ACL NETHERLANDS BV (as successor to AUTONOMY CORPORATION LIMITED), HEWLETT-PACKARD VISION BV, AUTONOMY SYSTEMS LIMITED and HEWLETT-PACKARD ENTERPRISE NEW JERSEY INC
-v-
MICHAEL RICHARD LYNCH and SUSHOVAN TAREQUE HUSSAIN
Case No. HC-2015-001324

First Expert Report by:
Gervase MacGregor

Report Dated:
29 November 2018

BDO

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GLOSSARY

Amgen	Amgen Inc
ASL	Autonomy Systems Limited, an indirect wholly-owned subsidiary of Autonomy
ATIC	MicroTech's Advanced Technology Innovation Center
Audit Committee	Autonomy's audit committee
Autonomy	ACL Netherlands BV (as successor to Autonomy Corporation Limited, formerly Autonomy Corporation Plc)
Autonomy Acquisition	The purchase of Autonomy by Bidco on 3 October 2011 for a total purchase price of £7.15 billion (approximately US$11.1 billion)
Autonomy Inc	Hewlett-Packard Enterprise New Jersey Inc (formerly Autonomy Inc)
Mr Avant	Donald Leonard Avant, Jr, Autonomy group head of operations from July 2011
Mr Avila	Eloy Avila, Autonomy chief corporate architect/CTO from September 2009 to June 2013
Mr Baiocco	John Francis Baiocco, Capax Discovery managing partner
Mr Baiocco's Witness Statement	Witness statement of Mr Baiocco dated 13 September 2018
Mr Barden	Phil Barden, Deloitte partner
BDO	BDO LLP
Bidco	Hewlett-Packard Vision BV, an indirect wholly-owned subsidiary of HP
Mr Blanchflower	Sean Mark Blanchflower, Autonomy head of R&D
Mr Blanchflower's Witness Statement	Witness statement of Mr Blanchflower dated 14 September 2018
Mr Bloomer	Jonathan William Bloomer, chair of Autonomy's Audit Committee from 2010 until its acquisition by HP
Mr Bloomer's Witness Statement	Witness statement of Mr Bloomer dated 15 November 2018
Mr Brice	Steven Brice of Mazars LLP, engaged on behalf of the US Government in the criminal proceedings brought against Mr Hussain
Capax Discovery	Capax Discovery LLC
CEO	Chief executive officer
CFO	Chief financial officer

Mr Chamberlain	Stephen Chamberlain, Autonomy vice president of finance
Claimants	ACL Netherlands BV, Hewlett-Packard Vision BV, Autonomy Systems Limited and Hewlett-Packard Enterprise New Jersey Inc
Comercializadora	Comercializadora Cobal's S.A De CV
Conceptual Framework	Conceptual Framework for Financial Reporting 2010
Consolidated Financial Statements	Autonomy's consolidated financial statements to 31 December each year
Defendants	Michael Richard Lynch and Sushovan Tareque Hussain
Deloitte	Deloitte LLP, Autonomy's auditor for the years ended 31 December 2003 to 2010
Deloitte's 2009 Guidance	Deloitte iGAAP 2009 – A guide to IFRS reporting
DiscoverTech	Discover Technologies LLC
Mr Egan	Christopher Bradley Egan, Autonomy Inc CEO throughout the Relevant Period
Mr Egan's Witness Statement	Witness statement of Mr Egan dated 13 September 2018
Mr Esterrich	Tomas Esterrich, MicroTech CFO
EY	Ernst and Young LLP
EY's 2008 Guidance	EY International GAAP 2008 – Generally Accepted Accounting Practice under International Financial Reporting Standards
EY's 2009 Guidance	EY International GAAP 2009 – Generally Accepted Accounting Practice under International Financial Reporting Standards
FASB	US Financial Accounting Standards Board
First Defendant	Dr Lynch
First Defendant's Amended Defence	First Defendant's Amended Defence and Counterclaim dated 4 April 2017
Framework	The Framework for the Preparation and Presentation of Financial Statements, superseded by the Conceptual Framework
FRC	Financial Reporting Council
FSA	Financial Services Authority
GAAP	Generally accepted accounting principles
Mr Goodfellow	Christopher James Robin Goodfellow, Autonomy's director of global accounts and chief technology officer of infrastructure throughout the Relevant Period
Mr Goodfellow's Witness Statement	Witness statement of Mr Goodfellow dated 14 September 2018

Mr Greenwood	Phillip Howard Greenwood, Autonomy head of connectors
Ms Gustafsson	Poppy Gustafsson, Autonomy European financial controller/corporate controller during the Relevant Period
Ms Gustafsson's Witness Statement	Witness statement of Ms Gustafsson dated 15 November 2018
Ms Harris	Elizabeth "Lisa" Jane Harris, part of the Autonomy finance team working on costs accounting from April 2005
Hearsay Notice of the Transcript of Proceedings of Mr S Truitt	Claimants' hearsay notice including the Transcript of Proceedings of Mr S Truitt dated 14 September 2018
Mr Humphrey	David Humphrey, chief technology officer of Virage Inc (an Autonomy group company) during the Relevant Period
Mr Humphrey's Witness Statement	Witness statement of Mr Humphrey dated 14 September 2018
HP	Hewlett-Packard Company
Mr Hussain	Sushovan Tareque Hussain, Autonomy CFO throughout the Relevant Period
Mr Hussain's Witness Statement	Witness statement of Mr Hussain dated 13 September 2018
IAS(s)	International Accounting Standard(s)
IAS 1	International Accounting Standard 1 'Presentation of Financial Statements'
IAS 2	International Accounting Standard 2 'Inventories'
IAS 8	International Accounting Standard 8 'Accounting Policies, Changes in Accounting Estimates and Errors'
IAS 18	International Accounting Standard 18 'Revenue'
IAS 34	International Accounting Standard 34 'Interim Financial Reporting'
IASB	The International Accounting Standards Board
IASC	International Accounting Standards Committee
IDOL	Intelligent Data Operating Layer (Autonomy software)
IFRS(s)	International Financial Reporting Standard(s)
IFRS 8	International Financial Reporting Standard 8 'Operating Segments'
IFRS 15	International Financial Reporting Standard 15 'Revenue from Contracts with Customers'
IM Licence FVA	Iron Mountain fair value adjustment
Iron Mountain	Iron Mountain Information Management Inc

Iron Mountain Digital	The digital division of Iron Mountain purchased by Autonomy in June 2011
ISRE 2410	International Standard on Review Engagements 2410
Keker, Van Nest & Peters	Keker, Van Nest & Peters LLP
Mr Knights	Richard Knights, Deloitte audit partner for Autonomy's 2008 and 2009 Consolidated Financial Statements
KPMG	KPMG LLP
KPMG's 2008/9 Guidance	KPMG Insights into IFRS - KPMG's practical guide to International Financial Reporting Standards, Fifth Edition 2008/9
Kraft	Kraft Foods Global, Inc
Mr Lucini	Fernando Lucini Gonzalez-Pardo, Autonomy head of pre-sales and chief architect
Mr Lucini's Witness Statement	Witness statement of Mr Lucini dated 14 September 2018
Dr Lynch	Michael Richard Lynch, Autonomy CEO throughout the Relevant Period
Dr Lynch's First Witness Statement	Witness statement of Dr Lynch dated 14 September 2018
Mr Martin	Alastair James Martin, responsible for Autonomy pre-sales and post-sales divisions in Europe and Asia, and group head of technical and customer operations, EMEA and APAC at the time of the HP acquisition of Autonomy
Mr Mercer	Nigel Mercer, Deloitte audit partner for Autonomy's Q2 2010 interim review and for the remainder of the Relevant Period
MicroTech	MicroTech LLC
Moreover	Moreover Technologies Inc, former data feed supplier to Autonomy
NAA	Deloitte National Accounting and Auditing team
OEM	Original equipment manufacturer
Mr Pao	Frank Pao, CEO of Vidient during the Relevant Period
Mr Pearson	Philip Michael Pearson, responsible for global technology equity investments at GLG Partners
PRISA	PRISA Digital S.L.
PRISA First Amendment	First amendment to an End User Software Licence agreement dated 31 March 2010 between Autonomy Spain S.L. and Ediciones El Pais, S.L., a subsidiary of PRISA Digital S.L.
Mr Puri	Rahul Puri, managing director of innovation and chief software architect at PRISA in the Relevant Period

Mr Puri's Witness Statement	Witness statement of Mr Puri dated 13 September 2018
PwC	PricewaterhouseCoopers LLP
PwC's 2009 Guidance	PwC IFRS manual of accounting 2009 – Global guide to International Financial Reporting Standards
PwC's 2010 Guidance	PwC Manual of accounting IFRS 2010
Q1	January to March
Q2	April to June
Q3	July to September
Q4	October to December
Relevant Period	The period from 1 January 2009 to 30 June 2011
Re-Re-Amended Particulars of Claim	Undated draft Re-Re-Amended Particulars of Claim, submitted on 23 July 2018
Re-Amended Reply	Undated draft Re-Amended-Reply and First Claimant's Defence to the First Defendant's Amended Defence and Counterclaim
Second Defendant	Mr Hussain
Second Defendant's Amended Defence	Second Defendant's Amended Defence dated 4 April 2017
Mr Shelley	Philip John Shelley, co-head of corporate broking at UBS/co-head of combined corporate broking and UK ECM team at Goldman Sachs during the Relevant Period
SOW	Statement of work
SPE	Structured Probabilistic Engine
Spurs	Tottenham Hotspur Plc
Mr Sullivan	Michael Sullivan, Autonomy CEO of Autonomy 'Protect' (the archiving and litigation discovery division of Autonomy)
Mr Sullivan's Witness Statement	Witness statement of Mr Sullivan dated 13 September 2018
Ms Syed	Laila Syed, VMS CFO
Transcript of Proceedings	Transcript of proceedings of the criminal proceedings brought by the United States Department of Justice against the Second Defendant in the United States District Court, Northern District of California
Mr S Truitt	Steven Bradley Truitt, MicroTech's chief operating officer throughout the Relevant Period
UK GAAP	UK generally accepted accounting principles

US GAAP	US generally accepted accounting principles
Vidient	Vidient Systems Inc
Vidient Purchase 1	Purchase of a three year licence to 'SmartCatch' software by Autonomy from Vidient on 1 January 2010
Vidient Purchase 2	Purchase of distribution rights for 'SmartCatch' and 'SmartCatch' analytics software by Autonomy from Vidient on 26 October 2010
Vidient Sale 1	Sale of a software licence from Autonomy to Vidient on 31 December 2009
Vidient Sale 2	Further to Vidient Sale 1, sale of additional functionality and extra licensed software from Autonomy to Vidient on 30 September 2010
VMS	Video Monitoring Services of America, Inc
VMS Data Licence	Three year licence for the provision of data by VMS to Autonomy under the VMS Data Licensing Agreement
VMS Data Licensing Agreement	Data Licensing Agreement between Autonomy and VMS dated 30 June 2009
VMS First Amendment	First Amendment to the VMS Data Licensing Agreement
VMS Purchase 1	Purchase of the VMS Data Licence by Autonomy from VMS on 30 June 2009
VMS Purchase 2	Purchase of data licences under the VMS First Amendment by Autonomy from VMS on 31 December 2010
VMS Sale 1	Sale of a software licence from Autonomy to VMS on 30 June 2009
VMS Sale 2	Sale of a software licence from Autonomy to VMS on 31 December 2010
VMS Sale 3	Sale of hardware from Autonomy to VMS on 31 December 2010
VMS Software Licence Agreement	Software Licence Agreement between Autonomy and VMS dated 31 December 2002
Mr Wang	Roger Wang, Autonomy's vice president of product development for Digital Safe throughout the Relevant Period
Mr Wang's Witness Statement	Witness statement of Mr Wang dated 20 September 2018
Mr Welham	Lee Peter Welham, Deloitte audit senior manager throughout the Relevant Period
Mr Welham's Witness Statement	Witness statement of Mr Welham dated 14 September 2018
Mr Yelland	Christopher Henry Yelland, Autonomy CFO from April 2012 to February 2013
Zantaz	Zantaz Inc, a company acquired by Autonomy in July 2007

1 INTRODUCTION AND TERMS OF REFERENCE

1.1 I am a practising Chartered Accountant having been admitted as an Associate of the Institute of Chartered Accountants in England and Wales in 1986 and a Fellow in 1996.

1.2 I joined a predecessor firm of BDO LLP ("BDO") in September 1982, became a manager in the firm in January 1987 and a partner in January 1991.

1.3 In June 1994, I assumed responsibility as partner in charge of my firm's forensic accounting department offering support to solicitors and others in respect of accountancy aspects of disputes and claims.

1.4 In 2008 I was appointed to BDO's board and was made responsible for all advisory services at BDO, consisting of forensic accounting and valuations, corporate finance and restructuring. I now have board responsibility for risk and regulatory matters at BDO and remain in charge of the forensic services department.

1.5 My principal areas of expertise and experience are share purchase and takeover disputes including providing expert determinations in respect of GAAP and warranty matters, regulatory investigations and business and quantum valuation. I have been appointed as an investigator for the UK accounting and financial reporting regulator, the Financial Reporting Council (FRC), under various forms of its accountancy disciplinary scheme on many occasions, investigating the professional conduct of audit firms and individuals in respect of their audit conduct and compliance with GAAP and ethics. I have also been an investigator for the (then) FSA and a s432 Companies Act Inspector. This work includes investigations into the conduct of the largest accounting and auditing firms. My investigations have led to significant disciplinary actions.

1.6 A large number of my assignments have involved the application of aspects of UK generally accepted accounting principles ("UK GAAP") or International Financial Reporting Standards ("IFRS(s)") and in particular, application at specific points in time.

1.7 I am a practising member of the British Academy of Experts, a member of the Society of Share and Business Valuers, a member of the Association of Certified Fraud Examiners, as well as the Institute of Chartered Accountants in England and Wales's Fraud Advisory Panel.

1.8 My CV is in **Appendix 1**.

1.9 I have been assisted by members of my staff in the preparation of this report. All work in this report has been carried out under my supervision and control and as such, any opinions and views in this report are my own.

Instructions and scope of report

1.10 I have been instructed by Clifford Chance LLP to provide forensic accounting services in connection with the matter of ACL Netherlands BV (successor to Autonomy Corporation Limited) ("Autonomy"), Hewlett-Packard Vision BV ("Bidco"), Autonomy Systems Limited ("ASL") and Hewlett-Packard Enterprise New Jersey Inc (together, the "Claimants") and Michael Richard Lynch ("Dr Lynch" or the "First Defendant") and Sushovan Tareque Hussain ("Mr Hussain" or the "Second Defendant") (together, the "Defendants").

1.11 I am instructed to provide expert evidence in "*Expert Field 1*" in this matter. The Court defines this field as relating to "*the appropriate accounting treatment for the impugned transactions, including as to their presentation in Autonomy's published information*".[1]

1.12 Specifically, I have been instructed on behalf of Dr Lynch to prepare a report providing my analysis of the accounting treatment of certain transactions or types of transactions, and certain disclosures in Autonomy's consolidated financial statements ("Consolidated Financial Statements"), which occurred during the period from 1 January 2009 to 30 June 2011 (the "Relevant Period") and as referred to at paragraph 1.14 below.

1.13 In this action, the Claimants allege in the undated draft Re-Re-Amended Particulars of Claim, submitted on 23 July 2018[2] (the "Re-Re-Amended Particulars of Claim"), that:

> *"Over the period from (at least) the first quarter of 2009 until the second quarter of 2011* … [Dr] *Lynch and* [Mr] *Hussain caused Autonomy group companies to engage in improper transactions and accounting practices that artificially inflated and accelerated Autonomy's reported revenues, understated its costs of goods sold ("**COGS**") (thereby artificially inflating its gross margins), misrepresented its rate of organic growth and the nature and quality of its revenues, and overstated its gross and net profits."*[3]

1.14 The Claimants categorise the alleged *"improper transactions and accounting practices"* as follows:

(a) *"Undisclosed, loss-making hardware sales"*; [4]

(b) *"Improper revenue recognition"*, which includes:

[1] Order of Mr Justice Hildyard dated 14 July 2016, paragraph 17(1).
[2] I have been informed by my instructing solicitors that since 23 July 2018, the Claimants have updated further a draft of the Re-Re-Amended Particulars of Claim, which I am told has not to date been accepted by the Court. For the purposes of this report, I have been instructed to rely on the draft Re-Re-Amended Particulars of Claim provided on 23 July 2018. However, I am aware that I may have to consider any subsequent amended Particulars of Claim at a later date.
[3] Re-Re-Amended Particulars of Claim, paragraph 26.
[4] Re-Re-Amended Particulars of Claim, paragraph 30.1.

(i) "*VAR*[5] *transactions*";

(ii) "*Reciprocal transactions*";

(iii) "*Acceleration of hosting revenue*";[6] and

(c) *"Misrepresented IDOL OEM*[7] *revenue"*.[8]

1.15 I have not been instructed to consider the final category, IDOL OEM revenue, in this report. The representation of IDOL OEM revenue in Autonomy's published information is not an accounting issue and is not covered by IFRS.

1.16 For the avoidance of doubt, I am not instructed to, nor do I provide, any opinions as to the standard of any audit or review work undertaken by Autonomy's auditors throughout the Relevant Period, Deloitte LLP ("Deloitte"). Where I refer to Deloitte's audit and review work, I do so principally for the contemporaneous evidence it provides. Deloitte was, in my view, by virtue of its understanding of the business and access to information, in the best position at the time to determine whether it had obtained sufficient appropriate audit evidence[9] for its purposes, and ultimately to conclude on whether Autonomy's Consolidated Financial Statements were properly prepared in accordance with IFRSs.

1.17 In regard to issues relating to Autonomy's accounting for and/or disclosures of transactions at the time, I was previously instructed by Keker, Van Nest & Peters LLP ("Keker, Van Nest & Peters") to provide forensic accounting services in connection with the matter of the United States and Mr Hussain (Case No. 3:16-cr-00462-CRB), which included attending parts of the trial at the United States District Court, in the Northern District of California, during February to April 2018. I set out further information concerning my instruction in that matter in section 3 below.

1.18 I do not act as accountant or auditor to any of the parties to the claim and except where specified I have carried out no audit or verification work in relation to the information on which I have relied.

1.19 Where I refer to 'Autonomy' in this report, I am referring to the group of Autonomy companies[10], including any Autonomy subsidiary. Although a specific transaction may have

[5] The Claimants define "VAR" as value-added reseller (Re-Re-Amended Particulars of Claim, paragraph 30.2.1.1).
[6] Re-Re-Amended Particulars of Claim, paragraph 30.2.
[7] Original equipment manufacturer.
[8] Re-Re-Amended Particulars of Claim, paragraph 30.3.
[9] As to the auditors' responsibility to obtain sufficient appropriate audit evidence, see for example Lee Peter Welham's witness statement dated 14 September 2018, paragraphs 25 and 54. As to Deloitte's testing designed to obtain sufficient appropriate audit evidence, see for example the witness statement of Poppy Gustafsson ("Ms Gustafsson") dated 15 November 2018 ("Ms Gustafsson's Witness Statement"), paragraph 21.
[10] The parent company of the group of Autonomy companies was Autonomy Corporation Plc, which became Autonomy Corporation Limited after it was acquired by Hewlett-Packard Company.

been carried out by a specific subsidiary of Autonomy, this will also have been accounted for by Autonomy at the consolidated level.

Factual matters and witnesses including Mr Welham of Deloitte

1.20 As will be apparent from my report, many of the accounting matters which form a large part of this dispute and on which I have been asked to opine in this report depend on the application of accounting principles to commercial facts. The application of the revenue recognition rules under international 'generally accepted accounting principles' ("GAAP"), which is pertinent to the majority of the allegations in respect of accounting matters in this case, is often highly fact dependent. In referring to 'GAAP' I note that there may be a wide range, at any given point in time, of generally accepted accounting practices among accountants and that what constitutes accepted practice can change over time, as well as from jurisdiction to jurisdiction. What is relevant therefore is what was accepted, or acceptable, generally at the relevant time in the reporting jurisdiction.

1.21 My overall methodology for dealing with the accounting matters is therefore to look at the facts as they were known at the time, and, in this respect, my most commonly used source of information for this purpose has been the contemporaneous Deloitte audit working papers. These essentially contain, for any individual transaction, the facts, the accounting treatment, an explanation of the accounting treatment and Deloitte's commentary and challenge on the accounting treatment. Deloitte's working papers contain a significant amount of detail on the vast majority, if not all, of these matters.

1.22 Both the Claimants and the Defendants have submitted a number of witness statements, some of which contain evidence which deal with accounting matters. At the time this report is submitted (29 November 2018) further witness statements have been exchanged (on 16 November 2018). These witness statements in large part consist of evidence responsive to prior witness statements.[11]

1.23 While it is not my role as an accounting expert to comment on the facts as stated in a witness statement, in a case where the facts are (or may be) critical to the accounting as applicable at the time, a fact and whether it is disputed or not may be highly relevant to the way in which a transaction can be accounted for.

1.24 In view of the above timings relating to the exchange of reply witness statements, I have not had enough time to deal with all of this information other than to carry out an initial consideration of the statements provided by those witnesses who identified as contemporaneous accountants or those charged with governance at Autonomy as well as

[11] I explain the implications for my report of these further witness statements below at paragraph 1.38.

also by certain other witnesses. Therefore, to the extent that this information has a bearing on my opinions in this report, I will deal with it in my supplemental report.

1.25 In this respect, in my opinion, there is one witness statement in particular that is of relevance, that of Lee Peter Welham ("Mr Welham") of Deloitte[12] dated 14 September 2018 ("Mr Welham's Witness Statement").

1.26 Mr Welham was a senior manager on the Deloitte audit team and reported to the Deloitte audit partners who signed off the relevant audit certificates during the Relevant Period.

1.27 In summary, Mr Welham deals with a number of accounting issues across a large number of transactions impugned in this case. In many cases, based on his own knowledge he also comments on auditing matters.

1.28 However, beyond this, Mr Welham has been asked by the Claimants to make a large number of additional assumptions regarding additional circumstances and/or issues relating to those transactions impugned in this case which, he is asked to further assume, the Claimants will establish as facts.

1.29 Mr Welham then seeks to explain how (now) he believes that Deloitte's accounting treatment judgements reached at the time (and potentially the opinions that Deloitte formed) might have been different in light of the 'assumed facts' by comparison to the information that was contemporaneously obtained by Deloitte. Only in some cases does Mr Welham explain any potential impact on accounting treatment judgements for a particular individual assumption within these overall alternative assumed circumstances or 'facts'.

1.30 I understand that these assumed circumstances and/or issues, insofar as they might or could impact the accounting treatment and/or judgements made at the time relating to the transactions, are disputed by the Defendants, generally individually per transaction, and collectively per transaction.

1.31 I understand that certain of the factual issues arising are the subject of supplemental evidence in witness statements that were exchanged on 16 November 2018, as noted above.

1.32 For the reasons set out above, I do not consider the assumptions made in Mr Welham's Witness Statement in detail or any rebuttal of those assumed factual matters in this report.

1.33 Accordingly, it is possible that my analysis of the accounting treatment applied and disclosures made by Autonomy at the time of these transactions might change depending on my further consideration of points made in factual evidence, including Mr Welham's

[12] Mr Welham is now a partner at Deloitte.

Witness Statement, and what the parties' reply witness statements have to say in relation to factual issues which underlie the assumptions Mr Welham has been asked to make. To the extent that this is the case, I intend to address it in my supplemental report.

1.34 In light of the disputed factual evidence and its potential impact on the accounting treatment, my approach in this report is to highlight the accounting issues from the allegations made by the Claimants, apply them to example transactions, where appropriate, based on earlier fact evidence, but highlight that my opinion may change dependent on particular determinations of fact.

Confidentiality

1.35 This document has been prepared strictly for use in the claim by Dr Lynch. However, I understand that my duty in providing written reports and giving evidence is to help the Court, and that this duty overrides any obligation to the party by whom I am engaged or the person who has paid or is liable to pay me.

1.36 I understand that this document will be made available to the parties, their legal advisers, other parties connected with the action and the Court. In all other respects, this report is confidential and should not be used, reproduced, or circulated for any other purpose, in whole, or in part, without my prior written consent. I will not accept liability to any party other than Dr Lynch.

Legal and factual issues

1.37 This report should not be read as expressing any opinion on factual matters which depend on disputed testimony of the witnesses of fact, or legal issues, although it inevitably reflects my understanding of the position. This is particularly relevant in this case in relation to issues of fact.

1.38 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. For the avoidance of doubt, I have not in this report laid out all of the fact witness evidence, some of which is competing, in undertaking my analysis. This is principally because at the time this report is submitted (29 November 2018) further witness statements have recently been exchanged (on 16 November 2018) that in my opinion are likely to impact any conclusions that I am able to determine in this report at this time. As such, this report contains my current views. While I refer to specific paragraphs within the evidence exchanged on 16 November 2018, as previously stated, my review of that evidence has not, in the limited time

available, been comprehensive. I make those references only for the purposes of illustration of certain facts.[13]

1.39 I consider it probable that eventual determinations of each individual fact could impact in alternative ways any final determination of the permitted, or permissible, accounting treatment for any given transaction in dispute in this case. This, in turn, may impact whether the annual and/or quarterly financial reports and information published by Autonomy contained potentially material errors and/or were properly prepared in accordance with IFRS.

