IN THE DISTRICT COURT
AT CHRISTCHURCH

CRI-2014-009-003937
CRI-2014-009-004024
[2015] NZDC 2319

FINANCIAL MARKETS AUTHORITY

v

MARK JOSEPH SCHROEDER
JUSTIN WILLIAM PRAIN

Hearing: 20 November 2014

Appearances: D M Robinson for the Informant
P McMenamin for the Defendants

Judgment: 20 February 2015

RESERVED JUDGMENT OF JUDGE E SMITH

The Charges

[1] The Financial Markets Authority ("FMA"), as Informant, have charged Mark Schroeder and Justin Prain ("the defendants") each as directors of Applefields Ltd ("AFL") with failing to deliver financial statements and an auditor's report to the Registrar of Companies ("Registrar") for the years ending 2011, 2012 and 2013 (i.e. each defendant faces three charges) pursuant to the requirements of ss 18 and 38(b) of the Financial Reporting Act 1993 ("FRA").

[2] The defendants do not dispute that they were each under a statutory obligation to deliver to the Registrar the requisite financial statements and auditor's report and accept they did not do so within the statutory timeframes.

[3] The defendants, however, rely on the statutory defence provided by section 40 of the FRA, in that they each assert, for each year, each took all reasonable and proper steps to ensure that those financial statements and auditor's report would be filed. Accordingly each of the defendants has pleaded not guilty to the charges.

Contested Issue

[4] The almost singular contested issue is whether or not the defendants have established the defence (on the balance of probabilities) they took all reasonable and proper steps to ensure a copy of AFL financial statements together with the auditor's report were delivered to the Registrar 20 days after those statements were required to be signed.

Statutory and Policy Framework

[5] The object of the Financial Reporting Act 1993, so far as it is relevant to this prosecution, is an Act that requires "issuers" of securities to the public to file financial statements that comply with generally accepted accounting practice and give a true and fair view of their affairs. This object is of critical importance. This requirement enables investors to receive regular and accurate information of a company's financial position.

[6] The FRA requires the directors of every "**reporting entity**" to ensure that financial statements are completed, (generally) within five months of a particular company's balance date. The statements must be dated and signed on behalf of the Board by two directors, or if the company in question has one director, by that director.

[7] "**Financial statements**" are defined in section 8(1) of the Act which provides relevantly:

> **8 Meaning of "financial statements"**
>
> (1) In this Act, the term financial statements, in relation to an entity and a balance date, means—

(a) A [statement of financial position] for the entity as at the balance date; and

(b) In the case of—

(i) An entity trading for profit, a [statement of financial performance] for the entity in relation to the accounting period ending at the balance date; and

(ii) An entity not trading for profit, an income and expenditure statement for the entity in relation to the accounting period ending at the balance date; and

(iii) An entity that is a building society within the meaning of the Building Societies Act 1965, a revenue and appropriation account for the entity in relation to the accounting period ending at the balance date; and

(c) If, in the case of a reporting entity, an applicable financial reporting standard requires a statement of cash flows for the reporting entity, a statement of cash flows for the reporting entity in relation to the accounting period ending on the balance date,— together with any notes or documents giving information relating to the [statement of financial position], statements, or account.

...

[8] Further the meaning of "**group financial statements**" is provided in s 9 FRA which (relevantly) provides:

9 Meaning of "group financial statements"

(1) In this Act, the term group financial statements, in relation to a group and a balance date, means—

(a) A consolidated [statement of financial position] for the group as at that balance date; and

(b) Where a member of the group trades for profit, a consolidated [statement of financial performance] for the group in relation to the accounting period ending on that balance date; and

(c) Where no member of the group trades for profit, a consolidated income and expenditure statement for the group in relation to the accounting period ending on that balance date; and

(d) If an applicable financial reporting standard requires a consolidated statement of cash flows for the group, a consolidated statement of cash flows for the group in relation to the accounting period ending on that balance date,— together with any notes or documents giving information relating to the [statement of financial position] or statement.

(2) In this Act, the term group financial statements, in relation to a group that comprises a reporting entity that is an overseas company and its subsidiaries, includes, in addition to the financial statements of the group, financial statements referred to in subsection (1) of this section for the group's New Zealand business prepared as if the members of the group were companies formed and registered in New Zealand.

[9] The obligation of the directors of every requisite reporting entity to provide financial statements is found in ss 10 and 13 of the Act which (relevantly) provide:

10 Obligation to prepare financial statements

(1) The directors of every reporting entity must ensure that, within 5 months after the balance date of the entity or, where the entity is required by any other Act to prepare financial statements or accounts within a shorter period after the end of its financial year or balance date, within that period, financial statements that comply with section 11 of this Act are—

(a) Completed in relation to the entity and that balance date; and

(b) Dated and signed on behalf of the directors by 2 directors of the entity, or, if the entity has only 1 director, by that director.

...

13 Obligation to prepare group financial statements

(1) Subject to subsection (2) of this section, the directors of a reporting entity that has, on the balance date of the entity, one or more subsidiaries, must, in addition to complying with section 10 of this Act, ensure that, within 5 months after that balance date or, where the entity is required by any other Act to prepare group financial statements or group accounts within a shorter period after the end of its financial year or balance date, within that period, group financial statements that comply with section 14 of this Act are—

(a) Completed in relation to that group and that balance date; and

(b) Dated and signed on behalf of the directors by 2 directors of the entity, or, if the entity has only 1 director, by that director.

(2) Group financial statements are not required in relation to a reporting entity that is a company [if, on the balance date of the company, the company is not an issuer and the only shareholders of the company] comprise [a reporting entity that is]—

(a) A body corporate that is incorporated in New Zealand or a nominee of such a body corporate; or

(b) A body corporate that is incorporated in New Zealand or a nominee of such a body corporate and a subsidiary of such a body corporate or a nominee of such a subsidiary.

[10] A company is a "**reporting entity**" for the purposes of the FRA if it satisfies any of the three criteria set out in section 2(1) of the Act which provides:

> **reporting entity** means—
>
> (a) an issuer; or
>
> (b) a company, other than an exempt company; or
>
> (c) a person that is required by any Act, other than this Act, to comply with this Act as if it were a reporting entity:

[11] The form and content of a reporting entity's financial statements is not prescribed by the Act. However, certain prerequisite content must feature as prescribed in section 11 of the Act which provides:

> **11 Content of financial statements of reporting entities**
>
> (1) The financial statements of a reporting entity must comply with generally accepted accounting practice.
>
> (2) If, in complying with generally accepted accounting practice, the financial statements do not give a true and fair view of the matters to which they relate, the directors of the reporting entity must add such information and explanations as will give a true and fair view of those matters.
>
> (3) Where the Registrar of Companies notifies a reporting entity that is incorporated or constituted outside New Zealand that the Registrar is satisfied that—
>
> > (a) The financial statements of the reporting entity comply with the requirements of the law in force in the country where the reporting entity is incorporated or constituted; and
> >
> > (b) Those requirements are substantially the same as those of this Act,— those financial statements shall be taken to comply with this section and every applicable financial reporting standard.]

