment terms and management fees payable to LMA and these facts supported a conclusion that it was appropriate to conclude that the entity was likely to continue as a going concern. We have set out the evidence and our views on this response at paragraphs 832–835.

AWPAF3 - MPF loan cash flow

803. AWPAF3, the MPF loan cash flow document, represented LMIM’s assessment of LM’s ability to continue as a going concern by way of a projected cash flow analysis up to 30 June 2013.
804. AWPAF3 was noted in AWPAF1 as evidence of management’s assessment of LM’s ability to continue as a going concern. The audit work on AWPAF3 appeared as handwritten figures and notes. The initials *RW* and the date *7/12/12* were also recorded. Similar to a number of the other work papers to which we have referred the objective and nature of the audit work undertaken was unclear from the notations on AWPAF3, and there was no explanation about what the handwritten figures and notes on AWPAF3 amounted to in terms of the audit assessment that was required of the information it contained regarding management’s assessment of LM’s ability to continue as a going concern. In our

view AWPAF3 was not sufficient and appropriate audit evidence of the performance of the obligation referred to in ASA 570.6.

805. We note the following details of the handwritten notations recorded on AWPAF3:
- (a) Against the projected balance for *Other Operating Expenses* of \$21,000,000 the auditor has noted 'this figure may require increasing'. Nothing further was recorded such as how, or whether, this matter impacted the Going Concern Audit Assessment.
 - (b) Loan payments were estimated to be \$102,177,000, a significant increase compared to loan payments of \$47,257,533 for the year ending 30 June 2012. The increase may have indicated there was appropriate expenditure occurring on development activities in the SPVs. The reason for the increase in estimated loan payments should have been checked because what those funds would be used for and the rate at which further funding would be required were examples of matters that were relevant to a going concern assessment. The notes on AWPAF3 do not record analysis of the reasons for any of the variations apparent between the subsequent period financial information and the 30 June 2012 financial information. In our view, the possible reasons for the variance should have been identified, considered, investigated, evaluated and recorded. The reasons for the variance were likely to significantly impact the inputs into the audit consideration of going concern, particularly in the context of the inherent uncertainties and variables involved in future projections recognised by ASA 570.
 - (c) There was an estimated cash inflow of \$190,000,000 from the issue of investment units in LM. There was no audit evidence about the reasonableness of this estimate. Our view is that appropriate professional scepticism demanded that the range and magnitude of the potential risks that may have impacted the level of this projected inflow over the relevant period were evaluated in the audit particularly given the size of and LM's reliance on that estimated cash inflow and having regard to the magnified risks to the development projects, and to the recoverability of LM's loan receivables, if the funding pipeline being provided by LM were to be interrupted before development completion. The audit evidence in the Audit Engagement File should have demonstrated proper investigation and assessment by the auditor of the basis for management's estimate.
 - (d) The projections showed a net decrease in cash of \$6,947,349. In the 30 June 2012 year of income, the net decrease in cash was \$2,204,240. There was no audit evidence showing that the auditor had properly scrutinised or investigated the reasons for the net decrease in cash and its potential impact on the going concern assumption. We refer to and repeat our views in the preceding paragraph.

Other Documents referred to by Mr Williams' Response

XC documents - Subsequent Events work papers (Forensic File)

806. Mr Williams relied on XC1 *Subsequent Events* and the documents to which it referred to deny that there was inadequate information and analysis with respect to going concern to satisfy the requirements of ASA 570.6 and 570.7.
807. The XC documents were on the Forensic File and not cross-referenced in AWPAF1, the lead audit work paper and we refer to and repeat our comments and finding at paragraphs 141–158 with respect to documents on the Forensic File, which form the basis of our view that those documents were not part of the Audit Engagement File or part of the audit evidence for the 2012 LM Audit Engagement within the meaning of ASA 230. We have nevertheless considered these documents as they are a contemporaneous record relevant to the question of what audit work may have been performed relevant to the obligations set out in ASA 570.6 and 570.7, as distinct from what audit evidence there was, and we set out our views and comments on their content and relevance below.
808. XC1 was prepared by AB on 29/11/2012 and reviewed by Mr Williams on 7/12/2012. It noted as completed the audit procedure described as 'Obtain a copy of the latest financial statements subsequent to period end' and referred to XC3-XC4 that Mr Williams submitted was an analysis of LM's financial information post 30 June 2012 before the 2012 LM Audit was signed on 7 December 2012 .
809. XC3, XC3/1, XC3/2 and XC3/3 appear to be documents obtained from LMIM ("XC3 Balance Sheet Record"). They are identified as the Balance Sheet as at 30 September 2012 and Profit & Loss Statement as at 30 September 2012. These documents present the comparative balances and transactions for the 12 month period ending 30 June 2012 and the period from 01/07/2012-30/09/2012.
810. Apart from the XC number references, the XC3 Balance Sheet Record contains no additional notations that evidenced what audit work was done. The financial information contained in the XC3 Balance Sheet Record appears to have been used within XC4, and XC5, which were WPIAS produced workpapers (the "XC Balance Sheet Review Forensic Work Papers").
811. With respect to the content of the XC Balance Sheet Review Forensic Work Papers we note the following relevant matters:
- (a) They represented a record of the subsequent Balance Sheet and Profit & Loss review that was performed in the 2012 LM Audit. This record suggests the audit work performed was minimal. The work documented comprises a calculation of the variance between the 30 June 2012 balance and the 30 September 2012 balance for each of the line items displayed in the XC3 Balance Sheet Record. The absolute and the percentage value of the variances between each of the line items was also recorded.
 - (b) Commentary is included beside some of the line items. Most of the comments are in type, except for two handwritten notations. The comments recorded refer to events in the relevant review period. The

commentary was not evidence that there had been an evaluation of the significance of the movements that had occurred since the period the subject of the 2012 LM Audit, or what their impact was on subsequent events audit testing, which was the nature of the audit work that in our view was required by ASA 570. For example, there is a 9.7% increase in Total Cash Assets recorded in the XC Balance Sheet Review Forensic Work Papers. Next to that increase is the commentary 'Increase in cash held in margin accounts' and then a handwritten notation 'new investor funds'. That record does not demonstrate analysis of the reason for the increase or indicate its impact on subsequent events audit testing, which is the nature of the audit work that should have been performed to satisfy the relevant audit objectives.

- (c) The parameters used to guide which line items and movements were considered for explicit review and which were not considered for explicit review were not recorded.
- (d) The review did not record conclusions with respect to specific line items, the outcome of the review, indicators that either supported existing preliminary audit assertions or supported the need for further audit scepticism, investigation and inquiry.
- (e) AWPXC5 was headed *Subsequent P&L review*. It was noted as prepared on 12 November 2012 and reviewed on 3/12/2012. Based on the balance sheet and P&L balances for the three months to 30 September 2012 that had been provided by management, it included a column entitled 'annualised' that included a 12 month projection for each item. The projections were based on dividing each of the 30 September 2012 figures (representing the 3 months to September) by 3 and then multiplying that figure by 12 to obtain a twelve month projection. There was no commentary addressing the column headed 'annualised'. The approach used did not take into account the likelihood that there would be variations in expenses and income patterns over the course of the year and that such variations were likely to have differing impacts depending on the nature of the item or expense in question. A more common approach would have been to first compare the same three months in the year prior to review month to month expense and income variations for guidance on determining the likelihood of similar variances in the future year to factor into the projections. In our view there should have been audit evidence outlining the basis for the approach taken.
- (f) With respect to the variances between the 30 June 2012 figures and the 12 month projections recorded in XC5, we make the following observations:
 - (i) An increase of \$2.7 million (4.4%) for Loan Income was recorded. As we have noted, much of this interest was being capitalised rather than representing a payment to LM. The continued capitalisation of loan interest income, should have been an indicator of heightened risk with respect to going concern and in this context warranted further audit investigation in our view. The comment recorded

beside this variance was ‘increases in interest – increases in loan balances’. That commentary did not provide evidence of consideration or investigation of the reasons for the increases in loan balances or the effect of interest, or any analysis of the impact of those matters on the Going Concern Audit Assessment.

- (ii) Management Fees were projected at \$1.8 million less and the comment recorded was *Reduction from that charged in prior year (at discretion of management)*. This commentary did not provide audit evidence that the basis had been considered and checked which in our view should have been part of the the Going Concern Audit Assessment.
- (iii) No provision for impairment was included in the annualised projection because no provision had been booked in the P&L balances for the three months to September 2012 which were used for the annualised projection. The comment recorded was ‘no impairment booked’. That comment evidences a lack of appropriate professional scepticism being applied and no analysis of why no impairment had been booked. There should have been consideration and assessment of whether additional impairment was required over the twelve month period.
- (iv) Currency gains and losses were the final category. Based on the annualised projections there was an \$11.1 million reduction in currency losses forecast. The basis of this projection also showed a lack of appropriate professional scepticism being applied to the amount forecast because the simple extrapolation of the three month amount for this item indicated there was no consideration given to the likelihood of variability due to currency fluctuations over the longer period.
- (v) There was further commentary noted against the Net Profit/(Loss) line item ‘currency fluctuations/reduction in impairment expense/increase in interest’. This comment appears directed to identifying items that were significant contributors to the positive variance to the forecast net profit. In our view that comment also demonstrates a lack of appropriate professional scepticism being applied because the contemporaneous documentation supports the view that those matters identified as contributing to the forecast of increased profit had not been subject to appropriate scrutiny or otherwise adequately evaluated by WPIAS in the audit.

Mr Williams submissions on XC documents

812. In support of his going concern conclusion, Mr Williams submitted that all indicators were that the balance sheet of LM was strengthening by reference to six or seven different KPIs, including liquidity and investor funds. We set out below his further detailed submissions as to what these records demonstrated, together with our further observations and views with respect to his submissions:

- (a) An increase in cash assets of \$1.6 million, that suggested no deterioration of immediate liquidity since 30 June 2012 and in fact an improvement in that immediate liquidity. There was no audit evidence of further analysis of the source of these increased cash holdings in The XC Balance Sheet Review Forensic Work Papers.
- (b) An increase in receivables of \$1.2 million. This increase was largely related to balances involving related parties and included interest on prepaid management fees that had been capitalised. The XC Balance Sheet Review Forensic Work Papers did not record analysis of recoverability or the impact of further capitalised interest on overall recoverability of related party receivables.
- (c) A decrease of \$2.5 million in prepayments largely attributable to a reduction in prepaid management fees (discussed in contention 4) of \$3.2 million. The XC Balance Sheet Review Forensic Work Papers did not record whether the decrease was an accounting entry representing the delivery of the related party management services which would not have had a substantial impact in terms of going concern assessment, or actual cash generated.
- (d) An increase in mortgage loans of \$19.3 million. This sum substantially increased LM's total assets as at 30 September 2012. It may have indicated continuance of funding activity for the developments underlying LM that was consistent with LM continuing as a going concern, although it may also have indicated that there were development activity cost overruns. The XC Balance Sheet Review Forensic Work Papers did not record analysis that looked behind the XC3 Balance Sheet Record that was provided by LMIM. The only commentary next to this line item was 'Increased loan balances.'
- (e) A decrease of \$6.1 million in total current liabilities. This was largely due to a reduction of \$4.8 million in Accrued Distributions Payable and \$1.9 million in *FEC*. What *FEC* represented is not clear from the documents to which we were referred. The XC Balance Sheet Review Forensic Work Papers did not record whether these were accounting entries or actual payments received and this distinction was relevant to the auditor's consideration of the going concern issue. Neither was there any record of analysis or further explanation about the nature of the entries.
- (f) An increase of \$23.8 million to the balance of 'Investor Funds'. The XC Balance Sheet Review Forensic Work Papers did not record analysis of this increase. This matter was particularly pertinent for LM because of the obvious reliance on continued inflows to ensure timely progress of the developments. It would be unusual to see audit evidence recording independent analysis of the investor applications, e.g.: were they from a diverse spread of investors or a concentrated source, the latter of which could be a factor heightening risk in a subsequent event context.

813. On its face the XC3 Balance Sheet Record did not apparently show cause for concern. The inflows of cash over the three months since 30 June 2012 had

continued at positive levels. However in our view it was not sufficient, having regard to the requirements of ASA 570 and the auditor's obligation to apply appropriate professional scepticism, to evaluate management's assessment of going concern by reference to a forecast for the following nine month period that simply replicated actual performance for the initial three month period without any scrutiny or deeper analysis of the source information or consideration of the variables that can affect forecasts of performance over a longer timeframe. In order to meet the ASA 570 requirements, that specifically referred to the inherent uncertainty involved in predicting future outcomes of events or conditions, the items in the annualised forecast we have referred to should have been properly considered and evaluated by WPIAS. Appropriate and sufficient audit evidence should also have been retained.

814. Based on our comments with respect to the XC Balance Sheet Review Documents in paragraphs 807-813, our view is that those records do not support the view that there was sufficient analysis and evaluation performed in the 2012 LM Audit with respect to management's going concern assessment. Even had those records been part of the audit evidence they would not in our view have represented appropriate and sufficient audit evidence.
815. Finally, in our view the audit evaluation of the going concern assumption demanded heightened professional scepticism to be applied having regard to the inherent risk of the assumptions to be made as to future events that was identified in ASA 570 and we refer to and repeat our comments with respect to the importance of applying appropriate professional scepticism in an audit.¹⁷⁵

AA5 documents - Audit Engagement File

816. Mr Williams also referred the Panel to the AWPAA5 entitled *LM Managed Performance Fund Year End 30 June 2012 - ASA 315 Identifying and Assessing the risks of material misstatement through understanding the entity and its environment*.
817. As its title suggests, AWPAA5 recorded matters relevant to the identification of risks in the audit. It set out the various consider points (audit procedures) and for the most part each of the audit steps are referenced to AWPAA5.4. AWPAA5.4 provides further information about the nature of the business, its structure, its financing sources, its accounting policies and internal control environment. This was relevant factual information, and did not evidence analysis of the linkage of the matters recorded to the performance of the going concern audit evaluation.
818. Mr Williams relied on AWPAA5.5 as providing evidence of the risk assessment process undertaken in the 2012 LM Audit with respect to the going concern assumption. AWPAA5.5 is an extract from LM's Information Memorandum that documented risks associated with investing in the financial product offered by LM. This was a valid source of management information that captured, documented and analysed the risks relevant to assessing the going concern assumption in the 2012 LM Audit. However, that record was not audit evidence

¹⁷⁵ See above n 58.

that the matters identified had been appropriately evaluated in the performance of the going concern assessment in the 2012 LM Audit. We refer to and repeat our comments with respect to the template generated documents.¹⁷⁶

819. AWPAs AA5, AA5.4 and AA5.5 are records that identified risks. Some of the risks identified were relevant to the consideration of going concern, although they did not specifically refer to going concern. For example, AA5.5/1, which is a copy of page 30 of the Information Memorandum records:

Liquidity Risk: A delay in meeting an investor's withdrawal request is possible where there are a significant number of withdrawal requests received at the same time, which absorb the cash reserves of the Fund and if assets of the Fund are not sufficiently liquid.

In certain circumstances the Manager may effectively suspend withdrawals for such periods as it determines. Refer to paragraph headed "Withdrawal Delays" on page 33 of this Information Memorandum.

Handwritten in the margin next to the above section is 'Low level of unpaid redemptions at 30/6/12.'

820. AWPAA5.6 is marked as being prepared by Evelyne Kwong on 9 May 2012, the same date that AWPAs AA5 and AA5.4 are marked as having been prepared. AWPAA5.6 was also a record of identified risks. It listed seven risks and the consequences of each of those risks in terms of the potential impact on the 2012 LM Financial Statements. One such identified risk was *Cash Flow* and the potential consequence identified was *Unable to pay investors upon redemption, going concern*. This was identified as a 'significant risk' (along with all the other risks listed on AWPAA5.6) and notes the likelihood as 2 - *Possible* and the consequence as being 4 - *Severe*. Under the AWP Reference column there was no work paper reference recorded, but a notation 'Follow Up: complete going concern review.' This single reference to going concern in AWPAA5.6 was the only explicit reference to it in any of the AA5 series of work papers to which Mr Williams referred us.
821. AWPAA5.7 completes the work papers to which Mr Williams referred in his Reply. It documented the auditor's understanding of the use of and exposure to foreign currency. It contains no explicit reference of direct relevance to the assessment of going concern.
822. The AA5 series of documents recorded risks but were not a record of how those risks were analysed or assessed in the 2012 LM Audit.

Mr Williams' responses to contention 2

823. Mr Williams asserted the following responses with respect to Contention 2.

¹⁷⁶ See above n 58.

Engagement Partner Response

824. The Engagement Partner Response¹⁷⁷ that was not pressed. We refer to and repeat our comments on the responsibilities of the Engagement partner in an audit.¹⁷⁸ It follows from our comments that Mr Williams' responsibility for the proper conduct of the 2012 LM Audit meant that he was responsible for all aspects of that audit, including to ensure that he supervised its performance so that relevant matters would not be overlooked by him, nor be dealt with improperly or inadequately by those assisting him.

Limited User/Limited Purpose Response

825. The Limited User/Limited Purpose Response. We refer to and repeat our comments and findings¹⁷⁹ that form the basis of our view that this response does not provide an answer to any of the allegations and contentions in these proceedings.

LM not a Trading Entity

826. Mr Williams denied that the relevant period was the expected date of the next audit report, on the basis that LM was not a trading entity, it did not employ personnel and it did not incur normal trading liabilities. Mr Williams submitted that the only reason the accounts were prepared as General Purpose Financial Statements was because it was provided for in LM's Constitution. We are not persuaded by this submission. Mr Williams agreed to conduct the 2012 LM Audit on the basis of the presentation of the 2012 LM Financial Statements as General Purpose Financial Statements and his obligation was to perform that obligation in accordance with ASA 570 which provided that the going concern assumption applied to their preparation. That assumption simply reflected that the entity was being viewed as continuing in business for the foreseeable future and that the financial statements were prepared and presented on that basis.

827. For those reasons we do not regard Mr Williams' response as providing a basis for asserting that the relevant period requirement in ASA 570 did not apply in the 2012 LM Audit.

When an Entity is considered a going concern

828. Mr Williams' further response to Contention Two was that an entity is a going concern when it is considered to be able to pay its debts as and when they fall due and to continue in operation without any intention or necessity to liquidate or otherwise wind up its operations for at least the next 12 months from the end of the reporting period (in this case 30 June 2013).

829. With respect to this response, we note that ASA 570 provided the framework within which management's going concern assessment with respect to LM was to be considered in the 2012 LM Audit and ASA 570 Aus. 13.1 provided that in

¹⁷⁷ See above n 28.

¹⁷⁸ Ibid.

¹⁷⁹ See above n 47.

evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall consider the relevant period being the period of approximately twelve months from the date of the auditor's current report to the expected date of the auditor's report for the next annual reporting period.¹⁸⁰

830. The consideration of whether the entity was able to pay its debts as and when they fell due and to continue in operation without any intention or necessity to liquidate or otherwise wind up its operations was required to be made in the context of the evaluation required by ASA 570 and should have involved careful scrutiny and testing of the information on which management's assessment of going concern was made, having regard to the auditor's knowledge of the entity from the audit, of matters relevant to the forecast and with heightened professional scepticism.
831. In our view this response was not a sound or complete basis for forming an appropriate conclusion with respect to the going concern assessment in the 2012 LM Audit.

Manager's control over cashflow management

832. Mr Williams' next response was that LMIM had complete discretion in relation to the cash flow management of LM, including the ability to suspend unit holder redemptions, vary loan terms, including interest rates, vary repayment terms and vary management fees payable to LMA.
833. Mr Williams agreed in cross examination that if it had become evident that the Manager was relying on its ability to freeze redemption payouts this may have caused market concern and discouraged investors from depositing further funds which would have the effect of stemming inflows to LM. Mr Williams could not recall whether there was any analysis done with respect to the projections of cash inflows from investor funds. There was no audit evidence this matter had been considered. The example of the possibility that investment inflows would be affected were LMIM to decide to freeze unit holder redemptions to manage expenditure if necessary should have been apparent had the matter been properly considered, with an appropriate degree of professional scepticism.
834. Mr Williams' evidence was that the more important matter in his view was that LM did not have to loan further money, that loan funds was its biggest expenditure and it was within its discretion to control it. In the context of LM's already significant exposures to the various developments, the risks facing those developments that we have discussed in the context of Contention One would be likely only to increase were LM to decide not to loan further funds to the developments. This would increase the risk of recoverability to LM's existing loan receivables. In our view this potential consequence should have been apparent had the matter been properly considered in the 2012 LM Audit, with an appropriate degree of professional scepticism.

¹⁸⁰ ASA 570 Aus 13.2.

835. For the above reasons we do not think that the basis of this Response demonstrated the appropriateness of the conclusion formed in the 2012 LM Audit that LM was likely to continue as a going concern.

Directors required to assess a company's ability to continue as a going concern

836. Mr Williams' next response was that the directors are required to assess a company's ability to continue as a going concern each time a financial report is approved (usually only annually).

837. It is not clear to us why this response was relevant to the allegations the subject of Contention 2 which were about whether Mr Williams had appropriately performed his obligations in the 2012 LM Audit with respect to the Going Concern Audit Assessment.

LM's risks manageable

838. Mr Williams said that the risk that LM was unable to pay all its debts as and when they became due and payable (which is a daily assessment) appeared manageable given that:

- (a) LM did not incur trading debts;
- (b) if a borrower (ie. one of the SPVs) was unable to repay its loan at the conclusion of the project, it would need to be impaired or written off in the books of LM at that time with an adverse impact on the underlying unit price (meaning that there was no cash impact on LM); and
- (c) a borrower (such as an SPV) could not incur debts on behalf of LM.

839. Mr Williams submitted that the fact that LM did not incur trading debts and that borrowers could not incur debts on behalf of LM and so LM was not incurring debt in Australia were matters that he had considered important in the Going Concern Audit Assessment. With respect to that part of this response set out in sub-paragraph (b) in the preceding paragraph, ASIC accepted that a journal entry to recognise impairment of a loan would not directly impact the cash position because the impairment expense would be debited and the loan receivable credited. ASIC submitted that LM was not only required to assess the recoverability of the projects/loans at the conclusion of a project however, but over their course, and book an impairment if expected cash inflows from the SPV/borrower were assessed at less than the loan principle. In that event there would be a cash impact on LM because the loan receivables were recorded with the future expectation of full (cash) repayment by the borrower. Therefore, a significant impairment booked during the course of a loan would have a significant impact on LM's expected future cash flows.

840. We agree with the analysis on which ASIC's submission in the preceding paragraph was based. In our view this response does not provide an answer to Contention 2 insofar as it does not demonstrate that the conclusion formed in the 2012 LM Audit that LM was likely to continue as a going concern was appropriate, because the carrying value of the loans was a matter that required consideration as part of the audit evaluation of the going concern assessment,

having regard to LM's obligation to book impairments over the course of projects as well as at their conclusion.

Relevant Period for Assessment

841. Mr Williams' final response to Contention 2 was that the Going Concern Audit Assessment extended to July 2013 because that was when the 2013 year end audit for LM was scheduled for completion (i.e. the expected date of the next audit report). With respect to this response, we refer to our finding on the First Going Concern Allegation at paragraph 843-851.

842. We now turn to a consideration of the specific allegations in Contention 2

Contention 2 - Allegations

First Going Concern Assessment Allegation - The Relevant Period Allegation

843. ASIC alleged that AWPAF3, which was the MPF cash flow assessment to 30 June 2013 did not consider or comply with the *relevant period* requirement in ASA 570 Aus. 13.1 as the cash flow assessment from management was only performed to 30 June 2013 (the "Relevant Period Allegation").

844. ASA 570 Aus. 13.1 provided that in evaluating management's assessment of the entity's ability to continue as a going concern, the auditor was required to consider the relevant period being the period of approximately twelve months from the date of the auditor's current report to the expected date of the auditor's report for the next annual reporting period.¹⁸¹

845. In terms of the documentary evidence that was relevant to this point, the *Going Concern Program*, described in paragraphs 792-797 contained a handwritten notation referring to AWPAF3 next to the audit procedure 'evaluation of management's assessment of the entity's ability to continue as a going concern.' The next procedure noted in that document was:

Consider the relevant period, which may be the same or may differ from that used by management to make its assessment as required by the applicable financial reporting framework. If management's assessment of the entity's ability to continue as a going concern covers less than the relevant period, the auditor shall request management to correspond to the relevant period used by the auditor.

This procedure was ticked as completed and the handwritten comment recorded was 'next audit to be completed by 30/09/13.'

846. There is no audit evidence that the audit team had requested management to provide projections beyond those contained in AWPAF3. When asked about the projections during cross-examination and whether Mr Williams thought it would have been prudent to request a cash flow projection for July 2013 in order to cover the relevant period, Mr Williams said he did not think he needed to because there were no triggers that indicated any concern. He said that he thought it was 'too far and forward' for the further one month period to have a

¹⁸¹ ASA 570 Aus 13.2.

major impact. Whether there were any triggers to indicate concern is not a relevant consideration in terms of the requirements of the relevant standard, ASA 570.2 discussed below.

847. Mr Williams' Response and evidence with respect to the Relevant Period Allegation was twofold:

- (a) That the relevant period was the expected date of the next audit report, but as LM was not a trading entity, had no employees and did not incur normal trading liabilities the relevant period requirement did not apply [R81(c)]; and
- (b) WPIAS' responsibility for evaluating the management assessment of going concern extended to July 2013 because that was when the 2013 year-end audit was scheduled for completion.

848. With regard to the first matter we refer to and repeat our comments and views on this response in paragraphs 826-827. The relevant standards do not support the argument that the relevant period provisions did not apply.

849. With regard to the second limb of Mr Williams' response to the Relevant Period Issue, Mr Williams provided evidence that showed that the date of the next audit report had been brought forward from 30/09/13 to the end of July 2013 and ASIC conceded that the relevant period was to 30 July 2013. Mr Williams' further evidence was that subsequent audit reviews would have involved consideration of the period subsequent to 30 June 2013 for which Mr Williams had not received details of management projections. We note there was no evidence such a review had been conducted before the audit was signed on 7 December 2012.

850. In our view the requirements of ASA 570.2, that referred to a period of approximately twelve months from the date of the auditor's current report to the expected date of the auditor's report for the next annual reporting period meant that Mr Williams should have requested information for the further one month period and included details for that further month in his evaluation of management's assessment of going concern before concluding the 2012 LM Audit.

851. We are satisfied that the Relevant Period Allegation has been established.

Second Going Concern Assessment Allegation

852. The Second Going Concern Assessment Allegation with respect to Contention 2 was that there was insufficient appropriate audit evidence on the Audit Engagement File with respect to the Maddison Estate, Aalto and LMC developments to show:

- (a) whether the level of pre-sales for each project had been achieved in order for the project to obtain senior debt financing;
- (b) whether the level of pre-sales were consistent with forecast timing;

- (c) whether construction contracts had been entered into and the progress of the developments; and
- (d) in relation to the Maddison Loan, that the circumstance that \$100,000,000 of the \$200,000,000 loan balance represented capitalised interest did not raise a significant concern in the audit with regard to the recoverability of that loan and therefore the ability of LM to continue as a going concern.

853. We are satisfied, based on our findings in Contention One with respect to:

- (a) Sub-Allegations (b), (f), (m), (r), (u) of the Sixth Maddison Loan Allegation;
- (b) the First Aalto/AIIS Loan Allegation;
- (c) the Sub-Allegations (a) and (f) of the Third Aalto Allegation; and
- (d) the Second, Third, Fourth and Sixth LMC Loan Allegations,

that there was insufficient appropriate audit evidence on the Audit Engagement File with respect to the matters the subject of the Second Going Concern Assessment Allegation.

854. Further, based on our comments in paragraph 840 we are satisfied that these matters were relevant to consider in the Going Concern Audit Assessment.

855. We are satisfied that the Second Going Concern Assessment Allegation has been established.

Third Going Concern Assessment Allegation

856. The Third Going Concern Assessment Allegation was that a reasonably competent auditor would have been concerned about LM's ability to continue as a going concern because of the following matters:

- (a) LM's largest loan was to Maddison which had been granted an extension of time to attempt to refinance the loan with Suncorp.
- (b) LM had loaned monies to the Maddison, AIIS and LMC developments which required significant financing for their completion. At the time of signing the Auditor's Report neither the financing or refinancing had been obtained.
- (c) LM loaned monies at interest rates of up to 25% p.a. that was capitalised to the loan balances without progress on development having necessarily occurred or there having been a corresponding increase in the value of the property.
- (d) The factors noted in AWP's AF2, *Going Concern Checklist* and AF1, *Going Concern Summary*.
- (e) The concerns with respect to LM's ability to recover the full value of loans.