1.40 Even in the event that a particular set of facts is determined in respect of a particular transaction, this would not necessarily result in one specific accounting treatment being the only permitted, or permissible, treatment.

1.41 In general, the application of certain accounting standards, and in particular some past accounting standards, requires or required the use of more discretionary professional accounting judgement and therefore may or could result in two different accountants (neither of whom is wrong) arriving at two different conclusions. In such a scenario, a difference in the conclusions reached would not, or does not, indicate that either of them was necessarily inappropriate but rather that they formed part of a range of possible conclusions, each or all of which might be, or could be appropriate.

Preparation of report

1.42 Any opinions or views expressed in this report are subject to any further information which may be made available to me.

Sources of information

1.43 The sources of information used for the purposes of preparing this report are set out in **Appendix 2**.

Structure of my report

1.44 The structure of the remainder of my report is as follows:

(a) in section 2, I provide a brief background to the current dispute;

(b) in section 3, I set out my involvement as an expert in the criminal proceedings brought against Mr Hussain by the US Government;

[13] My understanding, by reference to the Order of Mr Justice Hildyard dated 24 May 2018, was that this report was due on 14 November 2018, which would have been five days after further witness statements were due to be exchanged between the parties, although I have been informed by my instructing solicitors that both of these deadlines have recently changed at least once.

(c) in section 4, I discuss the accounting standards and related guidance in relation to revenue recognition that I consider to be relevant to this case;

(d) in section 5, I set out what I understand to be Autonomy's accounting policies for the recognition of revenue throughout the Relevant Period;

(e) in section 6, I set out the background to Deloitte's role as auditor of Autonomy in the Relevant Period and an overview of the evidence available from Deloitte;

(f) in section 7, I consider Autonomy's hardware sales during the Relevant Period;

(g) in section 8, I consider the matter of transactions with resellers (referred to by the Claimants as "VARs" or "value-added resellers");

(h) in sections 9, 10 and 11, I discuss four specific examples of such transactions with resellers;

(i) in section 12, I consider matters relating to the alleged reciprocal transactions;

(j) in sections 13 and 14, I discuss two specific examples of such alleged reciprocal transactions;

(k) in section 15, I consider the matter of the alleged acceleration of hosting revenue;

(l) in section 16, I consider the "other" transactions that the Claimants assert resulted in the improper or accelerated revenue recognition by Autonomy;

(m) in section 17, I provide a summary of my conclusions; and

(n) in section 18, I provide my expert's declaration.

2 BACKGROUND

Introduction

2.1 As this matter is in the public domain and the background to the parties and dispute is already covered in the legal submissions, I provide only a brief background here. I express no opinion on any of the factual matters set out in this section.

Overview

2.2 Throughout the Relevant Period Dr Lynch, the First Defendant, was the co-founder and chief executive officer ("CEO") of Autonomy,[14] the first claimant, while Mr Hussain, the Second Defendant, was the chief financial officer ("CFO").[15]

2.3 The witness statement of Dr Lynch dated 14 September 2018 ("Dr Lynch's First Witness Statement") states that the principal business of Autonomy was the sale and supply of software, in particular its Intelligent Data Operating Layer ("IDOL") platform[16], which specialised in the analysis of unstructured data[17].

2.4 Autonomy had a number of subsidiaries including (but not limited to) ASL, being the third claimant, and Hewlett-Packard Enterprise New Jersey Inc (formerly Autonomy Inc) ("Autonomy Inc"), the Autonomy group's main operating company in the USA and the fourth claimant.[18]

2.5 On 3 October 2011, Bidco, the second claimant and a subsidiary of Hewlett-Packard Company ("HP"), acquired Autonomy for approximately £7.15 billion, the equivalent of approximately US$11.1 billion.[19]

2.6 On 20 November 2012, HP issued a press release announcing a write down in the value of Autonomy in its books by US$8.8 billion[20]. HP stated that more than US$5.0 billion of this was linked to *"serious accounting improprieties, misrepresentation and disclosure failures"* on the part of Autonomy.[21]

2.7 In this action, the Claimants allege that Dr Lynch and Mr Hussain caused Autonomy to enter into "*improper transactions and accounting practices*"[22], which ultimately led to the write down by HP described above.

[14] Dr Lynch's First Witness Statement, paragraph 3.
[15] Re-Re-Amended Particulars of Claim, paragraph 22.
[16] Dr Lynch's First Witness Statement, paragraph 12.
[17] Dr Lynch's First Witness Statement, paragraph 46.
[18] Re-Re-Amended Particulars of Claim, paragraphs 7 to 11.
[19] Re-Re-Amended Particulars of Claim, paragraph 6.
[20] {SS0000051}, page 1.
[21] {SS0000051}, page 1.
[22] Re-Re-Amended Particulars of Claim, paragraph 26.

2.8 The Claimants contend that their case is founded on the allegedly improper recognition of revenue and non-disclosure of the nature of reported revenues which gave a misleading impression of Autonomy's performance and growth prospects, and therefore its value.[23] Dr Lynch asserts that, despite the allegations put forward by the Claimants, they have not suggested that there is any cash missing.[24] Accordingly, I do not understand this dispute to be based on the issue of missing cash.

[23] Re-Amended Reply, paragraph 43.
[24] First Defendant's Amended Defence, paragraph 28.1.

3 MY INVOLVEMENT AS AN EXPERT IN CRIMINAL PROCEEDINGS BROUGHT AGAINST MR HUSSAIN

3.1 Mr Hussain is the subject of criminal proceedings brought against him by the US Government (Case No. 3:16-cr-00462-CRB).

3.2 A number of the basic issues in this case, that is the allegations that various transactions entered into by Autonomy were improper and/or accounted for incorrectly, overlap with issues present in the US Government criminal complaint against Mr Hussain.

3.3 I was retained by Keker, Van Nest & Peters to provide a summary of expert accounting opinions in the criminal case.

3.4 During my work I was provided with access to various documents disclosed in the US court proceedings, mainly the electronic audit working papers of Deloitte relating to its annual audits and quarterly and interim (half yearly) reviews of Autonomy. I was also given access to various US Grand Jury transcripts and FBI interview notes of a number of potential witnesses and the documents on which those witnesses were questioned as exhibited to their interview transcripts and/or FBI interview notes.

3.5 I did not have full access to either the defence or US Government prosecution disclosure documents.

3.6 My understanding from Keker, Van Nest & Peters is that all of the documents in the case were under seal by way of Court order unless and until they were referred to in Court or otherwise released by the Court. For the avoidance of doubt, I have not relied on any of the information and documents that remain under seal, other than those that are also in evidence in the current case, for the purposes of preparing this report and in forming my conclusions.

3.7 Mr Hussain was tried at the United States District Court, in the Northern District of California, during February to April 2018. I was asked to attend the examination of a number of the prosecution witnesses. These witnesses were relevant to the accounting issues in the case such as representatives of resellers used by Autonomy, former employees of Autonomy and Deloitte witnesses including Mr Welham.

3.8 I was not called to give oral evidence in the US trial.

3.9 Finally, I have not been retained as an expert on behalf of Mr Hussain in these proceedings nor do I have any ongoing role in the US criminal proceedings.

4 IFRS ACCOUNTING STANDARDS AND GUIDANCE – REVENUE RECOGNITION

Introduction

4.1 In this section of my report I set out, by way of background:

(a) an overview of the key accounting matters, accounting and disclosure standards relevant to this case (paragraphs 4.4 to 4.7);

(b) an overview of IFRS accounting industry guidance produced by the 'Big 4' accounting firms to which I also refer (paragraphs 4.8 to 4.10); and

(c) the background to IFRS and Autonomy's financial reporting requirements, including comparing IFRS with US GAAP and the principles based nature of IFRS (paragraphs 4.11 to 4.21).

4.2 I then set out a detailed review of the sections of International Accounting Standard 18 'Revenue' ("IAS 18") that are relevant to the Claimants' allegations (paragraphs 4.22 to 4.88) as follows:

(a) the overall basis of revenue recognition;

(b) software revenue recognition;

(c) recognition of revenue from the sale of goods;

(d) rendering of services; and

(e) other revenue recognition matters.

4.3 Also in this section I set out some more general matters relevant to the accounting issues in this case:

(a) the need to consider the substance of transactions and other events (paragraphs 4.89 to 4.93);

(b) the concept of materiality (paragraphs 4.94 to 4.98); and

(c) the use of hindsight when amending comparative information for prior periods (paragraphs 4.99 to 4.102).

Overview – key accounting matters, accounting and disclosure standards

4.4 The key accounting matters in this case, in my opinion, are:

(a) the recognition of revenue (which is relevant to the majority of the Claimants' allegations); and

(b) the accounting for, and/or disclosure of hardware sales transactions in Autonomy's Consolidated Financial Statements and the interim financial results.

4.5 I consider that the following accounting and disclosure standards are relevant and hence are referred to by me in this report:

(a) International Accounting Standard 1 'Presentation of Financial Statements' ("IAS 1");

(b) International Accounting Standard 2 'Inventories' ("IAS 2");

(c) International Accounting Standard 8 'Accounting Policies, Changes in Accounting Estimates and Errors' ("IAS 8");

(d) International Accounting Standard 18 'Revenue' ("IAS 18");

(e) International Accounting Standard 34 'Interim Financial Reporting' ("IAS 34"); and

(f) International Financial Reporting Standard 8 'Operating Segments' ("IFRS 8").

4.6 In this section of my report, I deal primarily with revenue recognition, IAS 18 and related industry guidance which I consider is relevant in this case. In doing so I also set out the broad principal views of a range of professional accountants on interpretative issues and the judgemental application of the standards in practice.

4.7 I consider the matter of hardware, and the related accounting and disclosure standards and guidance, in section 7. I deal with the other accounting and disclosure standards listed at paragraph 4.5 as they arise in my report.

IFRS accounting industry guidance from the 'Big 4' accounting firms

4.8 In considering my opinions in this report, because of the nature of the judgement inherent in each and every transaction's recognition and/or measurement, I have also considered guidance on the application of the accounting standards from a number of industry standard practical guides for UK users of IFRS in publication at the relevant time. While such guidance of course does not supersede IFRS and is not mandatory, it is a helpful supplement to the accounting standards and gives a further insight to IFRS for users such as accountancy firms, regulators and a range of preparers of accounts.

4.9 The guidance that I have considered is as follows:

(a) PricewaterhouseCoopers LLP ("PwC") IFRS manual of accounting 2009 – Global guide to International Financial Reporting Standards ("PwC's 2009 Guidance");

(b) PwC Manual of accounting IFRS 2010, where different from the guidance produced in 2009 ("PwC's 2010 Guidance");

(c) KPMG LLP ("KPMG") Insights into IFRS – KPMG's practical guide to International Financial Reporting Standards, Fifth Edition 2008/9 ("KPMG's 2008/9 Guidance");

(d) Deloitte iGAAP 2009 – A guide to IFRS reporting ("Deloitte's 2009 Guidance");

(e) Ernst and Young ("EY") International GAAP 2008 – Generally Accepted Accounting Practice under International Financial Reporting Standards ("EY's 2008 Guidance"); and

(f) EY International GAAP 2009 – Generally Accepted Accounting Practice under International Financial Reporting Standards ("EY's 2009 Guidance"), where different from EY's 2008 Guidance.

4.10 These guides were published on a regular (generally annual) basis, reflecting not only new accounting standards coming into force, but also changing approaches to accounting practices over time. Again, as noted at paragraph 4.16, changing accounting practices over time is a feature of a principles-based financial reporting framework such as IFRS. As a result of this, it is possible to identify a degree of fluidity in accounting practices over time. As a result, in some cases, I have also had regard to accounting manuals published in respect of, for example, 2008.

Background to IFRS and Autonomy's financial reporting requirements

4.11 Autonomy prepared its Consolidated Financial Statements to 31 December each year[25] by reference to IFRSs as applied by the European Union, throughout the Relevant Period. IFRS is a set of principles companies follow when they prepare and publish their financial statements, providing a standardised way of describing the company's financial performance. Companies which are listed on a public stock exchange (as Autonomy was at the time) are legally required to publish their financial reports in accordance with the relevant accounting standards.[26]

4.12 The overall IFRS framework includes a series of accounting standards consisting of International Accounting Standards ("IAS(s)") issued by the International Accounting Standards Committee ("IASC") and newer IFRSs issued by the International Accounting Standards Board ("IASB") (which body has subsequently adopted and in places amended the older IASs). It also includes the Conceptual Framework for Financial Reporting 2010 (the "Conceptual Framework") (which replaced the Framework for the Preparation of and Presentation of Financial Statements (the "Framework") (both documents being

[25] Autonomy's financial quarters corresponded to calendar quarters. I refer to these as "Q1", "Q2", "Q3" and "Q4" as appropriate throughout the remainder of this report.
[26] **Exhibit A -** https://www.ifrs.org/about-us/who-we-are/.

conceptual documents and not accounting standards)). IFRS is intentionally principles-based rather than prescriptive.

4.13 Autonomy was also required to report its interim financial results to 30 June each year in the Relevant Period, and it did so by reference to IAS 34 as adopted by the European Union.[27]

4.14 IAS 34 prescribes the minimum content of an interim financial report and the principles for recognition and measurement in complete or condensed financial statements for an interim period.[28] IAS 34 states:

"*The Standard defines the minimum content of an interim financial report as including condensed financial statements and selected explanatory notes. The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported.*"[29]

4.15 Autonomy also prepared, and voluntarily published, its financial results[30] on a quarterly basis, i.e. for the period January to March (Q1) and July to September (Q3), throughout the Relevant Period. The quarterly results contain a statement that:

"*Whilst the financial information included in this quarterly announcement has been computed in accordance with…IFRSs…and IAS 34…this announcement does not itself contain all of the disclosures required by IFRSs and IAS 34.*"[31] [32]

Principles-based nature of IFRS

4.16 The principles-based nature of IFRS is such that its application is a matter of judgement given particular facts and circumstances. IFRS sets out the basic principles of accounting for transactions rather than specific rules that relate to every situation. Over time, new accounting standards come into force and accounting practices change. Therefore, while accountants will normally agree on the accounting treatment of an item, given the same or similar facts, in other cases, different accountants using their professional judgement can validly form different conclusions when applying IFRS. That is not to say that any one accountant is wrong and the other is right; instead it is a recognised feature of IFRS and other principles-based accounting frameworks that different accounting judgements can

[27] See for example {D003937362}, page 10, note 2.
[28] **Exhibit B** - IAS 34 – Objective.
[29] **Exhibit B** - IAS 34.6.
[30] I note here, paragraph 18 of the witness statement of Philip John Shelley ("Mr Shelley") dated 15 November 2018, which is provided for further context.
[31] For example, Autonomy Q1 2009 Results, page 9, Note 1 {D004256136}.
[32] In Q1 2010 and Q3 2010 interim financial results the reference to IAS 34 is not included {POS00359191} and {POS00359193}.

be reached from the same facts. I consider this to be widely accepted as a matter of form within the IFRS accounting industry. I agree with Mr Welham's statement that:

"*there are always a range of acceptable or reasonable accounting treatments applied in the financial statements depending on the judgements applied under the accounting standards. Accordingly, there will be a number of acceptable presentations in the financial statements which would be considered to represent a 'true and fair view'.*"[33]

4.17 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

IFRS compared with US GAAP

4.18 As noted above, IFRS is a principles-based set of accounting standards. Even within this framework IAS 18, in particular, was then considered by its very nature to be "*one of the few truly principles-based standards in the IFRS literature*"[34]. Conversely, US generally accepted accounting principles ("US GAAP") is, and was, regarded as a more prescriptive, rules based framework.

4.19 As an illustration of this, the length of two respective standards could be easily said to highlight the conceptually different approach to revenue recognition under these two frameworks. By way of example, IAS 18 (which deals with revenue recognition generally) is circa 20 pages long[35] and includes only four references to software transactions contained within the illustrative examples appended to the standard, whereas Statement of Position 97-2 under US GAAP runs to 50 pages, and deals exclusively and only with software revenue recognition under US GAAP requirements.

4.20 It is also relevant to highlight that since the Relevant Period, IAS 18 has been replaced by International Financial Reporting Standard 15 'Revenue from Contracts with Customers' ("IFRS 15") for annual reporting periods beginning on or after 1 January 2018[36]. IFRS 15 sets out that:

"*the previous revenue Standards in IFRS had different principles and were sometimes difficult to understand and apply to transactions other than simple ones. In addition, IFRS had limited guidance on important topics such as revenue recognition for multiple-*

[33] Mr Welham's Witness Statement, paragraph 56 (see also similar statement in Ms Gustafsson's Witness Statement at paragraph 17).
[34] **Exhibit C** - EY's 2008 Guidance, page 2053, paragraph 7.
[35] 20 pages including an 8 page appendix of illustrative examples (**Exhibit F**).
[36] IFRS 15 (September 2015), paragraph IN2 (The full standard of IFRS 15 has not been exhibited to this report, as I do not regard it as relevant).

element arrangements. Consequently, some entities that were applying IFRS referred to parts of US GAAP to develop an appropriate revenue recognition accounting policy".[37]

4.21 IFRS 15 was developed in order to remove the inconsistencies between accounting for revenue under IFRS and US GAAP.[38]

IAS 18 'Revenue'

4.22 IAS 18 prescribes the accounting treatment of revenue arising from the sale of goods, the rendering of services and the use by others of entity assets yielding interest, royalties and dividends.[39]

4.23 The principles-based nature of IAS 18 in particular means that judgement was required in its application. As noted at paragraph 4.16, this could lead different accountants to validly form different conclusions even though they are given the same or similar facts.

4.24 EY considered that there were practical issues with revenue recognition under IAS 18 as:

"*… judgement is required to apply* [the principles] *in practice, with the inevitable result that consistency is not always achieved. Nevertheless, consistency has tended to be achieved over time within specific industries on the basis of principles-based consensuses between the preparer, regulator and auditor communities.*"[40]

4.25 The guidance highlights the requirement to consider the substance of transactions, and not only their legal form, as referred to more generally at paragraphs 4.89 to 4.91. As set out in PwC's 2009 Guidance:

"*Revenue should be recorded based on the substance, not the form, of a transaction. The substance will not only be based on the transaction's visible economic effect; it will also have to be analysed based on all the transaction's contractual terms, or the combination of the contractual terms of linked transactions. Contracts, while inherently form-driven, often provide strong evidence of the intent of the parties involved, as parties to a transaction generally protect their interests through the contract.*"[41]

4.26 Further, PwC's 2009 Guidance sets out that:

"*Understanding a revenue transaction's substance requires more than a high-level knowledge of the business arrangement. It is often a lack of understanding of the details of contracts or of the existence of additional contractual terms, such as side letters or*

[37] **Exhibit D** - IASB *"Basis for conclusions on IFRS 15"* BC2 (b). While this standard was not in effect in the Relevant Period, it refers to the revenue standards in IFRS at the time.
[38] **Exhibit E** – Article from IFRS website: "*IASB and FASB issue converged Standard on revenue recognition*", dated 28 May 2014.
[39] **Exhibit F** - IAS 18.1.
[40] **Exhibit C** - EY's 2008 Guidance, page 2053, paragraph 7.
[41] **Exhibit G** - PwC's 2009 Guidance, page 9006, paragraph 9.30.

oral agreements, that creates difficulties in assessing revenue recognition. Only once the transaction has been properly understood, can the questions of when and how much revenue to recognise be addressed".[42]

4.27 PwC's 2009 Guidance also states:

"*In the majority of situations, the criteria for recognition of revenue will only be met once a signed contract is in place between the vendor and the customer. This is because the contract drives key issues such as measurement of consideration, costs and the probability of economic benefits flowing to the vendor. However, in rare cases it may be possible to recognise revenue before the sales contract has been signed if all key terms and conditions are agreed upon by both parties, for example where a master agreement is in place and criteria in paragraph 14 of IAS 18 have been satisfied. Before recognising revenue in such a situation, the entity should consider the likelihood of the contract being amended before it is signed. If the content of any possible or potential amendments is unknown, it becomes impossible to establish whether the recognition criteria have been met.*"[43]

4.28 It is clear, therefore, that:

(a) the required consideration under IAS 18 has to be based on a fact heavy analysis; and

(b) judgement is required to be exercised in order to recognise revenue under the standard.

4.29 While it is important to consider the substance of a transaction as well as its legal form, the contract terms can drive the accounting treatment and should not be ignored in determining the point at which revenue should be recognised and the measurement of revenue.

Software revenue recognition

4.30 Accounting for revenue generated from the sale of software licences was not specifically addressed under IAS 18. Again, this gives rise to the need for judgement in its application. There is only the following reference to licence fees in the illustrative examples appended to the standard:

"*An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract which permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform is, in substance, a sale. An example is a*

[42] **Exhibit G** - PwC's 2009 Guidance, page 9007, paragraph 9.31.
[43] **Exhibit G** - PwC's 2009 Guidance, page 9008, paragraph 9.38.

licensing agreement for the use of software when the licensor has no obligations subsequent to delivery."[44]

4.31 KPMG's 2008/9 Guidance notes that "*IFRSs do not provide specific guidance on revenue recognition for software-related transactions*"[45] and EY's 2008 Guidance acknowledges that:

"*…applying the general revenue recognition principles to software transactions can sometimes be difficult. The result of this has been that in practice software companies have used a variety of methods to recognise revenue,* ***often producing significantly different financial results for similar transactions***"[46]. [emphasis added]

4.32 EY's 2008 Guidance also highlights that:

"*…this* ***very principled-based approach requires preparers to exercise substantial judgement in practice****, and is unlikely to promote consistency when addressing the complex revenue recognition issues that characterise the software services industry*".[47] [emphasis added]

4.33 PwC's 2009 Guidance notes, though, that the:

"*sale of a standard software package … may be treated differently from software that needs to be customised for each customer. Entities that sell standard off-the-shelf packages generally treat their sales no differently from the sale of a physical product and recognise revenue on delivery*".[48]

4.34 I understand that Autonomy considered its software to be a standard product, in the sense that it did not require material customisation per sale.[49]

Recognition of revenue from the sale of goods under IAS 18

4.35 IAS 18.14 states that revenue from the sale of goods shall be recognised when the following five conditions have been satisfied:

(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;

(b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

[44] **Exhibit F** - Appendix to IAS 18, Illustrative Examples, paragraph 20.
[45] **Exhibit H** - KPMG's 2008/9 Guidance, page 830, paragraph 4.2.520.10.
[46] **Exhibit C** - EY's 2008 Guidance, page 2070, section 7.12.
[47] **Exhibit C -** EY's 2008 Guidance, page 2070, section 7.12.
[48] **Exhibit G** - PwC's 2009 Guidance, page 9028, paragraph 9.99.
[49] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, page 9 and **Exhibit J** - Autonomy's Consolidated Financial Statements 2010, page 13.

(c) the amount of revenue can be measured reliably;

(d) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.[50]

4.36 Below I set out relevant guidance on the practical application of the five criteria which must be satisfied in order to recognise revenue associated with the sale of goods under IAS 18.14.

(a) Transfer of significant risks and rewards of ownership

4.37 The transfer of the significant risks and rewards of ownership of the goods is viewed, consistent with my opinion, as the most crucial of the criteria used to determine the point at which revenue should be recognised on the sale of goods.[51] As noted in EY's 2008 Guidance:

"*The standard assumes that 'in most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer', but acknowledges that this may not always be the case.*"[52]

4.38 IAS 18 provides four examples of situations where an entity may retain (i.e. does not transfer) the significant risks and rewards of ownership as follows:

(a) when the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions;

(b) when the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the buyer from its sale of the goods;

(c) when the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the entity; and

(d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return.[53]

4.39 EY's 2008 Guidance also states:

[50] **Exhibit F** - IAS 18.14.
[51] **Exhibit C** - EY's 2008 Guidance, page 2028, section 3.7.
[52] **Exhibit C** - EY's 2008 Guidance, page 2029, section 3.7.
[53] **Exhibit F** - IAS 18.16.