[12] I pause to highlight that it is clear from s 11 that if in complying with the generally accepted accounting practice, the financial statements "*do not give a true and fair view of matters*" to which they relate, there is a clear mandatory onus on the directors of a reporting entity to add such information and explanations as will give a true and fair view of those matters (see s 11(2) FRA).

[13] What constitutes "**generally accepted accounting practice**" to which the financial statements must comply (see s 11(1)) is defined in section 3. That section provides:

> **3 Meaning of "generally accepted accounting practice"**
>
> For the purposes of this Act, financial statements and group financial statements comply with generally accepted accounting practice only if those statements comply with—
>
> (a) Applicable financial reporting standards; and
>
> (b) In relation to matters for which no provision is made in applicable financial reporting standards and that are not subject to any applicable rule of law, accounting policies that—
>
> (i) Are appropriate to the circumstances of the reporting entity; and
>
> (ii) Have authoritative support within the accounting profession in New Zealand.

[14] The directors of a reporting entity that has one or more subsidiaries must, in addition to preparing financial statements for the entity itself under s 11 also ensure the **group financial statements** are prepared in accordance with section 14. Section 14 provides:

> **14 Content of group financial statements**
>
> (1) The financial statements of a group must comply with generally accepted accounting practice.
>
> (2) If, in complying with generally accepted accounting practice, the group financial statements do not give a true and fair view of the matters to which they relate, the directors of the reporting entity must add such information and explanations as will give a true and fair view of those matters.
>
> (3) In any case where a subsidiary became a subsidiary of a reporting entity during the accounting period to which the group financial statements relate, the consolidated [statement of financial performance] or the consolidated income and expenditure statement for the group, must, unless any applicable financial reporting standard otherwise requires, relate to the profit or loss of the subsidiary for each part of that accounting period during which it was such a subsidiary, and not to any other part of that accounting period.
>
> (4) Subject to subsection (3) of this section, where the balance date of a subsidiary of a reporting entity is not the same as that of the reporting entity, the group financial statements must—

(a) If the balance date of the subsidiary does not precede that of the reporting entity by more than 3 months, incorporate the financial statements of the subsidiary for the accounting period ending on that date, or incorporate interim financial statements of the subsidiary completed in respect of a period that is the same as the accounting period of the reporting entity; or

(b)In any other case, incorporate interim financial statements of the subsidiary completed in respect of a period that is the same as the accounting period of the reporting entity.

(5) Where the Registrar of Companies notifies a reporting entity that is incorporated or constituted outside New Zealand that the Registrar is satisfied that—

(a) The group financial statements of the group that comprises the reporting entity and its subsidiaries comply with the law in force in the country where the reporting entity is incorporated or constituted; and

(b) Those requirements are substantially the same as those of this Act,— those financial statements shall be taken to comply with this section and every applicable financial reporting standard.

(6) Subject to subsection (3) of this section, group financial statements must, except where otherwise required by an applicable financial reporting standard, incorporate the financial statements of every subsidiary of the reporting entity.

[15] The term "subsidiary" is defined in section 2(1) which provides:

subsidiary means a subsidiary within the meaning of section 158 of the Companies Act 1955 or sections 5 to 8 of the Companies Act 1993, as the case may be; and includes any company or body corporate or association of persons that is classified as a subsidiary in any applicable financial reporting standard:

[16] The phrase "true and fair view" is not defined in the Act and from time to time it has been suggested its meaning is unclear[1].

[17] The culmination of these requirements on the issuer is the need to then deliver the financial statements and auditor's reports to the Registrar for **registration** of the financial statements. That obligation is contained in section 18 of the Act which provides:

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[1] See in particular commentary in Company and Securities Law in New Zealand 2nd edition, pages 466 to 467.

18 Registration of financial statements by issuers

(1) The directors of an issuer must ensure that, within 20 working days after the financial statements of the issuer and any group financial statements are required to be signed, copies of those statements together with a copy of the auditor's report on those statements are delivered to the Registrar for registration.

...

(2) The issuer must, at the same time, pay to the Registrar the prescribed registration fee.

(3) Any person may, on payment of the prescribed fee (if any), inspect the copies of an issuer's financial statements and auditor's report on those statements delivered to the Registrar under subsection (1).]

The Offence

[18] In this case the Informant argues that the defendants, as directors of AFL for the years 2011, 2012, and 2013, pursuant to section 38(b) of the Act, failed to deliver a copy of the financial statements of that issuer (or group) together with the auditor's report in accordance with section 18(1) of the Act so as to commit an offence liable upon conviction to a fine not exceeding $100,000. Section 38 provides:

38 Offences by directors of issuers

Where—

(a) The financial statements of an issuer and any group financial statements in relation to a group comprising an issuer and its subsidiaries are not audited in accordance with section 15 of this Act; or

(b) A copy of the financial statements of an issuer or group financial statements together with the auditor's report on those statements are not delivered to the Registrar in accordance with [section 18(1),—

every director of the issuer commits an offence and is liable on conviction to a fine not exceeding $100,000.

The defence pursued by the defendants

[19] It is, however, a defence for a director who is charged with a section 38(b) offence that as a director he or she took all reasonable and proper steps to ensure sections 18(1) and 38(b) were complied with. That defence appears in section 40 which provides:

40 Defences

It is a defence to a director of an entity charged with an offence under any of sections 36 to 39 of this Act if the director proves that—

(a) The directors of the entity took all reasonable and proper steps to ensure that the applicable requirement of this Act would be complied with; or

...

[20] For completeness, I set out s 41 of the Act cautioning and prohibiting misleading or false statements.

41 False statements

(1) Every person who, with respect to a document required by this Act,—

(a) Makes, or authorises the making of, a statement in the document that is false or misleading in a material particular knowing the statement to be false or misleading; or

(b) Omits, or authorises the omission, from the document of any matter knowing that the omission makes the document false or misleading in a material particular— commits an offence and is liable on conviction ... to imprisonment for a term not exceeding 5 years or to a fine not exceeding $200,000.

(2) For the purposes of this section, a person who voted in favour of the making of a statement at a meeting of directors or members or shareholders of an entity is deemed to have authorised the making of the statement.

Applicability of statutory framework to this prosecution

[21] The applicability of the above statutory framework (of relevance to this prosecution) would require:

(a) The directors of an issuer must ensure that within five months of balance date (in this case Applefields' balance date was 30 September of each year) financial statements are completed, dated, and signed by two directors (section 10 FRA); and

(b) The directors of an issuer must ensure the financial statements are audited within this prescribed time frame – (section 15 FRA); and

(c) The directors must then ensure that within five months from the balance date and 20 working days the financial statements and the auditor's report are delivered to the Registrar for registration (s 18 FRA) and;

(d) Where the financial statements of an issuer and the auditor's report are not so delivered to the Registrar in accordance with s 18, every director of the issuer commits an offence (s 38(b));

(e) It is a defence for a director charged with an offence under s 38(b) if the director proves (on the balance of probabilities) that:

(i) That director(s) took all proper steps to ensure the applicable requirement would be complied with; or

(ii) He or she took all reasonable steps to ensure that the directors of the entity complied with the requirements; or

(iii) In the circumstances, he or she could not reasonably have been expected to take steps to ensure the directors of an entity complied with a requirement (s 40 FRA).