- (f) The value of LM's loan receivables was significantly higher than the current *as is* value of the properties. Therefore if the borrowers were to sell the properties there would be a significant shortfall in funds available to LM.
 - (g) There was no audit evidence that LM had previously loaned material monies to borrowers that had repaid the loans following a successful development.
 - (h) The AWP's did not contain sufficient appropriate audit evidence to show that the Maddison and LMC Developments would be profitable and/or that the monies would be repaid to LM.
857. The facts the subject of (a) - (d) and (g) in the preceding paragraph were not in issue.
858. With respect to paragraph 856(e) and (f) we are satisfied that this matter was established, based on our findings with respect to:
- (a) Sub-Allegation (e) of the Sixth the Maddison Loan allegation;¹⁸²
 - (b) The Second Aalto Loan Allegation and Sub-Allegations (b), (d) and (g) of the Third Aalto/AIIS Loan Allegation; and
 - (c) Sub-Allegation (a) of the First LMC Loan Allegation¹⁸³ and the Fifth LMC Loan Allegation.¹⁸⁴
859. With respect to paragraph 656(h), we are satisfied that this matter was established, based on our findings with respect to:
- (a) the Subsequent Maddison Audit Response.¹⁸⁵
 - (b) the fact that there was no independent valuation with respect to the Maddison Estate Development on the Audit Engagement File;
 - (c) the Third Maddison Loan Allegation; and
 - (d) Sub-allegation (a) of the First LMC Loan Allegation,¹⁸⁶ the Third LMC Loan Allegation¹⁸⁷ and the Fifth LMC Loan Allegation.¹⁸⁸
860. As noted, the Third Going Concern Allegation was that based on the above matters a reasonably competent auditor would have been concerned about LM's ability to continue as a going concern.

¹⁸² See paragraphs 346-351.

¹⁸³ See paragraphs 602-609.

¹⁸⁴ See paragraphs 635-642.

¹⁸⁵ See above n 53.

¹⁸⁶ See above n 183.

¹⁸⁷ See paragraphs 624-628.

¹⁸⁸ See above n 184.

861. We have set out the requirements of ASA 570 in paragraphs 786-790 above. The provisions of that standard highlighted the importance of the responsibility attached to assessment of going concern and the critical role of the auditor in ensuring that management's assessment of going concern is performed appropriately by reference to the relevant requirements.
862. ASA 570 required the auditor to ensure there is sufficient and appropriate audit evidence about the appropriateness of management's use of the going concern assumption. Before concluding whether there is any material uncertainty that could cast doubt on the entity's ability to continue as a going concern the auditor must conduct discussion with management, consider whether any potential events identified (either individually or collectively) could cast doubt on the entity's ability to continue as a going concern and if there are any, to understand and evaluate the management plan to address those events. In addition the auditor has a separate obligation to remain alert throughout the audit for evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.¹⁸⁹
863. We refer to our discussion of the main going concern AWPAs in paragraphs 791-805. AWPAs recorded 'nil noted' with respect to:
- (a) whether events or conditions were identified that may cast significant doubt on the entity's ability to continue as a going concern;
 - (b) whether a material uncertainty existed; and
 - (c) the use of going concern assumption being appropriate but a material uncertainty existing.

And the conclusion noted in AWPAs was that 'In our opinion sufficient appropriate audit evidence has been obtained to materially meet the stated audit objective.'

864. The Going Concern Checklist identified some relevant risks, including the refinancing of the Suncorp Loan Facility (although not the timeframe), the negative operating cashflows and the reliance on new investor funds, but did not record how those risks were to be or had been addressed. It also recorded the following four mitigating factors:
- (a) Capability of delaying additional spending in projects/varying projects to suit cash flow;
 - (b) Fund has entered into DD discussions with various funding bodies; as per "Asset factors" above;
 - (c) History + regular new investments;
 - (d) Ability to reduce distributions levels as required (+redemption payouts).
865. The Going Concern Checklist did not provide a record of assessment of the strength, impact or practical value of those 'mitigating factors.' These were

¹⁸⁹ ASA 570.10 (a) and (b).

matters that should have been evaluated by the auditor if they formed the basis for the conclusion on going concern and we refer to and repeat our comments and findings with respect to Mr Williams' responses in paragraphs 823-841 and our further comments on his submissions with respect to the XC documents in paragraph 812.

866. Finally, the Going Concern Summary¹⁹⁰ recorded narrative with respect to risks as we have set out however that document did not record evidence that any testing or cross checking of the management information provided was performed in the audit. The conclusion in the Going Concern Summary was 'Based on the audit evidence we have sighted and the discretionary power of the Manager that allows it to control cash outflows, we are of the opinion that no material uncertainty exists that casts significant doubt on the Fund's ability to continue as a going concern.'
867. None of the documents we have described were records that provided evidence that the matters the subject of (a)-(h) in paragraph 856. In our view these matters were relevant to evaluate as they may have raised a concern about LM's ability to continue as a going concern and a proper consideration of the impact of those matters on management's assessment of going concern should have been part of the audit evidence. Having regard to the Relevant Benchmark,¹⁹¹ we are satisfied that a reasonably competent auditor in the circumstances of the 2012 LM Audit, would have been concerned about LM's ability to continue as a going concern as a result.
868. We are satisfied that the Third Going Concern Allegation has been established.

Fourth Going Concern Assessment Allegation

869. The Fourth Going Concern Assessment Allegation was that a reasonably competent auditor in the circumstances of the 2012 LM Audit would have identified the following matters and/or performed the following duties as part of the audit assessment of going concern and there was no evidence in the Audit Engagement File that these matters had been considered. We are satisfied that having regard to the Auditing Standards at the time the matters the subject of (a)-(m) were relevant to perform and/or consider with respect to the Going Concern Audit Assessment and that having regard to the Relevant Benchmark,¹⁹² a reasonably competent auditor would have adequately performed these matters in the 2012 LM Audit. The following matters were alleged.

Sub-Allegation 4(a)

Whether there were events and/or conditions that may have cast significant doubt over LM's ability to continue as a going concern in accordance with ASA 570.

870. We have set out the requirements of ASA 570.10 in paragraph 788.

¹⁹⁰ See paragraphs 799-802.

¹⁹¹ See above n 56.

¹⁹² Ibid.

871. The Going Concern Checklist described in paragraph 800 was an audit record that identified risks with respect to events and/or conditions that may have cast doubt on LM's ability to continue as a going concern. However, that document did not provide audit evidence that the risks identified were then adequately considered or appropriately investigated in the performance of the Going Concern Audit Assessment.
872. Based on the comments we have included with respect to the going concern audit documents to which we were referred by the parties and which are described in paragraphs 791-822 we are satisfied that that there was no evidence the risks identified in the Going Concern Checklist were investigated or evaluated when performing the Going Concern Audit Assessment were not adequately investigated.
873. ASA 570.10 required the auditor to determine whether management had already performed a preliminary assessment of the entity's ability to continue as a going concern. If, as in this matter that had been done, the auditor's obligation was to discuss that assessment with management and determine whether any events had been identified that individually or collectively, might cast significant doubt on the entity's ability to continue as a going concern and if so, what the management plan was to address those events or conditions.¹⁹³ There was no audit evidence about the nature of any discussions that had taken place with management with respect to the entity's assessment of its ability to continue as a going concern. Such a discussion was required by the provisions of ASA 570.10 and an important foundation plank with respect to the manner of performance of the going concern assessment in the audit and the subsequent audit conclusion. There should have been audit evidence that recorded the key points of the discussion with management that clarified management's response to the matters specified in ASA 570.10(a).
874. We are satisfied Sub-Allegation 4(a) has been established.

Sub-Allegation 4(b)

Whether based on the audit evidence obtained he had considered whether a material uncertainty existed, based on events or conditions, that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ASA 570 and to reduce the audit risk to an acceptably low level in accordance with ASA 200.

875. ASA 570.17 provided that based on the audit evidence obtained the auditor must conclude whether, in their judgement, material uncertainty existed related to events or conditions that individually or collectively, might cast doubt on the entity's ability to continue as a going concern. The standard defined material uncertainty as existing when the magnitude of the potential impact and likelihood of occurrence was such that, in the auditor's judgement, appropriate disclosure of the nature and implications of the uncertainty would be necessary for the financial report not to be misleading.¹⁹⁴

¹⁹³ ASA 570.10(a) and (b).

¹⁹⁴ ASA 500.17(b).

876. ASA 200.17 imposed the requirement to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level to enable the auditor to draw reasonable conclusions on which to base an opinion. What constitutes an acceptably low level of risk is a matter of professional judgement, often characterised as the level of residual audit risk that an auditor can accept. In the 2012 LM Audit, the audit approach had been to place no reliance on internal management controls. Audits conducted on this basis usually involve more rigorous audit testing such as specific audit testing of material account balances to a higher degree than if controls are to be relied upon.
877. Based on our findings in Contention One with respect to the lack of sufficient and appropriate audit evidence with respect to the loans, and the comments we have included with respect to the going concern audit documents which are described in paragraphs 791-822, and our finding with respect to the Third Going Concern Allegation, we are satisfied that a reasonably competent auditor would have formed the view that there were matters that collectively may have cast significant doubt on LM's ability to continue as a going concern and about which there was insufficient appropriate audit evidence to reduce the audit risk to an acceptably low level in accordance with ASA 200.17.
878. We are satisfied that Sub-Allegation (b) of the Fourth Going Concern Allegation has been established.

Sub-Allegation 4(c)

Whether LM's assessment of its ability to continue as a going concern did not cover the Relevant period and as such request the Manager and/or management to extend their assessment to correspond with the Relevant period in accordance with ASA 570.

879. Based on our comments and finding with respect to the Relevant Period Allegation in paragraphs 843-851 and having regard to the Relevant Benchmark¹⁹⁵ we are satisfied Sub-Allegation (c) of the Fourth Going Concern Allegation has been established.

Sub-Allegation 4(d)

Whether there was sufficient appropriate audit evidence and enquiries made of LM with respect to events that had occurred subsequent to year end but prior to the signing of the Auditor's Report, about the entity's actual performance between 1 July 2012 and 7 December 2012 and whether it was consistent with forecast cashflows and the status of the refinancing of the senior debt which were relevant to LM's ability to continue as a going concern in accordance with ASA 560.

880. We refer to paragraphs 250 and 734 that set out the relevant provisions of ASA 560 and we refer to and repeat our comments therein.
881. Based on our previous comments on the subsequent events documents in paragraphs 226, 306 - 308, 651, 735 and 806 - 815 we are satisfied that that there was no audit evidence that the actual operating figures for October 2012 and November 2012 were considered prior to signing the 2012 LM Audit. We are also satisfied that there was no audit evidence that the actual cash flows to 30 September 2012 were analysed in the 2012 LM Audit.

¹⁹⁵ See above n 56.

882. We are satisfied that a reasonably competent auditor in the circumstances of the 2012 LM Audit would have ensured there was sufficient appropriate audit evidence and enquiries made of LM with respect to events that had occurred subsequent to year end but prior to the signing of the Auditor's Report, about LM's actual performance (between 1 July 2012 and 7 December 2012) and would have evaluated whether those events were consistent with forecast cashflows and the status of the refinancing of the senior debt, which were matters relevant to LM's ability to continue as a going concern in accordance with ASA 560.
883. We are satisfied Sub-Allegation (d) of the Fourth Going Concern Allegation has been established.

Sub-Allegation 4(e)

Performed an adequate evaluation of the Manager's assessment of the entity's ability to continue as a going concern, including whether the assessment included all relevant information in accordance with ASA 570.

884. ASA 570.12 provided that the auditor must evaluate management's assessment of the entity's ability to continue as a going concern and ASA 570.14 provided that in making this evaluation the auditor must consider whether management's assessment included all relevant information of which the auditor is aware as a result of the audit.
885. We refer to and repeat our comments with respect to Sub-Allegation (a) of the of the Fourth Going Concern Allegation in paragraphs 870-874.
886. Based on those comments and our further comments included with respect to the going concern audit documents to which we were referred by the parties and which are described and discussed in paragraphs 791-815 we are satisfied that there was no explicit audit evidence of the underlying data generated by management on which the cash flow forecasts were based, no audit evidence that assumptions on which they were based had been evaluated by the audit team, no audit evidence that management's plans for future actions on going concern assessment had been identified or evaluated, and no audit evidence that the auditor had considered whether management's assessment included or did not take account of relevant information of which the auditor was aware as a result of the audit.
887. We are satisfied that evaluation by a reasonably competent auditor would have addressed the matters referred to in the preceding paragraph.
888. We are satisfied that Sub-Allegation (e) of the Fourth Going Concern Allegation has been established.

Sub-Allegation 4(f)

Identified that there was a significant uncertainty in relation to LM continuing as a going concern and performed additional audit procedures as required by ASA 570.

889. ASA 570.16 set out a series of procedures that were to be performed by an auditor if events or conditions are identified that that may cast significant doubt on the entity's ability to continue as a going concern.

890. We refer to:
- (a) Our finding with respect to the Subsequent Maddison Audit.¹⁹⁶
 - (b) Our finding with respect to Sub-Allegation (d) of the Sixth Maddison Loan Allegation at paragraphs 337 - 341 about the status of arrangements to refinance the Suncorp Loan Facility by 31 March 2013 at the time the 2012 LM Audit was signed on 7 December 2012.
 - (c) The potential impact on LM of the sum of each of the other matters the subject of the allegations in Contention One that we have found established with respect to the recoverability of the loan receivables.
891. Based on the findings set out in the preceding paragraph, we are satisfied that there was no audit evidence that established that significant uncertainty did not exist.
892. Mr Williams referred to the *control over cash flow* response. Based on our comments in paragraphs 832-835 this is not a matter that in our view a reasonably competent auditor would have taken into account in the 2012 LM Audit with respect to the audit evaluation of the going concern assessment.
893. Having regard to the Relevant Benchmark,¹⁹⁷ we are satisfied that a reasonably competent auditor would have identified that there was a significant uncertainty in relation to LM continuing as a going concern and performed the additional audit procedures as required by ASA 570 to evaluate whether their outcome affected the auditor's assessment of the risk of material misstatement.
894. Those procedures included:
- (a) Evaluating management's plans for future actions in relation to its going concern assessment, and whether the plan was feasible and the outcome is likely to improve the situation.
 - (b) Evaluating the reliability of data on which any cash flow forecast provided was based and assessing whether support for the assumptions underlying the forecast was adequate.
 - (c) Considering whether any additional facts or information had become available since the date of the assessment by management.
 - (d) Requesting written representations from management and where appropriate those charged with governance regarding the plan for future action and an assessment of the feasibility of those plans.
895. We are satisfied that Sub-Allegation (f) of the Fourth Going Concern Allegation has been established.

¹⁹⁶ See above n 53.

¹⁹⁷ See above n 56.

Sub-Allegation 4(g)

Identified that the 2012 Financial Report did not disclose the significant uncertainty regarding LM's ability to continue as a going concern in accordance with ASA 570.

896. We refer to and repeat our comments with respect to Sub-Allegations (a) and (f) of the Fourth Going Concern Allegation.

897. Based on those comments and our further comments included with respect to the going concern audit documents described and discussed in paragraphs 791-822 we are satisfied that a reasonably competent auditor in the circumstances of the 2012 LM Audit, would have identified that the 2012 LM Financial Statements did not disclose the significant uncertainty regarding LM's ability to continue as a going concern in accordance with ASA 570

898. We are satisfied that Sub-Allegation 4(g) has been established.

Sub-Allegation 4(h)

Applied an appropriate level of professional scepticism to the work performed on going concern in accordance with ASA 200.

899. In our view, having regard to the Relevant Benchmark¹⁹⁸ and our comments with respect to professional scepticism in an audit¹⁹⁹ a reasonably competent auditor demonstrating appropriate professional scepticism in the circumstances of the 2012 LM Audit would have applied heightened professional scepticism to this aspect of the 2012 LM Audit and as well as having ensured that the audit procedures performed with respect to the going concern assessment satisfied the requirements of the relevant Auditing Standards would have ensured there was increased scrutiny and testing of the management information provided and documented in the audit evidence.

900. As we have noted, the audit evidence represented by the records described in paragraphs 791-822 did not in our view demonstrate appropriate professional scepticism had been applied because they did not demonstrate that the full scope of those audit procedures were performed nor any scrutiny or analysis of the information provided by LMIM.

901. We refer to and repeat our comments and finding with respect to Sub-Allegation (f) of the Fourth Going Concern Allegation.

902. We are satisfied that Sub-Allegation 4(h) of the Fourth Going Concern Allegation has been established.

Sub-Allegation 4(i)

Identified the lack of disclosure by the Manager in accordance with ASA 570 which in turn would have resulted in a qualified opinion or adverse opinion having been expressed by RLW in accordance with ASA 705 contention g R80(g) AWPAF1 BC1.

903. ASA 570.18 provided that if the auditor concludes that the use of the going concern assumption is appropriate in the circumstances, but a material

¹⁹⁸ Ibid.

¹⁹⁹ See above n 58.

uncertainty exists he shall determine whether the financial report discloses clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.²⁰⁰

904. Mr Williams referred to AWPAF1 and AWPBC1 with respect to this Sub-Allegation. AWPAF1, the lead audit work paper for the going concern assessment, noted a conclusion that sufficient appropriate audit evidence has been obtained to materially meet the stated audit objective, although based on the documents we have discussed and reviewed²⁰¹ our view is that the conclusion expressed. We refer to and repeat our comments with respect to AWPBC1 in paragraph 965 with respect to this Sub-Allegation.
905. Having regard to the Relevant Benchmark²⁰² and based on; the disclosures in the 2012 LM Financial Statements that did not disclose any material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; our findings in Sub-Allegations (a) and 4(f) of the Fourth Going Concern Allegation; and our further comments included with respect to the going concern audit documents described in paragraphs 791-822, we are satisfied that a reasonably competent auditor, in the circumstances of the 2012 LM Audit, would have identified that the disclosure in the 2012 LM Financial Statements was insufficient having regard to the requirements of ASA 570 that required the auditor to consider whether a qualified or adverse opinion should have been issued in the 2012 LM Audit.
906. We are satisfied that Sub-Allegation 4(i) of the Fourth Going Concern Allegation has been established.

Sub-Allegation 4(j)

Adequately considered whether there was any material uncertainty or events or conditions that cast significant doubt on the entity's ability to continue as a going concern and ensured that relevant disclosures were made in the financial report in relation to the material uncertainty and amend the Audit Report accordingly in accordance with ASA 570.

907. We refer to and repeat our comments and findings with respect to Sub-Allegations (f) and (g) of the Fourth Going Concern Allegation.
908. Having regard to the Relevant Benchmark²⁰³ and based on our comments and findings in Sub-Allegation 4(i) we are satisfied that adequate consideration by a reasonably competent auditor of whether a material uncertainty existed that might cast significant doubt on the entity's ability to continue as a going concern in accordance with ASA 570, would, in the circumstances of the 2012 LM Audit, have resulted in a conclusion that there was material uncertainty, based on the lack of sufficient and appropriate audit evidence, that may have cast doubt on the entity's ability to continue as a going concern, that required relevant

²⁰⁰ ASA 570.18(b).

²⁰¹ See paragraphs 791-822.

²⁰² See above n 56.

²⁰³ Ibid.

disclosure in the 2012 LM Financial Statements and/or the 2012 LM Audit Opinion to have been amended accordingly.

909. We are satisfied that Sub-Allegation 4(j) of the Fourth Going Concern Allegation has been established.

Sub-Allegation 4(k)

Adequately assessed events that happened subsequent to year end but prior to the date of signing the Audit Report that had a potential impact on the entity's ability to continue as a going concern, including the assessment of the Fund's actual cash flows during this period compared to the forecast cash flows for the same period in accordance with ASA 560.

910. We refer to and repeat our findings with respect to Sub-Allegation (d) of the Fourth Going Concern Allegation.

911. Having regard to the Relevant Benchmark²⁰⁴ we are satisfied that a reasonably competent auditor in the circumstances of the 2012 LM Audit, would have adequately assessed events that happened subsequent to year end but prior to the date of signing the Audit Report that had a potential impact on the entity's ability to continue as a going concern, including the assessment of the Fund's actual cash flows during this period compared to the forecast cash flows for the same period in accordance with ASA 560, including the months of October 2012 and November 2012.

912. We are satisfied that Sub-Allegation (k) of the Fourth Going Concern Allegation has been established.

Sub-Allegation 4(l)

Adequately evaluated whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based in accordance with ASA 500.

913. We refer to and repeat our comments and findings with respect to the Second and Third Going Concern Allegations and Sub-Allegations (a), (b), (c), (d), (e), (f) and (g) of the Fourth Going Concern Allegation and to our description of and comments with respect to the going concern audit documents which are described in paragraphs 791-822.

914. Having regard to the Relevant Benchmark²⁰⁵ and based on the comments and findings referred to in the preceding paragraph, we are satisfied that a reasonably competent auditor in the circumstances of the 2012 LM Audit, having performed an evaluation of the reliability of the information produced by the entity and whether it was sufficiently precise and detailed,²⁰⁶ would not have concluded that the information was sufficiently reliable, precise and complete in order to be used in arriving at conclusions on which to base an audit opinion

²⁰⁴ Ibid.

²⁰⁵ Ibid.

²⁰⁶ ASA 500.9(b).

915. We are satisfied that Sub-Allegation (l) of the Fourth Going Concern Allegation has been established.

Sub-Allegation 4(m)

Adequately evaluated management's plans for future actions in relation to going concern assessment and evaluated the underlying data generated by management to prepare their cash flow forecasts in accordance with ASA 570.

916. There was no audit evidence that there was an evaluation of management's plans for future action in relation to the going concern assessment or an evaluation of the underlying data on which LMIM had based its cash flow forecasts in the 2012 LM Audit.

917. This was required by ASA 570.16 (b) and (c) that we have discussed in Sub-Allegation (f) of the Fourth Going Concern Allegation.

918. We refer to and repeat our comments and findings with respect to Sub-Allegations (a), (b) and (f) of the Fourth Going Concern Allegation and to our comments with respect to the going concern audit documents to which we were referred by the parties and which are described in paragraphs 791-822.

919. Having regard to the Relevant Benchmark²⁰⁷ and based on the comments and findings referred to in the preceding paragraph, we are satisfied that a reasonably competent auditor in the circumstances of the 2012 LM Audit would have, in accordance with the requirements of ASA 570, adequately evaluated management's plans for future action in relation to the going concern assessment and evaluated the underlying data generated by management to prepare its cash flow forecasts.

920. We are satisfied that Sub-Allegation (m) of the Fourth Going Concern Allegation has been established.

Contention 2 Sub-Contentions

921. The basis of Contention 2 was that, within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams had failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 Financial Report regarding consideration of going concern insofar as he had failed to carry out his duties with respect to the following matters:

Sub-Contention 2(a)

Properly consider all events and/or conditions that may cast significant doubt over LM's ability to continue as a going concern whilst performing risk assessment procedures and to remain alert to these events or conditions throughout the audit.

922. In addition to Mr Williams' responses to the four allegations in contention 2 that we have already considered, Mr Williams said that the matters the subject of this Sub-Contention had been properly considered and he referred to the Going Concern Summary and the Going Concern programme and AWPAA5. We refer to and repeat our comments on the Going Concern AWP's in paragraphs 791-805

²¹¹ See above n 138.

and AWPAA5 in paragraphs 816-822. Based on those comments and our findings with respect to the First, Second, Third and Fourth Going Concern Allegations, we are satisfied that the documents to which Mr Williams referred did not demonstrate sufficient and appropriate audit evidence that all events and/or conditions that may have cast significant doubt over LM's ability to continue as a going concern had been considered or that he had remained alert to these events or conditions throughout the audit.

923. Based on our findings in the First, Second, Third and Fourth Going Concern Allegations and having regard to the Relevant Benchmark,²⁰⁸ we have formed the view that Mr Williams' level of performance of his duties was not adequate.
924. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²⁰⁹ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 2(a) has been established.

Sub-Contention 2(b)

Adequately evaluate management's assessment of the entity's ability to continue as a going concern, including whether management's assessment included all relevant information and whether it had considered an appropriate future period.

925. In addition to Mr Williams' responses to the four allegations in contention 2 that we have already considered Mr Williams said that the matters the subject of this Sub-Contention had been properly considered and he referred to the Going Concern Summary and the Going Concern programme. We refer to and repeat our comments on the Going Concern AWPs in paragraphs 791-805. Based on those comments and our findings with respect to the First, Second, Third and Fourth Going Concern Allegations, we are satisfied that the documents to which Mr Williams referred did not demonstrate that there had been an adequate evaluation of management's assessment of the entity's ability to continue as a going concern, including whether management's assessment included all relevant information and whether it had considered an appropriate future period.
926. Based on our findings with respect to the First, Second, Third and Fourth Going Concern Allegations, and having regard to the Relevant Benchmark,²¹⁰ we have formed the view that Mr Williams' level of performance of his duties was not adequate.
927. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²¹¹ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 2(b) has been established.

²⁰⁸ Ibid.

²⁰⁹ See above n 138.

²¹⁰ See above n 56.

²¹¹ See above n 138.

Sub-Contention 2(c)

Evaluate management's plans for future actions in relation to going concern assessment and evaluate the underlying data generated by management to prepare their cash flow forecasts.

928. In addition to Mr Williams' responses to the four allegations in Contention 2 that we have already considered Mr Williams said that the matters the subject of this Sub-Contention had been properly considered and he referred to the Going Concern Summary and the Going Concern programme. We refer to and repeat our comments on the Going Concern AWP's in paragraphs 791-805. Based on those comments and our findings with respect to the First, Second, Third and Fourth Going Concern Allegations, we are satisfied that the documents to which Mr Williams referred did not demonstrate that there had been an adequate evaluation of management's plans for future actions in relation to the going concern assessment or the underlying data on which LMIM had prepared the cash flow forecasts.
929. Based on our findings with respect to the Third Going Concern Allegation and the Fourth Going Concern Allegation, and having regard to the Relevant Benchmark,²¹² we have formed the view that Mr Williams' level of performance of his duties was not adequate.
930. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²¹³ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 2(c) has been established.

Sub-Contention 2(d)

Adequately assess events that occurred subsequent to year end but prior to the date of signing the Audit Report that had a potential impact on the entity's ability to continue as a going concern, including the assessment of the Fund's actual cash flows during this period compared to the forecast cash flows for the same period.

931. In addition to Mr Williams' responses to the four allegations in contention 2 that we have already considered Mr Williams said that the matters the subject of this Sub-Contention had been properly considered and he referred to AWPXC1. We refer to and repeat our comments with respect to the XC documents in paragraphs 806-815. Based on those comments and our findings with respect to the First, Second, Third and Fourth Going Concern Allegations, we are satisfied that the documents to which Mr Williams referred did not demonstrate that he had adequately assessed events that occurred subsequent to year end but prior to the date of signing the 2012 LM Audit Opinion that may have had a potential impact on LM's ability to continue as a going concern, including the assessment of LM's actual cash flows during the period compared to the forecast cash flows for the same period and consideration of LM's actual performance in October 2012 and November 2012.

²¹² See above n 56.

²¹³ See above n 138.

932. Based on our findings with respect to the Third Going Concern Allegation and the Fourth Going Concern Allegation, and having regard to the Relevant Benchmark,²¹⁴ we have formed the view that Mr Williams' level of performance of his duties was not adequate.
933. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²¹⁵ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 2(d) has been established.

Sub-Contention 2(e)

Adequately consider whether a material uncertainty existed or conditions that may have cast significant doubt on the entity's ability to continue as a going concern and ensure that relevant disclosures were made in the financial report in relation to such material uncertainty and amend the Audit Report accordingly.