"*the responsibilities of each party during the period between sale and delivery should be established, possibly by examination of the customer agreements. If the goods have merely to be uplifted by the buyer, and the seller has performed all his associated responsibilities,* ***then the sale may be recognised immediately.***"[54] [emphasis added]

4.40 PwC's 2009 Guidance explains:

"*The transfer of the significant risks and rewards of ownership of goods, usually occurs when legal title or possession is transferred to the buyer…in some circumstances the transfer of the significant risks and rewards of ownership may occur before or after delivery.* ***The timing of the transfer will depend on the contract's specific terms and conditions.***"[55] [emphasis added]

4.41 However, PwC's 2009 Guidance also provides the following examples of potential indicators that the risks and rewards of ownership may not have passed:

(a) the seller retains the risk of physical damage to the product;

(b) the buyer lacks economic substance apart from that provided by the seller;

(c) there is significant doubt as to the buyer's intention or ability to take delivery of goods;

(d) the seller shares in the future revenue of the goods' onward sale; or

(e) the seller has a repurchase option at a fixed price.[56]

4.42 KPMG's 2008/9 Guidance states, "*In evaluating the point at which the risks and rewards of ownership transfer from the seller to the buyer, one of the considerations is the shipment terms*".[57]

(b) Entity retains neither continuing managerial involvement nor effective control

4.43 This condition is, by its nature, linked to the transfer of the significant risks and rewards of ownership referred to above. As Deloitte's 2009 Guidance notes, continuing managerial involvement:

"*… generally goes hand-in-hand with the risks and rewards of ownership…It would be unusual for an entity to retain managerial involvement to the degree usually associated with ownership or to retain effective control over goods without retaining the risks and rewards of ownership.*"[58]

[54] **Exhibit C** - EY's 2008 Guidance, page 2028, section 3.7.
[55] **Exhibit G -** PwC's 2009 Guidance, page 9014, paragraph 9.59.
[56] **Exhibit G** - PwC's 2009 Guidance, page 9016, paragraph 9.63.
[57] **Exhibit H** - KPMG's 2008/9 Guidance, page 813, paragraph 4.2.250.20.
[58] **Exhibit K** - Deloitte's 2009 Guidance, page 1370, paragraph 6.2.

4.44 KPMG's 2008/9 Guidance states, "*When the seller is **required to perform** any significant acts after the transfer, revenue is recognised only as those acts are being performed.*"[59] [60][emphasis added]

4.45 PwC's 2009 Guidance provides five potential indicators of continuing managerial involvement or retention of effective control as follows:

(a) the seller can control the future price of the item;

(b) the seller is responsible for the management of the goods subsequent to the sale;

(c) the terms of the transaction allow the buyer to compel the seller, or give an option to the seller, to repurchase the item at an amount not equal to fair value;

(d) the seller guarantees the return of the buyer's investment or a return on that investment for a significant period; and

(e) the seller has control over the re-sale of the item to third parties (for example, the seller can control the selling price, timing or counterparty of any re-sale transaction or, alternatively, re-sale is entirely prohibited).[61]

4.46 In a number of ways, it is possible to identify a tension between some of these potential indicators and a manufacturer's desire to control any potential exploitation of its own intellectual property. This is, in my experience, a feature of the sale of intangible assets such as software licences.

(c) Reliable measurement of revenue

4.47 In order to be able to recognise revenue from the sale of goods, there must be a reliable measurement of that revenue. IAS 18 provides the following guidance regarding the measurement of revenue:

"Revenue shall be measured at the fair value of the consideration received or receivable."[62]

"Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction."[63]

[59] **Exhibit H** - KPMG's 2008/9 Guidance, page 822, paragraph 4.2.380.10.
[60] In the context of Autonomy, I understand the Defendants' position to be that Autonomy chose to maintain contact with an end-user, subsequent to a sale to a reseller, for commercial reasons; See Dr Lynch's First Witness Statement, paragraphs 268 to 269 and the witness statement of Mr Hussain dated 13 September 2018, paragraph 118(B).
[61] **Exhibit G** - PwC's 2009 Guidance, page 9022, paragraph 9.83.
[62] **Exhibit F** - IAS 18.9.
[63] **Exhibit F** - IAS 18.7.

*"The amount of revenue arising on a transaction is **usually determined by agreement between the entity and the buyer or user of the asset**."*[64] [emphasis added]

"In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable."[65]

4.48 KPMG's 2008/9 Guidance states:

"*Revenue should be reliably measurable in order to be recognised. When revenue depends on the results of uncertain future events, the specific facts and circumstances need to be considered in order to verify whether revenue can be measured reliably*".[66]

4.49 PwC's 2009 Guidance describes the conditions necessary for a reliable estimate of revenue to be made in relation to the rendering of services but considers these conditions, when suitably adapted, are equally relevant for the sale of goods. The guidance sets out that the following should be agreed with the other party:

(a) each party's enforceable rights under the contract;

(b) the consideration payable and receivable; and

(c) the manner and terms of settlement.[67]

(d) Transfer of economic benefits

4.50 In order to recognise revenue, it must be probable that the economic benefits associated with the transaction will flow to the entity making the sale. It may be the case that this is not probable until the consideration is received or an uncertainty is removed.[68] In these cases, revenue may not be recognised until a point in time after the initial sale.

4.51 Under IAS 18 "*probable*" is not defined. IAS 18 was adopted by the IASB in April 2001. By way of analogy, the IASB also adopted IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' ("IAS 37") at the same time, which standard provided, for its own basis, a definition of probable as "*more likely than not*"[69], although explicitly notes that the interpretation of "*probable*" in the standard does not necessarily apply in other standards[70].

4.52 Tests of likelihood under IFRS, therefore, are again areas of professional judgement, to be considered at the time, and in light of the available information. Whether it is probable

[64] **Exhibit F** - IAS 18.10.
[65] **Exhibit F** - IAS 18.11.
[66] **Exhibit H -** KPMG's 2008/9 Guidance, page 807, paragraph 4.2.150.40.
[67] **Exhibit G -** PwC's 2009 Guidance, pages 9008 to 9009, paragraph 9.40.
[68] **Exhibit F** - IAS 18.18.
[69] IAS 37.IN2(b). (IAS 37 has not been exhibited to this report, as I do not regard it as relevant.)
[70] This is stated as a footnote to IAS 37.23.

that economic benefits will flow to the entity is the often referred to test of 'collectability', which by its very nature is an assessment of the likelihood of a future event given only current knowledge and information. The adoption of hindsight into such a test is therefore not appropriate.

4.53 It also follows, then, that where an uncertainty subsequently arises about the collectability of an amount that has previously been recognised as revenue, the amount of revenue is not adjusted, rather the accounting treatment is that the uncollectable amount is recognised as an expense, i.e. bad debt, which affects net profit but not the revenue figure.[71]

(e) The costs incurred can be measured reliably

4.54 IAS 18 states that revenue and expenses relating to the same transaction should be recognised simultaneously, meaning that revenue cannot be recognised if the associated expenses cannot be measured reliably.[72]

4.55 I understand that in this case, there are a small number of "other transactions" that the Claimants dispute on the basis of issues of future costs to deliver the product/services.[73] I consider "other transactions" in section 16 of this report.

Rendering of services under IAS 18

4.56 By comparison to revenue recognition associated with the sale of goods, IAS 18.20 states that when the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the end of the reporting period. The outcome of a transaction can be estimated reliably when the following four conditions are satisfied:

(a) the amount of revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the transaction will flow to the entity;

(c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and

(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.[74]

[71] **Exhibit F** - IAS 18.18.
[72] **Exhibit F** - IAS 18.19.
[73] Re-Re-Amended Particulars of Claim, paragraph 115.2.1.
[74] **Exhibit F** - IAS 18.20.

4.57 Conditions (a), (b) and (d) under IAS 18.20 for the rendering of services are identical to the conditions (c), (d) and (e) under IAS 18.14 required to recognise revenue on the sale of goods, described above in paragraph 4.35. However, IAS 18.20(c), requiring the reliable measurement of the stage of completion of the transaction, is a specific requirement relating to the recognition of revenue from the rendering of services.

Reliable measurement of the stage of completion of the transaction

4.58 IAS 18.21 sets out that under the stage of completion method, revenue is recognised in the accounting periods in which the services are rendered.[75]

4.59 IAS 18.23 sets out that an entity is generally able to make reliable estimates after it has agreed to the following with the other parties to the transaction:

(a) each party's enforceable rights regarding the service to be provided and received by the parties;

(b) the consideration to be exchanged; and

(c) the manner and terms of the settlement.[76]

4.60 As to the period over, or point at which, revenue from the rendering of services should be recognised, IAS 18.25 states:

"*For practical purposes, when services are performed by an indeterminate number of acts over a specified period of time, revenue is recognised on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed.*"[77]

4.61 When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue shall be recognised only to the extent of the expenses recognised that are recoverable.[78]

4.62 PwC's 2009 Guidance states that:

"*Where performance of a single service contract takes place over time, revenue should be recognised as performance takes place. For example, under a maintenance contract*

[75] **Exhibit F** - IAS 18.21.
[76] **Exhibit F** - IAS 18.23.
[77] **Exhibit F** - IAS 18.25.
[78] **Exhibit F** - IAS 18.26.

for six months, revenue should be recognised over the six months, as the service is provided over that period."[79]

4.63 PwC's 2009 Guidance also states:

"*When considering how to account for a service contract, it is essential to understand the contractual terms. By agreeing to the terms in the contract, the buyer specifies at what point the contract has value to them. This will then indicate when the criteria for revenue recognition are met.*"[80]

Other accounting matters

4.64 There are two further accounting matters which I consider are relevant to the revenue recognition criteria and the issues in this case. They are:

(a) first, the treatment of a sale where transactions are potentially linked and there has been an exchange of goods or services; and

(b) second, sales contracts which have multiple elements.

Linked transactions and exchange of goods or services

4.65 As a function of the requirement to be able to reliably measure revenue, the identification of the transaction must be considered carefully where transactions may be linked. This is highlighted in IAS 18.13 as follows:

"*… the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For example, an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together.*"[81]

4.66 However, IAS 18 does not expand upon how linked transactions may be identified. As EY's 2008 Guidance notes:

"*IAS 18 does not establish more detailed criteria for segmenting and combining revenue transactions … transactions have to be analysed in accordance with their economic substance in order to determine whether they should be combined or segmented for revenue recognition purposes.*"[82]

[79] **Exhibit G** - PwC's 2009 Guidance, page 9030, paragraph 9.108.
[80] **Exhibit G** - PwC's 2009 Guidance, page 9030, paragraph 9.109.
[81] **Exhibit F** - IAS 18.13.
[82] **Exhibit C** - EY's 2008 Guidance, page 2073, section 7.12.3.

4.67 KPMG's 2008/9 Guidance explained, "*two or more transactions may be linked so that the individual transactions have no commercial effect on their own. In these cases it is the combined effect of the two transactions together that is accounted for*".[83]

4.68 KPMG'S 2008/9 Guidance also provided the following indicators that transactions could be linked:

(a) the transactions are entered into at the same time or as part of a continuous sequence and in contemplation of one another;

(b) the transactions, in substance, form a single arrangement that achieves or is designed to achieve an overall commercial effect;

(c) one or more of the transactions, considered on its own, does not make commercial sense, but they do when considered together;

(d) the contracts include one or more options or conditional provisions for which there is no genuine commercial possibility that the option(s) or conditional provision(s) will, or alternatively will not, be exercised or fulfilled; and

(e) the occurrence (or non-reversal) of one transaction is dependent on the other transaction(s) occurring.[84]

4.69 If transactions are linked, and the transactions are the exchange of similar goods or services, they should be accounted for by reference to the first sentence of IAS 18.12, which states:

"*When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue.*"[85]

4.70 Deloitte's 2009 Guidance provides an example of a transaction where no revenue is generated when a wholesaler agrees that a retailer may return certain goods in exchange for others.[86]

4.71 However, Deloitte's 2009 Guidance also notes that IAS 18 does not provide any guidance on how to determine whether goods or services are of a similar nature.[87] Accordingly, in my opinion, this is an area of judgement to be exercised having regard to all the circumstances. If it is determined that the goods or services are dissimilar, the transactions

[83] **Exhibit H** - KPMG's 2008/9 Guidance, page 801, paragraph 4.2.100.10.
[84] **Exhibit H** - KPMG's 2008/9 Guidance, page 801, paragraph 4.2.100.20.
[85] **Exhibit F** - IAS 18.12.
[86] **Exhibit K** - Deloitte's 2009 Guidance, page 1346, paragraph 4.3.
[87] **Exhibit K** - Deloitte's 2009 Guidance, page 1347, paragraph 4.3.

should be regarded as those which generate revenue as set out in the last three sentences of IAS 18.12:

"When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred."[88]

4.72 The measure of fair value is described at paragraph 4.47 above.

4.73 I note that Phil Barden ("Mr Barden") is listed as the team leader of the principal authors of Deloitte's 2009 Guidance. Mr Barden was also a member of Deloitte's National Accounting and Auditing ("NAA") team[89] during the Relevant Period and was consulted on some specific technical accounting issues by the Deloitte audit team when carrying out its audits and reviews of Autonomy, as referred to later in this report.

4.74 Mr Barden's view on transactions involving the exchange of goods or services is set out in an email to the audit team as follows:

"*Even in a barter transaction, revenue will be recognised at fair value unless the items exchanged are 'similar'. If we are happy that each sale could each have taken place without the other, and that the items exchanged are not 'similar', then I would expect revenue to be recognised at fair value."*[90]

4.75 PwC's 2009 Guidance describes "*two-way trading transactions*" which arise "*where an entity sells a product to another entity and that other entity sells a different product to the first entity*".[91]

4.76 In respect of such a scenario, PwC provides guidance on the treatment of such transactions where cash is paid from entity A to entity B and is related to a transaction where entity B has to pay cash to entity A. PwC provides the following factors which should be considered which might lead to a net presentation of the transactions, being:

(a) The arrangements are entered into in close proximity to each other and/or their mutual existence is acknowledged in the separate agreements;

[88] **Exhibit F** - IAS 18.12.
[89] The NAA team was Deloitte's technical accounting department.
[90] {DEL1_002_1_00000071}.
[91] **Exhibit G** - PwC's 2009 Guidance, page 9042, paragraph 9.143.

(b) Lack of sufficient evidence to support the assertion that the amount being charged for the product or service in each transaction is its fair value; and

(c) The party to the transactions that receives the greater amount of cash inflows does not have a clear immediate business need for the product or service it is purchasing.[92]

4.77 Again, however, these are all issues to be considered in the individual circumstances of each transaction, and secondly, all areas where professional accounting judgement can differ, dependent on the individual view taken of each element of such a transaction or series of transactions.

Transactions involving multiple elements

4.78 IAS 18.13 provides the following guidance in relation to accounting for transactions which involve multiple elements:

"*The recognition criteria in this Standard are usually applied separately to each transaction. However,* ***in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction****. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed.*"[93] [emphasis added]

4.79 Again, IAS 18 does not expand upon how such components should be identified and I refer again to EY's 2008 Guidance at paragraph 4.66.

4.80 EY's 2009 Guidance also notes that, "*in particular* [IAS 18] *contains little guidance on the allocation of revenue to* [separate] *elements*".[94]

4.81 EY's 2009 Guidance refers to a method for allocating revenue to separate components of a software contract (by reference to the principles of Statement of Position 97-2 under US GAAP):

"*if there is VSOE* [vendor-specific objective evidence] *for the fair values of the undelivered elements in an arrangement, but not for one or more of the delivered elements in the arrangement, that fee can be recognised using the 'residual method'. This means deducting the values for which there is* [vendor-specific objective evidence]

[92] **Exhibit G** - PwC's 2009 Guidance, page 9044, paragraph 9.147.
[93] **Exhibit F** - IAS 18.13.
[94] **Exhibit L** - EY's 2009 Guidance, page 1610, section 6.6.2.

from the total revenue and treating the remaining balance as the share of revenue for the element for which there is no [vendor-specific objective evidence]."[95]

4.82 However, EY's 2009 Guidance also acknowledges, "*it is not necessary under IFRS to demonstrate* [vendor-specific objective evidence] *in order to allocate revenue on the basis of fair value of individual components*".[96]

4.83 KPMG's 2008/9 Guidance similarly notes that, "*IAS 18 provides only limited guidance on the identification of separately identifiable components*". It also provides further guidance on allocating revenue to each component of a multiple element transaction, suggesting two methods:

(a) the relative fair value method: "*the portion of the total consideration received or receivable to be allocated to the different components is determined by the ratio of the fair values of the components relative to each other*"; and

(b) the expected cost method: "*based on the expected costs to be incurred, together with a reasonable profit for each component, which might be reflected in the fair value of each component. As a result, allocation of the amount of revenue normally will not result in a loss for a component.*"[97]

4.84 Deloitte's 2009 Guidance separately notes that:

"*Failure to deliver one item or to perform one service specified by a sales arrangement does not necessarily preclude the immediate recognition of any revenue for that sales arrangement. IAS 18.13 notes that the revenue recognition criteria should be applied to the separately identifiable components of a single transaction.*"[98]

4.85 PwC's 2009 Guidance states that:

"*In assessing the transaction's substance,* ***the transaction should be viewed from the perspective of the customer and not the seller; that is, what does the customer believe they are purchasing?*** *If the customer views the purchase as one product, then it is likely that the recognition criteria should be applied to the transaction as a whole. Conversely, if the customer perceives there to be a number of elements to the transaction, then the revenue recognition criteria should be applied to each element separately.*"[99] [emphasis added]

[95] **Exhibit L** - EY's 2009 Guidance, page 1610, section 6.6.2.
[96] **Exhibit L** - EY's 2009 Guidance, page 1611, section 6.6.2.
[97] **Exhibit H** - KPMG's 2008/9 Guidance, page 800, paragraphs 4.2.90.32 to 4.2.90.36.
[98] **Exhibit K** - Deloitte's 2009 Guidance, page 1350, paragraph 5.1.
[99] **Exhibit G** - PwC's 2009 Guidance, page 9037, paragraph 9.132.

4.86 PwC's 2009 Guidance also notes that:

"If the vendor sells the different components separately (or has done so in the past), this is a strong indicator that separation is necessary for the purposes of revenue recognition: however, it is not a requirement. For example, even if the entity in question does not sell them separately, it may be that the transaction's components are sold separately by other vendors in the market. In such a situation, separation of the components may still be appropriate."[100]

4.87 PwC concluded that *"IFRS does not define identifiable components of a single transaction…The assessment of components and future obligations is a matter of judgement"*[101].

4.88 Again, therefore, it is demonstrable that areas of revenue recognition now in dispute between the parties can be reduced to disagreement in areas of subjective accounting where professional judgement is particularly relevant.

Other matters relevant to the accounting issues in this case

Substance of transactions and other events

4.89 An important requirement of IFRS is that the substance of transactions and other events is considered as well as their legal form, which may have consequences for the accounting treatment applied.

4.90 Both the Framework and the Conceptual Framework set out that:

"If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, an entity may dispose of an asset to another party in such a way that the documentation purports to pass legal ownership to that party; nevertheless, agreements may exist that ensure that the entity continues to enjoy the future economic benefits embodied in the asset. In such circumstances, the reporting of a sale would not represent faithfully the transaction entered into (if indeed there was a transaction)."[102]

4.91 I understand that differences as to what the "substance" or the "economic substance" of certain transactions or arrangements are have been identified and are now disputed.

[100] **Exhibit G** - PwC's 2009 Guidance, page 9038, paragraph 9.133.
[101] **Exhibit G** - PwC's 2009 Guidance, page 9038, paragraph 9.135.
[102] **Exhibit M** - The Framework for the Preparation and Presentation of Financial Statements, paragraph 35.

IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'

4.92 The Claimants' allegations refer in a number of places to IAS 8.10[103], which states:

"*In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information*

(a) *relevant to the economic decision-making needs of the users; and*

(b) *reliable, in that the financial statements:*

(i) *represent faithfully the financial position, financial performance and cash flows of the entity;*

(ii) *reflect the economic substance of transactions, other events and conditions, and not merely the legal form;*

(iii) *are neutral, ie free from bias;*

(iv) *are prudent; and*

(v) *are complete in all material respects.*"[104]

4.93 It appears that the Claimants seek to rely on IAS 8.10 in considering the substance of a transaction. The requirement to consider the substance of a transaction in the context of revenue recognition is included at IAS 18.13[105] (which is also referred to by the Claimants), and more generally in the Framework and the Conceptual Framework.[106]

Materiality

4.94 Separate to the accounting standards, I also comment on the concept of materiality as it applies to those accounting standards. In considering any potential outcome in the assessment of any given disputed accounting treatment, the issue of materiality cannot be ignored.

4.95 The Framework sets out the concepts that underlie the preparation and presentation of financial statements for external users. The Framework states that in order to be useful, information must be relevant to the decision-making needs of users.[107]

4.96 The concept of materiality under the Framework is described as follows:

[103] See paragraphs 13.21 and 15.14 of my report.
[104] **Exhibit N** - IAS 8.10.
[105] See paragraph 4.78 of my report.
[106] See paragraph 4.89 of my report.
[107] **Exhibit M** - The Framework for the Preparation and Presentation of Financial Statements, paragraph 26.

"The relevance of information is affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance…In other cases, both the nature and materiality are important …

Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."[108]

4.97 The Framework was superseded in September 2010 by the Conceptual Framework and the concept of materiality became:

"Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation."[109]

4.98 As a result of the above, whether any given alternative accounting treatment is subsequently determined to apply on its individual circumstances that existed at the relevant time, the question of whether an actual adjustment would then have been made in a given accounting period is yet a further issue for consideration. Judgement is necessarily required, given that IFRS does not specify how a materiality threshold should be arrived at. In general terms, however, in the remainder of my report I do not consider this issue further since it relates, or potentially relates, to future possible determinations of fact which is a matter for the Court rather than me.

Use of hindsight - amending comparative information for prior periods

4.99 In terms of accounting standards in general, I also make one further point.

4.100 When amending comparative information presented for prior periods in the financial statements, only contemporaneous information and evidence should be taken into account; information that becomes available after the financial statements have been authorised for issue should be disregarded.

[108] **Exhibit M** - The Framework for the Preparation and Presentation of Financial Statements, paragraphs 29 to 30.
[109] **Exhibit O** - The Conceptual Framework for Financial Reporting 2010, paragraph QC11.

4.101 This requirement is set out in IAS 8, which states that:

"*Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period.*"[110]

4.102 As a result, insofar as any claim is made that transactions should be restated for fundamental error, under IFRS any application of hindsight is explicitly prohibited.

[110] **Exhibit N** - IAS 8.53.

5 AUTONOMY'S REVENUE RECOGNITION ACCOUNTING POLICY

Introduction

5.1 In this section, I set out what I understand to be Autonomy's accounting policies for the recognition of revenue throughout the Relevant Period based on the Consolidated Financial Statements.

Background - selection of accounting policies

5.2 Autonomy's board of directors was responsible for selecting and applying appropriate accounting policies which complied with accounting standards and for presenting those accounting policies in a manner that provided relevant, reliable, comparable and understandable information (as a matter as set out in IAS 1).[111]

5.3 In addition, where there is a choice of accounting treatment or policy available under accounting standards, or where an accounting standard does not cover a specific transaction or is ambiguous, professional judgement must be applied by both the directors and the auditors to ensure that the accounting treatment and the accounting policy applied are appropriate given the company's circumstances.

Autonomy's accounting policy for revenue recognition

5.4 Autonomy's accounting policy for revenue recognition is set out in Note 2(e) to each of its 2009 and 2010 Consolidated Financial Statements. The respective notes set out the accounting treatment in respect of the two significant categories of revenue disclosed by Autonomy, i.e. revenue associated with the sale of goods and the revenue associated with the rendering of services.[112]

Sale of goods

5.5 Autonomy's accounting policy for the sale of goods identifies the treatment of the different elements of product revenues included in this category. This includes revenue from:

(a) software licence agreements, i.e. the sale of software licences as the sale of goods;

(b) sales of licences under original equipment manufacturer ("OEM") and reseller arrangements, providing for fees payable to Autonomy based on licensing of Autonomy's software to third party customers;

[111] **Exhibit P** - IAS 1.17(a) and (b).
[112] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, pages 41 and 42 and **Exhibit J** – Autonomy's Consolidated Financial Statements 2010, Note 2(e), pages 50 and 51.

(c) associated customer support and maintenance services linked to the sale of goods generally; and

(d) hosting, which is considered to be a product sold on a subscription basis.[113]

Accounting for revenue from software licence agreements

5.6 Autonomy's accounting policy for revenue from software licence agreements was disclosed as follows:

"*Revenues from software license agreements are recognised where there is persuasive evidence of an agreement with a customer (contract and/or binding purchase order), delivery of the software has taken place, collectability is probable and the fee has been contractually agreed and is not subject to adjustment or refund (i.e. is fixed and determinable).* […] *Revenue is recognized on contracts providing that the customer passes defined credit-worthiness checks.*"[114]

5.7 While I comment further on certain provisions of the relevant IFRS revenue recognition accounting standard in section 4, I note here that substantively, this accounting policy addresses, and discloses, Autonomy's approach to recognising revenue on sales of goods in line with IAS 18. I note, however, by way of general observation, that Autonomy does not appear to have included a reference to the fifth condition required by IAS 18.14 in its accounting policy for licence revenue, being that costs in respect of the transaction should be capable of being measured reliably.[115] However, the cost to Autonomy of providing its software to a customer was, I understand, minimal given that the cost to develop the software had already been incurred and Autonomy sold a standard product.[116]

5.8 According to the accounting policy, if the criteria listed in paragraph 5.6 were met in respect of software licence agreements, Autonomy accounted for the revenue as the sale of a licence.