Agreed Facts

[22] Pursuant to section 9 of the Evidence Act 2006 the Informant and Defendants admit the following agreed facts:

(i) Particulars of Company

(b) Applefields Limited ("AFL") is a limited liability company, incorporated on 25 July 1986;

(c) AFL was listed on the New Zealand Stock Exchange up until 28 January 2010;

(d) AFL's registered address for service is Level 3, 38 Clearwater Avenue, Christchurch;

(e) Justin William Prain was appointed a director of AFL on 26 July 2002 and remains a director at the time of prosecution and was a director for the financial years ending 2011, 2012 and 2013;

(f) Mark Joseph Schroeder was appointed a director of AFL on 3 March 2003 and remains a director at the time of prosecution and was a director for the financial years ending 2011, 2012 and 2013;

(g) George Thomas Carlton Kain was appointed a director on 15 April 2010. Mr Kain passed away on or about 29 December 2013;

(h) As at 6 November 2012 (the date on which the 2012 financial statements were filed) AFL had a total of 1,012 investors with a total share capital of $39,515,000.

(ii) Requirements to deliver financial statements to Registrar for registration

(i) AFL is an "issuer" for the purposes of the Financial Reporting Act 1993 (FRA) as it has allotted securities to the public;

(j) Under the Act, AFL is required to deliver financial statements and an auditor's report to the Registrar within five months and 20 days of the date of the nominated accounting period;

(k) AFL's nominated period is 1 October to 30 September (accounting period);

(l) Therefore for each accounting period AFL is required to deliver financial statements and an auditor's report to the Registrar on or before the twentieth working day of March;

(iii) Late filing of financial statements for the accounting periods 30 September 2009 and 2010.

(m) AFL was late filing statements and auditor's reports for the accounting periods ending 30 September 2009 and 2010 but the FMA is prohibited from laying charges in respect of those accounting periods because there is a three year limitation period.

(iv) The charging documents: late filing of financial statements for the periods ending 30 September 2011, 2012 and 2013.

(n) At the date of prosecution AFL has not delivered financial statements and auditor's reports to the Registrar for the accounting periods ending:

(i) 30 September 2011, i.e. due to be delivered on or before 28 March 2012;

(ii) 30 September 2012, i.e. due to be delivered on or before 28 March 2013;

(iii) 30 September 2013, i.e. due to be delivered on or before 28 March 2014.

Parties Arguments

Relevant Background and Evidence

[23] Much of the witness evidence was unchallenged, particularly their narrative as to how the defendants' failure to provide the financial accounts came about.

[24] AFL was originally incorporated in 1986 to grow and market apples nationally and internationally. In its early years it was a substantial company listed on the New Zealand Stock Exchange. The majority of the shares were held by the

late George Thomas Carlton Kain (known as "Tom") who was the driving force (together with members of his family) behind the company.

[25] Significant setbacks, particularly the regulatory environment, resulted in the company ceasing to trade in growing and marketing apples. However, the company retained significant real estate in and around Christchurch and became involved in land development (with mixed results).

[26] Justin Prain became a director of AFL in 2002, he also became a minority shareholder holding 2.41 per cent of the issued shares of the company. Mr Prain's experience is largely in the management of large scale property development projects.

[27] In 2003 Tom Kain approached Mr Schroeder (who was his friend) to become a director, the company having difficulty finding replacements. Mr Schroeder's evidence was that he agreed partly as an act of friendship, but also because he believed the company had the ability to provide some benefit to its shareholders (despite its much reduced operation from when it once marketed and grew apples).

[28] By the time Mr Schroeder became a director, the company was largely engaged in two areas of activity, each being development of land. The first was known as the Takamatua Development and the second a subdivision development at Yaldhurst Road, Christchurch. The Takamatua subdivision was wound up shortly after Mr Schroeder's appointment as director.

[29] There is a clear need to understand the nature, extent and nuances of the Yaldhurst Road development.

[30] A company, Noble Investments Limited ("NIL") owned significant land at Yaldhurst Road. NIL was controlled by Mr Gordon Stewart (being the sole director and shareholder). Mr Stewart is also a shareholder to approximately 10 per cent in AFL. For complete clarity (and it is critical) AFL never had, and never has had, any shareholding in NIL and accordingly I am satisfied from the evidence AFL had no influence or control over NIL's actions.

[31] NIL devised a wish to subdivide its Yaldhurst Road land holdings. It was intended to be a large scale project with a plan for some 254 sections for residential use, together with a village centre to be created from the site.

[32] Since re-investing (and re-inventing) itself from the growing and marketing of apples to land/property development, AFL had obtained some expertise in managing land developments. NIL therefore, wanting to develop its large scale project of subdivision at Yaldhurst Road, saw considerable efficacy in contracting with AFL to manage that development of the intended Yaldhurst Road subdivision.

[33] Mr Prain, as well as a director and minority shareholder of AFL, was directly contracted/engaged as Development Manager by NIL.

[34] I am satisfied therefore that AFL entered into a contract with NIL, whereby AFL would manage the development of the Yaldhurst Road subdivision. That contract/joint venture provided that if AFL brought the project (i.e. the subdivision of the Yaldhurst Road holdings) to fruition, AFL would earn the right to participate in the profits of the subdivision, after payments to NIL of NIL's capital advances and interests, to the extent of 95 per cent.

[35] For clarity, there was an amendment to the development joint venture agreement between AFL and NIL in 2007 in order to provide for AFL's prior share of 47.5 per cent of the rezoning profits to a higher share of 95 per cent of the development profits in return for the funding partner, being a company Southpac Property Investments Ltd ("Southpac") crystallising its rezoning interest and essentially reverting to a role as funder, earning interest on its investment thereof.

[36] This joint venture/contract as between AFL and NIL has relevant consequences (in terms of this prosecution) for AFL when it came to arranging audits in later years. In particular, and this is the fulcrum of the difficulties the defendants faced in not being able to prepare financial statements, is that the impact of that venture/contract is that in 2009 new accounting rules resulted in the directors eventually considering it likely NIL ought to be considered as a "***deemed subsidiary***"

of AFL and therefore required inclusion of NIL's accounts in the AFL "group accounts" and audit.

[37] It is important to perhaps pause and have an appreciation of the difficulties that AFL began to experience from 2006 onwards to obtain audited accounts. That history (which I set out below at paragraph [38]) also illuminates the efforts both professionally, personally, consistently, and honestly the directors of AFL went to at all times to obtain accounts and particularly auditors for the company, despite what became a string of consistent unwillingness from audit service providers within Christchurch and beyond to undertake these services.