934. In addition to Mr Williams' responses to the four allegations in contention 2 that we have already considered Mr Williams said that the matters the subject of this Sub-Contention had been properly considered and he referred to contention 2(a). We refer to and repeat our comments in contention 2(a) with respect to his response thereto. Based on those findings, we are satisfied that the documents to which Mr Williams referred did not demonstrate there had been adequate consideration by the auditor of whether a material uncertainty existed or whether there were conditions that may have cast significant doubt on the entity's ability to continue as a going concern nor that the auditor had ensured that the disclosures that were made in the 2012 LM Financial Statements reflected the material uncertainty or that the 2012 LM Audit Opinion was amended accordingly.
935. Based on our findings with respect to the Third Going Concern Allegation and the Fourth Going Concern Allegation and having regard to the Relevant Benchmark,²¹⁶ we have formed the view that Mr Williams' level of performance of his duties was not adequate.
936. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²¹⁷ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 2(e) has been established.

Sub-Contention 2(f)

Obtain reasonable assurance and sufficient appropriate audit evidence to reduce risk in relation to the entity's ability to continue as a going concern to an acceptably low level.

²¹⁴ See above n 56.

²¹⁵ See above n 138.

²¹⁶ See above n 56.

²¹⁷ See above n 138

937. In addition to Mr Williams' responses to the four allegations in contention 2 that we have already considered Mr Williams said that the matters the subject of this Sub-Contention had been properly considered and he referred to his response that the directors were required to assess a company's ability to continue as a going concern each time a financial report is approved (usually only annually). In our view this response was not relevant to the question of whether Mr Williams had appropriately performed his obligations in the 2012 LM Audit with respect to the Going Concern Audit Assessment that he was required to perform.
938. Based on our findings with respect to the First, Second and Third Going Concern Allegation and Sub-Allegations (a)-(g), (k)-(l) and (m) of the Fourth Going Concern Allegation, and having regard to the Relevant Benchmark,²¹⁸ we have formed the view that Mr Williams' level of performance of his duties was not adequate.
939. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²¹⁹ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 2(f) has been established.

Sub-Contention 2(g)

Failed to modify his audit opinion either by issuing a qualified opinion or in the alternative issuing an adverse opinion in relation to evidence indicating a material uncertainty regarding the entity continuing as a going concern.

940. Mr Williams said that the matters the subject of this Sub-Contention had been properly considered and he referred to the Going Concern Summary and the Going Concern programme and AWPBC1. We refer to and repeat our comments with respect to those documents in Sub-Contention 2(a).
941. Based on our findings with respect to the First, Second, Third and Fourth Going Concern Allegations, we are satisfied that the documents to which Mr Williams referred did not demonstrate that based on the audit evidence obtained, there was no reason to modify the 2012 LM Audit Opinion, either by issuing a qualified opinion or issuing an adverse opinion based on evidence indicating a material uncertainty regarding the entity continuing as a going concern.
942. Based on our findings with respect to Sub-Allegation (i) and (j) of the Fourth Going Concern Allegation and our comments and views with respect to the documents we have described and discussed in paragraphs 791-822, and having regard to the Relevant Benchmark,²²⁰ we have formed the view that Mr Williams' level of performance of his duties was not adequate.

²¹⁸ See above n 56.

²¹⁹ See above n 138.

²²⁰ See above n 56.

943. We refer to and repeat our comments about the nature of the Board’s task in proceedings commenced pursuant to section 1292(1)(d) of the Act²²¹ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 2(g) has been established.

Sub-Contention 2(h)

Display an appropriate level of professional scepticism.

944. Mr Williams said that he had displayed an appropriate level of professional scepticism and he referred to AWPAA2. AWPAA2 recorded risks identified with respect to the 2012 LM Audit. However, it does not record evidence of how those identified risks were assessed in the 2012 LM Audit and for this reason does not in our view provide evidence of the exercise of an appropriate level of professional scepticism in the performance of the 2012 LM Audit with respect to the evaluation of management’s going concern assessment.

945. Based on our findings with respect to the First, Second and Third Going Concern Allegations and Sub-Allegation (h) of the Fourth Going Concern Allegation and our comments in paragraph 815 and our further comments on the standard of appropriate professional scepticism expected in the performance of an audit at the time,²²² and having regard to the Relevant Benchmark,²²³ we have formed the view that Mr Williams’ level of performance of his duties was not adequate.

946. We refer to and repeat our comments about the nature of the Board’s task in proceedings commenced pursuant to section 1292(1)(d) of the Act²²⁴ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 2(h) has been established.

Sub-Contention 2(i)

Evaluate whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based.

947. Mr Williams said that he had evaluated whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based and referred to AWPAA1 which was the template document headed *Audit Plan and Overall Strategy*. We refer to and repeat our comments with respect to the template-generated documents that were used by WPIAS in the 2012 LM Audit.²²⁵ AWPAA1 does not demonstrate evidence of the evaluation of whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the

²²¹ See above n 138.

²²² See above n 58.

²²³ See above n 56.

²²⁴ See above n 138.

²²⁵ See above n 41.

conclusions on which his opinion was based with respect to the audit evaluation of management's going concern assessment.

948. Based on our findings with respect to the First, Second, Third and Fourth Going Concern Allegations and having regard to the Relevant Benchmark²²⁶ we have formed the view that Mr Williams' level of performance of his duties was not adequate.
949. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²²⁷ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 2(i) has been established.
950. We have not considered Sub-Contention (j) as it was pleaded in the alternative to the totality of Sub-Contentions (a)-(i) all of which we have found established.

Panel's Conclusion with respect to Contention 2

951. Based on the reasons and the conclusions we have set out above we are satisfied that, within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i). We regard the matters established in Contention 2 as substantive failures for which Mr Williams, as Engagement Partner on the 2012 LM Audit, was responsible.
952. We are satisfied that Contention 2 has been established.

CONTENTION 3 – RELATED PARTY LOANS

953. ASIC contends that within the meaning of subsection 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 Financial Report, regarding the accuracy and disclosure of related party loans.
954. Mr Williams denied Contention 3. He admitted that the related party disclosures that were contained in Note 12 to the 2012 Financial Report did not include all of the matters referred to in the relevant accounting and auditing standards, outlined below, and he submitted that the disclosures made were otherwise adequate.

Relevant Facts

955. The *Related Parties* section of the 2012 LM Financial Statements disclosed the following receivables were owed by related parties (other than LM Administration Pty Limited):

²²⁶ See above n 56.

²²⁷ See above n 138.

Related Party	Loan amount 30 June 2012	Loan amount 30 June 2011
<i>Peter Charles Drake</i>	<i>\$16,911,196</i>	<i>\$15,226,499</i>
<i>LM Capalaba Pty Ltd</i>	<i>\$14,968,213</i>	<i>\$9,610,476</i>
<i>Maddison Estate Pty Ltd</i>	<i>\$201,187,254</i>	<i>\$128,301,729</i>
<i>Aalto Apartments Pty Ltd</i>	<i>\$24,608,244</i>	<i>\$22,423,926</i>
<i>Ekard Property Trust</i>	<i>\$2,995,270</i>	<i>\$2,896,698</i>

956. The specific disclosure in Note 12 of the 2012 LM Financial Statements with respect to the loan to Peter Charles Drake was as follows:

Peter Charles Drake

As at 30 June 2012, the Fund had a loan receivable of \$16,911,196 (2011: \$15,226,499) from Peter Charles Drake, a director of the Manager. The loan is secured by a charge over LM Administration Pty Ltd in its own right and as trustee for the Ekard Property Trust, and by a charge over Century Star Investments. Century Star Investments is a shareholder of LM Investment Management Limited with a 50% stakeholding. An external report from an independent firm in November 2012 assessed this security holding at \$54 million (50% of assessed total of \$107 million). Interest on this loan is fully serviced monthly.

Operating EBIT of these two entities combined was a \$11.0 million EBIT profit for the year ended 30 June 2012 (2011: \$7.1 million). Operating EBIT forecast of these entities for the 2013 financial year is forecasted at \$8.8 million.

With respect to LMC, Maddison Estate, Aalto and Ekard Property Trust, the specific disclosures in Note 12 were as follows:

LMC

LM Capalaba Pty Ltd - this entity is a related party loan secured through a second mortgage over real property of which a joint venture agreement is currently in place stipulating a minimum interest return to the scheme. The Manager is currently in due diligence discussions and has received a conditional letter of interest from an offshore financier overall including the assessment of payout of the facility with the LM Australia Income Fund and financing the full construction of the project to completion.

Maddison Estate

Maddison Estate Pty Ltd (formerly LM Arrowtown Pty Ltd) – this entity is a related party loan secured over the assets of Maddison Estate Pty Ltd. Maddison Estate Pty Ltd controls the actual landholder of the subject real property Coomera Ridge Pty Ltd via contractual rights.

Suncorp loan facility: Maddison Estate Pty Ltd, a related party, has a current Suncorp loan facility of \$22,046,134. The facility has been varied, amended or restated on various occasions since 21 January 2008.

Suncorp have extended the loan facility to 31 March 2013 conditional on an amortised paydown to \$18 million by that date. The Manager is currently in due diligence discussions and has received a conditional letter of interest from an offshore financier to fully repay the Suncorp facility on March 31, 2013 and also finance the full construction of the project to completion.

Aalto

Aalto Apartments Pty Ltd – this entity represents a financial asset to the scheme based on the contractual right to receive cash. This receivable is contingent on certain events and the entity is a related party. AIIS Pty Ltd will be the actual recipient of the cash proceeds which is a wholly owned entity of the scheme. The scheme also holds a second mortgage security over the real property assets of AIIS Pty Ltd. The Manager is currently in due diligence discussions and has received a conditional letter of interest from an offshore financier overall including the assessment of payout of the facility with the First Mortgage Income Fund and financing the full construction of the project to completion.

Ekard Property Trust

Ekard Property Trust – this entity is a related party loan secured through a second mortgage over real property. The property is currently on the market and a current offer to fully recover the loan is being negotiated for contract signing as at date of this report. The offer will constitute a full recovery of the existing loan balance in the fund.

Note 12 to the 2012 M Financial Statements also stated:

From time to time the directors of LM Investment Management Limited, or their director related entities, may invest or withdraw from the Scheme. These investments or withdrawals are on the same terms and conditions as those entered into by other Scheme investors..... All transactions were approved on an arms' length basis and on normal terms and conditions.²²⁸

And...

...Through the "loan structure" referred to immediately above, the Fund makes a loan to an SPV on arms length terms with the ability to periodically assess the interest rate enabling the Fund to extract all the financial benefit that the SPV receives from the SPV's contractual participating interest in the underlying asset.

957. The last two disclosures extracted above are included under a heading *Other transactions with the Scheme* within the Related Parties section of the 2012 LM Financial Statements before the next sub-heading within that section 'Balance with related parties' under which the loans are disclosed.

Audit work papers

Lead audit work paper AWPAE1

958. The lead audit workpaper was identified as AWPAE1 and entitled *Related Parties*. It was noted as prepared by Evelyne Kwong on 11 May 2012, updated by AB on 29/8/12 and intialled by Mr Williams on 20/9/12 ("AWPAE1").

959. AWPAE1 listed audit procedures (all noted as completed) with respect to related party transactions under the headings:

1. Risk Assessment Procedures and Related Activities;
2. Identification and Assessment of the Risks of Material Misstatement Associated with Related Party Relationships and Transactions;
3. Responses to the Risks of Material Misstatements Associated with Related Party Relationships and Transaction;

²²⁸ 2012 LM Financial Statements, page 22 paragraph 1.

4. Evaluation of the Accounting for and Disclosure of Identified Related Party Relationships and Transactions;
5. Written Representations;
6. Communication with Those Charged with Governance; and
7. Reporting Considerations.

It was not in issue that the contents of the software generated template dealing with related party audit procedures that was the basis of document AWPAE1 reflected matters required by the various standards that were operative at the time.

960. Against the audit procedures listed under the various headings in AWPAE1, other audit file documents were cross referenced, including the following:

- (a) AWPAA2. This was the record of the 2012 LM Audit team planning meeting for the year ending 30 June 2012 held on 1 May 2012.

Under the heading 'To be alert for related party transactions. Refer to AE1' was the note 'Will document'.

Under the record of the discussion of the susceptibility of the Financial Report to material misstatement due to fraud which referenced ASA 240.15, AWPAA2 recorded the following questions/prompts and responses:

- (a) **3.1 How and where does the engagement team believe the entity's financial report may be susceptible to material misstatement due to fraud, including how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated?**

Misappropriation of funds – unauthorised loans and unauthorised payments. Note the walkthroughs conducted confirm the existence of controls around both payments and loan authorisation (including the appointment of the custodian on 1/11/11, increasing the security over the payments and assigning the legal ownership of the fund assets to the custodian).

Profits may also be manipulated by revising interest rates and discount rates used in the development feasibilities.

- (b) **3.2 Consider circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.**

As noted above, earnings may be "managed" by management to artificially increase profits, and therefore create better returns for investors, which makes the Fund more attractive to new investors and therefore facilitate / justify greater management fee payments.

- (c) **3.3 Consider the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalise committing fraud.**

As above. In addition, potential influence by the sole owner and CEO. It appears the corporate governance model lacks an independent/non executive director, with the consequent risk of reduced objectivity.

(d) 3.4 Consider management’s involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.

Refer to the walkthroughs conducted in relation to payments and loans.

(e) 3.11 Consider the risk of management override of controls

Potential influence of Peter Drake. Refer work completed AA5.6.

(b) AWPAE5, which was a copy of page 21 of the 2012 LM Financial Statements which recorded the related party disclosures.

(i) AWPAE5 documents the information set out at audit procedure 1.6 of AWPAE1, ticked as completed, which was ‘Document the names of all identified related parties and the nature of the related party relationships’.

(ii) AWPAE5 was also noted against audit procedure 3.4 of AWPAE1, ticked as completed – ‘3.4 If management has made an assertion in the financial report to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm’s length transaction, obtain sufficient appropriate audit evidence about the assertion.’ AWPAE5 does not record details relevant to this assertion.

(iii) AWPAE5 was further referenced to audit procedure 4.1 of AWPAE1, ticked as completed – ‘in forming an opinion on the financial report, evaluate: a) whether the identified relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework’. AWPAE5 does not record details of any audit evaluation of whether the identified relationships and transactions were appropriately accounted for and disclosed.

(iv) AWPAE5 does not a record any specific testing of balances or the consideration of the contentions underlying the disclosures on page 21 of the 2012 LM Financial Statements. There were tickmarks recorded on AWPAE5 which would typically indicate that the prior year balances had been agreed to the previous year’s signed accounts and current year balances and disclosures agreed to the audit file or perhaps the final signed accounts.

(c) AWPAE2 and AWPAE2/1. These documents record factual information regarding the related party loans including, the maximum loan amount (2011), the nature of the loan and changes/likely changes to the loans. It notes when the information was updated for each loan. AWPAE2 distinguishes between active loans and paid out loans. Each active loan noted was cross-referenced to an IB series workpaper which was the reference for the Loans Receivable audit workpapers. AWPAE2 and

AWPAE2/1 were noted as brought forward from the 30 June 2011 audit file and recorded 'nil significant changes noted'. Presumably that notation related to the 30 June 2012 year.

- (d) There are two further workpapers referenced in AWPAE2 that appear to be AWPAE2/2 and AWPAE2/3. AWPAE2/2 records 10 general loan related activities (e.g. insurance requirements; default management) and recorded comments regarding the nature of possible conflicts that could arise from such activities. AWPAE2/2 recorded the method of control against each of these activities and finally noted whether the activity was Related Party or not via a Y/N option. AWPAE2/2 does not cross reference any workpapers or record whether the controls noted have been tested, or record the relevance or outcomes of the activities described in terms of the performance of the 2012 LM Audit.

AWPAE2/3 sets out similar information to AWPAE2/2 for four LM specific (related party) loan activities such as the administration services provided by LMA Pty Ltd. AWPAE2/2 does not note the purpose or relevance of that information with respect to the 2012 LM Audit.

- (e) AWPA5.6. This AWP is titled *Identified risks of Material Misstatement*. With respect to related party transactions it noted the assertions affected as 'Accuracy and Valuation, Rights and Obligations and Related Party Disclosures', the likelihood as possible, the consequences as severe and follow up as 'review related party transactions; review the basis of management fees' and noted working paper references as *AE, F and RA*.

AWPA5.6 identified overpayment of management fees to related parties and related party loans as the consequences of related party transactions risk and noted no controls were to be relied upon.

AWPA5.6 is not audit evidence of overt consideration of additional risks presented by the related party transactions with respect to LM.

The AWPAE reference in AWPA5.6 appears to be to the entirety of the AE series of AWP's - there was no workpaper in the files to which we were referred identified by only the reference 'AE'.

- (f) The AE section of the audit work papers (AE1 onwards) records audit work performed with respect to the identification of related parties and the comparison of the information disclosed in the 2012 LM Financial Statements with the prior year report and included corporate register extracts.

The AE series of audit working papers did not include a record of explicit audit work with respect to the related party loans.

In our view the the AE series of audit workpapers is not audit evidence of relevant audit testing with respect to the related party loans.

- (g) As to the "F" series of AWPs, also cross referenced in AWPA5.6, there were three workpapers:

- (i) The FA audit program headed *Income Statement Audit Program*. This is a two page document presenting the assessed risks for each assertion across various account balances related to the Profit & Loss. AWPFA does not refer to related parties or related party loans.

AWPFA does not provide audit evidence of specific audit testing of relevant related party loan balances.

- (ii) AWPFA1 - this is a further two page document recording the consolidation accounting between LM and AIIS for the current year and prior two years. The first of the two sheets referred to the Balance Sheet and the second to the Profit & Loss.

AWPFA1 is not audit evidence of specific testing of the related party loan balances.

- (iii) AWPFB1 - *Payments/Income testing Summary*. It notes the key line items from the Statement of Comprehensive Income, including the total balance, the value of testing of that balance, the percentage which that testing represents and AWP references if relevant or a designation of *imm* (which we assume designated the balance as immaterial and not subject to audit testing). As its title suggests, AWPFB1 summarised the values of testing performed on income and expense items and identified some immaterial balances. The workpaper is not audit evidence of any specific audit testing of the related party loan balances.

961. The RA series of AWP's were also cross referenced in AWPAA5.6. This series comprised five workpapers that related to the prepayment of management fees, a related party balance disclosed in the 2012 LM Financial Statements, that is the subject of Contention 4. The RA series of documents were not audit evidence of specific testing of the related party loan balances.
962. Similarly, the AE and F series of workpapers to which Mr Williams also referred with respect to this contention were not audit evidence of any specific audit testing of related party loan balances.
963. Audit procedure 3.1 in AWPAE1 required the auditor to make an active and pervasive consideration of all related party transactions and balances that management has not previously identified or disclosed. Mr Williams asserted that AWPAA5.6, discussed above addressed audit step 3.1 in AWPAE1. While AA5.6 refers to related party transactions, the further supporting work papers referred to that we have described above, focus on the prepaid management fees. The work papers do not record any consideration of the audit step 'what may have not been identified to date' in AWPAE1, either in AA5.6 or any of the other work papers that were referenced AWP in AA5.6, i.e., the AE, F or RA series referred to in AA5.6.
964. There were other audit papers we were referred to including AWPBC1 *Forming an Opinion on the Financial Report*. This is a template produced by the Firm's auditing program software and lists various requirements in the Auditing

Standards in relation to drawing final conclusions based on the audit work performed, including consideration of the form of audit opinion to be issued. The document is described in detail in Maddison Sub-Allegation 1(m). We refer to and repeat our comments on AWPBC1 in paragraphs 438-441.

965. In general terms our view on the content of AWPBC1 is that the record it provides of the consideration that lead to the conclusion to issue an unmodified audit opinion was not adequate in terms of the requirements of ASA 500. This document does not provide audit evidence of any audit procedures with respect to related party loans in the 2012 LM Audit.
966. AWPAE1 also noted cross-references to AA3, HA, XD, GA, AA4, BG1 and BD. There were no submissions or evidence about their relevance to the matters the subject of Contention 3.
967. We have reviewed these documents/series of documents in order to gain an understanding of their nature.
968. An indication of the nature of these audit records is as follows:
- (a) AWPAA3 documented the outcomes from a meeting with management on 8 May 2012 and (presumably) members of the audit team, although no members of the audit team are listed in AWPAA3 as having been in attendance. In relation to related party matters at point 1.9, it recorded the auditor's updated understanding from the prior year. It noted management fees as the only significant related party transactions.
 - (b) AWPAA4 recorded the auditor's consideration as to fraud and the auditor's responsibility in relation to fraud. There is a reference to AWPAA5.6, discussed above.
 - (c) AWPBD - This work paper documents the formal communication between WPIAS and LMIM management about the nature of the auditor's responsibilities. It is audit evidence of what was communicated to those charged with governance in LMIM including the independent nature of the auditor's role and the obligation of those charged with governance to consider whether there were any matters of concern to be disclosed to the auditor. AWPBD has minimal relevance to the overt testing of related party loan transactions that is required in the performance of an audit where there are related parties. If the discussions associated with this communication had resulted in any disclosures with respect to related party matters it should have been documented as audit evidence.
969. Having regard to the content of the documents we reviewed when preparing our determination because Mr Williams had specifically submitted they were relevant audit evidence of the performance of appropriate and sufficient audit procedures with respect to the related party loan balances in the 2012 LM Audit and which we have described and discussed above,²²⁹ we are satisfied there was no audit evidence in the 2012 LM Audit that the additional risks posed to LM by

²²⁹ See paragraphs 958-968.

the related party loan transactions were properly identified, investigated and assessed. AWPAA2 recorded a notation to be alert for related party transactions, but AE1 to which it referred in this regard did not record any work performed with respect to the related party loan balances. The record of the discussion in AWPAA2 of the susceptibility of the Financial Report to material misstatement due to fraud which referenced ASA 240.15, did identify risks that were also relevant to the related party loan balances, although there was no audit evidence that the risks identified were followed up by performance of appropriate and relevant audit procedures with respect to the related party loan balances.

970. We now turn to a consideration of the allegations with respect to Contention 3.

The Related Party Loan Allegations

971. There were 4 allegations made with respect to Contention 3.

First Related Party Loan Allegation

972. The First Related Party Allegation made was that the disclosure made in the 2012 LM Financial Statements with respect to the loan to Mr Drake, did not contain the following information required by the Accounting Standards in relation to Related Party disclosures AASB 124 Aus 29.8.1 (December 2009) (“Aus 29.8.1”):

- (a) The amount of interest payable or paid in the reporting period to the reporting entity as required by Aus 29.8.1(b) (“Sub-Allegation 1(a)”);
- (b) The difference between the amount referred to in (a) and the sum of interest that would have been charged on an arm’s length basis as required by Aus 29.8.1(c) (“Sub-Allegation 1(b)”);
- (c) Each write down and allowance for doubtful receivables recognised by the disclosing entity and any of its subsidiaries - Aus 29.8.1(d) (“Sub-Allegation 1(c)”);
- (d) The highest amount of indebtedness during the reporting period - Aus 29.8.1(f) (“Sub-Allegation 1(d)”); or
- (e) A summary of the loan terms and conditions - Aus 29.8.1(h) (“Sub-Allegation 1(e)”).

973. Mr Williams admitted that the above disclosures were not made.

974. The matters alleged by ASIC were matters that fell within the sub-paragraphs of Aus 29.81 as set out above. Aus 29.81 required the disclosures to be made by LM in its financial statements.

975. Mr Williams repeated the Engagement Partner Response²³⁰ that he did not press, and the Limited User/Limited Purpose Response²³¹ and we refer to and repeat our comments and conclusions with respect to those matters that form the basis

²³⁰ See above n28.

²³¹ See above n47.

of our conclusion that they do not provide an answer to the allegations made in these proceedings.

976. Mr Williams further responded to each of Sub-Allegations (a)-(e) as follows:

Sub-Allegation 1(a)

977. Mr Williams submitted that the interest income for the year from the loan to Mr Drake was \$1,876,832.60 being 3% of the total interest income of \$60,661,058.00 and therefore was not material.

978. Mr Rea accepted in his evidence in cross examination that as a percentage of total interest revenue, interest revenue from the loan to Mr Drake was not material.

979. Mr Rea further stated, that the interest revenue of \$1,876,832.60 represented 8.7% of LM's net profit before distribution and so in that respect, should have been considered material.

980. The question of whether the relevant amount was material is not a matter that was contemplated by the provisions of Aus 29.8.1, the requirements of which were prescriptive.

981. In performing the audit of the 2012 LM Financial Statements, Mr Williams should have ensured that the information set out in Aus 29.8.1(b) of AASB 124 had been properly included as per the ASA (Aus 1.9) requirement.

982. On the basis the disclosure did not contain the information referred to we are satisfied that Sub-Allegation 1(a) of the First Related Party Loan Allegation has been established.

Sub-Allegation 1(b)

983. With respect to Sub-Allegation 1(b) Mr Williams said that there was no difference that required disclosure because the loan was on arms' length terms.

984. It was not in issue that if the loan to Mr Drake was on arms' length terms, there was no difference to disclose. ASIC submitted there was no disclosure that the loan to Mr Drake was an arm's length transaction, although this disclosure was recorded in the 2012 LM Financial Statements (Note 12) and we have therefore concluded with respect to Sub-Allegation 1(b) that there would have been no difference to disclose pursuant to Aus 29.8.1(c).

985. For these reasons our finding is that Sub-Allegation 1(b) of the First Related Party Loan Allegation has not been established.

Sub-Allegation 1(c)

986. With respect to Sub-Allegation 1(c), Mr Williams said that during the period 1 July 2011 to 30 June 2012 there were no write-downs and no allowances for doubtful debts.

987. Mr Williams relied on AWPIB13A. This was a loan statement on LMIM letterhead with respect to Peter Charles Drake that recorded a loan summary. It was dated 20/7/2012. It did not show there had been any write-downs or allowances for doubtful receivables in the relevant period. Mr Rea agreed in cross examination that as there were no write-downs or allowances for doubtful receivables, no disclosure Aus 29.8.1(d) would have been necessary. Based on this evidence and Mr Williams' response that during the period 1 July 2011 to 30 June 2012 there were no write-downs and no allowances for doubtful debts that required disclosure we find that Sub-Allegation 1(c) of the First Related Party Loan Allegation has not been established.

Sub-Allegation 1(d)

988. In relation to this Sub-Allegation, Mr Williams' evidence was that the highest amount of indebtedness in the reporting period was the closing balance of \$16,911,196.00 as was disclosed in the 2012 LM Financial Statements. This was corroborated by AWPIB13A/1.

989. Based on this evidence, we are satisfied that Sub-Allegation 1(d) of the First Related Party Loan Allegation has not been established.

Sub-Allegation 1(e)

990. In respect of Sub-Allegation 1(e), Mr Williams repeated the matters detailed above. The basis of Mr Williams' response to this Sub-Allegation lacked clarity. With respect to this sub-paragraph, his statement of evidence referred to paragraph 140 which stated 'The Firm released the final 2012 Audit Report, dated 07 December 2012, on 10 December 2012...'. Mr Rea's statement did not further address Sub-Allegation 1(e).

991. The detail disclosed in Note 12 of the 2012 LM Financial Statements was as follows:

As at 30 June 2012, the Fund had a loan receivable of \$16,911,196 (2011: \$15,226,499) from Peter Charles Drake, a director of the Manager. The loan is secured by a charge over LM Administration Pty Ltd in its own right and as trustee for the Ekard Property Trust, and by a charge over Century Star Investments. Century Star Investments is a shareholder of LM Investment Management Limited with a 50% stakeholding. An external report from an independent firm in November 2012 assessed this security holding at \$54 million (50% of assessed total of \$107 million). Interest on this loan is fully serviced monthly.

992. The information in the disclosure above referred to the security in respect of the loan, the amount of the loan and details of interest servicing. Insofar as it did not summarise other key terms of the loan such as repayment date, or any summary of the operative terms and conditions of the loan our view is that the disclosure was not sufficient to satisfy AUS 29.8.1(h) of AASB 129 that required disclosure of 'a summary of the terms and conditions of the loans'.