5.9 Separately, Autonomy sets out its criteria for recognising revenue derived from OEM or reseller arrangements, which provide for fees payable to Autonomy based on licensing of Autonomy's software to third party customers as follows:

"*Sales are generally recognised as reported by the OEM or reseller and is based on the amount of product sold. Sales are recognised if all products subject to resale are delivered*

[113] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, Note 2(e)(i) and **Exhibit J** – Autonomy's Consolidated Financial Statements 2010, Note 2(e)(i).
[114] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, Note 2(e)(i) and **Exhibit J** – Autonomy's Consolidated Financial Statements 2010, Note 2(e)(i).
[115] **Exhibit F** - IAS 18.14(e).
[116] See paragraph 4.34 of my report.

in the current period, no right of return policy exists, collection is probable and the fee is fixed and determinable."[117]

5.10 Again, these criteria prima facie align with the requirements of IAS 18.14(a) to (d).

5.11 It should be understood that the revenue referred to at paragraph 5.9 is potentially in addition to any revenue associated with any upfront sale of Autonomy software to an OEM, and that any reporting of sales by the OEM in this context was for the purpose of assessing the appropriateness of Autonomy recognising any additional revenue in accordance with the terms of the initial arrangement or agreement with the OEM.

Accounting for support and maintenance revenue

5.12 The accounting policy for revenue associated with support and maintenance, provided in conjunction with the sale by Autonomy of its sale of goods, is described as follows:

"*Revenues from customer support and maintenance are recognised rateably over the term of the support period. If customer support and maintenance is included free or at a discount in a licence agreement, these amounts are allocated out of the licence fee at their fair market value based on the value established by independent sale of the customer support and maintenance to customers. Support and maintenance consists primarily of the supply of products, such as patches and updates, to the standard software.*"[118]

5.13 On this basis, it appears that Autonomy recognised the provision of support and maintenance associated with a licence sale to be the sale of a good as the accounting policy specifically identifies the nature of the support and maintenance to be product related.

Accounting for hosting revenue

5.14 The sale of goods policy further includes the accounting policy regarding the disclosed treatment of revenues from the hosting business as follows:

"***Product revenues*** *from the hosted business are separated, using the residual method* [[119]]*, into capture and archiving. Revenues for capture are recognised in the period in which they are delivered. Revenues for archiving are recognised over the period that the customers have access to the group's software and proprietary storage technology. Product revenues from the hosted business relate to the execution of*

[117] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, Note 2(e)(i) and **Exhibit J** – Autonomy's Consolidated Financial Statements 2010, Note 2(e)(i).
[118] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, Note 2(e)(i) and **Exhibit J** – Autonomy's Consolidated Financial Statements 2010, Note 2(e)(i).
[119] The 'residual method' is described in section 4 at paragraph 4.81.

production operations on computers which the company runs in its data centres. Revenues are generated from the use of our software and computers and from us maintaining the data. Customers commit for periods between one month and up to three years."[120] [emphasis added]

5.15 It is clear therefore that, independent of the sale of a software licence, the accounting policy also separately disclosed that revenue associated with the hosting business was, or could be, captured as product revenue.

5.16 The policy goes on to state that the revenue from hosting transactions is generated in two ways, either "*Paid up front…with the archiving element deferred and recognized rateably over the contracted period of archiving*" or "*Paid on a pay-as-you-go basis, in which case the charge is based on the volumes of data ingested and stored each month*".[121]

5.17 As above, these revenue recognition policies applied to different products and associated scenarios, and could be paid for in alternative ways. Where the product was paid for on a pay-as-you-go basis, there would have been no requirement to defer revenue.

Rendering of services

5.18 In comparison to the sale of goods, including product revenues from its hosted business, Autonomy considered consulting and training revenues to constitute the rendering of a service and set out the accounting policy in respect of these transactions as follows:

"*Consulting revenues are primarily related to implementation services performed on a time and materials basis under separable service arrangements related to the installation of the group's software products. Revenues from consulting and training services are recognised as services are performed. If a transaction includes both license and service elements, license fee revenue is recognised upon shipment of the software, provided services do not include significant customisation or modification of the base product and the payment terms for licenses are not subject to acceptance criteria. In cases where license fee payments are contingent upon the acceptance of services, revenues from both the license and the service elements are deferred until the acceptance criteria are met.*"[122]

[120] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, Note 2(e)(i) and **Exhibit J** – Autonomy's Consolidated Financial Statements 2010, Note 2(e)(i).
[121] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, Note 2(e)(i) and **Exhibit J** – Autonomy's Consolidated Financial Statements 2010, Note 2(e)(i).
[122] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, Note 2(e)(ii) and **Exhibit J** – Autonomy's Consolidated Financial Statements 2010, Note 2(e)(ii).

6 THE ROLE OF DELOITTE

6.1 My starting point for considering the appropriateness of the accounting for any given individual transaction would be the contemporaneous evidence available in respect of that transaction, i.e. without the benefit of hindsight. An important part of the contemporaneous evidence is the working papers and associated documents prepared by an entity's auditors, which in this particular matter was Deloitte.[123]

6.2 In this section, I set out the background to Deloitte's role as auditor of Autonomy in the Relevant Period (paragraphs 6.4 to 6.13) and an overview of the documentary evidence available from Deloitte (paragraphs 6.14 to 6.22). I refer mainly to the background information contained in Mr Welham's Witness Statement but have also initially considered the further statements exchanged on 16 November 2018 of those witnesses who identified as contemporaneous accountants or those charged with governance at Autonomy and also of certain other witnesses. For the avoidance of doubt, as noted at paragraph 1.24, I have not had sufficient time to carry out a comprehensive review of the reply witness statements.

6.3 I am aware that Deloitte has been challenged by the FRC as to the quality of its audit work in respect of its audit of Autonomy, albeit there is no public outcome to date to this challenge, as set out at paragraphs 6.23 to 6.26.

Background to Deloitte's role as auditor of Autonomy

6.4 Deloitte is one of the "Big Four" global accounting firms. It audited Autonomy and its subsidiaries for the years ended 31 December 2003 to 2010[124], prior to the acquisition by HP. As auditor of Autonomy, Deloitte had responsibilities to the shareholders of Autonomy, and it was required to comply with International Standards of Auditing in its audit work.

Year end audits and quarterly reviews

6.5 In addition to its work as auditor of the Consolidated Financial Statements for each year end, Deloitte carried out reviews of Autonomy's interim reports with regard to International Standard on Review Engagements 2410 ("ISRE 2410"). Autonomy prepared its interim financial reports with regard to IAS 34 'Interim Financial Reporting'. Autonomy also voluntarily prepared quarterly reports which were surplus to the requirements of listed companies in the UK.

[123] Also see paragraph 1.21 of my report.
[124] From a review of the Autonomy Corporation plc statutory accounts filed with Companies House for the periods ended 31 December 2002 to 31 December 2011.

6.6 As part of its work Deloitte reviewed sales transactions over US$1.0 million.[125] I understand, in fact, that Autonomy prepared transaction 'bundles' for every revenue contract in excess of US$100,000.[126]

6.7 During the Relevant Period, Deloitte issued unqualified audit opinions on the 2009 and 2010 Consolidated Financial Statements.[127] In summary, this meant that, in its opinion, there were no material issues that prevented the Consolidated Financial Statements from showing a true and fair view.

6.8 Deloitte was also initially engaged to carry out the audit of the ASL financial statements for the 10 month period ended 31 October 2011 but resigned on 14 December 2012, as per documents filed with Companies House[128]. The preparation of the 2011 statutory financial statements pertained only to ASL and other UK statutory entities as individual companies, as following the acquisition of Autonomy by HP there was no longer a requirement to produce Consolidated Financial Statements for the Autonomy group.

Deloitte audit team

6.9 I understand that the Deloitte audit team was based at Autonomy's offices in Cambridge throughout the period the audits, and I assume the quarterly reviews, were taking place, and had access to Autonomy's finance, sales and technical personnel, as well as to Autonomy's files.[129]

6.10 As set out in Mr Welham's Witness Statement, in line with Deloitte standard practice and regulations, Deloitte's core audit team was assisted by:

(a) an engagement quality assurance review partner who provided a second partner review and consultation, and whose role it was to ensure the quality of Deloitte's work was consistent with its internal policies;

(b) an independent review partner who provided an objective evaluation of the significant judgements made by the engagement team and the conclusions reached in formulating the auditor's report to ensure independence. The independent review partner could not meet or have any interaction with the client and therefore was a step removed from the commercial relationship; and

[125] Mr Welham's Witness Statement, paragraphs 45 and 474.
[126] See for example, Ms Gustafsson's Witness Statement, paragraphs 64 and 65, and Elizabeth "Lisa" Jane Harris's ("Ms Harris") witness statement dated 16 November 2018, paragraph 21.
[127] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, page 35 and **Exhibit J** - Autonomy's Consolidated Financial Statements 2010, page 44.
[128] {POS00411352}.
[129] Ms Gustafsson's Witness Statement, paragraph 14.

(c) a professional standards reviewer who specialised in the application of accounting standards and determined whether an opinion given, was professionally appropriate, fully supported and documented appropriately.[130]

6.11 The audit team also consulted with Deloitte's NAA team when technical clarification and guidance on difficult accounting technical issues was required.[131]

Reporting to the Audit Committee

6.12 As part of its annual audit and quarterly and interim review work, Deloitte provided detailed reports to the Audit Committee of Autonomy ("Audit Committee") on a quarterly basis[132]. These reports included its comments on key issues and judgements in relation to revenue recognition and other matters, including its comments on the largest sales in the quarter covered by the report. The Audit Committee was independent of Autonomy management. Deloitte also held meetings solely with the Audit Committee, at which no Autonomy employees or executives were present.[133]

6.13 The reports provided to the Audit Committee were based on the review work carried out by Deloitte at the time and its contemporaneous discussions with the management of Autonomy. Consequently, I have found them to be very valuable in understanding the thinking of Deloitte at each relevant point in time during the Relevant Period, as well as its challenges to the management of Autonomy during its audit and review work.

Deloitte's working papers

6.14 As part of the disclosure process, Deloitte has provided its working papers and emails prepared during the course of its year end audits and quarterly reviews. I have found these working papers and emails between members of the Deloitte team and between Deloitte staff and Autonomy management again to be very useful in understanding the thinking of each of Deloitte and Autonomy on relevant issues at the time, as well as useful in understanding the challenges Deloitte raised to Autonomy and the changes made by Autonomy as a result.

6.15 These contemporaneous audit and review working papers repeatedly address matters that are the subject of this dispute, namely the recognition of revenue in accordance with IAS 18.14 and whether or not Autonomy's sales of hardware needed to be separately

[130] Mr Welham's Witness Statement, paragraphs 11 to 14 and Ms Gustafsson's Witness Statement, paragraphs 22 to 23.
[131] Mr Welham's Witness Statement, paragraph 14.
[132] For further detail of the role of the Autonomy Audit Committee, see for example, the witness statement of Jonathan William Bloomer ("Mr Bloomer") dated 15 November 2018 ("Mr Bloomer's Witness Statement").
[133] Witness statement of Mr Hussain dated 13 September 2018, paragraphs 39 to 42. See also, for example, Mr Bloomer's Witness Statement, paragraph 26.

disclosed in accordance with IFRS 8 or IAS 18. They also include internal discussions between the Deloitte audit team and a series of Deloitte senior independent review partners and technical partners on some of the issues now complained of by the Claimants.[134]

6.16 Of particular importance, I consider that the contemporaneous working papers prepared by Deloitte provide extremely valuable evidence of:

(a) the contemporaneous circumstances surrounding the transactions themselves and why Autonomy accounted for them in the way it did; as well as

(b) the contemporaneous views of Autonomy's auditor on each of the transactions.

6.17 In total, Deloitte's audit and quarterly review working papers indicate that it considered the vast majority, if not all, of the transactions that are now the subject of these proceedings, and that in many cases it challenged and discussed the individual transactions with Autonomy's management at the time. In the nature of revenue recognition, it is always the case that the circumstances of each transaction, and in particular the substance of each transaction, will dictate the accounting approach to be adopted for that transaction.

6.18 In order to review whether any particular individual transaction was accounted for appropriately, or at least within the broad range of permitted or permissible accounting judgements in respect of any given transaction, the best starting position is, in my opinion, the Deloitte working papers.

6.19 These have arguably the most valuable detailed analysis relating to the facts and judgements reached at the time.

6.20 Further, to determine whether there was any potential misstatement in the Consolidated Financial Statements of Autonomy again the starting position should be the Deloitte working papers.

6.21 I do appreciate that it is the overall contention of the Claimants that Deloitte was misled as to the relevant facts; that seems to me to be implicit in the assumptions given to Mr Welham. Here, as well, consideration needs to be given to the Deloitte working papers.

6.22 Finally, the Deloitte working papers contain the information that was contemporaneously available, untainted by any hindsight. They will also reflect information that was obtained by and made available to Deloitte at the time.

[134] See for example {DEL1_002_1_00000071}.

Regulatory action against Deloitte

6.23 While, as above, my starting point for considering the appropriateness of the accounting for any given individual transaction would be the contemporaneous Deloitte working papers available in respect of that transaction, I am also aware that Deloitte has been challenged as to the quality of its audit work in respect of its audit of Autonomy.

6.24 It is in the public domain that the FRC has delivered formal complaints under the Accountancy Scheme to Deloitte, Richard Knights ("Mr Knights") and Nigel Mercer ("Mr Mercer") (the audit engagement partners throughout the Relevant Period), including in relation to issues which are relevant to these proceedings, on 31 May 2018.[135]

6.25 In particular, Deloitte, Mr Knights and Mr Mercer, it is alleged by the FRC, *"failed (i) adequately to challenge Autonomy's accounting and disclosure of its purchases and sales of computer hardware, (ii) adequately to challenge Autonomy's accounting for transactions with value added resellers"*[136]. In addition, Autonomy's two most senior accountants at the time, including the Second Defendant, are also the subject of the regulatory complaint by the FRC.[137]

6.26 I understand, however, that there is no public outcome to date to this challenge by the FRC to either Autonomy's accounting or Deloitte's audit and review of that accounting. I accept, though, that the outcome of any such regulatory enforcement challenge is uncertain at this stage, and notwithstanding the Deloitte partners' defence of their audit opinion, or review findings, that either or both Deloitte partners may be subject to regulatory sanction and/or adverse findings. That is not the case, however, to date.

[135] **Exhibit Q** – Extract from FRC website 31 May 2018, "Disciplinary action in relation to Autonomy Corporation plc".
[136] **Exhibit Q** – Extract from FRC website 31 May 2018, "Disciplinary action in relation to Autonomy Corporation plc".
[137] **Exhibit Q** – Extract from FRC website 31 May 2018, "Disciplinary action in relation to Autonomy Corporation plc".

7 HARDWARE SALES

Introduction

7.1 While Autonomy's principal business was the sale and supply of software[138], during the Relevant Period Autonomy also made onward sales of hardware purchased from third parties[139]. The witness statement of Mr Hussain dated 13 September 2018 ("Mr Hussain's Witness Statement") describes these sales as follows:

*"Autonomy sold hardware on which Autonomy software was pre-installed or which was intended to be combined on-premises with a separate but linked purchase of Autonomy software ("**appliance sales**") and hardware other than as part of appliance sales."*[140] [141]

7.2 Mr Welham's Witness Statement states *"In common with many software companies, Autonomy also sold hardware as part of its software offering"*.[142]

7.3 The Claimants set out their allegations in respect of Autonomy's hardware sales in paragraphs 30.1 and 53 to 72 of the Re-Re-Amended Particulars of Claim. In particular, the Claimants allege that:

"The relevant accounting standards and other rules required fair disclosure and explanation of the nature and extent of Autonomy's hardware sales, including the pure hardware sales. However, Autonomy disclosed neither the existence nor the amount of such sales in its published information (or anywhere else)."[143]

7.4 The phrase "pure hardware sales" used by the Claimants is defined by the Claimants as being sales of hardware *"without modification by Autonomy and unaccompanied by any Autonomy software"*.[144]

7.5 In addition, the Claimants allege that *"Further, COGS* [costs of goods sold] *in respect of pure hardware sales was artificially reduced, thereby inflating Autonomy's reported gross margins."*[145]

[138] See paragraph 2.3 of my report.
[139] Mr Hussain's Witness Statement, paragraph 68.
[140] Mr Hussain's Witness Statement, paragraph 61.
[141] For the purposes of this section of my report, I make no distinction between different types of, or applications of, hardware.
[142] Mr Welham's Witness Statement, paragraph 173.
[143] Re-Re-Amended Particulars of Claim, paragraph 30.1.3.
[144] Re-Re-Amended Particulars of Claim, paragraph 30.1.2.
[145] Re-Re-Amended Particulars of Claim, paragraph 30.1.4.

7.6 In this section I consider:

(a) the disclosure requirements, if any, relevant to the hardware sales (paragraphs 7.8 to 7.67); and

(b) the accounting treatment of the costs associated with the hardware sales (paragraphs 7.68 to 7.75).

7.7 I then provide my conclusions (paragraphs 7.76 to 7.80).

Disclosure requirements

7.8 The Re-Re-Amended Particulars of Claim states:

"The revenues derived from hardware sales (including any associated third party software) were a significant category of revenue for Autonomy for the purposes of IAS 18, paragraph 35, and therefore should have been separately disclosed. Further, IFRS 8, paragraph 32, required revenues from external customers for each product or service, or each group of similar products and services, to be disclosed. Hardware was not similar to the other products and services sold by Autonomy and ought therefore to have been separately disclosed."[146]

7.9 Mr Welham states that Deloitte, as part of the 2009 year end audit, *"considered carefully the question of operating segments, in particular whether segmental disclosure was needed in the 2009 financial statements."*[147] This careful consideration included *"consulting with Phil Barden of the NAA team*[148] *and ultimately obtaining NAA sign off on the classification of Autonomy as a single operating segment company."*[149]

7.10 I consider the requirements and application of IAS 18 and IFRS 8 in this regard in turn below.

[146] Re-Re-Amended Particulars of Claim, paragraph 61.
[147] Mr Welham's Witness Statement, paragraph 264.
[148] Deloitte's NAA team.
[149] Mr Welham's Witness Statement, paragraph 264.

IAS 18.35 - Disclosure

7.11 IAS 18.35, referenced by the Claimants, states:

"An entity shall disclose:

(a) *the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;*

(b) *the amount of each significant category of revenue recognised during the period, including revenue arising from:*

(i) the sale of goods;

(ii) the rendering of services;

(iii) interest;

(iv) royalties;

(v) dividends; and

(c) *the amount of revenue arising from exchanges of goods or services included in each significant category of revenue."*[150]

7.12 I set out Autonomy's accounting policies in relation to revenue recognition in section 5. It is relevant to note that Autonomy's revenue recognition policies as disclosed covered the sale of goods, and separately the rendering of services.

7.13 The Claimants assert that revenues derived from hardware sales should have been disclosed separately by Autonomy because they represented a "*significant category*" of revenue under IAS 18.35.[151]

7.14 I do not agree with this interpretation of IAS 18.35.

7.15 It is clear from the wording of the requirement itself, set out in paragraph 7.11 above, that the revenue disclosure required is by "*category of revenue*". In particular, IAS 18.35(b) identifies one significant category as being "*the sale of goods*", this being distinct from, for example, "*the rendering of services*". In my opinion, the sale of goods category captures sales of <u>all</u> goods with no additional requirement in IAS 18 for it (or any of the other categories) to be broken down further.

7.16 In respect of onward sales of goods purchased from third parties specifically, as set out in, for example, EY's 2008 Guidance in respect of IAS 18:

[150] **Exhibit F** - IAS 18.35.
[151] Re-Re-Amended Particulars of Claim, paragraph 61.

"The term 'goods' includes goods produced by the entity for the purpose of sale ***and goods purchased for resale****, such as merchandise purchased by a retailer or land and other property held for resale."*[152] [emphasis added]

7.17 Sales of hardware purchased from third parties by Autonomy are therefore clearly captured by the category "*the sale of goods*" and do not in themselves represent a separate "*significant category*" of revenue distinct from other "*sale of goods*" requiring separate disclosure under IAS 18 as asserted by the Claimants.

7.18 This is the disclosure followed by Autonomy, as set out in Mr Hussain's Witness Statement, which states:

"Autonomy had two categories of revenue for the purposes of IAS 18, namely sale of goods and rendering of services … Autonomy did not consider the revenue from hardware sales to be a "significant category" for the purposes of IAS 18 …"[153]

7.19 Autonomy applied IAS 18.35 during the Relevant Period in its Consolidated Financial Statements by separately disclosing the amount of revenue in relation to the sale of goods and the rendering of services in the notes to the Consolidated Financial Statements.[154]

7.20 The disclosure was also audited (or in respect of interim reviews, reviewed) by Deloitte. Deloitte issued unqualified audit and/or review opinions (as the case may be) during the Relevant Period on the Consolidated Financial Statements of Autonomy, and/or interim/quarterly reviews. The year end audits, in particular, would have involved and did involve, as is apparent from review of the available working papers and reports to the Audit Committee, detailed consideration of the notes to the Consolidated Financial Statements including the aforementioned revenue notes.

7.21 Deloitte's consideration of Autonomy's application of IAS 18.35 is evidenced in an email exchange between the Deloitte audit team and Autonomy senior management on 25 January 2010 in the context of Deloitte's 2009 year end audit.

7.22 The Deloitte audit team and Autonomy senior management discussed the disclosure requirements of IAS 18.35, which led Deloitte's audit partner responsible for the Autonomy

[152] **Exhibit C** - EY's 2008 Guidance, page 2020, section 3.1.
[153] Mr Hussain's Witness Statement, paragraph 76.
[154] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, page 47, note 4, and **Exhibit J** - Autonomy's Consolidated Financial Statements 2010, page 57, note 4.

audit at the time, Mr Knights to conclude, "*I think the sale of goods/rendering of service works for IAS 18*".[155]

7.23 My conclusion that revenues derived from hardware sales did not represent a separate "*significant category*" of revenue under IAS 18.35 is consistent with these considerations by Deloitte.

IFRS 8 – Segmental reporting

7.24 On 19 January 2006, the IASB, which is the body that develops and approves IFRSs, published an exposure draft of an IFRS on segment reporting referred to as *"ED 8 Operating Segments"*.[156] The exposure draft resulted from:

"… the IASB's comparison of International Accounting Standard (IAS) 14 Segment Reporting with the US standard SFAS 131 Disclosures about Segments of an Enterprise and Related Information. The proposed IFRS would replace IAS 14 and align segment reporting with the requirements of SFAS 131."[157]

7.25 The aim of the new standard was to reduce differences between IFRS and US GAAP as part of the overall convergence project being carried out by the IASB and the US Financial Accounting Standards Board ("FASB").[158] Subsequently, on 30 November 2006, the finalised IFRS 8 was issued, effective for periods beginning on or after 1 January 2009.[159]

7.26 The core principle of IFRS 8 is as follows:

"An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates."[160]

7.27 IFRS 8 comprises 37 mostly inter-dependent paragraphs, plus two related appendices, with the primary emphasis of the standard being to require companies to identify their own internal operating segments and to report information about those operating segments in disclosures headed "*reportable segments*".[161]

7.28 Below, I discuss paragraphs 5 and 32 of the standard in more detail as these are the paragraphs relevant for the purposes of determining whether Autonomy's hardware sales required separate disclosure as alleged by the Claimants.

[155] {POS00142302}.
[156] **Exhibit R** - IASB press release dated 19 January 2006.
[157] **Exhibit R** - IASB press release dated 19 January 2006.
[158] **Exhibit R** - IASB press release dated 19 January 2006.
[159] **Exhibit S** - IASB press release dated 30 November 2006.
[160] **Exhibit T** - IFRS 8.1.
[161] **Exhibit T** - IFRS 8.

IFRS 8.5 – Operating segments

7.29 IFRS 8.5 defines an operating segment as:

"… a component of an entity:

(a) *that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),*

(b) *whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and*

(c) *for which discrete financial information is available."*[162]

7.30 In its 2009 and 2010 Consolidated Financial Statements, Autonomy disclosed that it had only one operating segment (and provided the rationale for this) in the segmental analysis note.[163] This is confirmed by Mr Hussain in his witness statement[164] and by Mr Welham in his witness statement[165].

7.31 The segmental analysis note also states:

"The group offers over 500 different functions and connectors to over 400 different data repositories as part of its product suite. Each customer selects from a list of options, but underneath from a single unit of the proprietary core technology platform. As a result, no analysis of revenues by product type can be provided."[166]

7.32 I understand that the Claimants do not allege that hardware sales represented a discrete operating segment for the purposes of IFRS 8.5. In this regard, the undated draft Re-Amended Reply and First Claimant's Defence to the First Defendant's Amended Defence and Counterclaim ("Re-Amended Reply") states:

"It is admitted that Autonomy operated and reported as one segment, and that hardware sales were not a separate operating segment. The Claimants have not contended otherwise."[167]

7.33 As set out at paragraph 7.20, Deloitte issued unqualified audit and/or review opinions (as the case may be) during the Relevant Period on the Consolidated Financial Statements of

[162] **Exhibit T** - IFRS 8.5.
[163] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, page 48, note 5 and **Exhibit J** - Autonomy's Consolidated Financial Statements 2010, page 58, note 5.
[164] Mr Hussain's Witness Statement, paragraph 77.
[165] Mr Welham's Witness Statement, paragraph 265.
[166] **Exhibit I** - Autonomy's Consolidated Financial Statements 2009, page 48, note 5 and **Exhibit J** - Autonomy's Consolidated Financial Statements 2010, page 58, note 5.
[167] Re-Amended Reply, paragraph 57.1.