AFL's efforts to obtain auditors 2006-2009

[38] Until 2005 AFL's auditors were Deloittes. Thereafter, as briefly as I can itemise the following audit challenges for AFL ensued:

(i) With Deloittes' departure Mr Schroeder was acquainted with Mr Purvis of Goldsmith Fox and through him secured their services for the preparation of 2006 accounts. They did so but thereafter advised they no longer intended to provide audit services so AFL again had to look for new auditors;

(ii) Extensive inquiries were undertaken by multiple persons within AFL to obtain new auditors, including discussions with Mr MacPherson, an officer of the Ministry of Economic Development who was supervising AFL's compliance with its statutory requirements. AFL was open and honest regarding its predicament in obtaining auditors and asked for assistance in obtaining the same. Mr MacPherson was able to effect an introduction to BDO Spicers in Auckland (the Christchurch office having prior been tried by Mr Schroeder without success) and BDO Spicers completed the audit of the 2007 and 2008 accounts accordingly;

(iii) AFL reappointed BDO Spicers for the 2009 year, but by letter of 27 July 2009 BDO gave notice that it tendered its resignation as auditor. Two reasons were cited. Firstly, that the group (meaning AFL) no longer fitted BDO's Client Risk Profile and secondly, delays in settling their prior audit fee and citing their ability to remain independent. For the defendants' part they explain that BDO Spicers' two reasons for resigning were a direct consequence and a symptom of a major problem the company had struck with the Yaldhurst Road development and contract with NIL. In particular, in 2006 a dispute had arisen with parties, who were both contract participants in the subdivision, and who owned land that adjoined and was to form part of the development. The dispute currently continues and is the subject of appeals and cross-appeals before the Court of Appeal and High Court. In order to protect their alleged claims these persons registered caveats against the whole of the land under development which had the effect of bringing the Yaldhurst subdivision project to somewhat of a halt. The caveats in essence meant it was impossible to raise finance to advance the subdivision and in essence from that point forward AFL had little or no access to monies. These caveats are subject to Court of Appeal proceedings;

(iv) The defendants' evidence was that more seriously, the market knowledge of these caveats brought AFL's viability into question in the market place and the creditworthiness of AFL was brought into doubt. The defendants' views are that this market perception of the company (i.e. vulnerable to failure), would result in an audit certifying the accounts might be called into question and therefore in the directors' view the company may not have been a good proposition to any auditor;

(v) In any event BDO Spicers' fees were eventually met, albeit delayed in payment given the cash flow issues;

(vi) In addition, the directors were of the view that two further factors created major impediments to secure a new auditor (post BDO Spicers Auckland), namely:

(a) The audit report that the company did receive from BDO Spicers Auckland was qualified as the auditor took the view that there was some doubt whether or not AFL was a going concern – the directors taking a different view and insisting it was a going concern; and

(b) The task of securing a new auditor was made immeasurably more difficult by the onset of the global financial crisis in 2008 in that a number of larger accounting firms withdrew from audit activities and those that continued were selective as to who they would accept as clients

(vii) I am satisfied that Mr Babe the company's accountant, made unavailing efforts to have BDO Spicers reconsider its decision.

(viii) The evidence of Mr Schroeder that the directors yet again "scrambled" to obtain auditors (post BDO) is a good characterisation of what happened. Each approached whoever they knew personally or professionally and cast their net relatively wide throughout New Zealand to obtain accountants who were prepared to act as auditors. Their inquiries were relatively extensive and they acted with integrity in their search for auditors;

(ix) It transpires that in or about December 2009 Mr Babe, the company accountant, reported he was able to secure the services of Myers and Co, Chartered Accountants, in Ashburton as auditor. That firm communicated its acceptance of the appointment on 11 September 2009, and AFL immediately appointed them as auditors and the financial statements were delivered accordingly. It is reasonable as at

that time AFL would have been confident that the 2009 accounts would be audited in time for their filing in March 2010;

(x) However, in February 2010 Myers and Co advised that because of review there would be a considerable delay in receipt of the accounts, thereafter AFL (through Mr Babe) applied pressure to the auditors to accelerate their efforts.

(xi) However on 3 April 2010 AFL received an email from Myers and Co as follows:

> "A visit from Practice Review and discussions with potential external quality reviewers (QCR) required for issuers such as Applefields Ltd has made our ability to accept the auditor position untenable".

(xii) Attached was a letter of resignation which stated:

> "Re Applefields Group:
>
> After completing our due diligence process for the above group and company in respect of a proposed audit of the financial statements for the year ending 30 September 2009 we are unable to accept an appointment as group auditors.

(xiii) The directors took the view that through no fault of their own they had been placed in a position where they were unable to deliver audited accounts on time;

(xiv) Yet again inquiries were made to obtain a new auditor. Eventually Michael Rondel of Poulson Higgs expressed a willingness as at 16 June 2010 but by 25 June 2010 as a result of internal audit, Poulson Higgs were of the view that due to the view of the risk management group within Poulson Higgs, Michael Rondel was unable to complete the audit;

(xv) Mr Babe again contacted the Companies Office, who recommended a Hamilton firm but they confirmed they had no experience in

development and subdivision so did not feel competent to complete the audit;

(xvi) It transpires that the company then approached Taurus Group of Christchurch. While unenthusiastic, Mr Wayne Bailey, a partner thereof, was prevailed upon to act as auditors (perhaps because of Mr Schroeder's family connection). In due course Mr Greg Wright, of the Taurus Group, was appointed auditor.

2009 Accounts completed by Taurus

[39] In the course of completing the accounts, Mr Wright, however, in September 2010, raised as an issue the contractual/joint venture relationship between AFL and NIL and the profit share arrangement. He considered NIL ought to be treated as a subsidiary of AFL and therefore as a "deemed subsidiary", and NIL accounts should be incorporated into the group accounts of AFL.

[40] For the defendants' part, they considered this an "insuperable" problem as they were quite unable to obtain the necessary accounts from Mr Gordon Stewart (in essence the sole shareholder and director of NIL) to complete group accounts of AFL incorporating NIL. In fact Mr Gordon Stewart strenuously, on Mr Prain's evidence, resisted the interpretation of NIL being a deemed subsidiary and argued despite AFL's dominant share of (potential) profits in NIL, he and NIL had a duty of care to the financier "Southpac Investments Ltd" which exercised effective control over NIL. That view was communicated to Mr Greg Wright of Taurus who was eventually prepared to accept that interpretation (at least at that time) i.e. NIL was in fact merely an agent of and was controlled by financier Southpac and had no connection to AFL, and the audit requirements for AFL's 2009 accounts were duly filed on **13 October 2010**.

[41] However, the issue of the relationship between NIL and AFL endured as did the discussions as to whether it was to be considered a deemed subsidiary or not.

2010 Accounts

[42] Taurus was reappointed as auditor to do the 2010 accounts. They were naturally interrupted by the February 2011 earthquakes (AFL premises and Taurus were red stickered – since demolished) and a necessity to recreate the AFL accounts followed. Taurus took some time to establish itself and Mr Wright himself underwent a serious illness.

[43] I am satisfied that the Companies Office were prevailed upon and granted an extension to file the 2010 financial statements with the grounds including: lack of staff, resources, client commitments, earthquake disruption and illness.

[44] Irrespective of those challenging circumstances in 2010 to prepare the accounts the same issue arose again concerning whether or not there was a need to incorporate NIL accounts into those of AFL as a result of the contractual relationship between the two companies.