993. We are satisfied that Sub-Allegation 1(e) of the First Related Party Loan Allegation has been established.

Second Related Party loan allegation

994. The Second Related Party Loan Allegation was that with respect to the other 4 related party loans set out in paragraph 955 (besides the loan to Mr Drake), the disclosures made did not contain the following information in accordance with the Accounting Standards in relation to Related Party disclosures AASB 124 Aus 29.9.1 (December 2009) (“Aus 29.9.1”) as follows:
- (a) interest revenue as required by Aus 29.9.1(a)(i);
 - (b) write-downs of receivables and allowances made for doubtful receivables as required by Aus 29.9.1(b)(ii); or
 - (c) a summary of the terms and conditions of the loan as required by 29.9.1(c).
995. We note that the SOFAC referred to Aus 29.8.1 with respect to the First Related Party Loan Allegation regarding Mr Drake’s loan and Aus 29.9.1 with respect to the Second Related Party Allegation with respect to the four other related party loans the subject of Contention 3. Aus 29.8.1 applied to loan balances and Aus 29.9.1 applied to any other balances and transactions with a related party (i.e everything except a loan balance.). Mr Rea’s evidence referred to Aus 29.8.1 with respect to all loan balances and ASIC’s submissions referred to both. While we are satisfied that disclosure with respect to all loans was required in accordance with the provisions of AASB 124, we are not satisfied the Second Related Party Loan Allegation has been established, because the subject of the allegation was the further loan balances set out in the table in paragraph 955 and the specific section of AASB 124 that required the alleged required disclosure for these loan balances was pursuant to Aus 29.8.1 rather than Aus 29.9.1 as referred to within the SOFAC.

Third Related Party Loan Allegation

996. The Third Related Party Loan Allegation was that the Audit Engagement File did not contain sufficient appropriate audit evidence:
- (a) to show that pre-sales targets for the Maddison project had been met; and/or
 - (b) to show whether senior debt financing had been obtained; and/or
 - (c) to show that construction contracts had been entered into; and/or
 - (d) to support the timelines of the project from inception to the time the audit was performed.
997. It was alleged that a reasonably competent auditor would have recognised that these circumstances, combined with the increase in the Maddison receivable (from \$128,301,729 to \$201,187,254) increased the risk that part of the Maddison Loan may not be recoverable.

998. The Panel refers to the findings it has already made with respect to the above matters in the context of Contention One in particular its findings with respect to:
- (a) the Subsequent Maddison Audit Response;²³²
 - (b) our finding in paragraph 278 with respect to the absence of any evidence of audit procedures having been performed nor any audit evidence about whether, with respect to the Maddison Development, project development timelines were being met and whether future projections were achievable;
 - (c) the First Maddison Loan Allegation;
 - (d) the Fifth Maddison Loan Allegation;²³³ and
 - (e) Sub-Allegations (d)-(f), (k)-(m), (r) and (u) of the Sixth Maddison Loan Allegation.²³⁴
999. Based on the findings set out above with respect to the Maddison Loan, we are satisfied that the Audit Engagement File did not contain sufficient appropriate audit evidence with respect to the matters alleged and, having regard to the Relevant Benchmark,²³⁵ we are satisfied that a reasonably competent auditor would have recognised that these circumstances, combined with the increase in the Maddison receivable (from \$128,301,729 to \$201,187,254) from the prior year, increased the risks with respect to recoverability of the Maddison Loan receivable.
1000. We are satisfied that the Third Related Party Loan Allegation has been established.

Fourth Related Party Loan Allegation

1001. The Fourth Related Party Loan Allegation was that a reasonably competent auditor in the circumstances of the 2012 LM Audit would have identified the following matters and/or performed the following duties as part of the related party loans assessment in the 2012 LM Audit and there was no evidence in the Audit Engagement File that these matters had been adequately identified considered and/or attended to. We are satisfied that the relevant Auditing Standards/Accounting Standards at the time specified that the matters the subject of Sub-Allegations (a)-(i) of the Fourth Related Party Loan Allegation were, having regard to the Relevant Benchmark²³⁶ audit responsibilities to be performed with respect to the related party loan transactions in the 2012 LM Audit. The matters alleged were as follows:

²³² See above n 53.

²³³ See paragraphs 313 and 314.

²³⁴ See paragraphs 315 - 317.

²³⁵ See above n 56.

²³⁶ Ibid.

Sub-Allegation 4(a)

A reasonably competent auditor would have identified that the significant increase in the receivable from Maddison Estate, heightened the risk that the transaction was not on an arm's length basis.

1002. The related party disclosures made by LMIM in the 2012 LM Financial Statements included the assertion that the loan arrangements were transacted at arm's length. The provisions of ASA 550.24 provided that if management had made that assertion in the financial report the auditor was to obtain sufficient audit evidence about the assertion.

1003. Having regard to the Relevant Benchmark,²³⁷ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have performed this obligation by making appropriate enquiries and retaining sufficient and appropriate audit evidence, including with respect to the details of the Maddison Loan.

1004. The audit evidence comprised the loan statements from LMIM to which we have referred and there was no other audit evidence that enquiries with respect to this matter had been made in the 2012 LM Audit.

1005. We are satisfied Sub-Allegation 4(a) has been established.

Sub-Allegation 4(b)

A reasonably competent auditor would have identified the possibility of misstatements having occurred regarding the loan balances (Mr Drake, Maddison Estate, Aalto and Ekard) in accordance with ASA 200.

1006. Other than the loan statements to which we were referred, there was no other audit evidence that demonstrated that the information provided by management in the 2012 LM Audit with respect to the related party loan balances had been tested or assessed in terms of the matters that were specified in ASA 200 such as the possibility of the potential risk of misstatement.

1007. In our view, having regard to the Relevant Benchmark²³⁸ and the requirements of ASA 200, and the audit evidence to which we have referred in the preceding paragraph, a reasonably competent auditor in the circumstances of the 2012 LM Audit, would have identified the possibility of misstatement in the 2012 LM Financial Statements with respect to the relevant loan balances as a matter to be addressed when performing the audit.

1008. We are satisfied that Sub-Allegation 4(b) has been established.

Sub-Allegation 4(c)

A reasonably competent auditor would have identified that the information provided by the Manager was inaccurate, incomplete and not precise in accordance with ASA 500.

1009. ASA 500 provided that the objective of the auditor was to design and perform audit procedures so as to enable the auditor to obtain sufficient appropriate audit

²³⁷ Ibid.

²³⁸ Ibid.

evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

1010. The evidence that we have discussed in the context of the First and Second Related Party Loan Allegations and Sub-Allegations 4(a) and 4(b) supports a view that the audit procedures planned and performed in the 2012 LM Audit with respect to the related party loan balances were not sufficient to satisfy the obligations imposed by the Auditing Standards at the time, and insofar as that was the case, that evidence was consistent with a view that the information that had been provided by management was incomplete and not sufficiently precise to meet the objective prescribed by ASA 500 referred to in the preceding paragraph.
1011. In our view, and having regard to the Relevant Benchmark²³⁹ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have identified that the related party loan arrangements required detailed scrutiny and the application of a heightened professional scepticism in order to obtain sufficient assurance that the related party loan arrangements did not pose an unacceptable financial risk to LM. In the circumstances of the 2012 LM Audit that would have involved the auditor seeking further more specific information from LMIM as to the loan arrangements and retaining audit evidence that demonstrated proper scrutiny of that information.

1012. We are satisfied that Sub-Allegation 4(c) has been established.

Sub-Allegation 4(d)

A reasonably competent auditor would have identified that the appropriate related party transaction disclosures had not been made in accordance with AASB 124 and ASA 550.

1013. We refer to and repeat our comments and our findings with respect to the First and Second Related Party Loan Allegations (to the extent they were established). We are satisfied that a reasonably competent auditor would have identified that the related party transaction disclosures made were not fully in accordance with AASB 124 and ASA 550.20.
1014. ASA 550.25 provided that in forming an opinion on the financial report in accordance with ASA 700, the auditor was required to evaluate whether the identified related party relationships and transactions had been appropriately accounted for and disclosed in accordance with the applicable reporting framework.
1015. We refer to and repeat our comments and findings with respect to the First Related Party Loan Allegation (to the extent it was established).
1016. We are satisfied that a reasonably competent auditor in the circumstances of the 2012 LM Audit would have identified that the appropriate related party transaction disclosures had not been made in accordance with AASB 124 and ASA 550.20.

²³⁹ Ibid.

1017. We are satisfied that Sub-Allegation 4(d) has been established.

Sub-Allegation 4(e)

A reasonably competent auditor would have identified that sufficient appropriate audit evidence had not been obtained to support the relevant related party disclosures had been made in accordance with ASA 500.6 and ASA 200.17.

1018. We refer to and repeat our comments and findings with respect to Sub-Allegations (a) and (e) of the First Related Party Loan Allegation and Sub-Allegations (a)-(d) of this allegation, our comments on the audit file documents we have described with respect to this contention in in paragraph 969.

1019. For those reasons and having regard to the Relevant Benchmark, we are satisfied that a reasonably competent auditor in the circumstances of the 2012 LM Audit would have identified that sufficient appropriate audit evidence had not been obtained to support an opinion that the relevant related party disclosures had been made in accordance with ASA 500.6 and ASA 200.17.

1020. We are satisfied Sub-Allegation 4(e) has been established.

Sub-Allegation 4(f)

Considered whether these related party transactions not being adequately disclosed resulted in the financial report not being prepared in all material respects in accordance with the applicable financial reporting framework and consequently consider if the audit opinion should be modified in accordance with ASA 700 and ASA 705.

1021. We refer to and repeat our comments and findings with respect to Sub-Allegations (a), (b), (c), (d) and (e) of this allegation.

1022. A reasonably competent auditor, in the circumstances of the 2012 LM Audit, would, having regard to the findings referred to in the preceding paragraph and the Relevant Benchmark,²⁴⁰ considered that a consequence of the related party loan balances not having been adequately disclosed in the 2012 LM Financial Statements was that the financial statements had not been prepared in all material respects in accordance with the applicable financial reporting framework and would consequently have considered whether the audit opinion to be issued required modification having regard to the provisions of ASA 700 and ASA 705.

1023. The audit evidence with respect to these matters in the 2012 LM Audit was not in our view sufficient or appropriate.

1024. We are satisfied Sub-Allegation 4(f) has been established.

Sub-Allegation 4(g)

Applied an appropriate level of professional scepticism to the work performed on related party transactions in accordance with ASA 200.

²⁴⁰ Ibid.

1025. We refer to and repeat our comments with respect to the importance of the auditor's responsibility to apply appropriate professional scepticism in an audit.²⁴¹ In our view the nature of the relevant related party loans and the related parties, particularly the Drake Loan, required heightened professional scepticism to be applied to the performance of audit procedures with respect to the related party loan balances in the 2012 LM Audit.

1026. Having regard to the Relevant Benchmark,²⁴² a reasonably competent auditor in the circumstances of the 2012 LM Audit would in our view have retained audit evidence that demonstrated that the relevant related party loan balance disclosures prescribed had been made appropriately in the 2012 LM Financial Statements and the requirements of the Auditing Standards observed in performing the audit of those disclosures in order to demonstrate that appropriate professional scepticism was applied to the work performed on related party transactions in accordance with ASA 200.

1027. The audit evidence in the 2012 LM Audit did not in our view demonstrate that appropriate professional scepticism was applied to the related party loan balances in the 2012 LM Audit.

1028. We are satisfied that Sub-Allegation 4(g) has been established.

Sub-Allegation 4(h)

Ensured that LM had made the disclosures referred to in the First and Second Related Party Loan Allegation.

1029. We refer to our and repeat our comments and finding with respect to Sub-Allegation 4(d).

1030. Having regard to the Relevant Benchmark,²⁴³ a reasonably competent auditor in the circumstances of the 2012 LM Audit would have ensured that related party disclosures were amended to appropriately reflect the requirements in the relevant standards.

1031. We are satisfied that Sub-Allegation 4(g) has been established to the extent of our findings in the First Related Party Loan Allegations.

Sub-Allegation 4(i)

Evaluated whether the audit evidence was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based (ASA 500.7 and 500.9).

1032. We refer to and repeat our comments and conclusion with respect to Sub-Allegation 4(c).

1033. Having regard to the Relevant Benchmark,²⁴⁴ a reasonably competent auditor in the circumstances of the 2012 LM Audit would in our view have evaluated

²⁴¹ See above n 58.

²⁴² See above n 56.

²⁴³ Ibid.

²⁴⁴ Ibid.

whether the audit evidence was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based. Based on our comments and views set out in Sub-Allegations (a)-(i) of this allegation we are satisfied that in the circumstances of the 2012 LM Audit, a reasonably competent auditor would have concluded that the audit evidence with respect to the related party loan balances was not sufficiently reliable and precise to support a conclusion that the relevant disclosures were adequate.

1034. We are satisfied that Sub-Allegation 4(i) has been established.

Finding on Fourth Related Party Loan Allegation

1035. For the above reasons, we are satisfied that the Fourth Related Party Loan Allegation has been established.

Contention 3 Sub-Contentions

1036. Based on the facts and the allegations discussed above, ASIC made eight Sub-Contentions that within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams had failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Financial Statements, regarding the accuracy and disclosure of related party loans.

Sub-Contention 3(a)

Obtain sufficient appropriate audit evidence to support the related party loan balances. (ASA 200.11, 200.17, 500.6 and 550.20)

1037. In addition to his responses to the specific allegations, which we have considered, Mr Williams said that Sub-Contention 3(a) was considered at AWPAA1. Mr Williams relied on AWPAA1 and AWPAE1 as sufficient appropriate audit evidence to support the related party loan balances.

1038. We have described and discussed AWPAE1 and related work papers in paragraphs 958-961 and refer to and repeat our comments on their relevance.

1039. AWPAA1 was the template document headed *Audit Plan and Overall Strategy*. As we have noted, there were related party transactions disclosed in the 2012 LM Financial Statements that required heightened professional scepticism to be applied to the performance of relevant audit procedures with respect to the possibility of fraud because of the inherent conflicts of interest in such arrangements and the relative ease with which inappropriate or unauthorised transactions may have occurred.

1040. The audit planning documentation to which Mr Williams referred us in this regard (AWPAA1) noted that there was no control reliance. In our view this meant it should have been regarded as important for the audit evidence of the procedures performed to demonstrate that relevant and appropriate authorisations for the related party loans were in place and that interest payments and other obligations were being met in accordance with the loan agreements. AWPAA1 is not audit evidence of the identification of the related party loan risk or that the audit procedures performed adequately addressed the risks.

1041. We refer to and repeat our comments and conclusion in paragraph 970 with respect to the documents relevant to Contention 3 that are described and discussed in paragraphs 958-968.
1042. For the above reasons, we do not consider AWPAA1 or AWPAE1 to provide documentary evidence supporting adequate audit work to support the related party loan balances disclosed in the 2012 LM Financial Statements.
1043. At the relevant time, ASA 200 set out standards with respect to overall objectives of the Independent Auditor and the conduct of an audit in accordance with Australian Auditing Standards.
1044. ASA 200.11 *Overall Objectives of the Auditor*, provided that in conducting an audit of a financial report, the overall objectives of the auditor were to obtain reasonable assurance about whether the report as a whole was free from material misstatement, due to either fraud or error to enable the auditor to express an opinion on whether the report was prepared in all material respects in accordance with the applicable financial reporting framework and to report on the financial report, and communicate as required by the Auditing Standards, in accordance with the auditor's findings.²⁴⁵
1045. ASA 200.17 provided that to obtain reasonable assurance the auditor shall obtain appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.
1046. ASA 500.6 required the auditor to design and perform audit procedures appropriate to the circumstances for the purpose of obtaining sufficient appropriate audit evidence.
1047. ASA 550.20 provided that as part of the ASA 330 requirement that the auditor respond to assessed risks, the auditor must design and perform further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions. These were required to include those specified in paragraphs 21-24 of ASA 550.20. Paragraph 24 of ASA 550.20 provided that if management had made an assertion in the financial report to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor was required to obtain sufficient appropriate audit evidence about the assertion
1048. We refer to our findings with respect to the Third and the Fourth Related Party Loan Allegation and to our conclusion with respect to the audit evidence with respect to Contention 3.²⁴⁶ Based on those findings and having regard to the Relevant Benchmark,²⁴⁷ our view is that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of ASA 200.11,

²⁴⁵ ASA 200.11(a) and (b).

²⁴⁶ See paragraphs 969; 996-1035.

²⁴⁷ See above n 56.

200.17 , ASA 500.6 and 550.20 had been met in the 2012 LM Audit, was not adequate.

1049. We refer to and repeat our comments about the nature of the Board’s task in proceedings commenced pursuant to section 1292(1)(d) of the Act²⁴⁸ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 3(a) has been established.

Sub-Contention 3(b)

Obtain sufficient appropriate audit evidence to ensure the basis for lending to related parties was appropriately authorised; (ASA 200.17 and 500.6).

1050. In addition to his responses to the specific allegations to which this Sub-Contention refers, which we have already considered, Mr Williams said that Sub-Contention 3(b) was considered at AWPAA1. We refer to and repeat our comments in Sub-Contention 3(a) with respect to Mr Williams’ reliance on AWPAA1. For those reasons, we do not consider AWPAA1 to provide documentary evidence supporting adequate audit work or audit evidence to ensure the basis for lending to related parties was appropriately authorised.

1051. Mr Williams also said that Sub-Contention (b) was considered ‘throughout the AWP Objectives and Conclusions’. This general reference does not demonstrate the discharge of Mr Williams’ obligation to obtain sufficient appropriate audit evidence with respect to the related party loan balances.

1052. The requirements of ASA 200.17 and 500.6 are set out and discussed in Sub-Contention 3(a).

1053. ASA 550.24 and 550.20 provided that if management had made an assertion in the financial report to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm’s length transaction, the auditor was required to obtain sufficient appropriate audit evidence about the assertion. In our view this would include ensuring the basis for lending to related parties was appropriately authorised.

1054. We refer to our conclusion with respect to the related party loans audit evidence.²⁴⁹ Based on that finding and having regard to the Relevant Benchmark,²⁵⁰ our view is that Mr Williams’ level of performance of his duties relevant to demonstrating that the requirements of ASA 200.11, 200.17, ASA 500.6 and 550.20 had been met in the 2012 LM Audit, was not adequate.

1055. We refer to and repeat our comments about the nature of the Board’s task in proceedings commenced pursuant to section 1292(1)(d) of the Act²⁵¹ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an

²⁴⁸ See above n 138.

²⁴⁹ See paragraphs 969.

²⁵⁰ See above n 56.

²⁵¹ See above n 138.

auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 3(b) has been established.

Sub-Contention 3(c)

Obtain sufficient appropriate audit evidence to reduce the audit risk in relation to the related party loan balances to an acceptably low level - ASA 200.17 and ASA 550.20

1056. Mr Williams said that this matter was considered in AWP Objectives and AWPAA1 respectively. We refer to and repeat our comments with respect to these audit documents in Sub-Contentions 3(a) and 3(b).

1057. We have referred to and considered ASA 200.17 and ASA 550.20 in Sub-Contention 3(a).

1058. We refer to our conclusion with respect to the related party loans audit evidence²⁵² and our findings with respect to the Third and Fourth Related Party Loan Sub-Allegations. Having regard to the Relevant Benchmark,²⁵³ these matters support the conclusion that Mr Williams had not obtained sufficient appropriate audit evidence to reduce the audit risk with respect to the related party loan balances to an acceptably low level in accordance with the obligation in ASA 200.17 and ASA 550.20 and we are satisfied that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of these Auditing Standards had been complied with, was not adequate.

1059. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²⁵⁴ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 3(c) has been established.

Sub-Contention 3(d)

Adequately assess the relevance and reliability of the information to be used as audit evidence (ASA 500.7 and 500.9).

1060. In addition to his responses to the specific allegations to which this Sub-Contention refers, which we have already considered, Mr Williams said that Sub-Contention 3(d) was considered at AWPAA1. We refer to and repeat our comments in Sub-Contention 3(a) with respect to Mr Williams' reliance on AWPAA1. For those reasons, we do not consider AWPAA1 demonstrates that Mr Williams adequately assessed the relevance and reliability of the information to be used as audit evidence.

1061. The requirements of ASA 500.7 and 500.9 and relevant explanatory guidance that was included in the standards at the time are set out in paragraph 730.

²⁵² See above n 249.

²⁵³ See above n 56.

²⁵⁴ See above n 138.

1062. Based on our conclusion with respect to the audit evidence relevant to Contention 2²⁵⁵ and our findings with respect to the Third Related Party Loan Allegation and Sub-Allegations (a), (b), (c), (e), (g) and (i) of the Fourth Related Party Loan Allegation and having regard to the Relevant Benchmark,²⁵⁶ we are satisfied that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of ASA 500.7 and 500.9 had been met in the 2012 LM Audit, was not adequate.

1063. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²⁵⁷ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 3(d) has been established.

Sub-Contention 3(e)

Ensure all related party disclosures required by the accounting standards were made by LM ASA 550.25.

1064. In addition to his responses to the specific allegations to which this Sub-Contention refers, which we have already considered, Mr Williams said that Sub-Contention 3(e) was considered at AWPAE1 and AWPBC1. We refer to and repeat our comments in Sub-Contention 3(a) with regard to Mr Williams' reliance on AWPAE1 as sufficient audit evidence with respect ensuring all related party disclosures required by the accounting standards had been made by LM.

1065. We have described and commented on AWPBC1 in paragraphs 439-441 which Mr Williams also relied on with respect to this matter. AWPBC1 is not audit evidence that the disclosures required by the accounting standards with respect to the related party loan balances had been made.

1066. At the relevant time ASA 500.25 provided:

In forming an opinion on the financial report in accordance with ASA 700, the auditor shall evaluate:

- (a) Whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

1067. Based on our findings with respect to the Sub-Allegation (a) and (e) of the First Related Party Loan Allegation and having regard to the Relevant Benchmark,²⁵⁸ we are satisfied that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of ASA 500.7 and 500.9 had been met in the 2012 LM Audit, was not adequate.

²⁵⁵ See above n 249.

²⁵⁶ See above n 56.

²⁵⁷ See above n 138.

²⁵⁸ See above n 56.

1068. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²⁵⁹ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 3(e) has been established.

Sub-Contention 3(f)

Display an appropriate level of professional scepticism when auditing related party transactions, account balances and disclosures - ASA 200.15.

1069. In addition to his responses to the specific allegation to which this Sub-Contention refers, which we have already considered, Mr Williams said that Sub-Contention 3(f) was considered at AWPAA2. We have referred to AWPAA2 in paragraph 960. AWPAA2 records risks of misstatement identified with respect to the LM Audit. However, it does not record evidence of how those identified risks were assessed in the LM Audit and for this reason does not in our view provide evidence of the exercise of an appropriate level of professional scepticism when auditing related party transactions, account balances and disclosures in the 2012 LM Audit.

1070. We refer to and repeat our comments with respect to the importance to audit quality of applying appropriate professional scepticism in an audit.²⁶⁰ Based on our findings with respect to the Third Related Party Loan Allegation and Sub-Allegations (a)-(g) of the Fourth Related Party Loans Allegation and our conclusion with respect to the Related Party Loans audit evidence²⁶¹ and having regard to the Relevant Benchmark,²⁶² we are satisfied that Mr Williams' level of performance of his duties relevant to demonstrating appropriate professional scepticism in the performance of the 2012 LM Audit with respect to the related party loan balances, was not adequate.

1071. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²⁶³ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 3(f) has been established.

Sub-Contention 3(g)

Evaluate whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based (ASA 500.9).

1072. We refer to and repeat our comments and finding with respect to Sub-Contention 3(d).

²⁵⁹ See above n 138.

²⁶⁰ See above n 58.

²⁶¹ See above n 249.

²⁶² See above n 56.

²⁶³ See above n 138.

1073. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²⁶⁴ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 3(g) has been established.

Sub-Contention 3(h)

Consider whether these related party transactions not being adequately disclosed resulted in the financial report not being prepared in all material respects in accordance with the applicable financial reporting framework and consequently consider if the audit opinion should be modified ASA 700.16 and 700.17 and ASA 705.6, 705.7 and 705.8.

1074. In addition to his responses to the allegations made in Contention 3, which we have already considered, Mr Williams referred to AWPBC1. We refer to and repeat our comments with respect to AWPBC1 in Sub-Contention 3(e). We do not consider that AWPBC1 provides evidence that Mr Williams considered whether the related party transactions not being adequately disclosed in the 2012 LM Financial Statements, resulted in that report not being prepared in all material respects in accordance with the applicable financial reporting framework or that he consider whether the report should be modified, as was required by the relevant standards referred to.

1075. Based on our findings with respect to the Sub-Allegation (a) and (e) of the First Related Party Loan Allegation and having regard to the Relevant Benchmark,²⁶⁵ we are satisfied that Mr Williams' level of performance of his duties relevant to demonstrating that the requirements of ASA 700.16 and 700.17 and ASA 705.6, 705.7 and 705.8 had been met in the 2012 LM Audit, was not adequate.

1076. We refer to and repeat our comments about the nature of the Board's task in proceedings commenced pursuant to section 1292(1)(d) of the Act²⁶⁶ and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 3(h) has been established.

1077. Sub-Contention (i) was put in the alternative to the totality of Sub-Contentions (a)–(h). On the basis of the findings we have made, we have not proceeded to consider Sub-Contention 3(i).

Panel's Conclusion with respect to Contention 3

1078. Based on the reasons and the conclusions we have set out above we are satisfied that, within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i). We regard the matters established in

²⁶⁴ Ibid.

²⁶⁵ See above n 56.

²⁶⁶ See above n 138.

contention 3 as substantive failures for which Mr Williams, as Engagement Partner in the 2012 LM Audit, was responsible.

1079. We are satisfied that Contention 3 has been established.

CONTENTION 4 – MANAGEMENT FEES

1080. Based on the facts outlined below, Contention 4 alleged that, within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Statements, regarding the completeness and accuracy of, and the Manager's rights and obligations with respect to, the payment of management fees in accordance with the relevant Auditing Standards.

1081. Mr Williams denied Contention 4 and we have considered his responses in the context of our consideration of each of the allegations and the Sub-Contentions.

1082. In closing submissions, ASIC identified that it was the pre-payment of \$20,752,639 in management fees to LMA that was the focus of this Contention. The Panel was referred to numerous aspects of the 2012 LM Audit that it was alleged did not conform to the ASA requirements, the most significant being the adequacy of the audit evaluation performed with respect to the reasons for the pre-payment, the basis for the amount of the pre-payment, the legitimacy of the fee, and the evidence that was relied on in support of its recoverability, particularly having regard to the involvement of a number of related parties and Mr Drake's level of control with respect to those parties.

Background facts and relevant documents

1083. The following relevant facts were not in issue:

(a) As we have already noted, LMIM was 100% owned by Mr Drake. He was also a director and shareholder of LMA, a company associated with LMIM.

(b) On 25 November 2009, LMIM executed a Deed Poll ('Deed') in relation to the establishment of LM. Clause 17.3 stated as follows:

The Manager is entitled to be paid a management fee from the Scheme Property up to 10% per annum of the Net Fund Value in relation to the performance of its duties as detailed in this Constitution and the Law. This fee is to be calculated monthly and paid at such times as the Manager determines.

(c) Mr Williams admitted that the Deed did not contain a clause that expressly permitted the prepayment of management fees and said that nor did the provisions of the Deed expressly prohibit the pre-payment of management fees.

(d) LM's Consolidated Constitution (undated) (the "Constitution") did not contain a clause expressly addressing the pre-payment of management fees. Mr Williams admitted this fact and said that nor did the provisions of The Constitution expressly prohibit the pre-payment of management fees.

- (e) The 2012 LM Financial Statements recorded that management fees of \$11,368,182 were expensed within the Consolidated Statement of Comprehensive Income in relation to the 2012 financial year. The equivalent expense for the 2011 financial year was \$1,397,727. As well as the \$11,368,182 management fee that had been expensed, the 2012 LM Financial Statements recorded prepaid management fees of \$20,752,639. These prepaid management fees were disclosed in the 2012 LM Financial Statements as an amount receivable from a related party of the Group, being LMA. The Consolidated Statement of Cash Flows records management fees amounting to \$26,953,511 paid during the year compared to \$3,270,787 in 2011.
- (f) As at 30 June 2012, the total management fees charged represented 3.2% of the Net Assets of the Fund, which sum was below the maximum of 10% of the Net Fund Value referred to in clause 17.3 of The Deed.