Autonomy, and/or interim/quarterly reviews. The year end audits, in particular, would have involved and did involve, as is apparent from review of the available working papers and reports to the Audit Committee, detailed consideration of Autonomy's segmental reporting as set out in the notes to the Consolidated Financial Statements. The Claimants confirm that *"Deloitte concurred with the decision to treat Autonomy as having one operating segment. That concurrence is not gainsaid by the Claimants"*.[168]

IFRS 8.32 – Information about products and services

7.34 The main focus of IFRS 8 when it was introduced was to require internal management reporting to become the foundation for segmental disclosures in the financial statements, but with some related 'entity-wide disclosures' also required regardless of whether that information was used in making operating decisions.

7.35 Under 'entity-wide disclosures', IFRS 8.32 states:

"An entity shall report the revenues from external customers for each product and service, or each group of similar products and services, unless the necessary information is not available and the cost to develop it would be excessive, in which case that fact shall be disclosed. The amounts of revenues reported shall be based on the financial information used to produce the entity's financial statements."[169]

7.36 The Claimants assert that this paragraph required Autonomy to separately disclose revenue from hardware sales because *"Hardware was not similar to the other products and services sold by Autonomy"*.[170]

7.37 IFRS 8 does not define "*similar*" products for the purposes of paragraph 32. As such, this is a matter of judgement.

7.38 Furthermore, the Claimants state that the provisions of IFRS 8.32, "*are to be applied by reference to the concept of materiality.*"[171] However, I note again for example, that in this regard, KPMG's 2008/2009 Guidance states:

"IFRS 8 does not provide materiality thresholds for determining the entity-wide disclosures, other than for major customer information. As a result, when otherwise not specified by the standard, ***judgement needs to be used to determine material items for entity-wide disclosure purposes****."*[172] [emphasis added]

[168] Re-Amended Reply, paragraph 57.2
[169] **Exhibit T** - IFRS 8.32.
[170] Re-Re-Amended Particulars of Claim, paragraph 61.
[171] Re-Amended Reply, paragraph 67.5.
[172] **Exhibit H** - KPMG's 2008/9 Guidance, page 1057, paragraph 5.2A.230.40.

7.39 Therefore, in my opinion, again judgement was (and is) the foundation when considering the application of IFRS 8.32.

7.40 In this context, in my opinion, the key area of judgement to be addressed is whether management considered that the sale of hardware was the separate sale of a different product to the sale of Autonomy's core IDOL product, or that it was incidental to sales of the core product, with its principal purpose being to facilitate further software sales.

7.41 I understand the latter to be the case (as I will now discuss), although this may be an issue disputed subsequently by the Claimants.

7.42 Mr Hussain's Witness Statement states that:

"The Notes [to the Consolidated Financial Statements in the 2010 Annual Report] … *explained the fact … that no analysis of revenues by product type could be provided."*[173]

7.43 Mr Hussain's Witness Statement also states:

"The goal or primary goal of these [hardware] *purchases, and the subsequent sales, was to drive high-margin software business. It was anticipated that these purchases might give rise to strategic and marketing relationships."*[174]

7.44 Similarly, Dr Lynch's First Witness Statement states:

"Autonomy entered into hardware sales to drive its software business in several ways, including: (a) they helped to secure or maintain strategic supplier status with our key customers and (b) they helped Autonomy to develop relationships with hardware suppliers with which Autonomy could work to develop appliances. Selling some hardware was a reasonable commercial decision. It enabled Autonomy to offer customers a one-stop-shopping solution for their business needs, thereby generating additional sales opportunities and securing long-lasting relationships."[175]

7.45 On this basis, I understand that Autonomy considered that the hardware sales were incidental sales made to drive its core software business and were not, therefore, a different product or service requiring separate disclosure under IFRS 8.32.

7.46 Deloitte agreed with Autonomy in this regard, and, as set out at paragraph 7.20 issued unqualified audit and/or review opinions (as the case may be) during the Relevant Period on the Consolidated Financial Statements of Autonomy, and/or interim/quarterly reviews.

7.47 The fact that Deloitte considered the entity-wide disclosures required by IFRS 8 is confirmed in the year end reports to Autonomy's Audit Committee. For example, the

[173] Mr Hussain's Witness Statement, paragraph 50 and this is also confirmed in Mr Hussain's Witness Statement at paragraph 240(F) which states that *"The term 'IDOL' did not refer to any one product per se."*
[174] Mr Hussain's Witness Statement, paragraph 68.
[175] Dr Lynch's First Witness Statement, paragraph 29(b).

"*Report to the Audit Committee on the audit of the year ended 31 December 2010*"[176] identifies on page 20 that under IFRS 8:

"*… additional entity-wide disclosures are prescribed that are required even when an entity had only one reportable segment. These include information about each product and service or groups of products and services.*"[177]

7.48 In identifying the explicit disclosure issue to Autonomy's Audit Committee[178], Deloitte also made Autonomy's full board of directors fully aware that it needed to consider and address the disclosure issue. This was not a case, therefore, where either Autonomy or Deloitte was not aware of the issue.

7.49 Mr Welham's Witness Statement explains that he has been asked by the Claimants' lawyers to make multiple assumptions relating to matters, he is asked to assume, the Claimants will establish as facts. None of the assumptions that Mr Welham has been asked to make in his witness statement appears to relate to disclosure of hardware sales under IFRS 8.32.

7.50 Moreover, Deloitte's 2009 and 2010 year end audit working papers show that Autonomy's hardware sales were carefully considered in the context of IFRS 8.32.

7.51 For example, the Deloitte audit team prepared a "*Consultation on difficult or contentious matters*" in relation to the 2009 statutory audit, which was reviewed for technical accounting considerations by Mr Barden.[179] The technical consultation document included a working paper with the objective to "*document the adoption of IFRS 8 and the impact on the notes disclosure on segments in the 2009 financial statements*".[180]

7.52 In relation to IFRS 8.32, the paper records:

"*Management have stated that they do not track revenues by product or by groups of similar products. Although branded differently, in effect all customers buy the same one product, IDOL, and for financial reporting purposes the group does not disaggregate into different categories by brand or by any other method. As a result no analysis of revenues by product type has been provided, per para 32 of IFRS8 but as the reasons why this has not been possible have been disclosed, this appears reasonable and the approach was agreed with Phil Barden from NAA. However, the split between product sales and provision of services will be disclosed as per IAS 18.*"[181]

[176] {DEL1_003_1_00000154} (Deloitte Audit Committee Report for the year ended 31 December 2010).
[177] {DEL1_003_1_00000154} (Deloitte Audit Committee Report for the year ended 31 December 2010).
[178] See also for example Mr Bloomer's Witness Statement on the same subject, paragraphs 91 to 94.
[179] {POS00149241}.
[180] {POS00149241}, page 3.
[181] {POS00149241}, page 9.

7.53 Similarly, in relation to the 2010 statutory audit, a 2010 audit working paper with the objective to *"review the guidance provided in IFRS 8 to ensure that the client has made the relevant financial statement disclosures in the current financial year"*[182] also refers to discussions with Mr Barden[183]. The paper concludes that: *"Autonomy has materially complied with the disclosure requirements of IFRS 8."*[184]

7.54 In relation to IFRS 8.22[185], and the general disclosures regarding products and services required under IFRS 8, the working paper records:

"Whilst there is no specific wording in note 5 with regards the types of products and services, we note that a sufficient explanation is given in note 2 (significant accounting policies) under 'revenue recognition' for the readers of the financial statements to understand the nature of the products and services offered by Autonomy."[186]

7.55 In relation to IFRS 8.32, the working paper records:

"All of the software solutions provided by Autonomy to its clients are underpinned by the single core IDOL technology. On that basis, management has provided the following analysis of the revenue balance for the group's single operating segment (Note 4):

- *Sale of goods;*
- *Rendering of services; and*
- *Interest receivable.*

We note that sale of goods includes all items of software and strategic hardware sold during the year. Rendering of services is the release of the support and maintenance revenue and the provision of professional services to clients.

As outlined above, ***management tracks all licence and strategic hardware sales as a single body of sales, being the sale of goods****. This is consistent with the financial information presented to Mike Lynch and it is the basis on which he makes his resource allocation decisions. Likewise, the deferred revenue release and the professional services rendered are also reported to Mike as a single line item.*

On that basis, we deem that ***management has appropriately disclosed a breakdown of revenue that is consistent with the information presented to the Chief Operating Decision Maker and is that used to produce the group's financial statements****.*

[182] {POS00168127}.
[183] {POS00168127}, page 1.
[184] {POS00168127}, page 1.
[185] As opposed to the separate requirements in IFRS 8.32.
[186] {POS00168127}, page 1.

It is worth noting that in their Q4 2010 press release, management did provide some representative revenue figures for the following virtual product categories:

- *IDOL Product;*
- *IDOL Cloud;*
- *IDOL OEM;*
- *Deferred revenue release; and*
- *Services.*

We note that whilst this information was able to be produced following some detailed analysis performed by management, these are not amounts extracted from the financial information that underpins the preparation of the financial statements. It was derived from a separate analysis purely [performed] *for providing some information to analysts on the performance of each virtual product category. It does not represent the way that revenues are analysed out on a regular basis for presentation to Mike Lynch.*

We also note that this is just one of several virtual buckets that management use to badge their different product offerings to analysts, another being the Protect, Promote and Power families. Again, no separate financial information is maintained on a regular basis to evidence the results for any of those virtual brands.

On that basis we note that the disclosure provided by management is in line with the requirements of IFRS 8."[187] [emphasis added]

7.56 Mr Welham (then the senior manager on the Deloitte audit team) raised the issue of IFRS 8.32 in an email exchange with Mr Hussain, Stephen Chamberlain (Autonomy vice president of finance ("Mr Chamberlain")), Mr Knights (the partner on the Deloitte audit team) and Antonia Anderson (another member of the Deloitte audit team) on 25 January 2010[188]. The email states that the disclosure requirement under IFRS 8.32 relates to:

"… breaking down revenues/services into their component parts … [which is] *over and above that of IAS 18 which requires revenue to be broken down by revenue type as per the 5 categories of revenue defined by the standard."*[189]

7.57 Thus, it is clear that Deloitte explicitly considered the question of whether Autonomy had complied with IFRS 8.32 at the time, and concluded that, with the nature of disclosures that it did make, it had done so, as Deloitte issued unqualified audit and/or review opinions

[187] {POS00168127}, pages 5 and 6.
[188] {POS00142302}.
[189] {POS00142302}, page 1.

(as the case maybe) during the Relevant Period on the Consolidated Financial Statements of Autonomy, and/or interim/quarterly reviews.

7.58 My overall view is that in respect of IFRS 8.32, judgement is required when determining whether an entity's sales of products and services require separate disclosure. On the basis that Autonomy's hardware sales were incidental to sales of the core software product, I agree with the conclusions reached by Deloitte that separate disclosure was not required.

Entity-wide disclosures made by comparable companies

7.59 Notwithstanding my above comments regarding Autonomy's compliance with IFRS 8.32, I consider that given that IFRS 8 was a new standard in 2009, discussion of the approach applied in practice by companies that also disclosed one reportable segment is relevant.

7.60 As a preliminary point, I note that a post implementation review was completed by the IASB in July 2013 in respect of its newly introduced standard (i.e. IFRS 8), which included a public consultation through a request for information.[190] In relation to entity-wide disclosures, including IFRS 8.32, the feedback compiled indicated that:

"Many participants think that entity-wide disclosures are poorly understood … Many think that entity-wide disclosures are inconsistently applied across entities and it is claimed that regulators frequently challenge the entity-wide disclosures made."[191]

7.61 In order to understand how other UK companies interpreted IFRS 8.32, I have reviewed the disclosure in the financial statements of some large UK companies that prepared their financial statements in accordance with IFRS in and around the Relevant Period, and that disclosed only one reportable segment. Below I discuss:

(a) Vodafone; and

(b) The Berkeley Group Holdings.

Vodafone

7.62 Vodafone is a global telecommunications company, selling a variety of communications services, including access charges, airtime usage, messaging, interconnect fees, data services and information provision, connection fees and equipment sales.[192] Its reported revenue in its 31 March 2010 financial statements was £44.5 billion.[193]

7.63 The *"Segment analysis"* note to its 2010 financial statements states that the group *"has a single group of related services and products being the supply of communications services*

[190] **Exhibit U** – IFRS Post-Implementation Review: IFRS 8 Operating Segments, July 2013.
[191] **Exhibit U** – IFRS Post-Implementation Review: IFRS 8 Operating Segments, July 2013, page 24.
[192] **Exhibit V** - Vodafone Group Plc Annual Report for the year ended 31 March 2010, page 80.
[193] **Exhibit V** - Vodafone Group Plc Annual Report for the year ended 31 March 2010, page 1.

and products".[194] Its disclosures for segment information were by geographic area, and it provided no additional breakdown of its products or services.[195]

The Berkeley Group Holdings

7.64 The Berkeley Group Holdings was a FTSE 100 property development company, which was "*engaged in residential-led, mixed-use property development, comprising residential revenue, revenue from land sales and commercial revenue.*"[196] It had only *"one reportable operating segment"*[197]. In its 30 April 2010 financial statements it recorded revenue of £615.3 million and total assets of £1.7 billion.[198]

7.65 The *"Segmental disclosure"* note to its 2010 financial statements did not provide any additional information on its products or services.[199] Note 1, *"Accounting policies"*, stated that *"Under the new standard, the Group has one reportable operating segment. Previously segmental information was reported for commercial units sold as part of mixed-use developments"*.[200]

7.66 These two companies' financial statements suggest to me that in the Relevant Period other large companies with a single operating segment were approaching the new entity-wide disclosure requirements in the same manner as Autonomy.

7.67 This is in line with my overall view that judgement is required when determining whether an entity's sales of products and services require separate disclosure.[201]

Accounting treatment relevant to costs associated with hardware sales

7.68 The Re-Re-Amended Particulars of Claim states:

"Accounting for a significant portion of the costs of purchasing pure hardware as sales and marketing expenses rather than COGS [cost of goods sold] *was not in accordance with the required accounting standards and so rendered the information in the Annual Reports and Quarterly Reports from Q3 2009 to Q2 2011 untrue and/or misleading …"*[202]

[194] **Exhibit V -** Vodafone Group Plc Annual Report for the year ended 31 March 2010, page 84, Note 3.
[195] **Exhibit V -** Vodafone Group Plc Annual Report for the year ended 31 March 2010, page 84, Note 3.
[196] **Exhibit W -** Berkeley Group Annual Report for the year ended 30 April 2010, page 69, Note 2.
[197] **Exhibit W -** Berkeley Group Annual Report for the year ended 30 April 2010, page 69, Note 2.
[198] **Exhibit W -** Berkeley Group Annual Report for the year ended 30 April 2010, pages 61 and 62.
[199] **Exhibit W -** Berkeley Group Annual Report for the year ended 30 April 2010, page 69, Note 2.
[200] **Exhibit W -** Berkeley Group Annual Report for the year ended 30 April 2010, page 65, Note 1.
[201] I note here also the comment made in the witness statement of Philip Michael Pearson ("Mr Pearson") dated 8 November 2018 at paragraph 61 as to potential issues arising when defining products from company to company.
[202] Re-Re-Amended Particulars of Claim, paragraph 68.

"In accordance with IAS 2, paragraphs 10 and 38, COGS should have included all of the costs of purchase of the hardware that was sold and recognised as revenue during the relevant accounting period."[203]

7.69 I consider IAS 2.10 and IAS 2.38 below. However, it should firstly be noted that irrespective of the category used, the costs of purchasing hardware are nonetheless included within Autonomy's consolidated income statements during the Relevant Period. As such, categorising a portion of the hardware costs as sales and marketing expenses (compared to categorising the hardware costs entirely as COGS) has no impact on net profit.

7.70 IAS 2 relates to the accounting treatment of inventories. IAS 2.10 states:

"The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition."[204]

7.71 IAS 2.38 states:

"The amount of inventories recognised as an expense during the period, which is often referred to as cost of sales, consists of those costs previously included in the measurement of inventory that has now been sold …"[205]

7.72 While IAS 2.38 does make reference to cost of sales it does not prescribe an accounting treatment for this item. IAS 2.38 requires only that the expense recognised consists of costs previously included in the measurement of inventory. It does not require that this expense must be presented specifically and in its entirety as *"cost of sales"* (or COGS) in the financial statements - the reference to cost of sales is solely an indication of how this expense is often described.

7.73 As there is no explicit accounting guidance under IFRS regarding how the cost of purchasing the hardware for resale should be allocated to particular line items in the financial statements, it is a matter of accounting judgement. This accords with the approach agreed by Deloitte at the time, as set out below.

7.74 Mr Welham acknowledged in his witness statement that in relation to the cost of purchasing the hardware there was an *"absence of any specific accounting guidance"*[206]. This was also noted by Mr Welham at the time of the Q1 2010 quarterly review during which he sent an email titled *"FW: COGS allocation"* to other members of the Deloitte audit team stating:

[203] Re-Re-Amended Particulars of Claim, paragraph 68.2.
[204] **Exhibit X** - IAS 2.10.
[205] **Exhibit X** - IAS 2.38.
[206] Mr Welham's Witness Statement, paragraph 174.

"If we take a step back and look at the guidance, ***there is nothing under IFRS****. So whilst what they are doing does not appear correct,* ***they are not technically in breach of an accounting standard*** *nor are they in breach of the Companies Act …"*[207] [emphasis added]

7.75 It is clear that Deloitte explicitly considered whether the accounting treatment applied by Autonomy to the hardware costs was in accordance with IFRS. Having reviewed the matter, Deloitte ultimately concluded that the allocation of costs was materially appropriate and, as at paragraph 7.20, issued unqualified audit and/or review opinions (as the case maybe) during the Relevant Period on the Consolidated Financial Statements of Autonomy, and/or interim/quarterly reviews.

Conclusions

7.76 I set out my conclusions in respect of the disclosure requirements applicable to Autonomy's hardware sales (if any) and the appropriate accounting treatment of the costs associated with the hardware sales during the Relevant Period below.

Disclosure requirements

7.77 I have considered the disclosure requirements relevant to the hardware sales and conclude as follows:

(a) in my opinion, Autonomy complied with IAS 18.35 during the Relevant Period, there being no requirement under this paragraph for Autonomy to separately disclose hardware sales from other sales of goods in its Consolidated Financial Statements and/or interim/quarterly reviews;

(b) in accordance with IFRS 8, during the Relevant Period, Autonomy disclosed that it had only one operating segment. I understand that the Claimants do not allege that hardware sales represented a separate operating segment[208];

(c) in respect of IFRS 8.32, judgement is required when determining whether an entity's sales of products and services require separate disclosure. On the basis that Autonomy's hardware sales were incidental to sales of the core software product, I agree with the conclusions reached by Deloitte that separate disclosure was not required; and

(d) in the Relevant Period, other large UK companies with a single operating segment appeared equally to apply IFRS 8.32 in a similar way to Autonomy in its Consolidated Financial Statements.

[207] {POS00148007}.
[208] See paragraph 7.32 of my report.

Accounting treatment relevant to costs associated with hardware sales

7.78 I have considered the accounting treatment of the costs associated with Autonomy's hardware sales, and their underlying substance as explained by the Defendants.[209]

7.79 Absent any explicit requirements or guidance under IAS 2 regarding how the cost of purchasing the hardware for resale should be allocated to particular line items in the income statement, I do not agree with the Claimants' assertion that Autonomy's treatment of the costs was not in accordance with IAS 2.10 and IAS 2.38.

7.80 In addition, the costs of purchasing hardware are in any case included within Autonomy's consolidated income statements in the Relevant Period. As such, categorising a portion of the hardware costs as sales and marketing expenses (compared to categorising the hardware costs entirely as COGS) has no impact on net profit.

[209] See paragraphs 7.43 to 7.45 of my report.

8 SALES TO RESELLERS

Introduction

8.1 As noted at paragraphs 1.13 to 1.14, the Claimants assert that Dr Lynch and Mr Hussain "*caused Autonomy group companies to engage in improper transactions and accounting practices*"[210] including *"Improper revenue recognition"*, which itself is said to comprise *"VAR transactions"*, *"Reciprocal transactions"* and *"Acceleration of hosting revenue"*.[211]

8.2 In this section of my report (and sections 9 to 11) I consider the matter of transactions with resellers (referred to by the Claimants as "*VARs*" or "*value-added resellers*"[212]).

8.3 First I set out a brief background and Autonomy's accounting treatment in respect of sales to resellers (paragraphs 8.5 to 8.9). I then set out the Claimants' overall allegations in respect of transactions with resellers (paragraphs 8.10 to 8.12).

8.4 In the following sections I consider the allegations made by the Claimants in the context of some example reseller transactions taken from the Claimants' schedules to the Re-Re-Amended Particulars of Claim. These example transactions are:

(a) Capax Discovery LLC ("Capax Discovery") (two examples, the first with end-user Kraft Foods Global, Inc ("Kraft") and the second with end-user Financial Services Authority ("FSA")) (section 9 of my report);

(b) MicroTech LLC ("MicroTech") (end-user Vatican Library) (section 10 of my report); and

(c) Comercializadora Cobal's S.A De CV ("Comercializadora") (end-user TV Azteca) (section 11 of my report).

Background

8.5 By way of background, resellers are entities that purchase a product from another entity before selling on to the end customer. Mr Welham states that *"sales by software companies to VARs were (and are) commonplace in the software industry"*.[213]

Autonomy's accounting treatment

8.6 When selling software to resellers, Autonomy treated the reseller (not the ultimate end-user) as its customer. If the relevant revenue recognition requirements were met, Autonomy recognised revenue on the sale to the reseller; whether or not the reseller had

[210] Re-Re-Amended Particulars of Claim, paragraph 26.
[211] Re-Re-Amended Particulars of Claim, paragraph 30.2.
[212] Re-Re-Amended Particulars of Claim, paragraph 30.2.1.1.
[213] Mr Welham's Witness Statement, paragraph 72.

sold the product on to an end-user was irrelevant for Autonomy's revenue recognition purposes.[214]

8.7 As set out in section 4, the applicable accounting standard for recognising revenue from the sale of goods (or rendering of a service) is IAS 18. Revenue from the sale of goods is recognised when the five criteria set out in IAS 18.14 are met.[215]

8.8 Autonomy's accounting policy for recognising revenue derived from reseller agreements, as set out in its Consolidated Financial Statements, aligns with the requirements of IAS 18.14.[216]

8.9 The main area of disagreement between the parties in this action regarding transactions with resellers is whether the transactions fulfilled certain of the five criteria for the recognition of revenue from the sale of goods under IAS 18.14, which I set out in section 4. The relevant criteria are discussed below.

Claimants' allegations

8.10 The Claimants assert that "*certain VARs were used to fabricate or accelerate what was then held out by Autonomy to be revenue and profits*."[217] The Claimants refer to resellers being used by Autonomy to recognise sales in respect of transactions that Autonomy had not been able to finalise by a financial quarter end despite, it is alleged, the reseller having no involvement in the transaction with the end-user.[218]

8.11 The Claimants allege false accounting with regard to such transactions with resellers, specifically non-compliance with three of the five conditions under IAS 18.14, which they describe as follows:

(a) with regard to IAS 18.14(a), the Claimants allege that Autonomy did not transfer to the reseller the significant risks and rewards of ownership. Instead, it was agreed and/or understood between Autonomy and the reseller that the reseller would not be required to pay from its own resources;

(b) with regard to IAS 18.14(b), the Claimants allege that Autonomy retained managerial involvement in the ongoing sales discussions with the end-user to the degree usually associated with ownership or effective control over the licence that was to be sold; and

[214] Dr Lynch's First Witness Statement, paragraph 239.
[215] See paragraph 4.35 of my report.
[216] See paragraphs 5.9 to 5.11 of my report.
[217] Re-Re-Amended Particulars of Claim, paragraph 30.2.1.1.
[218] Re-Re-Amended Particulars of Claim, paragraph 30.2.1.2.

(c) with regard to IAS 18.14(d), the Claimants allege that, at the time revenue was recognised by Autonomy, it was not probable that Autonomy would receive the economic benefits associated with the transaction.[219]

8.12 To put the matters into context, I consider some underlying themes of these Claimants' allegations by reference to some example transactions with resellers, as set out in sections 9 to 11.