[45] On 16 July 2012 Mr Wright sent the directors an email requesting further information[2]. It is clear that request from Mr Wright included (amongst other things): a request for a copy of the Amended Heads of Agreement for the joint venture for NIL; a copy of the last set of financial statements of NIL; letters from NIL confirming balance due of a debt as at 30 September 2010; copies of some of NIL ledgers: the amount lent to NIL by Southpac Property Limited as at September 2010 and September 2011; interest rate being incurred. Most of this material disclosure sought by Mr Wright was held by Mr Stewart of NIL who continued to refuse to make it available to the directors of AFL. Therefore discussions and negotiations between AFL, Mr Wright as auditor and Mr Stewart delayed matters.

[46] To achieve finalising the 2010 accounts I accept on the evidence it was necessary to create amended documentation to obtain certification from Mr Keenan as AFL's solicitor and alter the status of Mr Prain to provide the degree of separation of the companies (that is NIL and AFL) to bring them in line with the matters argued

[2] See Exhibit I

by Mr Stewart. It was only after this was done was Mr Wright as auditor, prepared to accept Mr Stewart's of NIL interpretation of audit requirements.

[47] Accordingly the 2010 accounts were completed and audited but not filed until 6 November 2012 (requisite extensions having been granted) and the fines for late filing imposed by the Companies Office withdrawn in September 2012.

[48] I have considered the 2010 accounts from AFL that were evidenced (see Exhibit P). In my view the directors' report of Mr Schroeder and Mr Prain of 2 November 2012 at the beginning of those 2010 accounts must be read in its entirety. That directors' report details the difficulties in the filing of the 2010 accounts and particularly alludes to the effect of the earthquakes, indicates the directors are positive about the eventual success of the project with Noble Development but there were a number of uncertainties, but if successful the directors anticipated the project would yield several million to the group but the timing of the yield was uncertain.

[49] A careful reading of the 2010 accounts show, however, the auditor's report by Taurus was a qualified opinion. Also it is to be noted the 2010 accounts are "group" accounts AFL having already some subsidiaries. That qualification (see page 27 of the 2010 accounts) indicate that in the auditor's opinion (as opposed to the directors' opinion) they did not consider the company and group a going concern as it cannot demonstrate the ability to raise sufficient finance to fund its ongoing operation and unable to pay accounts and other liabilities and reliant on the goodwill of the creditors to continue trading. They also emphasise a clause within the agreement with NIL providing Southpac to cancel that agreement if there material breaches and the agreement itself seems to have many variations by formal and informal communications due to change in circumstances and are dependent on the goodwill between the parties involved. The auditors were clear. That is, any expected future benefit accruing to the company from this agreement is therefore reliant on the continuing goodwill of Southpac.

[50] Other than the auditor's disagreement regarding the going concern assumption, Taurus's (as auditors) opinion was that the accounts comply with generally accepted accounting practice in New Zealand, the international financial

reporting standards and gives a true and fair view of the financial position of the group as at 30 September 2010.

Need for 2011 accounts

[51] With the 2010 accounts finally completed and behind them it appears the directors were somewhat hopeful that the 2011 accounts could be completed quickly in that they differed in no material matter from the 2010 accounts. A delay ensued despite frequent enquiries and the company heard nothing until 10 July 2013 when the directors were sent an email from the accountant Mr Babe stating "*Greg from Taurus rang and said there was a new auditor and they wanted to do two years at once. I have heard nothing else.*"

[52] However, by November 2011 the company's accountants John J Clark (Mr Babe) were beginning to indicate a tightening of accounting rules so that they would not likely allow an auditor to exclude NIL as a "deemed subsidiary" and advocated that NIL hand over its accounts so that they could be included in the AFL group accounts and in the audit. Mr Babe's advice in his letter to AFL included:[3]

> ...
>
> *You may recall that there had been discussions with auditors over the years regarding the treatment of Noble Investments Limited. Auditors have asked that Noble be consolidated into the accounts and the directors have resisted because Applefields does not control the shareholding or directors of Noble.*
>
> *Since the 2009 accounts were produced the accounting standards have been revised. The question about whether a company is consolidated now depends on power and returns. Taking the second test first, the question is can the investor receive variable returns from the investee? The first test is, does the investor have the power to affect the level of returns.*
>
> *My reading is that the answer to both questions is Yes. Therefore Noble will need to be consolidated into the Applefields annual accounts.*
>
> *Noble Investments Ltd will therefore require auditing. As well as the cost of the audit this step will also require that some of the issues that have been left to finalise will need to be addressed.*
>
> *Over the years there had been discussions about producing accounts for Noble Investments but I am not aware of any progress. This needs to be*

[3] Letter John J Clark Chartered Accountants to the Directors of Applefields Limited via email dated 28 November 2011 -see Exhibit C.

given some priority to enable the reporting deadlines to be met. This firm has resources to carry out the work if required.

...

[53] It appears, armed with the knowledge of the changing accounting standards alerted by Mr Babe in November 2011, Tom Kain emailed Mr Stewart on 6 December 2011 which said:

Re 2011 Applefields accounts

Gordon, It seems the powers that be that we will not be able to exclude NIL this year. Given that we need to advance the AFL accounts and audit how do we make a start on NIL. Michael Sharpe and Don could economically deal with this.

[54] Mr Stewart responded by email on 14 December 2011 saying:

NIL has now completely run out of money – nothing to pay Gold Band after 1/1 and nothing to pay Cardno apart from the recent GST refunds. I met with Southpac last Thursday and was not able to give them any good news on the title issue and borrowing side, so they have turned off the tap. I think an audit of NIL is a fairly low priority in that environment.

[55] It transpires that Taurus Group, in the course of completing the audit of the 2011 accounts, advised that they were no longer qualified to conduct the audit. This advice came with neither warning or explanation at the time.

[56] Yet again, inquiries by the directors for auditors began, with William Buck Christmas Gouwland ("WBCG") (acceptance letter 30 August 2013) eventually being prevailed upon to provide those services. That firm had hoped to do the two years accounts together. It was a condition of their engagement letter that they would require the financial statements for the year ended 30 September 2011 and all supporting information available.

[57] This matter is critical. The directors formed the view that this "disclosure" request by William Buck Christmas Gouwland included disclosure obligations which, the directors, on the advice they say they had received clearly required the provision of the NIL accounts (as a deemed subsidiary) so they could be consolidated with the AFL group accounts. Mr Schroeder's evidence was that the advice from Mr Babe was that the directors are required to sign the accounts stating

they are complete and that it was his view that the AFL account could not be complete without the inclusion of NIL.

[58] I accept the evidence of both Mr Prain and Mr Schroeder that they pressed Mr Stewart on many occasions to release the information from NIL and even offered to pay for auditing NIL's accounts so that those accounts could be included in the AFL audit. The directors, therefore, tried to devise ways to repair the relationship with Mr Stewart and persuade him to make the NIL accounts available and he has consistently refused to do so.

[59] Much of the defendants' litigation effort focused on demonstrating the difficulties they had in obtaining and retaining auditors. However, it must be remembered the charges cover the period from 28 March 2012 (the date on which the 2011 accounts became due) to 28 March 2014 (the date on which the 2013 accounts became due). I am satisfied throughout that relevant period the defendants had engaged willing auditors: firstly Taurus as at 3 August 2010 until 26 August 2013 – that day Taurus advising the Companies Office they intended to resign as auditor; and secondly WBGC then confirmed they were engaged as auditors on 30 August 2013. There is no evidence that WBCG otherwise than remains engaged or that they have resigned.