Audit Workpapers

1084. An audit working paper entitled *pre-paid management fees* was prepared by AB on 31 August 2012 and initialled by RW on 7/11/2012 (“AWPRA2”). It noted the prepaid sum of \$20,752,638.61 and under the heading ‘Summary’ it noted ‘LM Managed Performance Fund have paid across \$30m to LM Administration in management fees during the year ended 30 June 2012. \$11m has been expensed and \$20 million remains in “prepaid management fees”’. AWPRA2 further recorded that the fees were determined ‘under management’s discretion ensuring that it is within both the maximum allowance of 10% pa per the constitution and the current estimate stipulated in the current information memorandum of 3.5%.’ Under the heading ‘Queries raised during planning meeting (17/07/12)’ AWPRA2 noted the following points and responses thereto:

- (a) ‘How has the Board justified the increase in fees since 2011, **Management Response:** The rate of return to investors is ok, not impacted by the management fees. This will be a fixed fee going forward. The increase in management fee is reflective in the growth of the assets in the Fund and allows the Manager to employ additional resources required to properly manage those assets to the benefit of investors.’
- (b) ‘Obtain LMA Financials, **Management Response:** Will provide.’ Then in handwriting the comment: ‘- not finalised as at sign-off date.’
- (c) ‘Review recoverability, **Management Response:** Consider valuation over LM – latest valuation to be provided [RA4]’. RA4 is the BStar Report.
- (d) The work paper also calculated and noted the annual percentage of the expense for the 2012 year, which was shown as 3.2%. This calculation used LM’s 30 June 2012 Net Assets balance of \$355,369,011.92 and an expense balance of \$11,358,181.00.
- (e) Finally, the working paper noted (handwritten) that subsequent to year-end the prepayment had decreased to \$15M and referenced AWPXC4.

1085. With respect to the information recorded in AWPRA2, we note that:

- (a) Net Assets Attributable to Unit holders as per the final signed 2012 LM Financial Statements was \$353,156,353 not \$355,369,011.92 as noted in the work paper.
- (b) If the cash outflows (i.e. the amounts paid by LM) representing management fees in the 2012 year recorded in the 2012 LM Financial Statements had been used in the % of net fund value calculation instead of the amount that was expensed, the percentage was approximately 7.5% and more than double the estimate of 3.5% provided to unit holders in the current information memorandum referred to in paragraph 1084.
- (c) AWPXC4 includes a balance sheet for LM showing the movement between 1 July 2012 and 30 September 2012 under the heading of 'Subsequent Balance Sheet Review'. The balance of prepaid management fees at 30 September 2012 was recorded as \$14.781 million. It is not clear whether this is the information upon which the handwritten statement made on AWPRA2 referencing AWPXC4 was based.
- (d) A copy of the relevant page of the 2012 LM Financial Statements is AWPRA3. It notes a \$17.7 million balance with an AWP reference of XC. The XC work papers tendered to the Panel did not include a record of any balances after 30 September 2012. We were not referred to audit evidence that showed what, if any audit work had been carried out on verification of the \$17.7 million balance of prepaid management fees noted in the narrative contained within the Related Parties notes at Note 12(i) of the financial statements.

1086. AWPRA3 is a copy of page 23 of the 2012 LM Financial Statements that included Note 12 that we have already described. It records some commentary on the nature of the related parties. It is supported by RA3/1 that records the balance of the management fee account at the end of each month during the financial year to 30 June 2012.

1087. AWPRA4 is a report titled *Assessment of Capitalisation of Projected Future Earnings* prepared by Bstar Pty Ltd and dated November 2012. This AWP is relevant to the audit work involved in testing prepaid management fees.

1088. AWPRA5 – *Letter of Undertaking and Guarantee*, a four page document recording an agreement between Peter Drake and LMIM and the custodian of various funds including LMA. This document was relevant to Mr Drake's personal guarantee in relation to prepaid management fees.

1089. AWPAA5.6 identified the overpayment of management fees to a related party as a risk of material misstatement. The likelihood of a misstatement was assessed as 'possible' and the consequences as 'severe'. One of the items noted in the audit working papers to follow up was to 'review the basis of management fees'.

1090. At AWPAD3 *Materiality – Final* a materiality level of \$568,409.05 was calculated as being applicable for the testing of the Management Fees Expense of \$11,368,181. The materiality level set by Mr Williams for the Management Fees was 5 per cent of the expensed amount, being \$568,409.05.

1091. These references demonstrate that the AWP's identified the management fee expense and the pre-paid management fees as material balances both quantitatively and by their nature that therefore required the performance of specific audit work.

1092. By way of observation we found the audit papers relevant to this contention were poorly presented and particularly difficult to follow.

First Management Fee Allegation

1093. The First Management Fee Allegation was that there was insufficient appropriate audit evidence in the Audit Engagement File to show that Mr Williams had applied an appropriate level of professional scepticism when assessing the assumptions used in the BStar Report, its relevance for audit purposes and the competence, experience and expertise of its authors. The BStar Report (RA4) was referred to in AWPRA2 as audit evidence regarding the assessment of recoverability of the prepaid management fees.

1094. We refer to and repeat our description of and comments with respect to the BStar Report at paragraph 664 and we refer to and repeat our comments and finding with respect to the the First Drake Loan Allegation at paragraphs 671-693.

1095. We refer to and repeat our comments with respect to appropriate professional scepticism.²⁶⁷

1096. Based on our comments in the preceding two paragraphs and having regard to the Relevant Benchmark,²⁶⁸ we are satisfied that there was insufficient appropriate audit evidence in the Audit Engagement File to show that Mr Williams had applied an appropriate level of professional scepticism when assessing the assumptions used in the BStar Report, the relevance of the BStar Report for audit purposes and the competence, experience and expertise of the authors of the BStar Report.

1097. We are satisfied that the First Management Fee Allegation has been established.

Second Management Fee Allegation

1098. The Second Management Fee Allegation was that the Audit Engagement File did not contain sufficient appropriate audit evidence to:

- (a) support the legitimacy and amount of the prepaid management fee; and
- (b) show that Mr Williams had applied a level of professional scepticism with respect to concerns about related parties involved in the payment of management fees and/or the legitimacy of these transactions.

²⁶⁷ See above n 58.

²⁶⁸ See above n 56.

Mr Williams' Responses and Panel comments

1099. Mr Williams repeated the Engagement Partner Response that he did not press. We refer to and repeat our comments with respect to Mr Williams' responsibility as the Engagement Partner.²⁶⁹
1100. Mr Williams said that AWPRA2 illustrated the legitimacy and the quantum of the prepaid management fee as:
- (a) The total prepaid amount was within the stipulated amount within the Constitution (10% of the net fund value); and
 - (b) The amount expensed was within the amount disclosed in the Information Memorandum (being 3.5% of the net fund value).
1101. The reasons put forward in the above Response do not demonstrate the legitimacy of the character or the quantum of the prepaid management fee payment. The question of whether the quantum of the pre-payment was acceptable as within the range identified in the Constitution and the Information Memorandum would become relevant only after the legitimacy of the payment as a prepayment of management fees had first been verified in the audit.
1102. Mr Williams said that the prepaid management fee amount was authorised by the external custodian PTAL.
1103. The Trust Company (PTAL) Ltd was an external custodian recorded in AWPCA5. PTAL's role as custodian (not trustee) was to oversee the safe custody of the assets of the Fund. It is not the role of a custodian to question in a governance sense, a payment request received that is within already agreed parameters. In our view the evidence that PTAL had processed the payment requests does not, in isolation amount to audit evidence that the payments were independently 'authorised'. In our view this was not evidence demonstrating legitimacy of the payments made as pre-paid management fees.
1104. The audit work recorded at AWPCA5 that Mr Williams referred to was directed to assurance with respect to internal controls that supported the payment processes. AWPAA5.6 that we have referred to above, recorded the risk 'Redemptions are not properly authorised', as significant, the consequence of that risk as 'misappropriation of assets', the follow up as 'testing on redemptions' and working paper references as CA, F. However, the CA series of AWP's, as with a number of other AWP's we have referred to, do not clearly set out the audit objectives, nor any conclusions, making their usefulness and relevance in the context of the overall audit plan unclear. It is clear however that AWPCA5 does not provide audit evidence that in our view is relevant to the basis of a response that answers either sub-paragraph (a) or (b) of the Second Management Fee Allegation.
1105. Mr Williams denied that he had not applied and documented appropriate professional scepticism because the payment of management fees to related

²⁶⁹ See above n 28.

parties was recorded as an identified risk of material misstatement in AWPAA5.6.

1106. We have discussed AWPAA5.6 in paragraph 963(e) that was headed ‘Identified Risks of Material Misstatement’. This AWP notes ‘overpayment of management fees to related parties’ as a consequence of related party risk in the 2012 LM Audit. It refers to working papers AE, F and RA and in terms of follow up the comment ‘review the basis of management fees’ is recorded.
1107. We do not regard AWPAA5.6 as substantive audit evidence of either Sub-Allegation (a) or (b) as it does not address the legitimacy of the payment or record details of what conclusions were drawn from the audit procedures performed. The audit work papers to which AWPAA5.6 referred did not record the objectives or conclusions of the audit work performed and were not sufficient appropriate audit evidence of how the risk identified had been investigated, assessed or analysed. This document is a software-generated template and we refer to our discussion of the relevance of and circumstances in which weight will be given to these documents as evidence of audit work performed.²⁷⁰

Further evidence and finding on Second Management Fee Allegation

1108. During cross-examination Mr Williams accepted that an auditor would need to look carefully at a payment of management fees particularly because it was to a related party. Mr Williams also accepted that prepayment of management fees to a company related to Mr Drake would be a red flag to an auditor. He agreed that it was appropriate to look at the legitimacy of the prepayment.
1109. While the Constitution and the Deed did not expressly prohibit the prepayment of management fees, as Mr Williams pointed out, nor did the provisions of those documents expressly permit such payments.
1110. In our view, there should have been audit evidence of an evaluation of whether Clause 17.3 of the Constitution and the terms of the Deed Poll provided a proper basis for concluding the legitimacy of the payment for management fees in advance for duties to be performed in the future. Without that further evidence the auditor would not in our view have had a sufficient basis to conclude that the payment was legitimate on the basis of the specific terms in the Constitution and the Deed Poll. There was no audit evidence that this was considered in the 2012 LM Audit.
1111. Turning now to the allegation that was made, the relevant factual issue was whether the audit evidence supported the legitimacy and amount of the prepaid management fee.
1112. As noted AWPRA2 was the lead work paper for the prepaid management fee. As a general comment we note that it noted the risks and balances and identified certain audit steps the audit evidence of the performance of follow through audit work is limited.
1113. For example, the audit question ‘How has the board justified the increase in fees

²⁷⁰ See above n 28.

charged since 2011?’ is recorded in AWPRA2. The AWP then records the following response from management:

The rate of return to investees is ok, not impacted by the management fees. This will be a fixed fee going forward. The increase in management fees is reflective in the growth of the assets in the Fund and allows the Manager to employ additional resources required to properly manage these assets to the benefit of investors.

1114. There is no audit evidence of any further audit work regarding that response from management. In our view there should have been audit evidence that this statement was further explored. For example, what would the amount of the *fixed fee going forward* be and how would the fixed amount be determined? The *rate of return to investors* was not a matter in an audit context that was or should have been relevant to the question of the basis of the fee increases, particularly given the related party relationships involved. We note that the growth in LM’s assets was effectively capitalised interest (which would not explain the need to increase management resources) and the reference to ‘additional resources required to manage those assets’ was not specific. From an audit perspective more detailed information was required as the basis for the substantial increase in the fees was not answered appropriately by the matters referred to in that notation and nor in any other audit evidence with respect to the management fee balances.
1115. In our view the matters we have referred to demonstrates there was insufficient professional scepticism applied.
1116. Next to the audit step in AWPRA2 *LMA Financials are to be obtained*, there is a handwritten note that states ‘- not received as at sign-off date’. Mr Williams said in his closing submissions that the LMA Financials had been reviewed up to the end of September and were recorded on the Forensic File. We refer to and repeat our comments with respect to the Forensic File documents.²⁷¹ In our view the audit work performed and the audit evidence retained was not adequate, particularly having regard to the quantum of the fee and the related parties context.
1117. The final note in AWPRA2 was ‘Review recoverability’ and response noted ‘Consider valuation over LM. Latest valuation to be provided’. This comment referred to the BStar Report as the basis for valuation of LM. We refer to and repeat our findings with respect to the First Management Fee allegation in paragraphs 1093-1097 and the First Drake Loan Allegation in paragraphs 671-693.
1118. Another matter that was not explained by the audit evidence, and in our view should have been, particularly given the related party risk that had been identified, was why the payment of management fees had been made to LMA and not to LMIM, which was the Manager. In our view there should have been audit evidence that management was challenged about the basis of the payment to LMA and a record of the outcome of the further investigation of that matter.
1119. The AWPAA5.6 noted the risk of material misstatement. The requirement in ASA 200.15 was to plan and perform the audit with professional scepticism,

²⁷¹ See above n 51.

recognising the possibility of circumstances that could cause the financial report to be materially misstated. The facts that the pre-payment of fees was unusually large and that it had been paid to LMA not LMIM, should in our view have signalled to the auditor heightened risk of there having been a fraudulent transaction, particularly given the related party context. There should have been heightened professional scepticism applied to this transaction which in our view would have involved the performance of additional audit procedures to test and challenge the management information that had been provided. There should also have been detailed audit evidence of the basis for conclusions reached.

1120. There was no audit evidence that such audit work was performed, indeed to the extent there was audit evidence it was planned, it was not carried out in significant respects and there was no record of explanation about why this transpired in the audit. We refer to and repeat our comments with respect to the importance of applying appropriate professional scepticism in an audit.²⁷²

1121. Based on our views and findings above we are satisfied that the audit evidence did not demonstrate that the Audit Engagement File contained sufficient appropriate audit evidence either to support the legitimacy and amount of the prepaid management fee or to show that Mr Williams had applied appropriate professional scepticism with respect to the performance of audit procedures concerning the management fee payments. We are satisfied that the Second Management Fee Allegation has been established.

Third Management Fee Allegation

1122. The Third Management Fee Loan Allegation was that a reasonably competent auditor in Mr Williams' position would have identified the following matters and/or performed the following duties as part of the assessment of the payments of management fees recorded in the 2012 LM Financial Statements in the 2012 LM Audit and there was insufficient appropriate audit evidence in the Audit Engagement File that Mr Williams had adequately identified considered and/or attended to these matters. We are satisfied that the relevant Auditing Standards/Accounting Standards at the time specified that the matters the subject of (a)-(i) should have been carried out and having regard to the Relevant Benchmark,²⁷³ Mr Williams' duty was to ensure those requirements were observed.

Sub-Allegations 3(a) and 3(b)

Identified that the engagement file did not contain sufficient appropriate audit evidence and sufficient audit procedures were not performed to support the Manager's entitlement to prepaid management fees in accordance with ASA 200.

1123. We refer to and repeat our comments and findings with respect to the First and Second Management Fees Allegations.

1124. We are satisfied that a reasonably competent auditor in the circumstances of the 2012 LM Audit would have identified that sufficient audit procedures had not

²⁷² See above n 58.

²⁷³ See above n 56.

been performed in accordance with ASA 200 to support the Manager's entitlement to prepaid management fees and the Audit Engagement File did not contain sufficient appropriate audit evidence to support the Manager's entitlement to prepaid management fees.

1125. We are satisfied that Sub-Allegations 3(a) and 3(b) have been established.

Sub-Allegation 3(c)

Adequately evaluated whether the business rationale (or the lack thereof) for the prepayment of management fees suggested it might have been entered into in a fraudulent manner: ASA 240.

1126. We refer to and repeat our comments and findings with respect to the First and Second Management Fees Allegations. We are satisfied that the audit evidence in the Audit Engagement File did not demonstrate there had been an adequate or sufficient evaluation of the business rationale for the pre-paid management fee.

1127. In our view, a reasonably competent auditor in the circumstances of the 2012 LM Audit would have considered that:

- (a) The size of the pre-paid sum, particularly compared to the management fees expensed in the prior year;
- (b) the fact it was pre-payment for services to be performed in the future; and
- (c) had been made to a related party;

characterised the payment as an unusual transaction within the scope of ASA 240 and would have addressed the obligations set out in ASA 240 including evaluating the business rationale (or the lack thereof) for the transaction, to rule out the possibility it may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.²⁷⁴

1128. While AWPAA5.6 did note follow up action as 'review basis of management fee' there was no audit evidence that this work was performed.

1129. We are satisfied that Sub-Allegation 3(c) has been established.

Sub-Allegation 3(d)

Exercised a level of professional scepticism concerning any conflicts regarding Mr Drake's professional appointments and the prepaid management fees in accordance with ASA 200.

1130. We refer to and repeat our comments and findings with respect to the Second Management Fees Allegation and in particular our comments on Mr Williams' evidence in cross-examination.

1131. Mr Williams admitted that in addition to being a director of LMIM as at 30 June 2012, Mr Drake was also a director and shareholder of LMA.

²⁷⁴ ASA 240.32 (c).

1132. We are satisfied that neither the audit procedures referred to in AWPRA2 and AWPAA5.6 nor the audit evidence in the Audit Engagement File did not demonstrate that Mr Williams sufficiently considered the unusual nature of the transaction and the heightened risk posed by the related party issues that should have caused him to apply heightened professional scepticism to the pre-paid management fees transaction in the 2012 LM Audit.

1133. We are satisfied that a reasonably competent auditor applying appropriate professional scepticism would have recognised the heightened risk posed by these matters in the circumstances of the 2012 LM Audit and applied heightened professional scepticism to the planning and performance of audit procedures with respect to the management fee payments, including the pre-payments.

1134. We are satisfied that Sub-Allegation 3(d) has been established.

Sub-Allegation 3(e)

Designed and performed audit procedures to test the risks of management override of controls in accordance with ASA 240 in relation to any conflicts regarding Mr Drake's professional appointments and the prepaid management fees.

1135. At the relevant time ASA 240 provided as follows:

The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report

32(c) For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and other information obtained during the audit, evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.

44. The auditor shall include the following in the audit documentation of the auditor's understanding of the entity and its environment and the assessment of the risks of material misstatement required by ASA 315:

- a. The significant decisions reached during the discussion amongst the engagement team regarding the susceptibility of the entity's financial report to material misstatement due to fraud; and
- b. The identified and assessed risks of material misstatement due to fraud at the financial report level and at the assertion level.

45. The auditor shall include the following in the audit documentation of the auditor's responses to the assessed risks of material misstatement required by ASA 330:

- (i) The overall responses to the assessed risks of material misstatement due to fraud at the financial report level and the nature, timing and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level; and
- (ii) The results of the audit procedures, including those designed to address the risk of management override of controls.

1136. AWPAA5.6 identified the management override of controls as a significant risk. It noted working paper references 'CA, XD, AE, DF, remain alert throughout audit file' and follow up as 'review directors and credit committee minutes;

review related parties transactions; review unusual journals; review unusual transactions.’

1137. The audit papers referenced in AA5.6 to which we have referred above do not represent sufficient and appropriate audit evidence of the results of the audit procedures contemplated by ASA 240.45b set out above.
1138. Sufficient and appropriate audit evidence requires clarity. Cross reference notes should provide a trail that indicates the matters that the record of audit work referred to was directed to supporting and the reasons why the outcome of the work that was performed supports the conclusion ultimately reached.
1139. Based on the identification of override of management controls as a significant risk and our discussion of the audit evidence in the First and Second Management Fee Allegations and our comments in Sub-Allegation 3(b) and 3(c), we are satisfied that the audit evidence did not demonstrate that audit procedures had been performed that satisfied the requirements of ASA 240 in relation to Mr Drake's related party professional appointments and the prepaid management fees. Neither matter was the subject of specific audit procedures that would support the view that they had been identified as unusual and required any particular focus in terms of the audit work.
1140. Having regard to the Relevant Benchmark,²⁷⁵ we are satisfied that in the circumstances of the 2012 LM Audit, a reasonably competent auditor would have designed and performed audit procedures to test the risks of management override of controls in accordance with ASA 240 in relation to any conflicts of interest between Mr Drake's professional appointments and the payment of prepaid management fee amount.
1141. We are satisfied that Sub-Allegation 3(e) has been established.

Sub-Allegation 3(f)

Undertaken the “review the basis of management fees” noted in AWPAA5.6, so as to ensure that related party transactions in relation to management fees and prepaid management fees were not fraudulently entered into to improve the financial position of LMA in accordance with ASA 240.

1142. Based on our comments and findings in the Second Management Fees allegation and Sub-Allegations 3(b) and 3(c) of the Third Management Fee Allegation, we are satisfied that the provisions of ASA 240 were a relevant consideration to this aspect of the 2012 LM Audit and the audit evidence did not demonstrate that the audit procedure ‘review the basis of management fees’ recorded in AWPAA5.6 had taken place.
1143. Having regard to the Relevant Benchmark,²⁷⁶ we are satisfied that in the circumstances of the 2012 LM Audit, a reasonably competent auditor would have undertaken the ‘review the basis of management fees’ noted in AWPAA5.6, so as to ensure that related party transactions in relation to

²⁷⁵ See above n 56.

²⁷⁶ Ibid.

management fees and prepaid management fees were not fraudulently entered into to improve the financial position of LMA, in accordance with ASA 240.

1144. We are satisfied that Sub-Allegation 3(f) of the Third Management Fee Allegation has been established.

Sub-Allegation 3(g)

Exercised a greater level of professional scepticism regarding the work performed in relation to the validity of the management fees in accordance with ASA 200.

1145. We refer to and repeat our findings with respect to the Second Management Fee Allegation and Sub-Allegation 3(c) and refer to our comments on the appropriate application of professional scepticism.²⁷⁷

1146. Based on our comments in the preceding paragraph, we are satisfied that Sub-Allegation 3(g) of the Third Management Fee Allegation has been established.

Contention 4 Sub-Contentions

1147. Based on the Management Fee Allegations, it was contended that within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams had failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Financial Statements, regarding the completeness and accuracy of, and the Manager's rights and obligations to, management fees insofar as Mr Williams had failed to perform the matters the subject of Sub-Contentions (a)-(j). We consider those Sub-Contentions as follows:

Sub-Contention 4(a)

1148. It was contended that Mr Williams failed to identify and appropriately evaluate the relationship between the level of prepaid management fees compared to the Net Fund Value and whether this relationship indicated a risk of material misstatement and/or the presence of one or more fraud risk factors.

1149. ASA 240 sets out the auditor's responsibilities relating to fraud in an audit of a financial report. ASA 240.22 provided that an auditor must evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud and consider whether other information obtained by the auditor indicates a risk of material misstatement due to fraud.²⁷⁸ The auditor was also required to evaluate whether information obtained from the other risk assessment procedures and related activities performed may indicate whether fraud risk factors are present. While fraud risk factors may not necessarily indicate the existence of fraud, the provision noted they had often been found present in circumstances where fraud had occurred and therefore could indicate risks of material misstatement due to fraud.²⁷⁹ ASA 240.31 noted that management is in a unique position to perpetrate fraud

²⁷⁷ See above n 58.

²⁷⁸ ASA 240.23.

²⁷⁹ ASA 240.24.

because of their ability to manipulate accounting records and prepare a fraudulent financial report by overriding controls and due to the unpredictable nature of that risk, it must be considered as significant.

1150. Mr Williams denied this Sub-Contention on the basis that the matters raised by the relevant standards were considered at AWPAA2, the record of the Audit Team Planning Meeting and AA5.6 that we have discussed above.²⁸⁰ Neither of those work papers identified the risk of material misstatement from the perspective of the Net Fund Value. For completeness, we note that AWPRA2, which was not relied upon by Mr Williams in response to this Sub-Contention, does set out some evidence of review of the level of management fees as a percentage of the Net Assets of the Fund. This calculation seems to have been carried out for the purposes of checking that the amount of the management fee was within the allowable parameters set out in The Deed and did not include the amount of prepaid management fees paid.

1151. None of the three Management Fee Allegations addressed the subject of Sub-Contention 4(a). On that basis, we are satisfied that Sub-Contention 4(a) has not been established.

Sub-Contention 4(b)

1152. Sub-Contention 4(b) contended that Mr Williams failed to design and perform audit procedures to test the possible management override of controls including testing of journal entries.²⁸¹

1153. Mr Williams said that Sub-Contention 4(b) was considered at AWPAA4. This document was entitled *Auditor's Responsibility relating to Fraud in an Audit of a Financial Report, LM Performance Fund Year Ended 30 June 2012*. It was initialled by Mr Williams on 22 May 2012. This was a template-generated document and we refer to and repeat our comments with respect to the circumstances in which weight will be given to those documentary records.²⁸² AWPAA4 was not audit evidence of audit procedures performed with respect to testing the override of management controls.

1154. We have set out the relevant provisions of ASA 240 including ASA 240.45(b) in paragraph 1135.

1155. We refer to and repeat our comments with respect to AWPAA5.6.²⁸³ AWPAA5.6 recorded references to whole files as evidence of the follow up action taken without specifying what, or to what, the audit work was directed. It also recorded follow up notes but did not record whether or how those matters were followed up. For these reasons our view is that AWPAA5.6 was not appropriate and sufficient audit evidence that the relevant procedures had been performed.

²⁸⁰ See paragraphs 136(f) and 136(b).

²⁸¹ ASA 240.32.

²⁸² See above n 41.

²⁸³ See above n 280.

1156. We refer to and repeat our comments with respect to AWPCA5 in paragraphs 1103-1105 that form the basis for our view that AWPCA5 was not appropriate and sufficient audit evidence that Mr Williams had designed and performed audit procedures to test the possible management override of controls including testing of journal entries.

1157. We refer to our findings with respect to Sub-Allegation (e) of the Third Management Fees Allegation. Based on that finding we are satisfied that there was no audit evidence that Mr Williams had performed audit procedures to test the possible management override of controls including testing of journal entries in accordance with the requirements of ASA 240.32 and having regard to the Relevant Benchmark,²⁸⁴ we are satisfied that Mr Williams' level of performance of his duties was not adequate.

1158. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act²⁸⁵ and based on our comments above, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 4(b) has been established.

Sub-Contentions 4(c), (d), (e) and (f)

1159. These Sub-Contentions asserted that Mr Williams failed to obtain sufficient appropriate audit evidence:

- (c) That the Manager was entitled to prepaid management fees.
- (d) To support the recoverability of prepaid management fees.
- (e) In relation to management fees to reduce audit risk to an acceptably low level.
- (f) To assess the impact of a conflict of interest arising from Mr Drake's position as a director of both LM and LMA.

1160. In addition to his responses to the specific allegations to which these Sub-Contentions refer, which we have already considered, Mr Williams said that Sub-Contentions (c), (d), (e) and (f) were considered at AWPAA1.

1161. AWPAA1 was the template document headed *Audit Plan and Overall Strategy*.²⁸⁶ AWPAA1 does not provide audit evidence of performance in the audit of the matters the subject of Sub-Contentions (c)-(f).

1162. At the relevant time ASA 200.17 provided that to obtain reasonable assurance, the auditor shall obtain appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion and ASA 500.6 required the

²⁸⁴ See above n 56.

²⁸⁵ See above n 138.

²⁸⁶ See paragraph 136(a)

auditor to design and perform audit procedures appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

1163. We refer to our findings with respect to the First and Second Management Fee Allegation and each of the Sub-Allegations in the Third Management Fee Allegation with respect to the audit work performed and the audit evidence retained on the management fee payments in the 2012 LM Financial Statements. Based on those findings and having regard to the Relevant Benchmark²⁸⁷ we are satisfied that Mr Williams' level of performance of his duties was not adequate.
1164. We refer to and repeat our comments²⁸⁸ about the nature of the Board's task under section 1292 of the Act and based on our comments in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out, or perform adequately and properly the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contentions 4(c), 4(d), 4(e) and 4(f) have been established.

Sub-Contention 4(g)

1165. Sub-Contention 4(g) was that Mr Williams failed to display an appropriate level of professional scepticism in relation to the size of management fees and the nature and size of prepaid management fees, particularly in not adequately considering a conflict of interest that existed with a director of LM also being a director and shareholder of LMA, the recipient of the management fee.²⁸⁹
1166. In addition to his responses to the specific allegations to which this Sub-Contention refers, which we have already considered, Mr Williams denied Sub-Contention 4(g) on the basis that the matters raised by the relevant standards were considered at AWPAA2 which is the record of the Audit Team Planning Meeting.²⁹⁰ AWPAA2 does not provide audit evidence that appropriate professional scepticism was applied to considering the amount of management fees and the nature and amount of the prepaid management fees or the possible ramifications of the related party context of those payments in the 2012 LM Audit.
1167. We refer to our findings with respect to the First, Second and Third Management Fees Allegation. Based on our findings with respect to those allegations and having regard to the Relevant Benchmark²⁹¹ and our comments on the importance to audit quality of applying appropriate professional scepticism in the specific circumstances of an audit,²⁹² we are satisfied that Mr Williams' level of performance of his duties was not adequate.
1168. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act²⁹³ and based on our comments above, we are satisfied

²⁸⁷ See above n 56.