Conclusions

8.13 I have provided my conclusions in respect of each of the example transactions in this category in sections 9 to 11.

8.14 The specific circumstances of each of the transactions with resellers of course differs, as does the contemporaneous information and documentation that was available to Autonomy (and Deloitte) at the time that each transaction took place. As such, my conclusions in respect of each of the example transactions described in sections 9 to 11 cannot be assumed to apply to other transactions with resellers in the absence of a detailed review of each.

8.15 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

8.16 In particular, I refer to my earlier comments that the application of certain accounting standards, and in particular some past accounting standards, requires or required the use of more discretionary professional accounting judgement and therefore may or could result in two different accountants (neither of whom is wrong) arriving at two different conclusions. In such a scenario, a difference in the conclusions reached would not, or does not, indicate that either of them was necessarily inappropriate but rather that they formed part of a range of possible conclusions, each or all of which might be, or could be appropriate.

[219] Re-Re-Amended Particulars of Claim, paragraphs 79.1 to 79.3.

9 RESELLER CAPAX DISCOVERY (END-USERS KRAFT AND FSA)

Introduction

9.1 In section 8 of my report I consider the matter of transactions with resellers generally. In this section of my report I consider two examples of reseller transactions in respect of Capax Discovery (end-users Kraft and FSA).

Reseller Capax Discovery (end-user Kraft) – Q3 2009

Initial observation

9.2 This transaction provides an example of a sale of software where the appropriate accounting treatment of the revenue recognised might be affected by the terms determined (if any at all) of an alleged verbal arrangement. The existence or otherwise of the alleged verbal arrangement, and any alleged terms, are matters of disputed fact. It also appears to be an example of a transaction where Deloitte was aware of other factors now relied upon by the Claimants in classifying this as a transaction on which Autonomy improperly recognised revenue. For example, the software sold under the deal to Capax Discovery, and subsequently to Kraft, was primarily Digital Safe. At no point, however, did it appear that Deloitte challenged the upfront revenue recognised from the licensing of the Digital Safe software, or indicate to the contrary that it should be rateably recognised over the term of the licence. Similarly, Deloitte was aware of the delay in making the sale to Kraft in Q3 2009, and the subsequent direct sale to Kraft.

Transaction details

9.3 Transaction 3 from Schedule 3 to the Re-Re-Amended Particulars of Claim relates to a reseller transaction between Autonomy[220] and Capax Discovery (as a reseller) in Q3 2009. The identified end-user was Kraft and the licence fee agreed was US$4.0 million (plus 5% (US$200,000) of the licence fee in respect of support and maintenance for the first year).[221]

Autonomy's accounting treatment

9.4 Autonomy recorded a sale to Capax Discovery that was the subject of a purchase order dated 30 September 2009.[222] The purchase order notes it is "*issued under and pursuant*

[220] The contracting party is Autonomy Inc. However, as explained in paragraph 1.19, I refer to Autonomy group companies as Autonomy throughout this section.
[221] {CAPAX_000768}, pages 1 and 2.
[222] {CAPAX_000768}.

to a Value Added Reseller Agreement dated June 30, 2009".[223] [224] The invoice number was 5974-ANA and was dated 30 September 2009.[225]

9.5 Autonomy recognised licence revenue of US$4.0 million on 30 September 2009, with revenue in respect of support and maintenance of US$200,000 deferred to be recognised over the following year.[226]

9.6 Following this sale to Capax Discovery in Q3 2009 (which formed the first stage in an intended onward sale by Capax Discovery to Kraft), Autonomy subsequently signed a sale agreement direct with Kraft in Q4 2009 and, by letter dated 29 December 2009 released Capax Discovery from its obligations under the 30 September 2009 purchase order.[227] Autonomy then, according to the Claimants:

(a) issued a credit note (dated 31 December 2009) to Capax Discovery for US$4.2 million which debited the previously recognised revenue associated with the sales invoice raised on 30 September 2009 (for US$4.2 million);

(b) agreed to refund an initial US$400,000 upfront payment made by Capax Discovery, once Kraft had paid Autonomy all licence fees due under the new transaction; and

(c) agreed to pay Capax Discovery a "one-time" fee of US$400,000.[228]

9.7 The net effect on recognised revenue of the above in each of Q3 2009 and Q4 2009 was that the licence revenue recognised on the direct licence sale to Kraft by Autonomy in Q4 2009 was offset by the credit note (raised in Q4 2009) against the sale to Capax Discovery[229], i.e. the net effect on revenue in Q4 2009 was nil. This in turn meant that as a matter of accounting books and records the revenue recognised in Q3 2009 remained, but revenue was not double-counted on the direct sale to Kraft.

[223] {CAPAX_000768}.
[224] I have seen a copy of a "*Value Added Reseller Agreement*" between Autonomy and Capax Discovery which has an effective date of May 2009 but has no date of signature; it appears to have been faxed on 30 June 2009. It also notes that, "*This agreement shall be null and void and of no effect unless signed and returned by VAR to Autonomy on or before June 30, 2009*". I assume this to be the agreement referred to in the purchase order for this transaction {D003607774}.
[225] {D006977036}.
[226] Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 3.
[227] See for example, Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 3 and {POS00140402}.
[228] See for example, Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 3 and {POS00140402}.
[229] General ledger extracts of 'Licence Revenue – Commercial', 'Licence Revenue – VAR' and 'Deferred Revenue –Maintenance' have been provided in the Draft Claimants' Voluntary Particulars showing the recorded entries relating to recognition of revenue on the sale to Capax Discovery and subsequent reversal and sale to Kraft – CPX-KR 2009-03, pages 9,13 and 14, CPX-KR 2009-04, page 20 and CPX-KR 2009-07, pages 5 and 6.

Claimants' allegations

9.8 In respect of this transaction, the Claimants allege that, *"the use of Capax Discovery* [was] *a contrived means of accelerating the recognition of revenue from the hoped-for transaction with Kraft."*[230]

9.9 In line with the allegations in respect of reseller transactions more generally[231], in respect of this transaction the Claimants allege non-compliance with IAS 18.14(a), (b) and (d)[232], which are three of five conditions that must be satisfied for revenue to be recognised[233]:

(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods (IAS 18.14(a));

(b) the entity does not retain either continuing managerial involvement to the degree usually associated with ownership or effective control over the goods sold (IAS 18.14(b)); and

(c) it is probable that the economic benefits associated with the transaction will flow to the entity (IAS 18.14(d)).

Deloitte's work

Deloitte's testing of the Q3 2009 sale to Capax Discovery

9.10 Deloitte reviewed this sale as part of its Q3 2009 quarterly review procedures.

9.11 Deloitte reviewed the sale including the invoice, purchase order and original contract with Capax Discovery. Deloitte recorded that:

(a) the invoice number was 5974-ANA;

(b) the value of the invoice was US$4.2 million;

(c) the date of the invoice and contract was 30 September 2009;

(d) the contract was signed;

(e) the maintenance period was for one year from 30 September 2009 to 29 September 2010 and the maintenance element had been carved out at 5%;

(f) there were no acceptance criteria to be met;

(g) the accounts receivable balance was US$4.2 million; and

[230] Re-Re-Amended Particulars of Claim, paragraph 136.1A.0.3.
[231] See paragraph 8.9 of my report.
[232] Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 3.
[233] See section 4 for IAS 18.14 and relevant guidance.

(h) no unusual terms were noted in the original agreement.[234]

9.12 The Deloitte review working paper also states:

"The end user is Kraft and the VAR involved is Capax Discovery LLC. PDW [per discussions with] *Autonomy it is apparent that in depth discussions were held between Kraft and Autonomy prior to quarter end. Kraft were unable to finalise the deal until their board meeting on 15 October; hence Autonomy decided to sign a deal with Capax whereby Capax complete the deal with Kraft after the 15 October but take on all the risk. Deloitte have reviewed correspondence with all parties involved that supports this sequence of events…*

Per discussion with Steve Chamberlain (VP Finance), we noted that the background to this deal was that Autonomy were initially dealing directly with Kraft to secure the deal. However, due to internal procedures at Kraft, it meant that this deal could not be signed until the October 2009 board meeting. As such, in order to secure the deal during Q3 2009, Autonomy used the VAR Capax to sell the licence to Kraft, thus allowing Autonomy to secure the deal with Capax (albeit at a lower value) and recognise the revenue…

In order to support the above rationale, we have viewed the customer relationship management software used by Autonomy sales staff, to evidence the fact that Autonomy were dealing directly with Kraft. We note that there were meetings between Kraft and Autonomy dating back from July 2009 to the end of Q3 2009. Note that we have also seen an e-mail from Joel Scott (Senior US legal counsel) that contained draft professional service contracts between Autonomy and Kraft, thus evidencing that the two parties continue [to] *negotiate in good faith and that the deal is progressing."*[235]

9.13 Deloitte tested delivery of the software by agreeing this to "*an email dated 30 September 2009, from support@us.autonomy.com*[236]*, stating that the information is available for the customer to download from the website: http://customers.autonomy.com*" and concluded that this was satisfactory.[237]

9.14 Deloitte specifically considered the collectability of the amounts due from Capax Discovery, as follows:

"*Kraft is a large end user with the means to comfortably cover this contract. Capax is a reseller that Autonomy have used several times in the past. Whilst Capax are a relatively small reseller, Deloitte have reviewed their financials in prior quarters and noted they*

[234] {DEL1_003_1_00000161}.
[235] {DEL1_003_1_00000161}.
[236] This email was addressed to "*orders List Member*" but began "*Hello John Baiocco*" {D003597509}. John Baiocco was Capax Discovery's managing partner at the time. This email is dated 1 October 2009 at 6.17am, however, the time difference must be taken into account as Autonomy's office in San Francisco was eight hours behind Autonomy's office in the UK.
[237] {DEL1_003_1_00000161}.

are part of a much larger group. Additionally, a review of Capax payment histories has identified that all payments for previous large deals have been kept up to date with no issues arising (agreed to bank per cash collection testing)…

Capax paid Autonomy $400k of the purchase price upfront, as part of the licence deal. Note that following the licence sale to Kraft, Autonomy are expecting to continue to provide the required professional services directly to Kraft."[238]

9.15 Deloitte concluded:

"*Given that we have seen evidence that directly links Autonomy and Kraft, both pre and post the deal with Capax, we conclude that there is satisfactory evidence to support the fact that Kraft are the end user. As such, we conclude that this amount is recoverable, on the basis that Kraft are a multinational blue chip company, who will be able to pay Capax for the purchased licence. Note that the upfront payment from Capax also evidences their liquidity, which is further support for recognition.*"[239]

9.16 In its working paper[240], Deloitte set out its consideration of the requirements of IAS 18.14 for the recognition of revenue and concluded that the criteria had been met to recognise revenue on the transaction with Capax Discovery at the invoice date of 30 September 2009. This conclusion was based on the following (I have added in cross-references for the relevant paragraphs of IAS 18.14):

(a) "*The risks and rewards of ownership passed to the customer when the items were delivered. As all of Autonomy's obligations have been fulfilled the risks and rewards have been transferred.* [IAS 18.14(a)]

(b) *Autonomy has not retained any managerial control.* [IAS 18.14(b)]

(c) *The revenue can be measured effectively as it is stated on both the invoice and in the contract* [IAS 18.14(c)]

(d) *It is probable that economic benefits will flow to Autonomy* [IAS 18.14(d)]

(e) *There are no costs incurred in this transaction* [IAS 18.14(e)]."[241]

Deloitte's testing of the Q4 2009 direct transaction with Kraft

9.17 As described at paragraph 9.6 above, Autonomy subsequently entered into a direct agreement with Kraft in Q4 2009. Deloitte reviewed this subsequent sale and, in doing so also, reconsidered the earlier sale to Capax Discovery as part of its full audit testing for

[238] {DEL1_003_1_00000161}.
[239] {DEL1_003_1_00000161}.
[240] {DEL1_003_1_00000161}.
[241] {DEL1_003_1_00000161}.

the year ended 31 December 2009. Deloitte, in particular, prepared a dedicated memorandum, the objective of which was "*To summarise the facts surrounding the sale to Kraft (using Capax Discovery) in Q3 2009 and the subsequent deal signed directly between Autonomy and Kraft in Q4 2009*".[242]

9.18 Deloitte set out the details of the transaction between Autonomy and Capax Discovery and noted:

"*This was a deal where Autonomy had been negotiating directly with Kraft throughout Q3 2009 but due to time constraints the deal could not be signed directly before quarter end. As such, the deal was signed with Capax who would deliver the software to Kraft…*

During Q4 2009 Kraft expressed a willingness to sign the deal directly with Autonomy rather than through Capax. As such, Autonomy negotiated a fee with Capax to purchase the contract off them so that a deal could be signed directly between Autonomy and Kraft. In exchange for this right, Autonomy agreed to pay Capax $0.4 million and waive Capax's contractual obligations to Autonomy under the original contract. This has been treated as a third party commission cost in sales and marketing, which is deemed to be appropriate…

A contract was then signed between Autonomy and Kraft for a total licence amount of $4.0 million and first year support and maintenance of $0.2 million."[243]

9.19 Deloitte also considered the terms of the agreement dated 29 December 2009, releasing Capax Discovery from its obligations under the Q3 2009 transaction and stated:

"*We have reviewed the fully executed side agreement between Autonomy and Capax (dated 29 December 2009) and noted that it removes all rights Capax had to collect monies from Kraft and it removes any obligation to pay the original amounts due to Autonomy. We also note that Autonomy agreed to pay Capax a one-time fee of $0.4 million.*

This cost has been treated as a commission-based cost and has been taken to sales and marketing expense. This is considered to be appropriate accounting treatment and is therefore considered as satisfactory."[244]

9.20 Deloitte reviewed the direct agreement with Kraft and noted "*it provides Kraft with the same software as per the original agreement with Capax*" and that the Kraft agreement "[was] *considered to be the same as the one signed with Capax*".[245]

[242] {DEL1_003_1_00000073}, page 1.
[243] {DEL1_003_1_00000073}, page 1.
[244] {DEL1_003_1_00000073}, page 1.
[245] {DEL1_003_1_00000073}, page 1.

9.21 Deloitte considered the revenue recognised in Q4 2009 on the transaction with Kraft and noted:

"*In Q4 2009 management has recognised the revenue on the deal with Kraft (at $4.0 million) but reversed through the Q3 2009 revenue on the Capax deal (at $4.0 million). As such, the net impact in Q4 2009 is* ***zero****. For the full year results only a total amount of $4.0 million has been recognised, being the revenue recognised in Q3 2009. We have agreed this through to the revenue matrices, which have been agreed through to the consolidation. This is therefore considered to be satisfactory.*"[246]

9.22 Deloitte concluded:

"*We conclude that as no additional revenue has been recognised in Q4 2009, the year-end debtor position has been corrected and the full year revenue position is correct that this accounting treatment is satisfactory.*"[247]

9.23 Mr Welham highlighted this transaction to Mr Knights in an email dated 16 January 2010 and stated that the transaction had been "*appropriately accounted for in Q4 2009*".[248]

Deloitte's reports to the Autonomy Audit Committee

9.24 Deloitte referred to the sale between Autonomy and Capax Discovery in the Q3 2009 Deloitte Audit Committee Report when discussing the work carried out on revenue recognition as follows:

"*This is a $4 million licence deal for a suite of Autonomy software including Zantaz Digital Safe, Aungate and Introspect. Support and maintenance has been charged at $0.2 million which is consistent with fair value on a deal of this size. It should be noted that this deal has been signed through the reseller, Capax Discovery LLC…As Capax are up-to-date with their payment terms with Autonomy, and all other revenue recognition criteria have been met, management has concluded it is appropriate to recognise revenue.*"[249]

9.25 By comparison, Deloitte made no reference to the subsequent direct sale between Autonomy and Kraft, or to the credit note associated with the Q3 2009 Capax Discovery sale, in the key audit risks section within the Deloitte Audit Committee Report for the year ended 31 December 2009, or at all in that report.

[246] {DEL1_003_1_00000073}, page 2.
[247] {DEL1_003_1_00000073}, page 2.
[248] {POS00140549}.
[249] {DEL1_003_1_00000191}, page 3.

Witness evidence

9.26 Christopher Bradley Egan ("Mr Egan"), the CEO of Autonomy Inc during the Relevant Period[250] stated in his witness statement dated 13 September 2018 ("Mr Egan's Witness Statement") that he approached John Baiocco, Capax Discovery's managing partner during the Relevant Period ("Mr Baiocco"), regarding the deal with Kraft and:

"*I told him about the status of the Kraft deal, including the fact that I expected it to close shortly after the end of the quarter. I asked Capax Discovery to act as a VAR, to submit a purchase order for a Digital Safe license for onward licensing to Kraft, and to agree to pay $4 million for that software -- the same price I had been discussing with Kraft…I followed the guidance that Mr Hussain gave me…I told Mr Baiocco that Autonomy would continue its efforts to close a deal with Kraft and, when we were successful, we would get Kraft to pay its license fee to Capax so that Capax, in turn, could pay Autonomy. I also told him that, if for some reason we could not get Kraft to pay Capax, we would find another way to make sure that Capax did not have to reach into its own pocket to make a payment to Autonomy. I agreed that Autonomy would pay Capax 10% of the purchase price for assisting us by submitting a purchase order that said that Capax Discovery was obligated to pay for the software under the terms of the VAR agreement with Autonomy.*"[251]

9.27 Regarding the issue of the credit-worthiness of Capax Discovery, Mr Egan also stated:

"*I have been informed by the Claimants' lawyers that on September 30, in order to help to demonstrate to Autonomy's auditors that Capax Discovery remained a satisfactory credit risk, Autonomy paid Capax Discovery the sum of $1 million for EDD services that Capax Discovery had not actually performed (and was not then capable of performing); and that on the same day, Capax Discovery paid $968,750 to Autonomy in compliance with its payment obligation under the EDD software license agreement.*"[252]

9.28 It appears that this is not within Mr Egan's contemporaneous knowledge.

9.29 Mr Egan also stated that he continued to pursue the deal with Kraft and ultimately succeeded in closing that deal without Capax Discovery's involvement.[253] He went on to also state that Autonomy agreed to return Capax Discovery's deposit of US$400,000 and to pay Capax Discovery US$400,000 which, he says, was a "*fee for signing a purchase order "at risk" so that Autonomy could recognize $4 million of revenue in Q3 2009*".[254]

[250] I understand from paragraph 1 of Mr Egan's Witness Statement that Mr Egan was also responsible for Autonomy's sales activities in North and South America during the Relevant Period.
[251] Mr Egan's Witness Statement, paragraph 66.
[252] Mr Egan's Witness Statement, paragraph 68.
[253] Mr Egan's Witness Statement, paragraph 69.
[254] Mr Egan's Witness Statement, paragraph 71.

9.30 According to Mr Hussain:

"Autonomy's sales representatives and sales managers also signed a letter to Deloitte at the end of each year disclosing any side agreements that had been entered into with any customer to which they had sold Autonomy products or confirming that there were none. In each case, the VAR constituted Autonomy's customer."[255]

9.31 I do not know whether this requirement extended to Mr Egan.

9.32 Mr Baiocco stated in his witness statement dated 13 September 2018 ("Mr Baiocco's Witness Statement") that Capax Discovery did not attempt to license Autonomy software to Kraft.[256]

9.33 Mr Baiocco, in regard to his dealings with Mr Egan generally, states that the agreement with Mr Egan by way of a "handshake" was that Capax Discovery would not be required to pay Autonomy until Autonomy closed the deal with the end-user and the end-user:

(a) paid Capax Discovery;

(b) paid Autonomy (in which case Capax Discovery's debt under the agreement with Autonomy would be cancelled); or

(c) Autonomy had otherwise put Capax Discovery in funds to make the payment.[257]

9.34 However, at the same time, Mr Baiocco in his witness statement also acknowledged that:

"… there was always a risk that Autonomy might not follow through on my handshake agreement with Mr Egan. … our use of Capax Discovery as the vehicle for these VAR transactions was designed to protect the rest of the Capax group from this risk."[258]

9.35 I note that this matter was also the subject of Mr Baiocco's oral evidence during the criminal proceedings brought by the United States Department of Justice against the Second Defendant in the United States District Court, Northern District of California, as recorded in the transcript of those proceedings ("Transcript of Proceedings"). Given the length and nature of the transcripts I have attached an extract as **Exhibit Y**. In particular, I note the following comments made by Mr Baiocco:

"Q. On the one hand, did you insist that Capax took some risk on these deals they had to be 'good for it' if the direct deal between Autonomy and the end user fell through?

[255] Mr Hussain's Witness Statement, paragraph 138.
[256] Mr Baiocco's Witness Statement, paragraph 37.
[257] Mr Baiocco's Witness Statement, paragraph 30(b).
[258] Mr Baiocco's Witness Statement, paragraph 30(b).

[Mr Baiocco:] *Yeah. I mean, we did our best to get a guarantee but, I mean, in my opinion there was always some latent risk it could fall apart and they could turn back on their handshake deal and I'd be left with nothing. So, yeah, absolutely there was risk."*[259]

"*Q. Did Capax take substantial risk on every VAR deal with Autonomy?*

[Mr Baiocco:] *In the eyes of the law, yes.*

Q. Okay. I get the eyes of the law. What other eyes are there?

[Mr Baiocco:] *Well, I mean, if everything went wrong and somebody came to me, I had my name - we had our name signed on that contract. So, ultimately, you're right, we would have owed it or not paid it, but that was never the arrangement.*

Q. When the purchase order was signed, the financial - is this true that when the purchase order was signed by Capax, the financial risk of the deal was transferred to Capax?

[Mr Baiocco:] *In the eyes of the law, yes.*

Q. In the event the deal with the government end user did not close, Capax would own the software licences and ultimately have to pay Autonomy for them; is that true?

[Mr Baiocco:] *In the eyes of the law, yes, it is. …*

Q. And Capax evaluated the risk in these VAR transactions and decided the upside was worth the inherent risk. Right or wrong?

[Mr Baiocco:] *Correct."*[260]

9.36 As such, it appears apparent that Mr Baiocco was aware that, irrespective of any claimed "handshake" agreement (or presumably onward sale to an end-user) there was an obligation for Capax Discovery to pay for the goods purchased from Autonomy.

9.37 In contrast to Mr Baiocco, Mr Lynch states in his First Witness Statement that he:

"*…was not aware of any side agreement, "handshake agreement" or understanding between Capax and Autonomy that would prevent Autonomy from recovering any sum owed to Autonomy by Kraft but in any case under the terms of the contract, I understand that such a handshake agreement would be of no legal effect."*[261]

9.38 I also note the following comments made by Mr Baiocco in the Transcript of Proceedings regarding Capax Discovery's ability to pay Autonomy for software purchased under the reseller transactions such as the transaction described in this example:

[259] **Exhibit Y -** Transcript of Proceedings, Volume 4, page 631, lines 9 to 16.
[260] **Exhibit Y -** Transcript of Proceedings, Volume 4, page 640, line 12 to page 641, line 12.
[261] Dr Lynch's First Witness Statement, paragraph 279.

"Q…did you tell the investigators that Capax had a line of credit to pay for these VAR licenses?

[Mr Baiocco:] *We said what ultimately would happen if everything went wrong; and we said, "Well, ultimately we had a line of credit. We might have been able to do it."*

Q. You said you could pay it through your line of credit; it would have been painful, but you could pay for it?

[Mr Baiocco:] *That was my thought at the time."*[262]

My analysis

Existence of a "side agreement"

9.39 The Claimants allege that there was an agreement or understanding that Capax Discovery would not be required to satisfy any liability to Autonomy from its own resources.[263] I understand the evidence in this dispute to be that this alleged agreement was verbal and is based on the testimony of the Claimants' witnesses.

9.40 Despite the claimed "handshake" agreement described by Mr Baiocco, there are also comments made by Mr Baiocco (by reference to his witness statement and the Transcript of Proceedings) that appear to indicate that such an agreement was by no means certain, and that there remained the obligation on Capax Discovery to pay for the goods purchased, as set out at paragraphs 9.33 to 9.36. For the avoidance of doubt, this is a matter of dispute in these proceedings, but a finding one way or the other has the potential to impact accounting treatment for revenue.

Compliance with IAS 18

9.41 As set out in section 4 of this report, IAS 18 states that revenue from the sales of goods shall be recognised when the five conditions set out at paragraphs 14(a) to 14(e) have been satisfied[264]. I comment on the Claimants' allegation of non-compliance with IAS 18.14(a), (b) and (d) in respect of this transaction below. For the avoidance of doubt, I do not comment specifically in this section of my report on the nature of the sale of Digital Safe under this sale to Kraft, and whether it represents the sale of a good, or the sale of a service (as contended I understand by the Claimants). I note again, however, that there appears to be no accounting evidence considered at the time, and in particular by Deloitte,

[262] **Exhibit Y -** Transcript of Proceedings, Volume 4, page 635, lines 6 to 13.
[263] Re-Re-Amended Particulars of Claim, paragraph 74A.
[264] See paragraphs 4.35 of my report.

that supports a view now that sales of Digital Safe software in general, constituted a rendering of a service.