[60] Mr Babe gave further advice to Applefields by email of 19 December 2014 (one day prior to this hearing) referring to his letter of 28 November 2011 explaining the changes in the definition of control and accounting standards and pointing out it would be difficult to produce group accounts for Applefields Ltd without audited accounts from NIL.

[61] Mr Babe goes on to say at the end of that email (19 December 2014), (my emphasis added):

> *The directors are required to sign the accounts stating they are complete. I do not think AFL can be complete without the inclusion of Noble,* ***however this decision is ultimately the directors and auditors.***

[62] The defendants suggested they had a dilemma in terms of this prosecution in the sense that they say AFL has two potentially valuable assets set off against what

they judge to be manageable credit, liquidity and market risks. Those assets are the profits which may yet be realised in the Noble Village development and $50,000,000.00 of tax losses spread between AFL and its subsidiary companies which could be carried forward in certain circumstances. The directors are clear that AFL has no liquid assets and cash flow from the potential assets immediately. If it were not for these potential valuable assets Mr Prain's evidence was that the directors would long ago have recommended the company and its subsidiaries be wound up.

[63] The defendants therefore claim that their failure to produce audited accounts in accordance with ss 18 and 38(b) FMA has not arisen from any lack of effort or best endeavours to resolve the matter. Further they do not yet concede that the audits may never be accomplished, on the contrary. They have two plans they think can unlock the present stalemate so that they can provide true and correct records to the auditors. The first is to continue to try and persuade Mr Stewart to allow NIL accounts to be audited and made available. Alternatively, a conceivable way forward as argued by the defendants is for AFL and Southpac to agree that the amendment to the development joint venture agreement concluded in 2007 has been frustrated by the actions of the parties, without apportioning damages. This would enable the former joint venture agreement to receive AFL's 47.5 per cent share in that agreement to continue. In either case, audit of NIL would no longer be an issue and outstanding AFL accounts could be completed. Those discussions are on foot between the parties.

[64] There are other negotiations with a company interested in being absorbed into the AFL group so that they can utilise the group's public company status and benefit from substantial tax losses. This negotiation is subject to the audited accounts.

[65] In essence, the directors assert they are exercising their obligations with care and diligence and they have used and continue to use their utmost endeavours to produce audited accounts.

Arguments

(a) Defendants' arguments

[66] Against the above, in essence the defendants' argument is as follows:

(a) Under the FRA financial statements cannot be registered unless they are audited; and

(b) They cannot be audited unless they are signed; and

(c) They cannot be signed unless they are accurate (s 8 FRA) and in particular they comply with generally accepted accounting standards (s 11 FRA); and

(d) They must comply with applicable financial reporting standards (s 38 FRA); and

(e) All these matters required the consolidation of the NIL accounts into the AFL accounts; and

(f) AFL cannot obtain NIL accounts and therefore cannot take any further steps and the steps they have taken are reasonable.

[67] For completeness, the AFL accounts were group accounts so whereas the defendants argued s 11 contained the statutory requirement to comply with generally accepted accounting practice, in fact for group accounts that obligation is provided (in the exact same terms) in s 14(1) of the FRA.

[68] Paramount to the defendant's arguments that they have taken all reasonable steps, and they could not do anything else more than they have to comply, is the position that they are unprepared to sign the AFL accounts as complete or true and correct without the inclusion of the NIL accounts. To do so, the defendants believe, would be dishonest and are somewhat aghast at it being suggested to them they could take this option given their honestly held belief that NIL accounts should be

included because to do so, they say, such accounts would not qualify as financial statements in terms of the FRA. To do so would not comply with financial reporting requirements, that would not comply with generally accepted accounting practice and the directors would have no right to pass them off as being compliant financial statements which would be the effect of representation made by signing them. In addition, they argue that although the auditors may have been made aware of that discrepancy, the accounts themselves, upon which the public are intended to rely, would misrepresent the financial position of the company and mislead any shareholder, investor or other vested party.

[69] The defendants argue the primary objective of the Act is the preparation and availability of accurate financial statements which fairly disclose the state of the company's finances and the signing of accounts without the NIL accounts being incorporated would subvert that primary objective.

[70] To that end the defendants also emphasised that they took all **reasonable** and **proper** steps. Not only must these steps be reasonable, but they must also be proper.

(b) Informant's Arguments

[71] The Informant argues that the defendants have not established on the balance of probabilities they have taken all reasonable and proper steps to ensure the audited financial statements were filed in the requisite time, arguing alternatively or cumulatively:

(a) It has always been open to the directors to file audited accounts (albeit they may be qualified) but they have made a conscious decision not to; and/or

(b) Either the directors did not have an honest held belief that the NIL accounts had to be included as a subsidiary before signing the same or they made insufficient inquiries to verify the validity and veracity of Mr Babe's opinion that NIL accounts had to be included; and/or

(c) Irrespective of the above, there was nothing to stop the directors completing the accounts absent the NIL accounts, forwarding to the auditors (which in fact they did as at 9/11/2012) but make a statement pursuant to s 11(2) FRA that they believed the accounts incomplete and the reasons why i.e. unable to obtain NIL accounts; and/or

(d) The reason the directors refused to forward the accounts to the auditors with a s 11(2) certificate or statement was that they did not want the likely qualified auditor's opinion that would follow.

[72] Again, for my part insofar as "group accounts" are concerned, the Informant is wrong to rely on s 11(2) but more properly s 14(2) (although those provisions are identical in content).

The Law

[73] Neither the defendants or informants referred the Court to any cases with respect to the applicability of s 40 of the FRA. My own consideration of the law found no prior cases of potential material relevance other than perhaps *Ministry of Economic Development v Fenney*[4] also known as the "Feltex" case. While in that matter s 40 was referred to, the case was somewhat different in that the directors of Feltex were charged under s 36A FRA in relation to the accuracy of Feltex's interim financial statements. That section required the statements comply with any applicable financial reporting standards; the Feltex statements did not. My own consideration of that case suggests that the learned Judge gave weight to s 138 of the Companies Act 1993 and the defence provided in that legislation and imported its tenets in the FRA in allowing directors to honestly rely on information and advice received from their professional advisors and employees. I would not follow or adopt that approach. In my view there are specific, acute statutory defences provided in the Financial Reporting Act 1993 (that is s 40) and not only is there no need, it is improper to import the applicability in any way of a separate statute and that is s 138 of the Companies Act 1993 into the FRA.

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[4] (2010) 10 NZCLC 264, (DC) [Feltex]

[74] In any event, the parties did not raise the applicability of s 138 of the Companies Act 1993 as a defence, so further discussion is unwarranted.

Analysis

[75] I find as a fact that at all material times AFL had available to them auditors (Taurus and then WBCG) who were willing and able to complete the audits.

[76] Further, I find that as at 9 November 2012, it is clear that the draft 2012 accounts had been placed by Mr Babe (on behalf of AFL) into the drop box of Mr Wright, the auditors. At that time Mr Babe said he considered the accounts were right[5]. There is no suggestion by the defendants that as at 9 November 2012 when the draft accounts were given to the auditor (Mr Wright) that NIL accounts had been included (because they had not) or that they were angst or concerned or considered that the NIL accounts had to be included.