²⁸⁸ See above n 138.

²⁸⁹ ASA 200.15

²⁹⁰ See paragraph 136(b).

²⁹¹ See above n 56.

²⁹² See above n 58.

²⁹³ See above n 138.

that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 4(g) has been established.

Sub-Contention 4(h)

1169. Sub-Contention 4(h) was that Mr Williams failed to evaluate the competence and capabilities of a management expert, obtain an understanding of the work performed by the expert and to evaluate the appropriateness of that expert's work as audit evidence in relation to the BStar Report (ASA 500.8).

1170. In addition to his responses to the specific allegations to which this Sub-Contention refers, which we have already considered, Mr Williams said that Sub-Contention 4(h) was considered at AWPAA1.²⁹⁴ AWPAA1 does not provide audit evidence of the matters the subject of this Sub-Contention. We refer to and repeat our comments with respect to the circumstances in which weight will be given to the template-generated documents utilised in the 2012 LM Audit²⁹⁵.

1171. We have referred to the requirements in ASA 500.8 with respect to audit evidence prepared using the work of a management expert.²⁹⁶

1172. We refer to our findings with respect to the First Management Fee Allegation. Based on that finding, and having regard to the Relevant Benchmark,²⁹⁷ we are satisfied that Mr Williams' level of performance of his duties was not adequate.

1173. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act²⁹⁸ and based on our comments above, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act. We are satisfied that Sub-Contention 4(h) has been established.

Sub-Contention 4(i)

1174. Sub-Contention 4(i) was that Mr Williams failed to evaluate whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based (ASA 500.7: 500.9).

1175. In addition to his responses to the specific allegations to which this Sub-Contention refers, which we have already considered, Mr Williams said that Sub-Contention 4(i) was considered at AWPAA1. We refer to and repeat our previous comments in paragraph 1161 of this document with respect to AWPAA1. AWPAA1 does not demonstrate there was assessment of whether the audit evidence obtained was sufficiently reliable, precise and complete in order

²⁹⁴ See above n 286.

²⁹⁵ See above n 41.

²⁹⁶ See paragraph 759.

²⁹⁷ See above n 56.

²⁹⁸ See above n 138.

to be used in arriving at the conclusions on which Mr Williams' opinion was based with respect to the legitimacy and recoverability of management fees in the 2012 LM Audit.

1176. We refer to and repeat the provisions of ASA 500.7²⁹⁹ and ASA 500.9³⁰⁰ set out in our consideration of contentions 1(c) and 1(l).

1177. We refer to our findings with respect to the First and Second Management Fee Allegation and Sub-Allegations (a), (b), (c), (e) and (f) of the Third Management Fees Allegation Based on those findings and having regard to the Relevant Benchmark we are satisfied that Mr Williams' level of performance of his duties with respect to evaluating whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based, was not adequate.

1178. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act³⁰¹ and based on our comments above, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 4(i) has been established.

1179. Sub-Contention 4(j) was put in the alternative to the totality of Sub-Contentions 4(a) – (i). We have considered Sub-Contention 4(j) as an alternative allegation to Sub-Contention 4(a) that we are not satisfied was established. We have formed the view that the alternative Sub-Contention was also not established as it was not meaningful having regard to the absence of an allegation or finding on this matter. On the basis of our findings above, we have not considered Sub-Contention 4(j).

Panel's Conclusion with respect to Contention 4

1180. Based on the reasons and the conclusions we have set out above we are satisfied to the extent of our findings on the Sub-Contentions that, within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly, the duties of an auditor. To the extent they were established, we regard the matters established in contention 4 as substantive failures for which Mr Williams, as Engagement Partner, was responsible.

1181. We are satisfied that Contention 4 has been established.

CONTENTION 5 – MATERIALITY

1182. Contention 5 alleged that Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 LM Financial Statements with respect to the calculation of materiality in the manner set out in the Sub-Contentions.

²⁹⁹ See paragraph 730(a).

³⁰⁰ See paragraph 730(b).

³⁰¹ See above n 138.

Relevant Audit Documents

AWPAD

1183. The Materiality Program (“AWPAD”) was noted as prepared by Evelyne Kwong on 28 May 2012, updated by AB on 29/11/2012, first review by Andrea Blank 08/08/2012, second review by RW 8/10/2012 and completed by LD 22/11/2012. The audit objective noted was ‘to appropriately apply the concept of materiality in planning and performing the audit.’ It was a template of the nature we have discussed in our consideration of threshold matters.³⁰² The prepopulated components of AWPAD set out an approach to determining materiality that reflected the requirements of AASB 1031 and ASA 320. The boxes on the template were checked as completed by Evelyne Kwong on 28 May 2012.

1184. Audit procedures noted in AWPAD included:

- (a) ‘select the benchmark appropriate to the circumstances of the entity’, and the comment recorded next to this procedure was ‘Net assets attributable to unit holders (size of fund)’.
- (b) ‘select a percentage to be applied’ which said ‘10% considered an appropriate level given we are reporting internally to management and the Board of LMIM.’ This comment was cross-referenced to audit procedure 1.4 which was ‘consider relationship between the percentage and the chosen benchmark’.
- (c) ‘consider relevant financial data including financial results and financial positions, the period to date financial results and financial position, and budgets or forecasts for current period adjusted for significant changes in the circumstances of the entity...and relevant changes of conditions in the industry or economic environment in which the entity operates. Consider using a normalised benchmark figure if there is an exceptional transaction included in the base figure.’ The comment recorded next to this box was ‘NCN to use a normalised benchmark.’ The acronym ‘NCN’ was not explained.

1185. AWPAD referenced AD3 next to audit procedure 5.1 ‘*Materiality for the financial report as a whole.*’

1186. Finally, AWPAD recorded ticks in the boxes ‘yes’ and ‘completed’ and ‘Conclusion - in our opinion sufficient appropriate audit evidence has been obtained to materially meet the stated audit objective’.

1187. AWPAD3 was headed *Final Materiality - Final*. It is noted as prepared by AB on 29/11/12 and completed by LD on 3/12/2012. It recorded:

- (a) *Materiality for the financial report as a whole* and noted the benchmark as net assets, the total as \$353,156,132.42, the percentage as 10% and the materiality level as \$35,315,613.24.

³⁰² See above n 138.

- (b) *Materiality level for particular classes of Transactions, Account Balances or Disclosures* and noted the benchmark as Management Fees, the total as \$11,368,181, the percentage as 5% and the materiality level as \$568,409.05.
- (c) *The Clearly Trivial Materiality level* as \$3,500,000.
- (d) *Performance Materiality – Final*. Total asset amount noted was \$343,244,915.12 and materiality range 5%, \$17,162,245.76 -10%, \$34,324,491.51. Total liabilities amount \$11,049,021.19 and materiality 5%, \$552,451.06 – 10%, \$1,104,902.12. Net assets amount \$353,156,132.42 and materiality 5%, \$17,657,806.62 – 10%, \$35,315,613.24. Income amount \$69,501,270.87 and materiality 5%, \$3,475,063.54 – 10%, \$6,950,127.09. Expenses amount \$48,139,979.33 and materiality 5%, \$2,406,998.97 – 10%, \$4,813,997.93. Net Result (before tax) amount \$21,361,291.54 and materiality 5%, \$1,068,064.58 – 10%, \$2,136,129.15.

1188. There were also interim and initial materiality work papers retained on the Audit Engagement File.

1189. In support of his assertion that WPIAS appropriately applied the concept of materiality when performing the 2012 LM Audit with respect to each of the Sub-Contentions, Mr Williams also referred in his Response to AWPBC1, AWPDD, AWPAA2 and AWPAA1 (R107). We have referred to these documents in the context of our findings with respect to each of the Sub-Contentions (a)-(e) below.

1190. Mr Williams' Response also referred to AWPFB1. This document was headed *LM Managed Performance Fund Payments/Income testing Summary*. It was noted as prepared on 7/11/2012 and reviewed by AB on 9/11/2012. This document summarised expenses and income, recorded cross-references to other work papers for each of the expenses and income recorded, recorded total amounts of various expenses and income, the amount tested and the % tested. It recorded total expenses of \$48,139,978, total amount tested as \$32,835,996 representing 68.21%. It recorded total income of \$69,501,270 of which \$55,759,788 was tested representing 80.23% and recorded net profit as \$21,361,292. This document did not contain any explanatory narrative as to the audit objectives it was intended to address.

General comments on the concept of materiality

1191. ASA 320.2 referred to the concept of materiality as defined within the context of the relevant financial reporting framework as providing the frame of reference to the auditor for determining materiality in the audit. In the 2012 LM Audit that was AASB 1031 which dealt with general purpose financial statements.

1192. At the relevant time:

- (a) AASB 1031 defined materiality as:

Material - Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the

financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

- (b) Required the standards specified in other Australian Accounting Standards to be applied when the information resulting from their application was material and stated that information was material if its omission, misstatement or non-disclosure had the potential, individually or collectively, to:
 - (i) influence the economic decisions of users taken on the basis of the financial statements; or
 - (ii) affect the discharge of accountability by the management or governing body of the entity.

1193. Materiality in the general purpose financial statement AASB 1031 reporting framework therefore depended on the size or nature of the omission or misstatement and was to be judged in the surrounding circumstances and the size or nature of the item, or a combination of both.

1194. At the relevant time, AASB 1031 included quantitative thresholds that were arbitrary levels to guide the materiality assessment as follows:

- (a) If the amount was equal to or greater than 10% of the appropriate base amount, materiality might be presumed.
- (b) If the amount was equal to or less than 5% of the appropriate base amount materiality might not be presumed.

1195. The relevant Auditing Standards referred to overall materiality and performance materiality.

1196. ASA 320.10 required the auditor, when establishing overall audit strategy, to determine materiality for the financial report as a whole. If, in the specific circumstances of the entity, there was one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial report as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial report, the auditor was also required to determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

1197. ASA 320.9 relevantly provided that for the purposes of the Accounting Standards, performance materiality meant the amount or amounts set by the auditor at less than materiality for the financial report as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements would exceed materiality for the financial report as a whole.

1198. ASA 320.11 required the auditor to determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.

1199. ASA 320.6 provided relevant guidance on setting materiality in an audit. It said:

In planning the audit, the auditor makes judgements about the size of misstatements that will be considered material. These judgements provide a basis for:

- (i) Determining the nature timing and extent of risk assessment procedures;
- (ii) Identifying and assessing the risks of material misstatement; and
- (iii) Determining the nature, timing and extent of further audit procedures.

The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. Although it is not practicable to design audit procedures to detect misstatements that could be material solely because of their nature the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial report.

1200. ASA 320.8 set out the auditor's objective as being to apply the concept of materiality appropriately in planning and performing the audit. The Auditing Standards make a distinction between *overall* materiality and *performance* materiality. In practical terms, overall materiality is the initial reference point for guidance in relation to materiality in the audit and is usually the benchmark for assessing whether the sum of the unadjusted errors/matters identified in an audit has a material impact on the financial statements as a whole.

1201. The following questions are relevant to an auditor's determination of overall materiality:

- (a) Who will be the users of the financial report?
- (b) What information is important to their economic decisions?
- (c) Are there qualitative factors that are also relevant to consider in setting overall materiality?

1202. In practice it would not be unusual for the audit procedures to include steps for determining an appropriate benchmark that in addition to including the consideration of the specific circumstances of the entity, would apply a risk weighting based on the type of entity that was being audited. Entities such as those of a retail or wholesale investment management nature (such as LM) are usually regarded as having a heightened risk profile and in our view, having regard to the Relevant Benchmark,³⁰³ the starting point for consideration of an appropriate level of overall materiality in the 2012 LM Audit, should have around the level of 3% of net assets, reflecting an appropriate weighting for that

³⁰³ See above n 56.

risk profile and aligned with achieving the audit objective of minimising the likelihood of not detecting material misstatements in the financial statements.

1203. *Performance* materiality is the level of materiality used for specific audit testing to reduce to an appropriately low level the risk that the aggregate of undetected misstatements exceeds overall materiality.

1204. *Performance* materiality is relevant to decisions in an audit about matters such as:

- (a) Which balances in the financial statements are most appropriate to focus on.
- (b) The level of audit testing of individual transactions to be performed including working out a sample size.
- (c) How to deal with any differences that arise from analytical review procedures undertaken.
- (d) Assessment of the risk of material misstatement at the account balance level.

1205. There was no specific guidance in the Auditing Standards at the time as to a level at which performance materiality was to be set. As a matter of practice the level set was typically between 10%-25% below overall materiality in order to provide a buffer for the possibility of undetected misstatements. In any given audit the percentage reduction used from within this range would usually reflect the auditor's assessment of the risk of the audit engagement because of the correlation between that risk and the risk of the likelihood of undetected misstatements in the financial statements. The higher the audit engagement risk, the lower the performance materiality level (as a % of overall materiality) that it would usually be appropriate to set. For example, in an audit engagement evaluated as high risk, performance materiality might be set at, say 75% of overall materiality, reflecting an evaluation that audit testing of significantly lower balances is prudent and in an audit engagement evaluated as low risk, the performance materiality might more likely be set at around 90%, resulting in less audit testing to be undertaken at that level of performance materiality.

1206. In contrast to overall materiality which is set having regard to the needs of prospective users of a financial report, performance materiality is directed to ensuring that audit risk is acceptable. The overarching objective specified was to apply the concept of materiality appropriately in planning and performing the audit.³⁰⁴ In our view, having regard to the provisions of the standards at the time and the provisions of the relevant reporting framework, that would have involved a consideration of materiality in the context of the identified purpose of the 2012 LM Financial Statements as general purpose financial statements, to provide information in the financial report that was useful to users for making and evaluating economic decisions with respect to that entity.

³⁰⁴ ASA 320.8.

1207. Setting overall materiality was central to the professional judgement involved in the audit evaluation of whether the information that had been included, and its manner of presentation in, the 2012 LM Financial Statements, met those objectives. The usefulness of the information in the 2012 LM Financial Statements would be impaired if that objective was not achieved.

1208. The responsibility to perform appropriate audit procedures to detect material misstatements in an entity's financial statements on a consistent and reliable basis relies on the appropriate application of the concept of materiality by the auditor and in our view was a key audit responsibility in the 2012 LM Audit.

Contention 5 materiality allegations

1209. There were three allegations with respect to Contention 5 as follows.

First materiality allegation

1210. Mr Williams set the materiality level at:

- (a) 10% of net assets.
- (b) 165% of net profit.

ASIC alleged that a reasonably competent auditor would have set the materiality level by reference to typical benchmarks of:

- (a) Between 0.5% and 3% using net assets; and
- (b) 10% of net profit.

1211. Mr Williams' responses to the First Materiality Allegation were as follows:

- (a) He relied on the Limited Users/Limited Purpose Response.
 - (i) In support of his argument, Mr Williams referred to paragraph 4 of ASA 320 that provided:

The Auditor's determination of materiality is a matter of professional judgement and is affected by the auditor's perception of the financial information needs of the users of the financial report.
 - (ii) In his statement of evidence, Mr Williams said it was relevant that the users in this case were the LMIM Board and the members of the Manager, being related parties controlled by Peter Drake, and the Audit Report was intended for internal use only. This evidence was consistent with the documentary record provided by AWPAD that we have described in paragraph 1183-1187 that noted '10% considered an appropriate level given we are reporting internally to management and the Board of LMIM.'
 - (iii) Mr Williams' response depended on the Limited Purpose/Limited User Response and we refer to and repeat our comments and finding

on that response.³⁰⁵ Based on that finding, and our finding with respect to the Second Materiality Allegation, it follows that the difficulty with Mr Williams' response is that he should have recognised that it was not appropriate to base his judgement on a user group so confined. The evidence demonstrated the potential user group was wider and had he properly recognised this matter a proper consideration of the financial needs of users of the financial report as was required by ASA 320.4 should not have been resulted in the overall materiality being set at the level of 10% of net assets in the 2012 LM Audit, which, having regard to our comments in 1202 was high for this type of entity.

- (b) Mr Williams second response was that performance materiality, and therefore the identification of the income and expense items to be tested, and therefore ultimately the net profit, was set at 10% of the income and expenses respectively (AWP's AD1, AD2, AD3) and AWPFB1 Payments/Income Testing Summary evidenced that the level of materiality was applied to the profit and loss items such that the only items identified as immaterial were finance costs (\$38,896); legal fees (\$106,305); other expenses (\$372,696); interest revenue – cash assets (\$462,052) and other income (\$42,991).
- (i) With respect to this response we note AWPFB1 records the Payments/Income Testing Summary set out in Mr Williams' Response. That document does not record what materiality measure was being used or the level applied as Mr Williams' response asserted.
- (ii) One item recorded in AWPFB1 as material was \$7,881,609 of realised foreign exchange gains. That record is consistent with a lower level of materiality having been applied to that item because applying the overall materiality level set would have resulted in that figure (on its face) being immaterial.
- (iii) The audit evidence in AWPFB1 was therefore consistent with the testing performed having been done at a performance materiality level lower than overall materiality although AWPFB1 does not specify the level of testing, nor that it was performance materiality testing, nor the basis of the testing. We refer to our further comments with respect to AWPFB1 in paragraph 1190. In our view AWPFB1 was not sufficient and appropriate audit evidence of performance materiality testing.
- (iv) In our view, the fact that AWPFB1 records evidence of the use of income and expenses testing at a lower level of materiality than the overall materiality recorded as set in AWPAD does not address the subject matter of this allegation which is the appropriateness of level of overall materiality that was initially set in the 2012 LM Audit. We

³⁰⁵ See above n 47.

refer to and repeat our comments on the concept of materiality and its importance to an audit in paragraphs 1191-1208.

- (v) For these reasons our view is that this response does not answer the First Materiality Allegation.
- (c) Repeated the Engagement Partner Response, which Mr Williams did not press. He said further that Ms Blank, in her professional judgement, adopted the 10% materiality level. We refer to and repeat our comments on the Engagement Partner Response, and Mr Williams' responsibility as Engagement partner in the 2012 LM Audit,³⁰⁶ that form the basis for our view that this response does not provide an answer to the First Materiality Allegation.

Further Evidence and Mr Williams' submissions on first materiality allegation

1212. As we have noted, materiality for the financial statements as a whole was determined on the basis of 10% of *Net Assets attributable to unit holders (size of the fund)* and AWPAD noted that '10% considered an appropriate level given we are reporting internally to management and the board of LMIM'. There was no other documentary evidence of the basis on which the overall materiality level was set.
1213. Mr Rea's evidence was that the materiality level of 10% of net assets used in the 2012 LM audit was significantly higher than the typical range of 0.5% to 3% of net assets for entities of a retail or wholesale investment nature. His evidence was that this range was based on information gathered through compliance program activities conducted by ASIC and that the lower figure of 0.5% was not common but could be applied in circumstances where, for example, there had been significant issues identified in a prior audit period.
1214. We accept Mr Rea's evidence with respect to his opinion on the materiality range for entities of a retail or wholesale investment nature at the time of the 2012 LM Audit and we refer to and repeat our comments in paragraph 1202. ASIC's regulatory role with respect to the supervision of registered auditors provides it with a broad perspective and unique insight into current audit practice with respect to setting an appropriate materiality level in an audit and the range of factors that may relevantly bear upon an auditor's determination.
1215. Mr Rea's further evidence was that based on the level of overall materiality set by Mr Williams, the application of the concept of materiality as envisaged by the relevant auditing standards, would have allowed Mr Williams to sign the 2012 LM Audit Report on the basis that there were no material misstatements in the 2012 LM Financial Statements, even in the theoretical circumstance that there had been a \$34,000,000 overstatement of the Maddison Loan, if that were the only unadjusted difference identified, when such an error would have represented approximately 159% of the net profit of LM before distributions and approximately 17% of the Maddison Loan receivable.

³⁰⁶ See above n 47.

1216. We agree that the example to which Mr Rea referred in his statement highlights that the overall materiality level recorded in AWPAD was set at a level that was unlikely to achieve the objective of overall materiality that we have discussed above.
1217. When cross-examined by Mr Williams, Mr Rea agreed that the assessment evidenced by AWPFB1 would have been no different had a materiality threshold within the range asserted by ASIC been applied because the only items considered immaterial were well within the lower end of that threshold.
1218. We accept this was the case in terms of what was evidenced by AWPFB1 in that regard but note it did not record details of the materiality measure used or the level applied which in our view was a relevant matter.
1219. In his final submissions Mr Williams relied on the importance of the auditor's professional judgement to a determination of materiality. We agree that the relevant standards at the time underscored the importance of professional judgement applied to the specific circumstances of a given audit. Mr Williams' submissions further rested on the importance of the user group to determining the approach scope and methodology of an audit and we also accept the relevance of that matter to the auditor's consideration of appropriate materiality. Based on our finding with respect to the Second Materiality Allegation and the Limited User/Limited Purpose Response³⁰⁷ however, Mr Williams should have appreciated from the information of which he was aware that the user group for the 2012 LM Financial Statements was potentially wider. If Mr Williams had agreed to perform the audit engagement on a limited basis, both the engagement documentation between WPIAS and the client as well as his audit opinion should have accurately reflected the details of the parameters of the limited basis.
1220. Mr Williams also submitted that ASIC was wrong to contend that the materiality level of 165% of net profit was set by WPIAS and he referred to the AWPAD documents we have discussed above which he said demonstrated that different materiality levels were applied to each of the relevant line items. He said that these line items would be used to determine whether an adjustment would be made to the financial statements and the level at which the audit risk was acceptable was a matter for his professional judgement. We have considered this submission but we do not regard its basis as consistent with the documentary evidence we have set out, in particular AWPAD described in paragraph 1184. As we have noted we would expect performance materiality testing to use a lower level for materiality than the overall materiality level that was set but the fact that this occurred does not lead to a conclusion that Mr Williams would have adjusted the financial statements on the basis of the lower materiality levels applied.
1221. Having regard to its importance, the audit evidence in the Audit Engagement File with regard to materiality was not detailed nor clear about the manner in which it was applied. In our view it was not sufficient and appropriate audit evidence. For example, the audit workpapers AC6 (Analytical Procedures workpaper), RA2 (Prepaid Management Fees workpaper), DD (Evaluation of

³⁰⁷ See above n 47.

Identified Misstatements workpaper) and FB1 (Payments/Income Testing Summary) did not document a materiality value. Given the nature of these workpapers that information was relevant and should have been documented. For these reasons our view is that the audit evidence did not support Mr Williams' submission.

Finding on First Materiality Allegation

1222. The basis of the first allegation was that, in the circumstances of the 2012 LM Audit, a reasonably competent auditor would have set the materiality level at a lower level than that set by Mr Williams. This was particularised in the following way:

- (a) That if the benchmark used to set materiality was to be net assets, a range of between 0.5 and 3% was appropriate. In dollar amounts this equated to setting a materiality level of between \$1,765,780 and \$10,594,683.
- (b) That, otherwise the benchmark for setting the materiality level should have been 10% of net profit, which would have been \$2,136,129.

1223. We refer to and repeat our comments on setting overall materiality appropriately and Mr Rea's evidence discussed above. If the benchmark to be used for overall materiality was to be net assets, then, having regard to our comments, Mr Rea's evidence and to the Relevant Benchmark,³⁰⁸ we are satisfied that a reasonably competent auditor in the circumstances of the 2012 LM Audit, would have set the overall materiality at a level of between 2.0% - 3% of net assets. Our view recognises that the actual level set would depend on the auditor's professional judgement based on his or her assessment of the relative importance of the range of issues, both quantitative and qualitative raised by the specific circumstances of the particular audit. That assessment should be recorded in the audit evidence.

1224. With regard to the second way in which this allegation was particularised – that otherwise the benchmark for setting the materiality level should have been 10% of net profit – which would have been \$2,136,129 (to which Mr Williams' response was the same as the first way in which the allegation was particularised) our view is that a finding on this matter would not provide any further insight into the relevance of the overarching question of whether Mr Williams has performed his duties adequately and properly within the meaning of section 1292(1)(d)(i) of the Act.

1225. It was clear from the Audit Engagement File evidence that net assets had been used as the base for calculating overall materiality (AWPAD, audit step 1.1 and 1.2) and the 2012 Audit Closing Report (page 12) documented a final materiality value of 35,300,000 (i.e. 10% of final net assets).

1226. What is generally the most important feature of the level of overall materiality set, which is a matter for professional judgement, is the dollar level that results from application of the auditor's chosen approach rather than the method selected for its calculation, although different methods are more suitable in certain contexts.

³⁰⁸ See above n 56.

1227. To the extent that the resultant dollar level of overall materiality using the second approach would have been \$2,136,129, we comment that this represents the very conservative end of the 0.5% - 3% range (approximately 0.6%) that we have discussed above and, having regard to Mr Rea's evidence that the lower end of the range 0.5% was not common, but suitable in circumstances such as when there had been significant issues identified in a prior audit period, we note that setting materiality at that level was not indicated by Mr Williams' prior year audit of LM.

1228. We find the First Materiality Allegation has been established based on the overall materiality level being set at 10% of net assets in the 2012 LM Audit.

Second Materiality Allegation

1229. The Second Materiality Allegation was that a reasonably competent auditor would have considered users of the accounts to include unitholders and financiers.

1230. This allegation was premised on two bases:

- (a) The first was a reference in ASIC Regulatory Guide (RG) 43 *Financial Reports and Audit Relief at* [43.3] to an Administrative Appeals Tribunal decision that stated that '*users*' should be given a wide interpretation, with the result that not only present and prospective shareholders, present and prospective creditors and customers are users, but also employees of the company.
 - (i) ASIC Regulatory Guide 43 was stated to be 'A guide for companies, registered schemes or disclosing entities; their directors; and auditors.... it explains how ASIC may exercise its powers to grant relief from the financial reporting and audit requirements of Part 2M.2, 2M.3 and 2M.4 (other than Div 4) of the Corporations Act 2001.'
 - (ii) The reference to the interpretation to be given to users of a financial report to which the allegation refers was made in the overview to Regulatory Guide 43 and authority for that view attributed to dictum in the decision *In Re Incat Australia Pty Ltd and Another and ASIC 33 ACSR 132 (Incat decision)*. This dictum was that *users* [of a financial report] should be given a wide interpretation, with the result that not only present and prospective shareholders, present and prospective creditors and customers are users, but also employees of the company. It was based on a finding in the legal proceedings that the applicants in the matter fulfilled the criteria for classification as large public companies.
 - (iii) In our view the statement of principle with respect to users made in the *Incat* decision is not referable to LM, based as it was on a specific finding in the case that the user base identified was reasonable in circumstances where the applicants in the matter fulfilled the criteria

for classification as large public companies, a classification that LM did not fall within.

- (iv) For these reasons we are not satisfied that the allegation has been established on its first premise.
- (b) The second premise of the Second Materiality Allegation was the reference to the provisions of Paragraph OB2 of the AASB Framework for the Preparation and Presentation of Financial Statements that:

...the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. These decisions involve buying, selling, or holding equity and debt instruments, and providing or settling loans and other forms of credit.

Comments and Finding on second premise of Second Materiality Allegation

1231. The facts pleaded in support of this allegation were the provisions of the *Deed Poll* executed on 25 November 2009 by LMIM with respect to the establishment of LM. Paragraph 25 of the deed, *Accounts and Reports* stated that:

- (a) The accounts of the Scheme must be kept and prepared by the Manager in accordance with applicable Accounting Standards and the Law; and
- (b) The Manager must prepare and make available to Members the financial statements of the Scheme for each financial year...

The 2012 LM Audit Report stated that:

We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

1232. Mr Williams' response to this allegation was that there was no requirement whether under the Deed Poll or otherwise for audited financial statements to be prepared.

1233. In our view this does not respond to the subject of the allegation. Mr Williams specified the terms of WPIAS' engagement to audit the 2012 LM Financial Statements and made a representation in the subsequent audit report in the terms set out in paragraph 1231.

1234. In our view, having regard to the Relevant Benchmark³⁰⁹ a reasonably competent auditor would ensure that the audit report issued was consistent both with the terms of the engagement between the auditor and the entity for performance of the audit and representations in the audit report to the extent they are made.

1235. Turning now to the substance of the second materiality allegation, the particulars referred to the term of the Deed Poll that 'The Manager must prepare and make available to Members the financial statements of the Scheme for each financial

³⁰⁹ See above n 56.

year...’ as a basis for alleging Mr Williams should have considered there would be a broader user group.