IAS 18.14(a) – transfer of significant risks and rewards of ownership

9.42 IAS 18.14(a) requires that the entity has transferred to the buyer the significant risks and rewards of ownership of the goods.

9.43 At the time of the transaction, Autonomy had entered into a legally binding contract that specified that Autonomy would sell software to Capax Discovery. The Value Added Reseller Agreement between Autonomy and Capax Discovery sets out:

"*Once the Autonomy Products on a purchase order have been shipped by Autonomy, VAR may not cancel or amend the purchase order without the prior written consent of Autonomy.*"[265]

9.44 As set out at paragraphs 9.33 to 9.36, despite the claimed "handshake" agreement[266] described by Mr Baiocco, there are also comments made by Mr Baiocco (by reference to his witness statement and the Transcript of Proceedings) that contradict that the risks and rewards of ownership were not transferred to Capax Discovery, and that Mr Baiocco understood this to be the case.

9.45 Whether the risks and rewards of ownership had passed to Capax Discovery was one of the issues specifically tested by Deloitte during its Q3 2009 quarterly review of this transaction. As noted at paragraph 9.16 above, Deloitte concluded that when the goods were delivered and "*all of Autonomy's obligations have been fulfilled the risks and rewards have been transferred*".[267]

9.46 As set out at paragraph 9.13, Deloitte tested the delivery of this software and considered the results of that testing satisfactory.

IAS 18.14(b) – entity retains neither continuing managerial involvement nor effective control

9.47 IAS 18.14(b) requires that the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.

[265] {D003607774}, page 3, clause 5.1.
[266] I note, although it is a legal matter, that the Value Added Reseller Agreement referred to above contained an entire agreement clause. I understand this is also a matter pleaded by Dr Lynch, see for example, First Defendant's Amended Defence, paragraph 99A.
[267] {DEL1_003_1_00000161}.

9.48 According to Deloitte's 2009 Guidance, this is linked to the risks and rewards of ownership and it would be unusual for an entity to maintain managerial involvement to the degree associated with ownership without retaining the risks and rewards.[268]

9.49 In respect of the transactions with resellers that the Claimants allege were "*contrived*", which includes the transaction described in this example, the Claimants allege that:

"*Autonomy retained managerial involvement in the ongoing sales discussions with the end-user to the degree usually associated with ownership or effective control over the licence that was to be sold.*"[269]

9.50 As set out at paragraphs 9.15, 9.18 and 9.26 above for example, following the sale to Capax Discovery, I understand that it is not disputed that there was continued contact between Autonomy and Kraft (and then subsequently a direct arrangement between Autonomy and Kraft and the cancellation of Capax Discovery's liability).

9.51 However, an assessment of revenue recognition based on events that occurred subsequently to the sale involves the use of hindsight and information that would not have been available at the time of the initial recognition. Such events would not therefore impact on revenue recognition, which should be based only on contemporaneous information.

9.52 Deloitte was aware that, following the transaction between Autonomy and Capax Discovery, there was continued contact between Autonomy and Kraft. Again, for example, as noted at paragraphs 9.12 and 9.15, Deloitte took some assurance from the fact that Autonomy and Kraft continued to communicate to progress the deal, in particular subsequent to the sale to Capax Discovery, explicitly stating:

"*Note that we have also seen an e-mail from Joel Scott (Senior US legal counsel) that contained draft professional service contracts between Autonomy and Kraft, thus evidencing that the two parties continue* [to] *negotiate in good faith and that the deal is progressing…*

…we have seen evidence that directly links Autonomy and Kraft, both pre and post the deal with Capax."[270]

9.53 This does not have the effect of prompting Deloitte to consider whether the revenue recognised on the sale to Capax Discovery in Q3 2009 was in any way inappropriately recognised at the time of this sale.

[268] See paragraph 4.43 of my report.
[269] Re-Re-Amended Particulars of Claim, paragraph 79.2.
[270] {DEL1_003_1_00000161}.

9.54 While it is important to consider the substance of a transaction as well as its legal form, as noted at paragraphs 4.25 to 4.29, the contract terms can drive the accounting treatment and should not be ignored in determining the point at which revenue should be recognised and the measurement of revenue.

9.55 Instead, at the time of the sale with Capax Discovery, Deloitte recognised Autonomy had entered into a legally binding contract that specified that Autonomy would sell software to Capax Discovery. The "*Value Added Reseller Agreement*" between Autonomy and Capax Discovery sets out that the "*VAR shall assume all responsibility and liability to End Users with respect to the Autonomy Products.*"[271]

9.56 On the basis of this contract clause, ongoing Autonomy contact, communication and/or negotiation with an end-user of its software to the degree usually associated with ownership of that software was not an act which Autonomy was required to perform in the circumstances where Autonomy had already made a sale to Capax Discovery. Further, I understand that where Autonomy chose to maintain contact with an end-user subsequent to the sale of its software to a reseller designated for that end-user, this was for genuine commercial reasons. Accordingly, this was not considered by Autonomy management to undermine the accounting on the sale to the reseller.[272]

9.57 Dr Lynch outlines the reasons as to why Autonomy may have continued to communicate with end-users beyond recognition of a sale, explaining that the commercial reality of Autonomy's relationships with the end-user would often have involved various Autonomy departments communicating with the end-user:

"*… Autonomy's end users were often repeat customers and used Autonomy software throughout their companies, in different branches and subsidiaries, to address different IT needs. Autonomy's technical, financial, legal and sales teams would have been in constant communication with these end users.*

… Autonomy sometimes sold resellers one part of a much larger solution. Autonomy would confer with the end user when negotiating and supporting the larger solution, even if the reseller was responsible for a smaller part.

… Autonomy may have had a better relationship with the end user, or the end user may have preferred negotiating with Autonomy directly, even if the end user was ultimately willing to purchase through the reseller."[273]

9.58 While subsequent contact with a previously identified potential end-user may possibly constitute managerial involvement (dependent on the exact facts, and in any event it must

[271] {D003607774}, page 2, clause 3.3.
[272] Dr Lynch's First Witness Statement, paragraphs 268 to 269.
[273] Dr Lynch's First Witness Statement, paragraph 268.

still relate to a level of involvement associated with ownership over the goods sold), the act of contact itself is not necessarily determinative of the test within IAS 18.14(b).

9.59 In addition, whether Autonomy retained any managerial control was one of the issues specifically considered by Deloitte during its review of the transaction between Autonomy and Capax Discovery. As noted at paragraph 9.16 above, Deloitte concluded that Autonomy had not retained any managerial control under this transaction usually associated with ownership of the goods sold, even in the knowledge of the subsequent contact with Kraft.

9.60 Indeed, Deloitte also considered the subsequent direct sale from Autonomy to Kraft and concluded that this had been accounted for appropriately at the time, as set out at paragraphs 9.17 to 9.23 (with appropriate adjustments relating to the earlier sale to Capax Discovery).

IAS 18.14(d) transfer of economic benefits

9.61 IAS 18.14(d) requires that it is probable that the economic benefits associated with the transaction will flow to the entity.

9.62 In respect of the transactions with resellers that the Claimants allege were "*contrived*", which, as already noted, includes the transaction described in this example, the Claimants allege that:

"*In many cases the VAR did not have the means to pay the Autonomy group company in the absence of an onward sale of the relevant licence to the identified end-user.*"[274]

"*At the time the revenue was recognised by Autonomy, it was not probable that the Autonomy group company would receive the economic benefits associated with the contrived VAR transaction. The Autonomy group company…agreed and/or understood that the VAR would not be required to satisfy any liability to Autonomy from its own resources. In many instances, the VAR did not have the resources to pay its accumulated purported obligations to the Autonomy group company unless the Autonomy group company completed a sale to the end-user and caused the end-user to pay the VAR or the Autonomy group company made a payment to the VAR for rights, goods or services that Autonomy did not need or use.*"[275]

9.63 Regarding the collectability of the transaction between Capax Discovery and Autonomy, I note that the "*Value Added Reseller Agreement*" between Autonomy and Capax Discovery

[274] Re-Re-Amended Particulars of Claim, paragraph 74.3.4.
[275] Re-Re-Amended Particulars of Claim, paragraph 79.3.

sets out that the "*VAR shall not be relieved of its obligations to pay fees owed to Autonomy hereunder by the non-payment of fees by an End User*".[276]

9.64 As noted at paragraph 9.14, Deloitte gave consideration to Capax Discovery's ability to pay Autonomy by relying on its review of Capax Discovery's financial information in prior quarters, the fact that it was part of a much larger group of companies, its payment history and the fact that Capax Discovery had paid Autonomy US$400,000 upfront on this transaction.[277]

9.65 Deloitte also concluded that the intended end-user, Kraft, as a large end-user, also had the means to pay for this contract.[278] However, I note that this conclusion is not directly relevant for the purposes of Autonomy's recognition of the Q3 2009 sale to Capax Discovery, on the basis that Autonomy and Deloitte considered that the risks and rewards had passed to Capax Discovery and the conditions of IAS 18.14 had been satisfied on that sale.

9.66 Deloitte concluded:

"*we conclude that this amount is recoverable, on the basis that Kraft are a multinational blue chip company, who will be able to pay Capax for the purchased licence. Note that the upfront payment from Capax also evidences their liquidity, which is further support for recognition.*"[279]

9.67 Further, I refer to Mr Baiocco's comments in the Transcript of Proceedings as set out at paragraph 9.38 above. These comments would appear to support that, at the time, Capax Discovery was capable of paying for the software it purchased from Autonomy by utilising its available line of credit. The issue of whether Mr Baiocco and Capax Discovery wished to pay for the software purchased is a question of fact. I note though that I have not been able to locate a signed audit confirmation provided to Deloitte from Capax Discovery for Q3 2009.

Summary – Capax Discovery (identified end-user Kraft)

9.68 In respect of the overall allegation that this was a *"contrived"* transaction made in order to accelerate the recognition of revenue on a transaction with Kraft, in my opinion the claims made that Autonomy did not comply with IAS 18.14(a), (b) and (d) appear to the contrary to have been considered at the time of original revenue recognition. As set out in my analysis above, the contemporaneous documentation I have reviewed indicates the assessment that these requirements of IAS 18 were met. These requirements were specifically reviewed by Deloitte and ultimately, on the basis of the evidence available at

[276] {D003607774}, page 4, clause 7(c).
[277] {DEL1_003_1_00000161}.
[278] {DEL1_003_1_00000161}.
[279] {DEL1_003_1_00000161}.

the time, Deloitte was satisfied that the accounting treatment applied by Autonomy on the transaction with Capax Discovery was appropriate, as was the accounting treatment of the subsequent transaction between Autonomy and Kraft.

9.69 With regard to the allegation by the Claimants of the existence of a side agreement in relation to this transaction, this is a matter of disputed fact. However, I consider that from the documentation I have reviewed, if such an arrangement did exist, it appears that Mr Baiocco understood it did not relieve Capax Discovery's recognised obligation to pay Autonomy in respect of the transaction should Autonomy enforce its rights, nor countermand Mr Baiocco's understanding of Capax Discovery's obligation to pay.

9.70 To the extent that assertions, and in particular regarding a side arrangement, made by the Claimants' witnesses are taken as fact this could impact my views as to the accounting treatment for this sale adopted by Autonomy, but nonetheless would still need to be considered in light of all other relevant evidence available at the time (given the nature of the judgement question of revenue recognition as well as the nature of ongoing dialogue with auditors in general).

9.71 In particular, if based on the facts available at the time it is determined that a side agreement did exist such that Capax Discovery did not have an obligation to pay Autonomy from its own funds in respect of the transaction (assuming that this arrangement was known within Autonomy, as alleged), this could be a factor in determining whether or not the risks and rewards of ownership were transferred and/or it was probable that there would be a transfer of economic benefit and therefore whether or not the criteria for revenue recognition under IAS 18.14 had been met at the time that revenue was recognised by Autonomy.

9.72 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

Reseller Capax Discovery (end-user FSA) – Q1 2010

Initial observation

9.73 This transaction provides another example of a deal where the appropriate accounting only follows once the exact terms (if any at all) of a possible verbal arrangement are determined as a matter of disputed fact. This itself, however, would still not be the sole factor that would need to be assessed and considered in determining the accounting treatment for revenue.

Transaction details

9.74 Transaction 10 from Schedule 3 to the Re-Re-Amended Particulars of Claim relates to a transaction between Autonomy[280] and Capax Discovery (the reseller) in Q1 2010. The identified end-user was the FSA and the licence fee agreed was US$4.3 million (plus US$214,286 in respect of support and maintenance).[281]

Autonomy's accounting treatment

9.75 Autonomy made a sale to Capax Discovery that was the subject of a purchase order dated 31 March 2010.[282] The purchase order states that it *"is issued under and pursuant to a VAR agreement dated May 2009"* between Autonomy and Capax Discovery.[283] The invoice was number 6815-ANA and was dated 31 March 2010.[284]

9.76 Autonomy recognised licence revenue of US$4.3 million on 31 March 2010, with revenue in respect of support and maintenance of US$214,286 deferred to be recognised over the following year.[285]

9.77 I understand that subsequently ASL agreed a sale direct with the FSA, although for a different transaction amount in Q3 2010.

Claimants' allegations

9.78 In respect of this transaction, the Claimants allege that:

"… the Capax Discovery/FSA purchase order was a contrived transaction entered into for the purpose of enabling the premature recognition of revenue by Autonomy and on the basis of an agreement or understanding (as set out in paragraph 74A [of the Re-Re-Amended Particulars of Claim]*) that Capax Discovery would not in fact be required to satisfy any liability to Autonomy Inc from its own resources."*[286]

9.79 In line with the allegations in respect of transactions with resellers more generally[287], in respect of this transaction the Claimants allege non-compliance with IAS 18.14(a), (b) and (d)[288], which are three of five conditions that must be satisfied for revenue to be recognised[289]:

[280] The contracting party is Autonomy Inc. However, as explained in paragraph 1.19, I refer to Autonomy throughout this section.
[281] Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 10.
[282] {HP-SEC-00856350}.
[283] {HP-SEC-00856350}.
[284] {D006977611}.
[285] Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 10.
[286] Re-Re-Amended Particulars of Claim, paragraph 77.
[287] See paragraph 8.11 of my report.
[288] Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 10.
[289] See section 4 for IAS 18.14 and relevant guidance.

(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods (IAS 18.14(a));

(b) the entity does not retain either continuing managerial involvement to the degree usually associated with ownership or effective control over the goods sold (IAS 18.14(b)); and

(c) it is probable that the economic benefits associated with the transaction will flow to the entity (IAS 18.14(d)).

9.80 It is unclear to me at this time whether in regard to this transaction centred on the FSA, the Claimants contend that another amount of revenue should have been recognised, and that being the case, at what time and in what amount.

Deloitte's work

Deloitte's testing

9.81 Deloitte carried out a detailed review of this transaction as part of its Q1 2010 quarterly review procedures. Deloitte reviewed this sale as the sale of a licence. Deloitte reviewed the transaction including the invoices, purchase order and original contract with Capax Discovery. Deloitte confirmed that:

(a) the invoice number was 6815-ANA;

(b) the total value of the invoice was US$4.5 million;

(c) the date of the invoice was 31 March 2010;

(d) the purchase order was signed;

(e) the maintenance period was for one year from 31 March 2010 to 30 March 2011 and the maintenance element had been carved out at 5%;

(f) there were no acceptance criteria to be met;

(g) the accounts receivable balance was US$4.5 million; and

(h) no terms were identified which might restrict revenue recognition.[290]

9.82 The Deloitte audit working paper also states:

"We have reviewed the original VAR agreement and the purchase order to identify any terms that might restrict revenue recognition. No such terms were noted.

[290] {DEL1_002_1_00000133}.

We have also obtained a revenue confirmation from the customer which confirms that the above invoice is valid and that there are no side agreements."[291]

9.83 Deloitte then gave consideration to Capax Discovery's ability to pay Autonomy. As to the revenue confirmation referred to at paragraph 9.82, a letter from Capax Discovery dated 12 April 2010 shows that the debt in relation to the FSA deal was outstanding; the audit confirmation provided by Mr Baiocco also states that the invoices listed were properly charged to Capax Discovery's account and that there were no side letters or other agreements affecting the debt.[292]

9.84 Deloitte specifically considered the collectability of the amounts due by reviewing the recovery on historical sales to Capax Discovery at the time of the transaction, stating, "*… we have reviewed their payments made in Q1 2010 and their overall payment history*".[293] The Deloitte working paper notes that Capax Discovery made payments to Autonomy during 2009 and Q1 2010 under previous agreements and that, while amounts were outstanding at Q1 2010, they were only just overdue and expected by Autonomy in April.[294]

9.85 Although not directly relevant to the collectability of the revenue associated with this transaction between Autonomy and Capax Discovery, Deloitte noted that the end-user, the FSA, was a key regulator financed by the financial services industry and concluded that it was therefore able to meet its contractual commitments to Capax Discovery.[295]

9.86 Deloitte also obtained a copy of a letter from Capax Discovery to Autonomy dated 14 April 2010 and signed by Mr Baiocco which states that Capax Discovery, "*…maintains a very positive cash flow, along with a substantial cash reserve*" , "*has access to a $6MM line of credit, along with other capital as required*" and "[Capax] *Discovery's management … is more than confident that we can serve as a very financially viable partner with Autonomy now and in the future.*"[296]

9.87 In its working paper[297], Deloitte set out its consideration of the requirements of IAS 18.14 for the recognition of revenue and concluded that the criteria had been met to recognise revenue on the transaction with Capax Discovery at the invoice date of 31 March 2010. This conclusion was based on the following (I have added in cross-references for the relevant paragraphs of IAS 18.14):

[291] {DEL1_002_1_00000133}.
[292] See by way of reference to the receipt of the letter, Mr Welham's Witness Statement, paragraph 288; {POS00146619}.
[293] {DEL1_002_1_00000133}, page 2.
[294] {DEL1_002_1_00000133}, page 2.
[295] {DEL1_002_1_00000133}, page 2.
[296] {POS00147347}.
[297] {DEL1_002_1_00000133}.

(a) "*The risks and rewards of ownership passed to the customer when the items were delivered. As all of Autonomy's obligations have been fulfilled the risks and rewards have been transferred.* [IAS 18.14(a)]

(b) *Autonomy has not retained any managerial control.* [IAS 18.14(b)]

(c) *The revenue can be measured effectively as it was stated on both the invoice and in the contract* [IAS 18.14(c)]

(d) *It is probable that economic benefits will flow to Autonomy* [IAS 18.14(d)]

(e) *There are no costs incurred in this transaction* [IAS 18.14(e)]."[298]

Deloitte's report to the Autonomy Audit Committee

9.88 Deloitte expressly referred to this transaction in its Q1 2010 Deloitte Audit Committee Report section on "Key risks - revenue recognition" as follows:

"The Group has entered into one significant deal with payment terms greater than one year in the quarter with Capax Global[299] *for £4.5 million which we have discounted and included on our schedule of errors of fact."*[300] [301]

9.89 The adjustment proposed by Deloitte on its "schedule of errors" appears to relate to the time value of money in the context of extended payment terms[302] with Capax Discovery and not the overall issue of revenue recognition.

Witness evidence

9.90 According to Mr Baiocco, the Q1 2010 sale was introduced to him by Mr Egan "*right at the end of the quarter*"[303]. However, Mr Egan does not refer to or otherwise confirm his involvement with this transaction in his witness statement.[304]

9.91 Mr Hussain acknowledges however that "[he] *and other Autonomy staff continued sales efforts directed at the FSA*"[305], that Autonomy did (subsequently) enter into a direct arrangement with the FSA and that Autonomy "*cancelled Capax's liability under the Capax/FSA transaction as a matter of discretion and in the belief that it was acting in its*

[298] {DEL1_002_1_00000133}.
[299] Deloitte refer to this as a transaction with Capax Global, but this should actually refer to Capax Discovery.
[300] {DEL1_003_1_00000245}, page 3.
[301] The amount of US$0.3 million in relation to the discounting of the Capax Discovery deal is included on a list of uncorrected misstatements in the Q1 2010 Deloitte Audit Committee Report. {DEL1_003_1_00000245}, page 16.
[302] I.e. the idea that money that is available at the present time is worth more than the same amount in the future, due to its potential earning capacity.
[303] Mr Baiocco's Witness Statement, paragraph 47.
[304] Mr Egan's Witness Statement.
[305] Mr Hussain's Witness Statement, paragraph 122.

own commercial interests by so doing."[306] Mr Baiocco states that Capax Discovery's liability to Autonomy in this regard was cancelled on 7 September 2011.[307]

9.92 As set out at paragraph 9.57, Dr Lynch outlines the reasons as to why Autonomy may have continued to communicate with end-users beyond recognition of a sale.

9.93 I have set out at paragraphs 9.33 to 9.36 above comments from Mr Baiocco from his witness statement with regard to his dealings with Mr Egan generally and from the Transcript of Proceedings regarding the risk that Capax Discovery took on the reseller deals. I also set out at paragraph 9.38 Mr Baiocco's comments from the Transcript of Proceedings on Capax Discovery's ability to pay Autonomy for software purchased under the reseller transactions such as the transaction described in this example.

9.94 Mr Baiocco does not mention specifically in his witness statement his provision to Deloitte of the confirmation letter dated 12 April 2010 and referred to at paragraph 9.83, which shows that the debt in relation to the FSA deal was outstanding; I note also that the same confirmation also confirmed that the invoices listed were properly charged to Capax Discovery's account and that there were no side letters or other agreements affecting the debt.[308] In witness statement terms, in direct comparison, Mr Baiocco deals only with such confirmation letters in general terms, claiming that any such confirmations (provided by him) to Deloitte were directed by Mr Egan, but were false.[309] Mr Egan does not directly confirm this specific claim. It is not clear whether Mr Baiocco's statement as to false confirmations extends to the letter dated 14 April 2010 referred to at paragraph 9.86.

9.95 As set out in paragraphs 9.30 to 9.31, according to Mr Hussain, Autonomy's sales representatives and managers signed a letter to Deloitte at the end of each year disclosing any side agreements entered into with customers[310]. I do not know whether this requirement extended to Mr Egan.

My analysis

Allegation that transaction was "contrived"

9.96 In respect of the allegation by the Claimants that this transaction *"was a contrived transaction entered into for the purpose of enabling the premature recognition of*

[306] Mr Hussain's Witness Statement, paragraph 122.
[307] Mr Baiocco's Witness Statement, paragraph 59.
[308] See by way of reference to the receipt of the letter, Mr Welham's Witness Statement, paragraph 288; {POS00146619}.
[309] Mr Baiocco's Witness Statement, paragraph 90.
[310] Mr Hussain's Witness Statement, paragraph 138.

revenue"[311], this appears to be an issue of hindsight, as well as an uncorroborated claim as to the provenance of the transaction.

9.97 As set out in paragraph 9.91, Mr Hussain states that Autonomy did (subsequently) enter into a direct arrangement with the FSA (and that Autonomy did cancel Capax Discovery's liability). This information would not have been available to Autonomy at the time of the transaction. There is also no suggestion that this was arranged in advance and, therefore, can only be hindsight.

9.98 At the time of the transaction, Autonomy had entered into a legally binding contract that specified that Autonomy would sell software to Capax Discovery, who would subsequently then sell it on to the FSA. While Capax Discovery's liability was in the event cancelled, as set out at paragraph 9.91, Mr Hussain asserts that this was a matter of discretion in Autonomy's commercial interests. As to the question of motivation behind the post sale actions of Autonomy, this I regard as a question of disputed fact in this matter.

Existence of a "side agreement"

9.99 The Claimants allege in this dispute that there was, in general, an agreement or understanding that Capax Discovery would not be required to satisfy any liability to Autonomy from its own resources.[312] This alleged agreement was verbal and is based on the testimony of certain Claimants witnesses.

9.100 Despite the claimed "handshake" agreement described by Mr Baiocco relating to this sale (which I note again is not corroborated), there are also comments made by Mr Baiocco (by reference to his witness statement and the Transcript of Proceedings) that indicate that such an arrangement was by no means certain, and it appears that there was an obligation on Capax Discovery to pay for the goods purchased, as set out at paragraphs 9.33 to 9.36. For the avoidance of doubt this is a matter of dispute in this proceeding, but a finding one way or the other has the potential to impact accounting treatment for revenue.

Compliance with IAS 18

9.101 As set out in section 4 of this report, IAS 18 states that revenue from the sales of goods shall be recognised when the five conditions set out at paragraphs 14(a) to 14(e) have been satisfied[313]. I comment on the Claimants' allegation of non-compliance with IAS 18.14(a), (b) and (d) in respect of this transaction below.

[311] Re-Re-Amended Particulars of Claim, paragraph 77.
[312] See paragraph 9.78 of my report.
[313] See paragraphs 4.35 to 4.55 of my report.

IAS 18.14(a) – transfer of significant risks and rewards of ownership

9.102 IAS 18.14(a) requires that the entity has transferred to the buyer the significant risks and rewards of ownership of the goods.

