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Autonomy made 80% less UK profit than stated, Hewlett-Packard finds

American firm investigated irregularities in accounting at British software company it bought for more than \$10bn

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Cambridge-based software company Autonomy Corporation was bought for more than £10bn by Hewlett-Packard. Photograph: Tim Ireland/PA

Hewlett-Packard's long-running investigation into claims of accounting irregularities by the former management team of Autonomy, the British software company it bought for more than £7.1bn, has concluded that the firm's main UK trading company made 80% less profits and 54% less revenues than originally stated.

Accounts to be published this week at Companies House will show HP has drastically revised the 2010 performance of Autonomy Systems Ltd (ASL), and its holding company Autonomy Corporation Ltd (ACL). HP has been combing through Autonomy's books since May 2012, when it says a whistleblower claimed that false accounting was used to flatter its performance during its period as one of the largest technology companies on the London Stock Exchange.

After buying Autonomy in 2011, HP wrote down the value of the company by £5.5bn in November 2012. The writedown drove the US firm to a \$6.9bn quarterly loss at the time, and led to furious accusations from the British company's founder Mike Lynch that he and his management team were being made "scapegoats for HP's own failings".

"These restatements, and the reasons for them, are consistent with HP's previous disclosures regarding accounting improprieties in Autonomy's pre-acquisition financials," HP said in a statement released on Monday. "The substantial work necessary to prepare these accounts has revealed extensive accounting errors and misrepresentations in the previously issued 2010 audited financial statements, including the exact problems previously identified by HP."

The findings in the UK will have a substantial impact on Autonomy's overall performance for the year before it was sold, because ASL accounted for roughly one third of the company's stated \$870m (£565m) revenues in 2010.

According to the accounts, many of the issues related "to the overstatement of revenues in Autonomy's US operations".

Profit at ASL has been revised down from £106m to £20m. Its revenue number was originally stated as £176m, but is now reported as £81m. The 2010 loss at ACL, the holding company, has been restated from the original £12m to £22m.

A spokesman for Lynch and his former management team said Ernst & Young, the auditor hired by HP, had not signed off Autonomy's restated accounts. In the Companies House filing for ASL, Ernst & Young states: "We have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion."

The former Autonomy management team released a statement saying: "We continue to reject these allegations by HP. Given the size of HP's writedown, we are very surprised by the small size of the adjustments in ASL that are attributed to the ongoing accounting dispute, which represent a few per cent of group revenue. We know even these include revenue that will be recognised at a later time, under HP's new approach."

HP chief executive, Meg Whitman, has vowed to recover the money lost on Autonomy for her shareholders, although doing so could take years. In the meantime, HP and its directors are being sued by shareholders, who claimed they ignored red flags from analysts and industry experts questioning Autonomy's accounts. An update on the case is expected on 28 February.

HP's complaints about Autonomy's financial reporting are being investigated by the US justice department and the UK's Serious Fraud Office. Among the issues HP said it uncovered was: revenue being recognised for products where payments were unlikely to be made by the buyers; barter-type transactions where the value of the sale could not be properly assessed; and sales of hardware wrongly logged as software.

HP found the ownership of a 20% stake in Realise Ltd, an IT consultancy, was recorded as being held by ASL, when it should have been recorded as belonging to its holding company, ACL. HP also corrected sums relating to staff expenses.

A closer look at the debtors and creditors columns shows Autonomy's original accounts claimed the company was owed more by third parties and its own subsidiaries abroad than HP thought it should have been. The original accounts put the amount owed to ASL at £266m, when HP thinks the figure should have been £148m. Amounts owed by other group companies were originally recorded at £216m, but have been revised to £108m.

ASL owed money too. The original accounts put debts at £36m, but HP believes £64m was outstanding in 2010.

Lynch has argued that much of the discrepancy between what Autonomy's annual results suggested the company was worth and what HP now believes it should be valued at stem from applying different accounting rules. HP uses the GAAP system, while Autonomy filed under IFRS, which is more common in the UK.

A spokesperson for Autonomy said many of the errors uncovered in the British subsidiaries would have been regarded as such under both IFRS and GAAP.

However, the accounts show that nearly £14m of the £86m profit reduction at ASL is due to a change of accounting policy. Research and development costs had been recognised across the lifetime of the product they related to under Autonomy's original

accounting system. Under the new GAAP policy, they are fully charged to the year in which the costs were incurred.

HP claimed in 2012 that Lynch's management team, which included finance director Sushovan Hussein, had made a "willful" effort to "inflate the underlying financial metrics of the company in order to mislead potential buyers". The accusation was that Autonomy had mischaracterised revenue from loss-making low-end hardware sales that represented as much as 15% of the company's revenue. HP said Autonomy also presented licensing transactions where no end-customer existed at the time of sale as revenue.

A spokesperson for the former senior management of Autonomy said: "We continue to reject these allegations by HP. Given the size of HP's writedown, we are very surprised by the small size of the adjustments in Autonomy Systems Ltd that are attributed to the ongoing accounting dispute, which represent a few per cent of group revenue. We know even these include revenue that will be recognised at a later time, under HP's new approach."

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