1236. It follows from our finding with respect to the Limited User Response³¹⁰ and our comments with respect to applying appropriate professional scepticism,³¹¹ together with the evidence of Mr Williams’ knowledge of the terms of the Deed Poll requiring LM to make available to members the annual financial statements for LM and the refinancing that was in train at the time, that had Mr Williams properly considered the composition of the potential user group, he would have concluded there was a high likelihood that it would have included both the LM unit holders and the potential financiers with whom LMIM was then negotiating, having regard to the credibility and commercial weight attaching to audited financial statements compared to unaudited financial statements. In our view this was particularly so in the 2012 LM Audit because of Mr Williams’ status as a registered company auditor and the statements in the 2012 LM Audit Report that the audit had been performed in accordance with the Auditing Standards.

1237. Had the group of potential users been properly constituted, and having regard to the Relevant Benchmark,³¹² Mr Williams would have had to consider the appropriate level for overall materiality in terms of the objectives of that wider group.

1238. For the above reasons we are satisfied, based on the second premise of the Second Materiality Allegation, and having regard to the Relevant Benchmark,³¹³ that a reasonably competent auditor exercising appropriate professional scepticism would have considered users of the 2012 LM Financial Statements to include unit holders and financiers and we find the Second Materiality Allegation has been established.

Third Materiality Allegation

1239. The Third Materiality Allegation was that a reasonably competent auditor in Mr Williams’ position would have identified, considered and/or performed the following four matters with respect to materiality in the 2012 LM Audit and there was insufficient appropriate audit evidence in the Audit Engagement File that Mr Williams had adequately addressed those matters. We are satisfied that the relevant Auditing Standards/Accounting Standards at the time specified that the matters the subject of Sub-Allegations 3(a)-3(d) should have been carried out, and having regard to the Relevant Benchmark,³¹⁴ those requirements should have been observed in the 2012 LM Audit. These matters were as follows.

Sub-Allegation 3(a)

A reasonably competent auditor would have identified that the materiality levels for the 2012 LM Financial Statements set out in AWPAD3 were set at a higher level than could reasonably be expected to influence the economic decisions of users, including

³¹⁰ See above n47.

³¹¹ See above n58.

³¹² See above n56.

³¹³ Ibid.

³¹⁴ Ibid.

shareholders and creditors, as materiality was higher than LM's net profit before distribution which is not in line with the concept of materiality in AASB 1031.

1240. AASB 1031 defined materiality as:

Material - Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

1241. The definition of materiality in AASB 1031 makes clear that two important factors to be considered for determining materiality with respect to disclosures in a financial report are the users of that report and what information is likely to be important to their economic decisions.

1242. The focus of an appropriate overall materiality level in an audit is also based on the user's needs and expectations and represents the auditor's professional judgement of the users' tolerance for misstatements – what financial information, if omitted, misstated or not disclosed would be unlikely to have the potential to affect the economic decisions of users of the financial report?

1243. AWPAD recorded with respect to overall materiality in the 2012 LM Audit the benchmark as net assets, the total as \$353,156,132.42, the percentage as 10% and the materiality level as \$35,315,613.24.

1244. Our finding on the First Materiality allegation was that the level set for overall materiality was significantly higher than the level at which a reasonably competent auditor would have set that benchmark and we have accepted Mr Rea's evidence that the effect of the overall materiality set in the 2012 LM Audit would have been that Mr Williams could have signed the audit report on the basis of no material misstatements, even had there been a \$34,000,000 overstatement of the Maddison Loan, when that error would have represented approximately 159% of the net profit of LM before distributions and approximately 17% of the Maddison Loan receivable (were that the only unadjusted difference to have been identified).

1245. We are satisfied that a materiality level that could omit such an error had the potential to affect the usefulness to potential users of the information provided by the 2012 LM Financial Statements, in terms of their potential economic decisions with respect to LM, and so would not have met the objective of the general purpose financial reporting framework we have discussed, to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity

1246. Having regard to our reasons for and finding with respect to the Second Materiality Allegation, we are satisfied that a reasonably competent auditor would have identified that the overall materiality level set for the 2012 LM Financial Statements as recorded in AWPAD3 could result in financial information being omitted misstated or not disclosed in those financial

statements that could have had the potential to affect the economic decisions of users of those financial statements, including the LM unit holders.

1247. Based on AWPFB1, Mr Williams argued that audit testing was nevertheless performed on all of the balances one would expect to be tested. We accept AWPFB1 evidenced audit testing of the specific balances it recorded although it was in our view directed to performance materiality testing and we refer to our comments with respect to the different objectives of performance materiality and overall materiality in paragraphs 1203-1206.

1248. We are satisfied that Sub-Allegation 3(a) has been established.

Sub-Allegation 3(b)

A reasonably competent auditor would have determined that the materiality level was too high for him to be able to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level in accordance with ASA 200.

1249. With respect to this Sub-Allegation Mr Williams referred us to the audit evidence of materiality testing having been performed at lower levels than the determined overall materiality level of \$35,300,000 and we have accepted that in the 2012 LM Audit appropriate balances and transactions were generally subject to audit at a level below the overall materiality level set in AWPAD that was not inconsistent with the concept of performance materiality, although there was no audit evidence with respect to how and at what level it was set as part of the audit plan. The evidence was that the audit fieldwork conducted was substantive in nature (i.e. not performed on a sample basis) and was consistent with the audit focus having been on the large material balances.

1250. For example, the Loan Balance work papers, AWPIB2 include a list of the individual loans comprising the balance that was tested that added up to \$322,946,299. AWPIB2 records that the total value of loans tested was \$282,345,299 (83.49%). It does not record the materiality level used to determine the audit testing coverage or an explanation of basis of or methodology for selecting the loans for testing. One of the loans, Lifestyle Investment Company Pty Ltd the value of which was recorded as \$30,066,913 was not tested. While that loan balance was still less than the determined overall materiality of \$35,300,000 (and was likely to have been below performance materiality although as per our comments above this was not clear from the audit evidence) there were numerous much smaller loan balances that were tested. That audit evidence is consistent with a flaw in the audit testing approach insofar as it had resulted in testing on numerous smaller balances, but no audit testing performed on the largest loan sum below the overall materiality level set as recorded in AWPAD.

1251. Although audit testing of individual balances had taken place in the 2012 LM Audit at much lower levels than the overall materiality level that was set, the above example highlights that the audit evidence does not speak to the sufficiency of that audit testing in terms of demonstrating the appropriateness of the materiality level set and we refer to our comments on the concept of audit materiality in paragraphs 1203-1206.

1252. Having said that, the substantive audit approach adopted meant that the level at which overall materiality was set would not in principle have prevented sufficient appropriate audit evidence being obtained (had that testing been carried out appropriately and we have referred to an example in paragraph 1250 that suggests it was not) to reduce audit risk to an acceptably low level. We also refer to our comments in paragraph 1206 with respect to the different objectives of overall materiality and performance materiality. For these reasons we are not satisfied that Sub-Allegation (b) of the Third Materiality Allegation has been established on its terms.

Sub-Allegation 3(c)

Considered whether the use of such a high materiality level resulted in the financial report not being prepared in all material respects in accordance with the applicable financial reporting framework and consequently consider if the audit opinion should be modified in accordance with ASA 700 and ASA 705.

1253. We refer to and repeat our comments with respect to the appropriate application of materiality in an audit in paragraphs 1203- 1208 and to our comments and findings with respect to the Second Materiality Allegation and Sub-Allegation (a) of the Third Materiality Allegation.

1254. Based on those comments and reasons and having regard to the Relevant Benchmark,³¹⁵ we are satisfied that a reasonably competent auditor would have considered whether the use of such a high materiality level resulted in the financial report not being prepared in all material respects in accordance with the applicable financial reporting framework and consequently consider whether the audit opinion should have been modified in accordance with ASA 700 and ASA 705.

1255. We are satisfied that Sub-Allegation 3(c) has been established.

Sub-Allegation 3(d)

Displayed a higher level of professional scepticism when determining materiality in accordance with ASA 200.

1256. We refer to and repeat our comments with respect to the appropriate application of professional scepticism,³¹⁶ our comments with respect to the importance of setting appropriate materiality in an audit,³¹⁷ our comments and findings with respect to the First and Second Materiality Allegation and to Sub-Allegation 3(a) and 3(c) of the Third Materiality Allegation, and having regard to the Relevant Benchmark,³¹⁸ we are satisfied that a reasonably competent auditor would have displayed a higher level of professional scepticism when determining materiality.

1257. We are satisfied that Sub-Allegation (d) of the Third Materiality Allegation has been established.

³¹⁵ Ibid.

³¹⁶ See above n 58.

³¹⁷ See paragraphs 1207-1208.

³¹⁸ See above n 56.

Contention 5 Sub-Contentions

1258. We now turn to consider whether the Contention 5 Sub-Contentions, of which there were 6, have been established based on our findings on the materiality allegations.

Sub-Contention 5(a)

That within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 Financial Report by failing to appropriately apply the concept of materiality when performing the audit of the 2012 Financial Report.

1259. In response to this Sub-Contention (a) Mr Williams referred to ASA 450 the subject of which was *Evaluation of Misstatements Identified during the Audit Application*.

1260. The introduction to ASA 450 states ‘This Auditing Standard deals with the auditor’s responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial report.’ Mr Williams also referred to AWPDD which was headed *Evaluation of Misstatements* and recorded that none had been identified.

1261. In our view these two matters do not advance a consideration of whether the concept of materiality was appropriately applied in the 2012 LM Audit. Setting appropriate overall materiality and performance materiality is a precursor to, and has a significant bearing upon, the identification of misstatements. The fact that none were identified in the 2012 LM Audit does not speak to this issue.

1262. Mr Williams also referred to AWPAD and AWPBC1. We refer to and repeat our comments on those documents in paragraphs 1183-1186 and 774-778 that form the basis for our view that neither of these documents affects our conclusion with respect to this Sub-Contention.

1263. We refer to our findings with respect to the First and Second Materiality Allegation and Sub-Allegations (a), (c) and (d) of the Third Materiality Allegation and our comments on the concept and appropriate application of materiality in an audit.³¹⁹ Based on those findings and having regard to the Relevant Benchmark, we are satisfied that Mr Williams’ level of performance of his duties with regard to appropriately applying the concept of materiality when performing the audit of the 2012 Financial Report was not adequate.

1264. We refer to and repeat our comments about the nature of the Board’s task under section 1292 of the Act³²⁰ and based on our comments above, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 5(a) has been established.

³¹⁹ See paragraphs 1191-1208.

³²⁰ See above n 138.

Sub-Contention 5(b)

That within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 Financial Report by failing to set a materiality level for the audit of the 2012 Financial Report that would have enabled him to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.

1265. Based on our finding with respect to Sub-Allegation (b) of the Third Materiality Allegation, we are not satisfied this Sub-Contention has been established.

Sub-Contention 5(c)

That within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to his audit of the 2012 Financial Report by failing to display an appropriate level of professional scepticism in relation to the determination and calculation of the materiality for the audit of the 2012 Financial Report.

1266. In response to Sub-Contention 5(c) Mr Williams referred to AWPAA2. We have referred to AWPAA2 in paragraph 960. AWPAA2 records risks of misstatement identified with respect to the LM Audit. However it does not record evidence of how those identified risks were assessed in the LM Audit and for this reason does not in our view provide relevant evidence with respect to this sub-contention.

1267. We refer to our findings with respect to the First and Second Materiality Allegation and Sub-Allegation (a), (c) and (d) of the Third Materiality Allegation. Based on those findings and our comments on the concept and appropriate application of materiality in an audit,³²¹ and professional scepticism,³²² and having regard to the Relevant Benchmark³²³, we are satisfied that Mr Williams' level of performance of his duties was not adequate.

1268. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act³²⁴ and based on our comments above, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 5(c) has been established.

Sub-Contention 5(d)

That within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to evaluating whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based.

1269. We refer to our findings with respect to the First and Second Materiality Allegation and Sub-Allegations (a), (c) and (d) of the Third Materiality

³²¹ See paragraphs 1191-1208.

³²² See above n 58.

³²³ See above n 56.

³²⁴ See above n 138.

Allegation and our comments on the audit evidence.³²⁵ Based on those findings and our comments on the concept and appropriate application of materiality in an audit,³²⁶ and professional scepticism,³²⁷ and having regard to the Relevant Benchmark, we are satisfied that Mr Williams' level of performance of his duties with regard to evaluating whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based, was not adequate.

1270. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act³²⁸ and based on our comments above, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 5(d) has been established.

Sub-Contention 5(e)

That within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams failed to carry out or perform adequately and properly the duties of an auditor in relation to considering whether the use of such a high materiality level resulted in the financial report not being prepared in all material respects in accordance with the applicable financial reporting framework and consequently consider if the audit opinion should be modified.

1271. We refer to our findings with respect to the First and Second Materiality Allegation and Sub-Allegations (a), (c) and (d) of the Third Materiality Allegation. Based on those findings and our comments on the concept and appropriate application of materiality in an audit,³²⁹ and our comments on the importance of applying appropriate professional scepticism,³³⁰ and having regard to the Relevant Benchmark, we are satisfied that Mr Williams' level of performance of his duties with regard to considering whether the use of such a high materiality level resulted in the financial report not being prepared in all material respects in accordance with the applicable financial reporting framework and consequently consider whether the audit opinion required modification, was not adequate.

1272. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act³³¹ and based on our comments above, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 5(e) has been established.

Sub-Contention 5(f)

1273. Sub-Contention 5(f) was made in the alternative to Sub-Contentions 5(a)–(e). It contended that *“in the event that RLW did in fact adequately identify, consider*

³²⁵ See paragraph 1221.

³²⁶ See paragraphs 1191-1208.

³²⁷ See above n 58.

³²⁸ See above n 138.

³²⁹ See above n 326.

³³⁰ See above n 58.

³³¹ See above n 138.

and/or attend to any of the matters referred to in paragraphs (a) to (e) above, then RLW was required to and failed to document the fact that he had so identified, considered and attended to those matters". We have considered this alternative allegation with respect to Sub-Contention 5(b) that we are not satisfied was established. We have formed the view that the alternative Sub-Contention has also not been established as it was not meaningful as an alternative to Contention 5(b).

Panel's conclusion with respect to Contention 5

1274. Based on our findings on each of the Contention 5 Sub-Contentions that we have found established, we are satisfied that to the extent of our findings on these Sub-Contentions, within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor.

CONTENTION 6 – APPROPRIATENESS OF AUDIT OPINION

1275. ASIC contended that Mr Williams failed to carry out his duties as an auditor with respect to forming his opinion on the 2012 LM Financial Statements.

1276. The 2012 LM Audit Opinion was issued on 7 December 2012 on an unmodified basis.

1277. Based on our findings in Contentions One to Five in this matter we are satisfied that Mr Williams failed to carry out and perform his duties as an auditor with respect to the 2012 LM Audit and the 2012 LM Audit Opinion in a number of significant respects as we have addressed in our reasons for the findings on those contentions in this determination.

1278. Mr Williams denied this contention on the basis of the matters he asserted in his responses to each of the other contentions that we have addressed in our reasons for finding with respect to Contentions One to Five.

1279. The allegation in Contention 6 was that a reasonably competent auditor, in the circumstances of the 2012 LM Audit, would have sought further audit evidence and if sufficient appropriate audit evidence was not available would have:

- (a) Withdrawn from the audit (ASA 705.13(b)(i)); or
- (b) Disclaimed the opinion (ASA 705.9, 705.13(b)(ii)); or
- (c) the audit opinion and issued a qualified opinion (ASA 705.7(b)).

("Appropriateness of Audit Opinion Allegation").

1280. Based on our findings with respect to the allegations that were established in Contentions One to Five and our findings with respect to those contentions, we are satisfied a reasonably competent auditor, in the circumstances of the 2012 LM Audit, would have sought further audit evidence and if sufficient appropriate audit evidence was not available would have:

- (a) Withdrawn from the audit; or
- (b) Disclaimed the opinion; or
- (c) Modified their audit opinion and issued a qualified opinion (ASA 705.7(b)).

1281. We are satisfied the Appropriateness of Audit Opinion Allegation has been established.

Contention Six Sub-Contentions

1282. Contention Six comprised seven Sub-Contentions that Mr Williams had failed to carry out or perform adequately and properly the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act.

1283. These Sub-Contentions were based on the requirements within ASA 700 that were operative at the relevant time.

1284. ASA 700 required the auditor to form an opinion on whether the financial report was prepared in all material respects in accordance with the applicable financial reporting framework.³³² In order to form that opinion, the auditor was required to conclude whether he had obtained reasonable assurance about:

- (a) whether the financial report was free from material misstatement; and
- (b) whether due to fraud or error, taking into account;
 - (a) his conclusion on whether sufficient appropriate audit evidence had been obtained;³³³
 - (b) his conclusion with respect to whether uncorrected misstatements were material either individually, or in aggregate;³³⁴ and
 - (c) the evaluations required within ASA 700.³³⁵

1285. ASA 700.12 required the auditor, in that evaluation to assess whether the financial report had been prepared in accordance with the requirements of the applicable financial reporting framework and provided that this evaluation was to include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements.³³⁶ If the auditor was unable to obtain sufficient appropriate audit evidence or concluded that the financial report as a whole was not free from material misstatement, then ASA 700.17 provided that the opinion in the auditor's report must be modified in accordance with ASA 705.

³³² ASA 700.10.

³³³ in accordance with ASA 330.

³³⁴ in accordance with ASA 450.

³³⁵ ASA 700.11.

³³⁶ ASA 700.12.

1286. ASA 705 set out the circumstances in which the auditor was required to modify, qualify or disclaim the opinion. We have already set out the relevant provisions at paragraph 773.

Sub-Contention 6(a)

Incorrectly concluding that he had obtained reasonable assurance about whether the financial report as a whole was free from material misstatement whether due to fraud or error.

1287. By the terms of the 2012 LM Audit Engagement and pursuant to the provisions of the ASA 200.17, Mr Williams was required to plan and perform the 2012 LM Audit so as to obtain sufficient appropriate audit evidence to enable him to draw reasonable conclusions on which to base his audit opinion.

1288. We refer to our finding on the Appropriateness of Audit Opinion Allegation. Having regard to the Relevant Benchmark³³⁷ and based on our comments and findings with respect to:

- (a) Contention 1 (a), (b), (c), (i), (j), and (l);
- (b) Contention 2 (e), (f), and (i);
- (c) Contention 3 (a), (b), (c), (d) and (g);
- (d) Contention 4 (b), (c), (d), (e), (f), (h) and (i); and
- (e) Contention 5 (a) and (d),

we have formed the view that Mr Williams' level of performance of his duty to form a proper opinion on the 2012 LM Financial Statements in accordance with ASA 700, was not adequate.

1289. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act³³⁸ and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 6(a) has been established.

Sub-Contention 6(b)

Incorrectly concluding that uncorrected misstatements were not material.

Sub-Contention 6(d)

Incorrectly concluding that there was sufficient appropriate audit evidence to conclude that the 2012 LM Financial Statements as a whole were free from material misstatement.

1290. In forming his conclusion in the 2012 LM Audit, Mr Williams was required to consider whether uncorrected misstatements were material, either individually or in the aggregate.

³³⁷ See above n 56.

³³⁸ See above n 138.

1291. Further, ASA 700.17 required Mr Williams to modify the audit opinion in accordance with ASA 705 if he was unable to obtain sufficient appropriate audit evidence that the report was free from material misstatement.

1292. Mr Williams said that this was considered at AWPBC1. We have considered the contents of AWPBC1 and refer to and repeat our comments with respect to that document at paragraphs 438-441 and 774-778 and to our comments on the template generated documents that were utilised in the 2012 LM Audit.³³⁹ that form the basis of our view that AWPBC1 did not demonstrate that Mr Williams had properly concluded that there was sufficient appropriate audit evidence to conclude that the 2012 LM Financial Statements as a whole were free from material misstatement.

1293. We refer to our finding on the Appropriateness of Audit Opinion Allegation. Having regard to the Relevant Benchmark³⁴⁰ and based on our comments and findings with respect to Contentions 1, 3, 4 and 5, we have formed the view that Mr Williams' level of performance of his duty to form a proper opinion on the 2012 LM Financial Statements in accordance with the matters set out in ASA 700.11(b) and 700.17 was not adequate as Mr Williams did not have sufficient appropriate audit evidence to form a proper conclusion as to whether there were uncorrected material misstatements in the 2012 LM Financial Statements, either individually or in aggregate that should have caused him to conclude in accordance with ASA 700.17(b) that an audit opinion modified in accordance with ASA 705 was necessary with respect to the 2012 LM Financial Statements.

1294. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act³⁴¹ and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contentions 6(b) and (6)(d) have been established.

Sub-Contention 6(c)

Failing to adequately and properly consider the indicators of possible bias in management judgments.

1295. Mr Williams said that this was considered at AWPBC1. We have considered the contents of AWPBC1 and refer to and repeat our comments with respect to that document at paragraphs 438-441 and 774-778 and to our comments on the template-generated documents that were utilised in the 2012 LM Audit.³⁴² that form the basis of our view that AWPBC1 did not demonstrate that Mr Williams had properly considered the indicators of management bias.

³³⁹ See above n 41.

³⁴⁰ See above n 56.

³⁴¹ See above n 138.

³⁴² See above n 41.

1296. In forming his conclusion in the 2012 LM Audit, Mr Williams was required to evaluate the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements.³⁴³

1297. We refer to our finding on the Appropriateness of Audit Opinion Allegation. Having regard to the Relevant Benchmark³⁴⁴ and based on our comments and findings in Contentions 1-4 we have formed the view that Mr Williams' level of performance of his duty to form a proper opinion on the 2012 LM Financial Statements in accordance with the matters set out in ASA 700.12 was not adequate, as Mr Williams either did not have sufficient appropriate audit evidence to properly evaluate indicators of possible bias in management's judgements in the 2012 LM Audit, or he did not appropriately test management information on which he based the 2012 LM Audit Opinion.

1298. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act³⁴⁵ and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 6(c) has been established.

Sub-Contention 6(e)

Failing to properly evaluate whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based (ASA 500.7 and ASA 500.9).

1299. Mr Williams said that contention 6(e) was considered at AWPAA1 - *Audit Plan and Overall Strategy for LM Performance Fund Year End 30 June 2012*. We refer to and repeat our comments with respect to the template-generated documents that were used by WPIAS in the 2012 LM Audit.³⁴⁶ AWPAA1 does not demonstrate evidence of the evaluation of whether the audit evidence obtained was sufficiently reliable, precise and complete in order to be used in arriving at the conclusions on which his opinion was based.

1300. We have set out and discussed the requirements of ASA 500.7 and 500.9 in paragraph 730.

1301. We refer to our finding on the Appropriateness of Audit Opinion Allegation. Based on our comments and findings in contention 1-5 and having regard to the Relevant Benchmark,³⁴⁷ we have formed the view Mr Williams' level of performance of his duty to properly evaluate whether the audit evidence was sufficiently reliable, precise and complete in order to be used in arriving at his conclusions on which the 2012 LM Audit Opinion was based, was not adequate.

³⁴³ ASA 700.12.

³⁴⁴ See above n 56.

³⁴⁵ See above n 138.

³⁴⁶ See above n 41.

³⁴⁷ See above n 56.

1302. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act³⁴⁸ and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 6(e) has been established.

Sub-Contention 6(f) and 6(g)

Failing to identify the need to modify the 2012 LM Audit Opinion and either withdrawing, disclaiming or modifying the 2012 LM Audit Opinion after the request to audit Maddison was rejected and in the absence of obtaining further relevant audit evidence.

1303. Mr Williams said that this matter was considered in AWPBC1. We have considered the contents of AWPBC1 and refer to and repeat our comments with respect to that document at paragraphs 438-441 and 774-778 and to our comments on the template-generated documents that were utilised in the 2012 LM Audit.³⁴⁹ that form the basis of our view that AWPBC1 did not demonstrate that Mr Williams should not have withdrawn from the 2012 LM Audit or disclaim or modify the 2012 LM Audit Opinion.

1304. We refer to the requirements in ASA 700 and ASA 705 discussed in paragraphs 1284-1286.

1305. We to our finding on the Appropriateness of Audit Opinion Allegation. Based on our comments and findings in contention 1(m) and having regard to the Relevant Benchmark,³⁵⁰ we have formed the view Mr Williams' level of performance of his duty to properly identify what the requirements of ASA 700 and ASA 705 required him to do in the circumstances of the 2012 LM Audit when he was unable to perform an audit of Maddison before finalising the 2012 LM Audit Opinion, was not adequate.

1306. We refer to and repeat our comments about the nature of the Board's task under section 1292 of the Act³⁵¹ and based on the matters we have referred to in the preceding paragraph, we are satisfied that Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act and we are satisfied that Sub-Contention 6(f) and 6(g) have been established.

Panel's Conclusion with respect to Contention Six

1307. Based on our findings on each of the Contention Six Sub-Contentions we are satisfied that, within the meaning of section 1292(1)(d)(i) of the Act, Mr Williams has failed to carry out or perform adequately and properly, the duties of an auditor.

1308. We are satisfied that Contention Six has been established.

³⁴⁸ See above n 138.

³⁴⁹ See above n 41.

³⁵⁰ See above n 56.

³⁵¹ See above n 138.

RESPONDENT'S SUPPLEMENTARY WRITTEN SUBMISSIONS

1309. Some time after the substantive hearing in this matter another law firm retained by Mr Williams sought to make further submissions to the Panel on his behalf ("Supplementary Written Submissions").
1310. ASIC objected to the Supplementary Written Submissions.
1311. As Mr Williams had been unrepresented at the hearing and the Supplementary Written Submissions were relatively brief, the Panel considered the matters raised in the submission dated 16 May 2018 and our comments follow on the three primary points they raised.
1312. The first supplementary submission was that the Panel should not have proceeded with the hearing of this matter after its ruling on the preliminary points because it should not have proceeded to hear evidence when Mr Williams was unable to be present at the hearing due to illness. As to this matter we refer to paragraph 73 that makes clear the basis on which the panel proceeded in this matter, in particular that there was no evidence tendered or heard while Mr Williams was indisposed.
1313. The second supplementary submission was that Mr Lynch's arguments on the preliminary points were correct and deserved reconsideration. When the Panel's ruling on the preliminary points was delivered, the parties were notified that detailed written reasons for its decision to proceed would be included in its written determination. Those reasons are set out in paragraphs 34-70. Those reasons include consideration of Mr Lynch's submissions on each of the preliminary points raised by the Respondent's legal team.
1314. The third supplementary submission was that ASIC in this matter had been motivated to exercise its functions with an 'excess of zeal.' The Panel was asked to take into account two matters; an unsuccessful ASIC action against Mr Drake³⁵² (relevant specifically to this proceeding); and public criticism of ASIC, 'not as a matter of evidence', but as a 'real world factor' upon which the Panel should revisit the legal arguments already raised. This matter was not put as a separate ground or basis for us to consider finding that we cannot hear and determine this matter.
1315. Counsel for Mr Williams referred to *Ostrowski v Palmer* [2004] HCA 30 that it was argued stands for the proposition that CADB should not conduct this matter with 'excessive regulatory zeal' such that it would result in 'oppression'.
1316. In *Ostrowski*, Callinan and Heydon JJ in the context of their comments with respect to the decision to prosecute the defendant, make a simple point that on the peculiar facts of that case, it was highly unusual for a prosecutor to pursue the affected party, when the facts accepted at first hearing determined that although the defendant was in breach of a regulation, he believed on good

³⁵² *ASIC v Drake (No 2)* [2016] FCA 1552.

authority that he was compliant with those regulations.³⁵³ The harshness of the prosecution was aggravated by the fact that the breach occasioned an onerous *mandatory* penalty if found guilty. Callinan and Heydon and JJ said:

Extraordinarily, and after the uncontested facts to which we have referred emerged, the appellant pressed the prosecution. To do so...in the further circumstances that a conviction would result not only in the distress and opprobrium that any conviction carries, but also in the imposition of harsh mandatory penalties, has the appearance of an act of mindless oppression.³⁵⁴

1317. In our view this precedent does not assist Mr Williams. The facts in the decision cited are quite different and distinguishable. As a registered auditor Mr Williams has a statutory duty to carry out his professional duties adequately and properly within the meaning of section 1292(1)(d) and the Board has jurisdiction under section 1292 of the Act to hear and determine applications made by ASIC or APRA with respect to registered auditors, and a discretionary power to impose a sanction on a registered auditor whom it is satisfied has not so performed his/her duties. The question of excess regulatory zeal does not arise, although of course any decision of the Panel to impose a sanction must be an appropriate exercise of its discretion.