[77] There is no evidence as to why the auditor (Mr Wright) did not proceed to complete the audit for the 2011 accounts and certainly the defendants were not stopping them doing so (because of the exclusion of the NIL accounts or any other reason). The evidence of Mr Schroeder[6] that the consensus is now from both the accountant and the auditor that the rules had been amended and that the audit requirements for 2011 were more stringent and it was now essential to incorporate the NIL accounts is, in my view, exaggerated evidence. Mr Schroeder's evidence of the auditor's advice of the essentiality to incorporate the NIL accounts is based on an email from Mr Wright dated 16 July 2012[7].

[78] That email discusses NIL only as follows:

> 5. **Southpack Property Holding Limited (Southpack Property Investments Ltd?)**
>
> As the funds lent to NIL have a material impact on the final results of the development and alleged potential profits for AFL I ask the following:

[5] Exhibit J
[6] See his Brief of Evidence paragraph [47]
[7] See Exhibit I

What is the balance of the amount lent to NIL as at 30 September 2010 and as at 30 September 2011?

What is the interest rate being accrued?

As per above, what is the correct company name or are there two Southpac companies?

Best regards

Greg Wright

[79] Mr Wright's email of 16 July 2012 did not provide advice that the incorporation of the NIL accounts into AFL's accounts was "essential". Mr Wright asked three discrete questions, the answers to which were all within the knowledge of AFL.

(a) Did the defendants have an honest held belief NIL accounts needed to be incorporated as a subsidiary into the AFL accounts?

[80] The Informant argues that the defendants did not have an honest held belief that they needed to incorporate NIL accounts as a deemed subsidiary, or if they did it was not reasonable for them to hold that belief given their lack of further investigation as to the reliability and veracity of that information or opinion of Mr Babe.

[81] I am satisfied that by letter dated 28 November 2011 from the defendants' professional advisor, Mr Babe (accountant with John J. Clark – the company's accountants), the defendants as directors received advice that the NIL accounts needed to be consolidated into the AFL accounts as a deemed subsidiary. It is clear that there had been discussions prior about the propriety of inclusion of the NIL accounts and although the company had reasonably and properly avoided having to incorporate them as a deemed subsidiary prior, that was no longer appropriate from the 2011 accounts.

[82] I consider Mr Babe's advice a genuinely held opinion by him.

[83] Mr Babe's further professional advice was that "the directors are required to sign the accounts stating they are complete"[8].

[84] I am satisfied that Mr Babe's advice that the need to include the NIL accounts as a deemed subsidiary equally applied for the years ending 2012 and 2013.

[85] Mr Babe's evidence, however, was augmented by his late advice to the directors by email of 19 November 2014 (Exhibit R) while reiterating his belief that NIL accounts need to be incorporated because of the applicable accounting standards, he says:

> The directors are required to sign the accounts stating they are complete. I do not think AFL accounts can be complete without the inclusion of Noble, however this decision is ultimately the directors' and auditors.

[86] I reject that the advice provided by Mr Babe was other than honestly held by him and other than properly given to the defendants. The defendants were right to take that advice seriously and consider it. I am further satisfied that both defendants considered the advice from Mr Babe was to be taken seriously and they had an honest held belief regarding its veracity and accuracy.

[87] The Informant argues, however, that it was not reasonable nor proper for the directors to simply rely on the advice of Mr Babe without taking the further step or steps of verifying the veracity and accuracy of that advice with other professionals i.e. lawyers, auditors or other professional opinions.

[88] There is no evidence that prior auditors or AFL's current auditors held the view that was communicated to the directors that the incorporation of the NIL accounts was essential, critical or required.

[89] The limit of the defendants' further inquiries as to the accuracy and propriety of Mr Babe's advice was limited. For Mr Schroeder's part, his evidence was, in terms of obtaining other opinions or advice, limited to his own evidence[9].

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[8] See Exhibit R – Mr Babe's email advice to the defendants of 19 November 2014 (that is one day before the hearing).

[9] See Notes of Evidence page 34 paragraph 30.

Q So you've known since 2006 this was an issue right?

A Our Chairman was a tax lawyer from Wellington. I did rely to some extent on his knowledge and Tom Kain was a lawyer too. I've not, and I'm not an accountant. I do have to rely on other people's judgment on those matters rather than actually investigate or rewrite the law myself.

[90] I accept that the defendants took no meaningful or appreciable steps to obtain any alternative view or confirming opinion or advice from an auditor, accountant or lawyer as to the correctness of Mr Babe's advice. They accepted Mr Babe's advice and since doing so have steadfastly refused to submit the accounts without the inclusion of NIL saying that they cannot submit them as NIL will not provide them to the company.

[91] The question is whether it was reasonable and proper for the directors to test the advice received from Mr Babe? It was certainly open to the directors to obtain whatever other advice they deemed fit and appropriate. I find that they did not and have not and at least at the time of the prosecution do not intend to. It has to be remembered AFL is a company with significant share capital of $39,515,000.00. The directors would have known the last audited accounts (2010) had an opinion by the auditors (not shared by the directors) the company was unlikely a going concern. The directors must have therefore known the critical need for shareholders and investors to be provided with audited accounts and accurate, timely transparency about the company's financial position. That together with the very clear obligations on the directors (as well as possibly facing criminal charges) must have brought home to them the need to inquire further than Mr Babe's advice even if they considered Mr Babe's advice correct. Section 40 FRA uses the verbs "***took*** all reasonable and proper steps" and "to ***ensure***". This precludes passive acceptance of such critical advice without corroboration. There was, in my view, a distinct need for the directors to enquire further.

[92] If the defendants obtained such advice which was contrary to that of Mr Babe, they would simply then be left with contradictory advice and still would have to make a decision as to whether the NIL accounts ought to be included or not. Alternatively further advice may support Mr Babe's conclusions.

[93] Given the seriousness of the position that arose, i.e. the complete failure to file critical accounts for years 2011, 2012 and 2013 I am of the view that it would have been a reasonable and proper step for the directors to make further inquiries of other professionals i.e. other accounting experts and/or auditors or lawyers. However, a determinative view is not required given my findings below.

(b) Should the accounts have been submitted absent the NIL accounts being consolidated?

[94] Given the directors believed NIL accounts to be a deemed subsidiary and consolidated accounts were required, and faced with circumstances where they could not in any way obtain the NIL accounts, were the defendants acting reasonably and properly in taking no further steps? It was always open to them to nevertheless submit AFL's accounts to the auditors for the years 2011, 2012 and 2013 absent the NIL accounts. The defendants argue to do so would be misleading, dishonest and not complying with proper accounting standards or acceptable approaches to their obligations and they say to do so would be tantamount to providing misleading information so they simply could not sign the accounts as correct. I disagree.