APPROPRIATE ORDERS

Sanctions Hearing

1318. On 29 October 2018, the Panel held a hearing in relation to what orders, if any should be made under section 1292(2) of the Act in relation to Mr Williams, having regard to our determination that he has failed to carry out or perform adequately and properly the duties of an auditor (“the Sanctions Hearing”).

1319. At the Sanctions Hearing, Mr Williams was represented by counsel Mr Lynch SC and ASIC was represented by Mr McNally SC.

Mr Williams’ evidence and submissions on sanction

1320. Mr Lynch submitted that an appropriate sanction, based on the matters found established in these proceedings, would be a reprimand.

1321. His submissions on behalf of Mr Williams may be summarised as follows:

- (a) The Panel’s findings did not necessarily require the cancellation or suspension of Mr Williams’ registration as an auditor because sections 1292(1) and 1292(9) contemplate the availability of a range of sanctions in combination or as alternatives in response to findings by a Panel that professional failures had occurred.

³⁵³ The facts of the case were that the Respondent was found guilty of fishing in a prohibited area. He was given materials at a State government office that made no reference to the prohibition. At no point did he understand he was fishing in breach of the regulations, and he had reasonable grounds to believe he was complying with his licence.

³⁵⁴ *Ostrowski v Palmer* [2004] HCA 30 at [70].

- (b) The Panel's findings with respect to contentions 1-6 do not per se establish a lack of fitness and propriety.
- (c) The consideration as to appropriate sanction should commence by first recognising that Mr Williams was not the registered auditor who actually undertook the audit and except where he was personally responsible for undertaking the work performed, the matters the Board found established were not directly indicative of an inability on his part to perform the duties of an auditor, but a failure to review in sufficient depth the work done by others in his firm.
- (d) The relevant issue was that Mr Williams had misapprehended the extent of the tasks to be performed in the audit rather than being unable to perform what, on a proper understanding of the relevant auditor duties, should have been done. Mr Williams had allowed the fact that the audit was not one required by the Corporations Act to influence the manner of its performance. His misapprehension explains for example the decision to defer the audit of Maddison and indicates that an appropriate response by the Panel to its findings is not cancellation or suspension of Mr Williams' registration as an auditor.
- (e) Mr Williams' professional history and qualifications demonstrate his expertise as an auditor and evidence his 'commitment to and achievement of an above average level of professional competence for himself and others' and 'the oddity, in the sense of it being conduct atypical of him, of what has been found against him in this matter.'
- (f) The matters that support Mr Williams continuing to hold registration as an auditor included:
 - (i) His decision to refrain from performing audits since March 2017;
 - (ii) The fact that the proceedings themselves have served to amend any misunderstanding of his professional obligations;
 - (iii) The atypical nature of the conduct found established that is unlikely to be repeated; and
 - (iv) A suspension or cancellation would be punitive, going against the overarching purpose of the sanctions.

Character evidence

1322. Before commencement of the substantive hearing before the Board Mr Williams had filed four statements which attested to his professional standing as an auditor and within the accounting profession. These were tendered at the sanctions hearing in support of the submissions on sanction.

1323. ASIC did not object to the tender of these statements, although noted the statements were prepared before the Panel's determination had been made. Each of the statements were marked as exhibits in the proceedings.

1324. There were also four letters, dated 25 October 2018 from Mr Williams' solicitor to each of the referees that were also admitted as evidence in the proceedings. These letters were in identical terms. They enclosed a copy of the Board's determination and asked each of the referees to advise whether they wished to qualify, modify or in any way change the evidence in the statements they had previously signed, a copy of which had been enclosed. The letter asked each recipient to provide an email in terms set out in the letter confirming they did not require changes to their earlier statement.
1325. A further statement from one of the four referees, Mr Patrick Ponting was tendered and marked as an exhibit in the proceedings following this process. Mr Ponting's further statement confirmed that before making it he had been made aware of the contentions and Mr Williams' responses to those contentions and the determination of this Panel. Mr Ponting attested to his opinion that Mr Williams' was of good fame and character and to his good professional reputation, in particular his reputation for developing more effective approaches to audit and initiatives for the betterment of the profession. The statement referred to the significant contributions Mr Williams has made to the profession and to CPA Australia. Mr Ponting expressed the view that Mr Williams has a robust reputation for professional scepticism and noted that in audit engagements where they had both been involved, Mr Williams did not accept the reliability of financial statements without objective evidence and noted that he had established a culture of zero tolerance for accounting standard breaches in his practice. Mr Ponting did not state that he had read the Panel's determination in this matter nor did the statement address any matters that provided explanation of or context to the events the subject of these proceedings and the apparent inconsistency between our findings in this matter and Mr Ponting's view about Mr Williams' reputation for robust professional scepticism.
1326. With respect to the other three referees, Mr Lynch submitted that each of them had confirmed that they did not wish to alter their previous statements, although the Board was provided with no further evidence in this regard. The further statements were in a similar vein insofar as their focus was Mr Williams' integrity, his significant professional standing and his contributions to the accounting profession and beyond that did not address or provide context to the matters the subject of our determination.
1327. The first statement was from Mr Paul Cooper, a director of a number of government, not for profit and private company boards and an accountant by profession who is a current Fellow of CPA Australia. Mr Cooper has known Mr Williams in a professional capacity for more than twenty years and said he has no hesitation in attesting to Mr Williams' outstanding career, integrity, competence and professionalism. In his opinion, Mr Williams displays all of the desirable elements of an independent company auditor. He said he has no doubt that Mr Williams is a fit and proper person to be a registered auditor based on the skills Mr Cooper observed first hand when he retained him to undertake a forensic examination in a potential fraud matter in the course of which Mr Williams demonstrated a healthy level of professional scepticism. Mr Cooper also noted Mr Williams' innovative approach to adding expertise when conducting audit engagements in his practice and noted the positions of responsibility Mr Williams has held for CPA Australia.

1328. The next statement was provided by Mr Bryan Adams, who, until March 2000 had been a regional commissioner of ASIC. Mr Adams is a Fellow of the CPA, has been an accountant since July 1984 and over the course of his career was involved with CPA Australia at both a state and national level. Currently he is a director and chairman of compliance committees for several public companies. Mr Adams has also known Mr Williams in a professional capacity for more than twenty years. Mr Williams has been appointed as auditor for several public companies of which Mr Adams was at the time a director and in that context had been involved in assessing his professional skills, qualifications and capability to undertake audit engagements. Mr Adams was impressed by Mr Williams' technical audit capability and his focus on delivering cutting edge systems. He had observed directly his zero tolerance approach to accounting standard breaches and his willingness to qualify audit opinions if necessary. He commented on Mr Williams' extensive knowledge that he has observed in the context of their work with the CPA and referred to unpaid work performed by Mr Williams for the benefit of the profession as a whole of which he was aware. He expressed the view that Mr Williams' overriding commitment is to the delivery of integrity, tenacity and independence in his audit practice.

1329. The fourth statement was provided by Mr Richard John Morrow FCA who has been a chartered accountant since 1978 and has known Mr Williams for over fifteen years. Mr Morrow said he has always found Mr Williams to act professionally and ethically as befits his professional role and has never had any reason to doubt his integrity and honesty.

1330. None of the referees who provided the statements we have summarised were called to give evidence at the hearing. We have commented on the character evidence and the further submissions made in relation to it, in our discussion on appropriate sanction below.

ASIC's submissions on sanction

1331. ASIC in its submissions highlighted a number of what it termed areas of concern with regard to the defences and evidence advanced by Mr Williams in these proceedings and submitted that these concerns should bear upon the Panel's determination of the appropriate sanction to be imposed. Those matters were:

- (a) Mr Williams' defence, maintained until the 9th day of the hearing, that Ms Blank was "Lead Engagement Partner" on the 2012 LM Audit and not him. Mr McNally submitted that Mr Williams persevered with this defence until confronted with documentary evidence proving otherwise in cross-examination and that the refusal to accept culpability, paired with his deficient understanding of the responsibilities of an Engagement Partner in an audit under the relevant auditing standards, showed that Mr Williams was not a fit and proper person to remain registered as an auditor.
- (b) The Limited Purpose/Limited User response was also a matter that demonstrated Mr Williams' inadequate understanding of his duties in connection with performing the 2012 LM Audit.

- (c) Mr Williams consistently relied upon the firm’s audit templates and quality control procedures as demonstrating there had been compliance with the applicable auditing standards although there were numerous instances where the substance of what had been recorded in those templates did not demonstrate or refer to documents or evidence that in fact supported compliance with the relevant auditing standards/requirements.
- (d) The Panel’s finding was that the Forensic file did not form part of the Audit Engagement File and the audit documentation was not prepared so an experienced auditor with no previous connection to the audit would understand ‘what procedures were undertaken and the results of those procedures’ as prescribed by the relevant standard.
- (e) Mr Williams had misunderstood the operation of ASA 560 – which, the Panel had observed in its determination, reflected a quite fundamental misunderstanding of the scope, purpose and meaning of that Standard.

1332. ASIC further submitted that the overarching purpose of a sanction is to protect the public by ensuring those unfit to practice are not allowed to continue to do so and the imposition of a sanction may take into account the potential deterrent effect on other registered auditors resulting from the sanction to be imposed and its concomitant influence on maintaining public confidence in the professional conduct of auditors.³⁵⁵

1333. Those matters canvassed, ASIC submitted that the appropriate course would be for the Panel to cancel Mr Williams’ registration as an auditor and relied on four authorities to support this submission:

- (a) The first was *Davies v Australian Securities Commission*³⁵⁶ wherein Hill J found that a failure to adequately and properly carry out the duties of an auditor under section 1292(1)(d) of the Act will in the ordinary course mean that a person is not fit and proper to remain registered as an auditor.
- (b) The second was *Gould v Companies Auditors and Liquidators Disciplinary Board* in which Lindgren J held that failures under section 1292(2)(d)(ii) of the Act (then in force): ‘...without more, demonstrate that the person is not a fit and proper person to remain registered...’;³⁵⁷
- (c) Third was the Board’s decision in the matter of *Fiorentino*³⁵⁸ in which the Board said at paragraph 1007:

Here, our findings were not expressly under the “fit and proper person” head in s 1292. Nevertheless, findings under the first head of s 1292 will often, if not usually, suggest that the person is not a fit and proper person to remain registered as a liquidator.

³⁵⁵ Determination of the Board, Matter No 03/VIC14 (*Dowsley*).

³⁵⁶ (1995) 131 ALR 295 (“*Davies*”).

³⁵⁷ *Gould v Companies Auditors and Liquidators Disciplinary Board* (2009) 71 ACSR 648, 664 [102].

³⁵⁸ Determination of the Board, Matter No 03/NSW13.

- (d) The fourth was the Board's decision in *Hill*³⁵⁹ at paragraph 176 the CALDB, as it then was, adopted the views of Hill J in *Davies v Australian Securities Commission*³⁶⁰ and also said at paragraphs 202 and 204:

Once a person is found not to be a fit and proper person to remain registered as an auditor, cancellation may be seen as a logical consequence, however it is clear that the discretion under s 1292 is not constrained in its terms and suspension for a period may also be an appropriate sanction having regard to the factors set out in relevant precedents.

And at paragraph 204:

Nevertheless where a finding is made that a person is not a fit and proper person to remain registered, there does need to be some reason why suspension, rather than cancellation, would be the appropriate order.

1334. ASIC submitted on the basis of the above precedent that the appropriate sanction was for Mr Williams' registration as an auditor to be cancelled because the Board's findings with respect to the conduct the subject of this application demonstrate a misunderstanding by him of the operation of the Auditing Standards that goes to the core of an auditor's professional responsibility and those failures show that Mr. Williams fails to meet the second and third limbs of the test of "fitness" in *Hughes v Vale*.

1335. There were supplementary oral submissions made by each party at the hearing which we have considered in the context of our discussion on sanction below.

Appropriate sanction – relevant factors

1336. The function being performed by the Board in exercising powers under section 1292(2) of the Act was described by the Full Court of the Federal Court in *Albarran v Companies Auditors and Liquidators Disciplinary Board* (2006) 233 ALR 37 at page 47 as follows:

The purpose or object of the inquiry undertaken by the board, in exercising the power conferred by s1292(2), is not the ascertainment or enforcement of any legal right, but the determination whether, in the view of the board, taking into account past failures of duties, a defeasible right should continue into the future. No punishment is imposed by reason of any conclusion that duties or functions have not been carried out or performed adequately and properly. Rather, upon being satisfied of past failures of duty, the board is empowered to deal with the continued existence of a statutory right. The question of the adequacy and propriety of the carrying out or performance is to be judged by the board by making an evaluative or subjective determination. Having made that evaluative or subjective determination, the board will consider whether the rights of the registered liquidator as to the future are to be changed by the exercise of the power under s1292(2) in the light of all the considerations before it that are considered relevant.

1337. It is common ground that the principle that guides the Board in the exercise of its sanction powers is protection of the public. In *Re Young and Companies Auditors and Liquidators Disciplinary Board*³⁶¹ the AAT said that the jurisdiction created by section 1292 is of a protective nature and: 'it seems that the protection of the public should be the principal determinant of a proper order but that this may

³⁵⁹ Determination of the Board, Matter No 01/NSW14.

³⁶⁰ (1995) 131 ALR 295.

³⁶¹ (2000) 34 ACSR 425 [80].

be achieved by an order affecting registration of the person in question. In other words, deterrence is an element of public protection.’

1338. Further, in the Board’s decision in *McVeigh*³⁶² it was said that in exercising its powers under sections 1292(1) or (9) of the Act:

- (a) Our prime concern must be protection of the public;
- (b) The protection of the public includes the maintenance of a system under which the public can be confident that the relevant practitioner and all other practitioners will know that breaches of duty will be appropriately dealt with;
- (c) The personal circumstances of the practitioner are to be given limited consideration.

1339. We are cognisant of the statement in *Davies*³⁶³ that a failure to adequately and properly carry out the duties of an auditor under section 1292(1)(d) of the Act will in the ordinary course mean that a person is not fit and proper to remain registered as an auditor. The question for us is whether cancellation is a logical consequence or whether there are relevant matters that provide a basis for exercising the discretion vested in us under section 1292 to impose a different sanction such as suspension for a period, that would also be capable of meeting the objectives we have set out above.

1340. Mr Williams’ counsel made the submission that cancellation or suspension of Mr Williams’ registration by the Board would be punitive, and go against the overarching purpose of our sanctions power. This submission is not consistent with the relevant precedent that a finding under section 1292(1)(d) of the Act will in the ordinary course mean that a person is not fit and proper to remain registered as an auditor nor that the Panel’s prime concern must be protection of the public.

1341. The bases for our finding that Mr Williams failed to perform adequately and properly the duties of an auditor within the meaning of section 1292(1)(d)(i) of the Act are in our view serious and significant in many respects. We do not consider that a reprimand would be an appropriate sanction as it would not reflect the seriousness of our findings nor serve the objective of protecting the public, nor be a deterrent to other registered auditors. We agree with ASIC’s submission that the matters summarised in paragraph 1331 demonstrate Mr Williams’ lack of proper understanding and interpretation of the operation and application of the relevant Auditing Standards when he performed the 2012 LM Audit. Knowledge of these matters and an understanding of how they are to be properly applied in differing contexts in our view fundamentally underpins the duty to ensure the proper performance of an audit to an adequate professional standard as the Engagement Partner.

1342. In order to form our view on an appropriate sanction having regard to the matters discussed in paragraph 1339 and the parties’ submissions, we have considered the following matters:

³⁶² Determination of the Board, Matter No 10/VIC08 at 12.7.

³⁶³ (1995) 131 ALR 295.

- (a) The degree to which our findings call into question Mr Williams' fitness as a registered auditor.
- (b) Whether there are ameliorating circumstances that impact our view on the seriousness and the significance of the conduct the subject of our findings and/or the likelihood of its recurrence in the future.
- (c) Whether there is a basis to be confident that Mr Williams would be fit to resume as a registered auditor following a period of suspension of his registration.

The degree to which our findings call into the question Mr Williams' fitness as a registered auditor

1343. The pre-eminent Australian authority on the concept of “fit and proper” is the High Court’s decision in *Hughes and Vale*.³⁶⁴ The expression is employed as a test for capacity to perform an office or role in widely differing contexts. In *Hughes and Vale* it was said that “Fit” (or “idoneus”) with respect to an office involves three things, honesty, knowledge and ability. Their Honours acknowledged these concepts are flexible and the relevant assessment will depend on the office involved.³⁶⁵

1344. Their Honours in *Hughes and Vale*³⁶⁶ noted that the requisite degree of knowledge and ability to satisfy the test of fitness is informed by the nature of the office concerned. With respect to registered auditors there can be no doubt that a high standard of honesty, knowledge and ability applies. The law entrusts registered auditors with important duties and responsibilities. The proper and adequate discharge of those duties and responsibilities is essential to maintaining the integrity, stability and security of Australia’s financial system as well as public confidence in that system and the auditing profession. The public depends on and is entitled to expect that a high professional standard will be maintained that is both commensurate with the professional standing enjoyed by auditors and properly reflects the importance of their role in our community. It is this context that informs our views about the degree to which our findings call into question Mr Williams’ fitness as a registered auditor.

1345. It was common ground that with respect to the first limb of the test in *Hughes and Vale*³⁶⁷ Mr Williams’ trustworthiness was not in question. ASIC submitted that based on the Panel’s findings Mr Williams did not satisfy the further necessary elements of that test, namely knowledge and ability. ASIC submitted that the Board’s findings, by reason of their sheer scope, reveal that Mr Williams does not have the necessary ability to continue to be a registered auditor.

1346. We agree that the circumstances and the findings that ASIC referred to in its submissions that we have summarised in paragraph 1331 are matters of serious concern that demonstrate a level of knowledge and ability as a registered auditor

³⁶⁴ *Hughes & Vale Pty Ltd v New South Wales [No 2]* (1955) 93 CLR 127.

³⁶⁵ *Ibid* 156.

³⁶⁶ *Ibid*.

³⁶⁷ *Ibid*.

that falls well short of the high standard of fitness to which registered auditors must be held having regard to the significance of their duties and responsibilities.

1347. One submission made on Mr Williams' behalf at the sanctions hearing was that there was a fundamental issue about his responsibility under section 1292(1)(d)(i) for failings identified that were attributable to audit work performed by others because section 1292(1)(d)(i) was directed to the individual responsibility of registered auditors in the performance of their duties. The basis of that submission indicates to us that Mr Williams continues to misunderstand the significance and scope of the responsibility of the Engagement Partner on an audit to ensure that audits are performed properly. This duty is one within the meaning of section 1292(1)(d)(i) of the Act.
1348. A further relevant aspect of our findings is the degree to which they indicate Mr Williams' lack of ability to make proper professional judgements. There is no doubt that recognising the need for and applying appropriate professional scepticism relies on the exercise of proper professional judgement and our findings record numerous instances where that simply did not occur or did not occur to the degree it should have. The fact that the AUASB's explanatory pronouncement on how to apply professional scepticism had just been published amplifies the significance of Mr Williams' oversights in this regard. In the case of a registered auditor, professional judgement is centrally important to demonstrating adequate ability in terms of fitness as it is integral to the proper discharge of so many important aspects of the duties of an auditor. This was not evident in many aspects of Mr Williams' conduct the subject of these proceedings including; his decision to sign an unqualified audit opinion with respect to LM in 2012; his decision with respect to the appropriateness of a Subsequent Maddison Audit; the basis on which he advanced the Limited User/Limited Purpose Response; the inconsistency between the documented terms of his firm's engagement to conduct the audit and what he said in his statement of evidence about the terms that were discussed as the basis for the audit engagement; and his reliance in the proceedings on documentation he identified as audit evidence that was obtained after the audit was completed. These examples demonstrate a capacity for professional judgement that falls well short of the high standard of fitness to which registered auditors must be held having regard to the significance of their duties and responsibilities.
1349. The matters referred to above indicate the pervasiveness of the lack of understanding about what was required by the Auditing Standards that was apparent by what occurred in the 2012 LM Audit and form the basis for our conclusion that the knowledge and ability demonstrated by Mr Williams conduct of the 2012 LM Audit fell well short of the high standard of fitness to which registered auditors must be held having regard to the significance of their duties and responsibilities.

Whether there are ameliorating circumstances that impact our view on the seriousness and the significance of the conduct the subject of our findings and/or the likelihood of its recurrence in the future.

1350. Mr Williams submitted that the issue to which the basis of his approach in this matter is attributable was his view that the scope and purpose of the audit was

limited in the manner outlined in our discussion of the Limited Purpose/Limited User Response.³⁶⁸ In our view this matter does not provide comfort that our findings should be viewed as less serious or unlikely to recur. Our finding was that it was improbable that the 2012 LM Audit Opinion was prepared for the Limited Users and only for the Limited Purpose and even if it had been, that response does not provide a legitimate reason for accepting that there was an appropriate basis for Mr Williams not to have performed the audit to the required professional standard³⁶⁹. The 2012 LM Audit Opinion signed by Mr Williams expressly stated that the 2012 LM Financial Statements complied with the Auditing Standards. We refer to and repeat our final point in our discussion on the Limited User/Limited Purpose response³⁷⁰ which was that the fact that Mr Williams advanced it as an answer to the contentions indicates in our view, having regard to the Relevant Benchmark, that his understanding of the requirements of the relevant auditing standards and how they informed the discharge of his professional responsibilities with respect to the 2012 LM Audit was not adequate. We make the further point that it is another example of a lapse of proper professional judgement on Mr Williams' part. For these reasons we do not regard the Limited User/Limited Purpose Response as evidence of ameliorating circumstances.

1351. Mr Lynch submitted that the conduct the subject of our findings was an atypical isolated incident. The character evidence we have described above, and Mr Williams' professional qualifications and history as a registered auditor weigh in favour of the view that the conduct we are concerned with here was atypical. We are cognisant of Mr Williams' long experience and reputation as a registered auditor, the respect of his professional peers that is evident in their testimonials and the fact that he has not previously been the subject of professional disciplinary action. We accept the character evidence. However, that evidence does not assist the Board with the matter about which it would be necessary for us to be able to form a view before a period of suspension of Mr Williams registration could be considered as an appropriate sanction because it is not evidence that provides a basis for forming a view that we could be confident, following a period of suspension, that Mr Williams would be fit to resume practice as a registered auditor. None of the statements specifically addressed the Board's findings or provided explanation or comfort as to why serious and significant lapses of professional judgement and other failures to perform his duties as an auditor occurred nor why it was logical to conclude they were confined to the 2012 LM Audit or would not otherwise recur.

1352. Mr Lynch further submitted that the conduct was unlikely to be repeated both on the basis of the character evidence tendered and because the proceedings themselves had served to amend any misunderstanding on Mr Williams' part of his professional obligations.

1353. As to the first aspect of this submission, our view is that the character evidence does not provide a basis for concluding that the conduct is unlikely to be repeated because none of those statements addressed the specific matters the subject of

³⁶⁸ See paragraphs 119-134.

³⁶⁹ Ibid.

³⁷⁰ See paragraph 134.

our findings or referred to circumstances at play that explained why the conduct had occurred and why it was unlikely to be repeated. This is particularly relevant given the seriousness and extent of the matters identified in these proceedings that caused us to comment on the pervasiveness of the lack of knowledge and ability evidenced by our findings.

1354. As to the second aspect of this submission, we comment that the way in which this matter was conducted does not support this submission. For example it was submitted at the sanctions hearing that the relative number of hours spent by Mr Williams on the audit compared to the other auditors at his firm who had worked on the matter was relevant to Mr Williams' commensurate responsibility for the failings identified. That submission in our view demonstrates Mr Williams' continuing lack of appreciation and understanding of the important and distinct nature of his role and responsibilities as Engagement Partner in an audit and does not provide us with a basis for confidence that similar conduct would not recur. Similarly our comments in paragraph 1350 on Mr Williams' reliance on the Limited Purpose/Limited User Response as explaining why the audit was performed in the way that it was do not give us confidence that these proceedings have served to amend the lack of knowledge and ability demonstrated by our findings.

1355. We also refer to and repeat our comments in paragraph 1348 which are relevant to the point of whether we could be confident that the conduct would not recur were we to suspend Mr Williams' registration. Those comments address the important matter of what our findings indicate about Mr Williams' capacity for proper professional judgement, a matter that is not easily developed or improved and yet is integral to the proper performance of so many of the duties of a registered auditor. The character evidence does not reveal an explanation as to why Mr Williams' professional judgement was so lacking in so many of the decisions that he made with respect to the 2012 LM Audit.

Is there is a basis for confidence that Mr Williams would be fit to resume as a registered auditor following a period of suspension of his registration?

1356. ASIC submitted that suspension of Mr Williams registration as an auditor would be an appropriate sanction open only if the Panel could be satisfied that after a period of time Mr Williams would be fit to resume practice. We agree that this is the appropriate consideration. In the Board's decision in *Fiorentino*³⁷¹ reference was made to the dictum in *Law Society of New South Wales v McNamara* (1980) 47 NSWLR 72 at [76] ("*McNamara*") where it was stated:

An order for suspension must be based upon a view that at the termination of the period of suspension the practitioner will no longer be unfit to practice because, subject to any limitation imposed on the issue of a practising certificate, his name will then be on the roll of solicitors and he may resume his practice.

1357. ASIC pointed out that there was no evidence before the Panel that would allow us to form such a view with any confidence and that in the absence of such evidence a period of suspension would not be appropriate.

³⁷¹ Determination of the Board, Matter No 03/NSW13, 204 [1006].

1358. We have considered the degree to which our findings call into question Mr Williams' fitness as a registered auditor in paragraphs 1343-1349 and have concluded that Mr Williams conduct the subject of our findings fell well short of the high standard of fitness to which registered auditors must be held having regard to the significance of their duties and responsibilities.
1359. We have considered whether there is evidence of ameliorating factors that explain the conduct that occurred or would give us confidence that it would not recur were the Panel to suspend Mr Williams' registration for a period. We have concluded that to the extent there was evidence (being the character evidence) it did not sufficiently address the matters necessary to provide the Panel with confidence that Mr Williams would be fit to resume practice as a registered auditor at the end of a period of suspension.
1360. Having regard to the nature of our findings, in particular the matters discussed in paragraphs 1346-1355, it is difficult to envisage what additional evidence could have been provided that would have sufficed to address all of the concerns as to Mr Williams' fitness raised by our findings and provided us with the requisite confidence that were we to suspend Mr Williams' registration as an auditor, he would be fit to resume practice at the end of that period of suspension.
1361. Mr Williams did not express contrition with respect to his conduct the subject of our findings and his approach to the sanctions hearing was not consistent with acknowledgement on his part of the seriousness of our findings. In our view these two matters taken together with the evidence advanced on sanction by Mr Williams weigh in favour of a view that cancellation of registration is the most appropriate sanction to be imposed in order to protect the public and deter other registered auditors from engaging in similar conduct.
1362. For those reasons, we have formed the view that the sanction that most appropriately addresses the primary purpose of our sanctions power to protect the public is to cancel Mr Williams' registration as an auditor.
1363. Mr Williams' counsel in his submissions said that Mr Williams voluntarily withdrew from performing audits in March 2017 until the outcome of these proceedings was known. We note that in November 2017 Mr Williams gave a similar undertaking to the Board in an application he made to adjourn the hearing of this matter. Consequently, a period to enable arrangements to be made to handover responsibility for existing matters is not a necessary consideration in this matter and as there were no other relevant submissions with respect to the date on which any sanction should take effect, there is no reason for our sanction order not to take immediate effect.

Order

1364. We order that the registration of Mr Reginald Lance Williams as an auditor be cancelled with immediate effect.

Notice

Within 14 days of the date hereof formal notice of this Decision will be given to Mr Williams under section 1296(1)(a) of the Act, a copy of that notice will be lodged

with ASIC under section 1296(1)(b) and the Board will cause to be published in the Gazette a notice in writing setting out the Decision.

Maria McCrossin
Chairperson
Companies Auditors Disciplinary Board

Glossary

ASA	The Australian Auditing Standards that were operative at the time of the 2012 LM Audit
APES	The Australian Professional Ethical Standards that were operative at the time of the 2012 LM Audit
Regulations	Regulations from time to time under the <i>Corporations Act 2001</i>