[95] In my view, the answer to the directors' predicament in not being able to obtain necessary information they thought they needed in order to complete the accounts, submit them to the auditor, file and register them, was to explain this predicament to the auditor. This very circumstance is anticipated by s 14(2) FRA which provides (my emphasis):

> ...
>
> (2) If, in complying with generally accepted accounting practice, the group financial statements do not give a true and fair view of the matters to which they relate, *the directors of the reporting entity must add such information and explanations as will give a true and fair view of those matters.*
>
> ...

[96] If s 11 is applicable, the exact same position in s 11(2) is available for the entity.

[97] At no time were the directors prohibited from submitting what accounts could be prepared to the auditors with a very clear, precise explanation by them that they held a belief that NIL accounts should be incorporated but they were unable to obtain the same. In reality, I find the directors failed to do that because they assessed that to do so, the auditors may either not complete the accounts or return a qualified audit, a matter that the directors wished to avoid. Whatever their perceived belief about the nature and state of the audit that would be returned, there was nothing to stop the directors taking this **step** (which I have considered reasonable and proper) to submit the accounts with the proper certificate, notation and report that the accounts are accurate in all regards other than in their view the failure to include NIL for the reasons that that information cannot be legally obtained by them.

[98] In particular, I refer to the following exchange between the Court and Mr Prain[10]:

> Q And you believing it is a deemed subsidiary except that the accounts have to be-
>
> A Yeah, I believe it's deemed for the purposes of meeting the FMA requirements a deemed subsidiary.
>
> Q But you cannot get those accounts, so you are saying therefore you have done everything you reasonably can?
>
> A Short of shooting someone, yeah I think we've done and are continuing to do everything we can. Now in my experience on complex matters of this kind, a negotiated commercial solution is always the way forward.
>
> Q But you are saying to me, "Judge look I cannot be liable because a deemed subsidiary will not co-operate with me". That is it, isn't it?
>
> A No, I'm not entirely saying that. I am saying that I can't be liable because I have used every last endeavour I can think of and still am to resolve the problem. I haven't given up on it.
>
> Q But you will not try an avenue that includes signing the accounts without Noble.
>
> A No, because I think that's got a 90% chance of failure when it comes to final audit.
>
> Q Well you will get an audit they would qualify

[10] See Notes of Evidence page 66 lines 9 through to 32 and page 67 lines 1 through to 24.

A No, but then if they do that then I've got to put forward my judgment that they're wrong.

Q That's right.

A As a director, I'm not prepared to do that on the advice of God. I think it is correct –

Q Then do not put forward your advice thereon, it is up to you but you see one of the arguments that you could have just done. The auditors are not going to refuse to do the audit, are they, or is that your evidence?

A They're going to qualify it.

Q That's right, you just do not want a qualified audit, you have already got one.

A No, no they're going to qualify it on a critical matter.

Q Which will affect –

A And it is critical to, you see take away the FMA requirements and now start arguing the commercial reality, are we or are we not in control of that development, can we assert that we're owed the money that the joint venture says we're owed.

Q It seems to me that you can sign, you are choosing not to because you do not want a qualified audit and as a matter of prudence that is a proper thing to do.

A Yes, I don't want, we will get another qualified audit but I don't want it qualified in respect of this matter.

Q I do not think the FMA cares whether you get a qualified audit or not.

CROSS EXAMINATION CONTINUES: MR ROBINSON

Q So that's the point, isn't it, you can actually complete your accounts, can actually file them, you can actually register them, that is true, isn't it?

A Yes

[99] Certainly Mr Prain's evidence was that he could not sign the accounts as "complete" without reference to NIL[11].

[100] While few, if any, companies would want a qualified auditor's report and it is reasonable for them to ensure that did not happen, they cannot omit to submit

[11] See Notes of Evidence Page 67 lines 28 to 31 and page 68 line 1 to 3

accounts to the auditors in order to avoid that happening when they had an obligation to do so.

[101] I am fortified in the view I have come to by the policy considerations of the Act. If the defendants are right in saying that because they cannot obtain information they think is essential for the completion of the accounts they are legitimately acting so that the accounts are not only not submitted for the years 2011, 2012 and 2013, potentially they may not be submitted for many more years to come i.e. as long as NIL do not co-operate in forwarding their accounts or AFL cannot get those NIL accounts or accounting practices and standards change so that NIL would no longer be a deemed subsidiary.

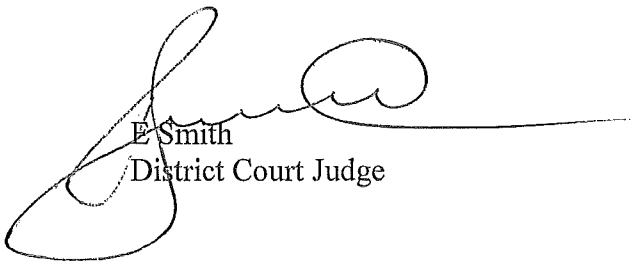
[102] I accept there may well be extenuating, unusual intervening circumstances that might mean a company is quite unable for a period of time to complete accounts. This is not unusual with serious illnesses or deaths of company accountants or directors, fundamental company members or acts of God such as earthquakes where records are lost and need to be created or qualifications to the information provided to the auditors noted by directors under s 14(2) and/or s 11(2). In my view, however, the circumstances as presented to these defendants do not qualify to enable them to not sign the accounts complete as far as they can be complete with the clear qualification as s 14(2) and/or s 11(2) of the FMA provides, that they believe there should be more information (i.e. inclusion of another subsidiary) that they simply cannot obtain, explain why it cannot be obtained and then leave it to the auditors to provide their report (or not - qualified or not) which can then be registered.

[103] It cannot be right in these circumstances for AFL to be a non compliant issuer on an indefinite, ongoing basis. Reporting provisions in the FRA are there to ensure that issuers that cannot comply, cannot continue to be issuers if they cannot meet statutory criteria that are entirely designed to ensure timely and transparent audited accounts from which investors and shareholders are able to be appraised of the exact financial positioning, circumstance and nature of the company in which they have a holding or investment.

[104] For the above reasons, therefore, I find that for the financial reporting years ending 2011, 2012 and 2013 both defendants, on the balance of probabilities, failed to take all reasonable and proper steps to ensure the applicable requirements of the Act were complied with, in failing to submit the accounts to the auditors. There was nothing to prohibit the directors forming the view that those accounts should have NIL accounts consolidated given the honest held belief they were a deemed subsidiary but the fact they had that view, and could not obtain those accounts, did not prevent the forwarding of the accounts to the auditors. I do not accept that the forwarding of the accounts without the NIL consolidated accounts would not have been complying with generally accepted accounting practice or improper in circumstances where it was legislatively open to the directors under s 14(2) or s 11(2) to notify the auditors that the financial statements they provided do not give a true and fair view of matters by adding such information, explanations as would give a fair and true view i.e. that it is their belief the accounts might be incomplete having regard to generally accepted accounting principles absent of the consolidation of NIL.

[105] The fact that the auditors may have refused the audit or returned a qualifying audit was not sufficient to prevent that **step** i.e. submitting the accounts anyway with the qualification under s 14(2) and/or s 11(2) of the Act. In failing to do so, they failed to take a reasonable and proper step.

[106] Accordingly, for the above reasons I find the charges against each of the defendants proven.



E Smith
District Court Judge