9.103 As set out at paragraphs 9.33 to 9.36, despite the claimed "handshake" agreement described by Mr Baiocco, there are also comments made by Mr Baiocco (by reference to his witness statement and the Transcript of Proceedings) that indicate that risks and rewards of ownership were indeed transferred to Capax Discovery, and that Mr Baiocco, the managing partner of Capax Discovery, understood this to be the case.

9.104 In addition, whether the risks and rewards of ownership had passed to the customer was one of the issues specifically tested by Deloitte during its Q1 2010 quarterly review of this transaction. As noted at paragraph 9.87 above, Deloitte concluded that Autonomy had not retained the risks and rewards.

IAS 18.14(b) – entity retains neither continuing managerial involvement nor effective control

9.105 IAS 18.14(b) requires that the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.

9.106 According to Deloitte's 2009 Guidance, this is linked to the risks and rewards of ownership and it would be unusual for an entity to maintain managerial involvement to the degree associated with ownership without retaining the risks and rewards.[314]

9.107 As set out at paragraph 9.97 above, following the transaction with Capax Discovery, there was continued contact between Autonomy and the FSA (and then subsequently a direct arrangement between Autonomy and the FSA and a much later cancellation of Capax Discovery's liability).

9.108 However, an opinion based on any events that occurred subsequent to the transaction involves hindsight. Such events do not therefore impact on revenue recognition, which should be based only on contemporaneous information.

9.109 While it is important to consider the substance of a transaction as well as its legal form, as noted at paragraphs 4.25 to 4.29, the contract terms can drive the accounting treatment and should not be ignored in determining the point at which revenue should be recognised and the measurement of revenue.

9.110 At the time of the transaction, Autonomy had entered into a legally binding contract that specified that Autonomy would sell software to Capax Discovery, who would subsequently

[314] See paragraph 4.43 of my report.

sell it on to the FSA as the identified end-user.[315] The master reseller agreement between Autonomy and Capax Discovery set out that the "*VAR shall assume all responsibility and liability to End Users with respect to the Autonomy Products.*"[316] Accordingly, prima facie, there was no obligation for Autonomy to continue communications with the FSA.

9.111 Further, I understand that where Autonomy chose to maintain contact with an end-user subsequent to the sale of its software to a reseller designated for that end-user, this was for genuine commercial reasons. Accordingly, this was not considered by Autonomy management to undermine the accounting on the sale to the reseller.[317]

9.112 As set out in paragraph 9.57 above, Dr Lynch explained in his witness statement the reasons why Autonomy may have continued to communicate with end-users beyond recognition of a sale to a reseller. These reasons appear to relate to other aspects of Autonomy's commercial relationship with an end-user.

9.113 In addition, whether Autonomy retained any managerial control was one of the issues specifically considered by Deloitte during its review of this transaction. As noted at paragraph 9.87 above, Deloitte concluded that Autonomy had not retained any managerial control. As I have previously noted, it did this also in regard to Autonomy's sale to Capax Discovery where the identified end-user was Kraft, in the full knowledge that Autonomy remained in contact with Kraft, unlike (I understand) the situation with ongoing contact with the FSA.

IAS 18.14(d) – transfer of economic benefits

9.114 IAS 18.14(d) requires that it is probable that the economic benefits associated with the transaction will flow to the entity.

9.115 As noted at paragraphs 9.83 to 9.85, Deloitte gave consideration to Capax Discovery's ability to pay Autonomy, considered the collectability of the amounts due and reviewed a letter signed by Mr Baiocco that states that Capax Discovery, "*…maintains a very positive cash flow, along with a substantial cash reserve*", "*has access to a $6MM line of credit, along with other capital as required*" and "[Capax] *Discovery's management … is more than confident that we can serve as a very financially viable partner with Autonomy now and in the future.*"[318]

9.116 Further, I refer to Mr Baiocco's comments in the Transcript of Proceedings as set out at paragraph 9.38 above. These comments would appear to support that, at the time, Capax Discovery was capable of paying for the software it purchased from Autonomy by utilising

[315] See paragraph 9.98 of my report.
[316] {D003607774}, page 4.
[317] Dr Lynch's First Witness Statement, paragraphs 268 to 269.
[318] {POS00147347}.

its available line of credit. The issue of whether Mr Baiocco and Capax Discovery wished to pay for the software purchased is a question of fact.

9.117 Deloitte also concluded that the end-user, the FSA, as a key regulator financed by the financial services industry, was able to meet its contractual commitments to Capax Discovery.[319] However, I note that this conclusion is not directly relevant for the purposes of Autonomy's recognition of the sale to Capax Discovery, on the basis that Autonomy considered that the risks and rewards had passed to Capax Discovery and the conditions of IAS 18.14 had been satisfied on that sale.

9.118 As noted at paragraph 9.87 above, Deloitte concluded at the time, on the basis of assertions made, in particular by Capax Discovery, that it was probable that economic benefits would flow to Autonomy.

Summary – Capax Discovery (identified end-user FSA)

9.119 In respect of the overall allegation that this was a *"contrived"* transaction made in order to prematurely recognise revenue, in my opinion the claims made by the Claimants that Autonomy did not comply with IAS 18.14(a), (b) and (d) appear to the contrary to have been considered at the time of original revenue recognition. As set out in my analysis above, the contemporaneous documentation I have reviewed indicate the assessment that these requirements of IAS 18 were met. These requirements were specifically reviewed by Deloitte and ultimately, on the basis of the evidence available at the time, Deloitte was satisfied that the accounting treatment applied by Autonomy was appropriate.

9.120 With regard to the allegation by the Claimants of the existence of a side agreement in relation to this transaction, this is a matter of disputed fact. In this case I also note that it appears uncorroborated as a matter of witness evidence. The legality of such an arrangement is a matter outside of my expertise. However, I consider that from the documentation I have reviewed, if such an arrangement did exist, it appears that Mr Baiocco understood it did not relieve Capax Discovery's recognised obligation to pay Autonomy in respect of the transaction should Autonomy enforce its right, nor countermand Mr Baiocco's understanding of Capax Discovery's obligation to pay.

9.121 To the extent that assertions, and in particular regarding a side arrangement, made by the Claimants' witnesses are taken as fact, for example as regards allegations of false confirmations being provided to Deloitte, this could likewise impact my views as to the accounting treatment for this sale adopted by Autonomy, but would still need to be considered similarly again in light of all other relevant evidence available at the time

[319] See paragraph 9.85 of my report.

(given the nature of the judgemental question of revenue recognition as well as the nature of ongoing dialogue with auditors in general).

9.122 In particular, if based on the facts available at the time it is determined that a side agreement did exist such that Capax Discovery did not have an obligation to pay Autonomy from its own funds in respect of the transaction (assuming that this arrangement was known within Autonomy, as alleged), this could be a factor in determining whether or not the risks and rewards of ownership were transferred and/or it was probable that there would be a transfer of economic benefit and therefore whether or not the criteria for revenue recognition under IAS 18.14 had been met at the time that revenue was recognised by Autonomy.

9.123 I understand, however, that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

10 RESELLER MICROTECH (END-USER VATICAN LIBRARY) – Q1 2010

Introduction

10.1 In section 8 of my report I consider the matter of transactions with resellers generally. In this section of my report I consider an example of a sale to MicroTech (with identified end-user Vatican Library).

Initial observation

10.2 In my opinion, any assessment of the permitted, or permissible, accounting treatment, and in particular in this example the appropriate period for recognition of the revenue, is likely to be a product of the facts in dispute. According to the Claimants this sale to MicroTech was backdated. Other evidence, however, suggests that contrary to this, this sale was agreed verbally in principle in the period in which Autonomy recognised it. Notwithstanding such an obvious difference that such an issue could potentially have on the quarterly accounting for this transaction at the time, there are also multiple interpretations of disputed facts that could potentially impact the accounting for this transaction.

Transaction details

10.3 Transaction 13 from Schedule 3 to the Re-Re-Amended Particulars of Claim relates to a transaction between Autonomy[320] and MicroTech (the reseller) in Q1 2010. The identified end-user was the "*Biblioteca Apostolica Vaticana*" or Vatican Library.[321] The licence fee including support and maintenance was priced at US$11.55 million.[322]

Autonomy's accounting treatment

10.4 Autonomy made a sale to MicroTech that was the subject of a purchase order dated 31 March 2010.[323] The purchase order notes it is *"Under Autonomy Government Reseller Agreement Dated as of June 29, 2006"*.[324] The invoice was number 6837-ANA and was dated 31 March 2010.[325]

[320] The contracting party is Autonomy Inc. However, as explained in paragraph 1.19 of my report, I refer to Autonomy group companies as Autonomy throughout this section.
[321] {D002807019}, page 2.
[322] {D002807019}, page 2.
[323] {D002807019}.
[324] {D002807019}.
[325] {D006916661}.

10.5 Autonomy recognised licence revenue of US$11.0 million on 31 March 2010, with revenue in respect of support and maintenance of US$550,000 deferred to be recognised over the following year.[326]

Claimants' allegations

10.6 In respect of this transaction, the Claimants allege that *"the March 2010 purchase order was a contrived transaction entered into for the purpose of enabling the recognition of revenue that should never have been recognised"*.[327]

10.7 In other words, it appears that the Claimants are alleging that no revenue should ever have been recognised on this sale.

10.8 The Claimants further allege, in the Re-Amended Reply:

"Documentation in relation to certain Disputed VAR Transactions was deliberately backdated, including… (b) a purchase order valued at US$11.55 million with MicroTech, for end-user the Vatican Library, which was backdated to 31 March 2010;"[328]

10.9 In line with the allegations in respect of reseller transactions more generally[329], in respect of this transaction the Claimants allege non-compliance with IAS 18.14(a), (b) and (d)[330], which are three of five conditions that must be satisfied for revenue to be recognised[331]:

(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods (IAS 18.14(a));

(b) the entity does not retain either continuing managerial involvement to the degree usually associated with ownership or effective control over the goods sold (IAS 18.14(b)); and

(c) it is probable that the economic benefits associated with the transaction will flow to the entity (IAS 18.14(d)).

Deloitte's work

Deloitte's testing

10.10 Deloitte reviewed this transaction as part of its Q1 2010 quarterly review procedures.

[326] Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 13.
[327] Re-Re-Amended Particulars of Claim, paragraph 78.
[328] Re-Amended Reply, paragraph 78.3.2.
[329] See paragraph 8.11 of my report.
[330] Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 13.
[331] See section 4 for IAS 18.14 and relevant guidance.

10.11 Deloitte noted that this transaction was a part of *"a wider ongoing project/proposal for work with the Vatican Library"* to convert all books and records into an electronic format that is stored and made available on the internet.[332] Deloitte stated that this licence deal was likely to be one of several similar deals over the coming quarters.[333]

10.12 Deloitte reviewed the supporting documents in respect of the transaction including the invoice, purchase order and original contract with MicroTech. Deloitte recorded that:

(a) the invoice number was 6837-ANA;

(b) the value of the invoice was US$11.55 million;

(c) the date of the invoice and purchase order was 31 March 2010;

(d) the purchase order was signed;

(e) the maintenance period was for one year from 31 March 2010 to 30 March 2011 and the maintenance element had been carved out at 5%;

(f) there were no acceptance criteria to be met;

(g) the accounts receivable balance was US$11.55 million; and

(h) no terms were identified which might restrict revenue recognition.[334]

10.13 The Deloitte audit working paper states:

"We have reviewed the signed PO from Microtech and the original VAR between Autonomy and Microtech. This was done to identify any terms which might restrict recognition of this revenue. No such terms were noted.

We have also obtained a revenue confirmation from the customer which confirms that the above invoice is valid and that there are no side agreements."[335]

10.14 Deloitte specifically considered whether the risks and rewards of ownership of the software had passed to MicroTech at the time of the sale. As to the revenue confirmation referred to at paragraph 10.13, a letter signed by Tomas Esterrich, MicroTech's CFO ("Mr Esterrich"), on 13 April 2010, confirmed that the invoice in relation to the Vatican Library deal was proper and unpaid as of 31 March 2010[336]. The letter also confirmed that the invoices listed were properly charged to MicroTech's account and that there were no side letters or other agreements in effect.[337]

[332] {POS00176888}, tab "(10) Vatican (Micro)".
[333] {POS00176888}, tab "(10) Vatican (Micro)".
[334] {POS00176888}, tab "(10) Vatican (Micro)".
[335] {POS00176888}, tab "(10) Vatican (Micro)".
[336] The invoice reference in this letter is 6820-ANA, whereas the invoice referred to by Deloitte in its working paper is 6837-ANA. It is not clear what the explanation is for this discrepancy.
[337] {POS00146540}.

10.15 Deloitte tested delivery of the software by agreeing this to "*an email dated 31 March 2010 (from michaelm@autonomy.com to stevet@microtech.net) stating that the software is available for download via Autonomy CSS*" and to evidence of shipment on the Autonomy system.[338]

10.16 Deloitte specifically considered the collectability of the amounts due by reviewing the recovery on historical sales to MicroTech at the time of the transaction, stating:

"During Q1 2010 Autonomy received a total of $10.7 million from Microtech in settlement of previous deals. This was in line with the payment terms on those deals.

We have reviewed the debtors ledger at 31 March 2010 and note that Microtech is current with all of their debts to Autonomy".[339]

10.17 As MicroTech was a non-listed US company, Deloitte also requested and obtained recent financial information from MicroTech.[340] This information was provided by Mr Esterrich in an email to Mr Chamberlain dated 14 April 2010[341] and states that MicroTech's revenue was US$185.0 million for the 2009 financial year and was projected to be US$305.0 million for the 2010 financial year.[342] The letter also sets out that MicroTech had current assets of approximately US$25.0 million, cash of approximately US$8.0 million and access to a line of credit of US$10.0 million. Mr Esterrich also represented that many of MicroTech's contracts were "*large, multi-year U.S. Federal Government engagements* [which] *create a very stable cash flow for operations*".[343]

10.18 Deloitte also considered industry analysis on MicroTech and noted that MicroTech had won awards during 2009.[344]

10.19 Deloitte concluded:

"*Given the financial data noted above, the strong cash collection in the quarter and the above industry awards, we consider that there are no indicators that this deal with Microtech is not recoverable.*"[345]

10.20 In its working paper[346], Deloitte set out its consideration of the requirements of IAS 18.14 for the recognition of revenue and concluded that the criteria had been met to recognise revenue on the transaction with MicroTech at the invoice date of 31 March 2010. This

[338] {POS00176888}, tab "(10) Vatican (Micro)".
[339] {POS00176888}, tab "(10) Vatican (Micro)".
[340] {POS00176888}, tab "(10) Vatican (Micro)".
[341] {POS00146641}.
[342] {POS00146642}.
[343] {POS00146642}.
[344] {POS00176888}, tab "(10) Vatican (Micro)".
[345] {POS00176888}, tab "(10) Vatican (Micro)".
[346] {POS00176888}, tab "(10) Vatican (Micro)".

conclusion was based on the following (I have added in cross-references for the relevant paragraphs of IAS 18.14):

(a) "*The risks and rewards of ownership passed to the customer when the items were delivered. As all of Autonomy's obligations have been fulfilled the risks and rewards have been transferred.* [IAS 18.14(a)]

(b) *Autonomy has not retained any managerial control.* [IAS 18.14(b)]

(c) *The revenue can be measured effectively as it is stated on both the invoice and in the contract* [IAS 18.14(c)]

(d) *It is probable that economic benefits will flow to Autonomy* [IAS 18.14(d)]

(e) *There are no costs incurred in this transaction* [IAS 18.14(e)]."[347]

Deloitte's report to the Autonomy Audit Committee

10.21 Deloitte referred to this transaction in the Q1 2010 Deloitte Audit Committee Report when discussing the work carried out on revenue recognition as follows:

"*The deal to this reseller was an $11.0 million licence deal for the Vatican Library as the end user. This is the first of a series of software deals to this end user as part of a project to archive the entire collection of the library. The software has been sold through Microtech as they will be working directly with another third party with regards to the integration and installation of this software into the wider project and the Vatican Library computer systems. Support and maintenance has been carved out at 5% and deferred which is consistent with the established fair value of software sales of this magnitude.*"[348]

Witness evidence

10.22 It appears that, to support their allegations, the Claimants have submitted a hearsay notice including the Transcript of Proceedings of Steven Bradley Truitt, MicroTech's chief operating officer throughout the Relevant Period ("Mr S Truitt") dated 14 September 2018 ("Hearsay Notice of the Transcript of Proceedings of Mr S Truitt").

10.23 Given the length and nature of the Hearsay Notice of the Transcript of Proceedings of Mr S Truitt, I refer only to selected parts by reference to specific considerations in my analysis below.

[347] {POS00176888}, tab "(10) Vatican (Micro)".
[348] {DEL1_003_1_00000245}, page 2.

10.24 Dr Lynch described the project with the Vatican Library as "*immense and thus it was necessary to involve other partners*"[349] and stated that MicroTech purchased "*some of the software to be used by the Vatican*"[350].

10.25 Dr Lynch also described the rationale for choosing MicroTech as the reseller in this deal, given that they were based in the United States rather than Italy as follows:

"*MicroTech's location and familiarity with Italian was less important than its familiarity with Autonomy's products and its ability to help with things like services and writing application code.*"[351]

10.26 Dr Lynch explained that:

"*Autonomy continued negotiating with the Vatican after it sold software to MicroTech because the MicroTech deal was one component of a much larger project. After the sale to MicroTech, Autonomy continued to work on closing the larger deal. This did not undermine the sale to MicroTech, because MicroTech was on risk.*"[352]

10.27 Mr Hussain stated:

"*The MicroTech transaction was properly accounted for. MicroTech was on risk for the debt it owed to Autonomy regardless of whether MicroTech was able to sell the software on to the Vatican Library or some other end-user, and MicroTech confirmed in writing to Deloitte that it had assumed the significant risks and rewards of ownership in relation to the licences purchased. MicroTech also had effective control over the software that it purchased from Autonomy, and it was considered probable that the economic benefits associated with the transaction would flow to Autonomy. Both Deloitte and the Audit Committee were aware of the transaction. Autonomy's accounting treatment of the revenue from the transaction was accepted by Deloitte and approved by the Audit Committee.*"[353]

10.28 By comparison, Mr Egan explained that, while he "*was not involved in contacts with the Vatican Library because* [his] *sales responsibility was…primarily for sales to customers in the United States and, secondarily, for sales in the rest of the Americas*":[354]

"*Mr Hussain asked me to see if MicroTech would agree to take a part of the deal that Autonomy was trying to sell to the Vatican Library. He ultimately gave me the amount: $11.5m….MicroTech agreed to take the deal.*"[355]

[349] Dr Lynch's First Witness Statement, paragraph 300.
[350] Dr Lynch's First Witness Statement, paragraph 303.
[351] Dr Lynch's First Witness Statement, paragraph 303.
[352] Dr Lynch's First Witness Statement, paragraph 307.
[353] Mr Hussain's Witness Statement, paragraph 133.
[354] Mr Egan's Witness Statement, paragraph 97.
[355] Mr Egan's Witness Statement, paragraph 98.

10.29 Similarly, Fernando Lucini Gonzalez-Pardo, Autonomy head of pre-sales and chief architect from approximately 2009 ("Mr Lucini") explained, in his witness statement dated 14 September 2018 ("Mr Lucini's Witness Statement"), that he prepared Autonomy's proposal for the Vatican Library project and also set out his understanding of the opportunity[356] but stated he "*had no knowledge of* [the MicroTech/Vatican Library] *transaction at the time*"[357].

10.30 However, Mr Lucini also stated that he did not believe a reseller was required on the Vatican Library project as:

"*Autonomy's proposal was always for an "end to end solution", i.e. Autonomy was to supply all software, hardware, implementation, maintenance and support.*"[358]

10.31 Mr Lucini further noted that "*The purchase order provided for payment by MicroTech 90 days from the date of the contract. There was no prospect of a deal with the Vatican concluding within that timeframe*".[359]

My analysis

Compliance with IAS 18

10.32 As set out in section 4 of this report, IAS 18 states that revenue from the sales of goods shall be recognised when the five conditions set out at paragraphs 14(a) to 14(e) have been satisfied[360]. I comment on the Claimants' allegation of non-compliance with IAS 18.14(a), (b) and (d) in respect of this transaction below.

IAS 18.14(a) – transfer of significant risks and rewards of ownership

10.33 IAS 18.14(a) requires that the entity has transferred to the buyer the significant risks and rewards of ownership of the goods.

10.34 In respect of the transactions with resellers that the Claimants generally allege were "*contrived*", which, according to the Claimants, includes the transaction described in this section, the Claimants allege that:

"*… the relevant Autonomy group company did not transfer to the VAR the significant risks and rewards of ownership. Instead, it was agreed and/or understood between Autonomy*

[356] Mr Lucini's Witness Statement, paragraph 57.
[357] Mr Lucini's Witness Statement, paragraph 59.
[358] Mr Lucini's Witness Statement, paragraph 60.
[359] Mr Lucini's Witness Statement, paragraph 60.
[360] See paragraph 4.35 of my report.

and the VAR that the VAR would not be required to pay from its own resources for the software that it purported to licence."[361]

10.35 I note the following regarding the requirement to pay for the software under this transaction from the Hearsay Notice of the Transcript of Proceedings of Mr S Truitt:

"*Q. …Why did you continue to affirm that the debt was the debt was the debt to Deloitte, auditors?*

A. Well, for several of them -- and there were many, as I testified earlier, for quite the period of time until I got some assurances - which, by the way, never said we didn't have to pay our debt. What it said was - is that we would have the means to do so, maybe, is what I started to think and feel a little better, which is not quite the same thing.

But I did it, frankly, mostly out of habit. I mean we had been doing this. We had been doing it the same exact way. It was legitimate then. It's legitimate now."[362]

10.36 Mr S Truitt, however, also makes various comments regarding a side arrangement with Autonomy but he acknowledges that MicroTech was never told that it did not have to pay its debts to Autonomy. He also acknowledges that the potential existence of a side agreement was his understanding from his brother, David Truitt[363].[364]

10.37 Further, in relation to this transaction between Autonomy and MicroTech, the Claimants also allege that "*MicroTech has stated in litigation with Autonomy Inc in the United States that it never received the software that was the subject of the March 2010 purchase order*".[365]

10.38 I note the following regarding the delivery of software under this transaction from the Hearsay Notice of the Transcript of Proceedings of Mr S Truitt:

"*Q. And the second email down where it says "Michael McCarthy to Steve T at MicroTech," is that delivery of the software? Sending a key, sending users names and so on?*

[Mr S Truitt:] *It appears to be.*

Q. Okay, and the date on that, it was sent March 31st, 2010 at 10:11, right?

[Mr S Truitt:] *Right. I was just double checking that it was for this deal. Yeah. That appears to be true."*[366]

[361] Re-Re-Amended Particulars of Claim, paragraph 79.1.
[362] Hearsay Notice of the Transcript of Proceedings of Mr S Truitt, Volume 17, page 3337 (lines 7 to 17).
[363] David Truitt was co-owner of MicroLink, which was acquired by Autonomy in Q1 2010.
[364] Hearsay Notice of the Transcript of Proceedings of Mr S Truitt, Volume 17, pages 3253 (line 4) and 3337 (lines 18 to 24).
[365] Re-Re-Amended Particulars of Claim, paragraph 78.5.
[366] Hearsay Notice of the Transcript of Proceedings of Mr S Truitt, Volume 17, pages 3351 (lines 21 to 25) to 3352 (lines 1 to 3).

…

"*Q…But the software was delivered on March 31st; right?*

[Mr S Truitt:] *That's what the e-mail said.*"[367]

10.39 It appears therefore, that Mr S Truitt's evidence above regarding the delivery of this software correlates with Deloitte's understanding of how and when the software was delivered as described at paragraph 10.15 above. Deloitte concluded, based on software delivery in this instance, that "*The risks and rewards of ownership passed to the customer when the items were delivered*".[368]

IAS 18.14(b) – entity retains neither continuing managerial involvement nor effective control

10.40 IAS 18.14(b) requires that the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.

10.41 According to Deloitte's 2009 Guidance, this is linked to the risks and rewards of ownership and it would be unusual for an entity to retain managerial involvement to the degree associated with ownership without retaining the risks and rewards.[369]

10.42 In respect of the transactions with resellers that the Claimants allege were "*contrived*", which includes the transaction described in this section, the Claimants allege that:

"*Autonomy retained managerial involvement in the ongoing sales discussions with the end-user to the degree usually associated with ownership or effective control over the licence that was to be sold.*"[370]

10.43 I understand that Deloitte was aware that following the transaction with MicroTech, there was continued contact between Autonomy and the Vatican Library. For example, notes taken by a member of the Deloitte audit team in the "*2010* [year end] *Planning meeting*" describe this continued contact as follows:

"*Microtech - Medieval library deal – still ongoing – recent meeting with* [Dr Lynch, Mr Hussain] *and* [Vatican Library]…

Nothing signed that will mean Microtech gets paid"[371]

10.44 This does not appear to have prompted Deloitte to reconsider whether the revenue recognised on the sale to MicroTech in Q1 2010 was in any way inappropriately recognised.

[367] Hearsay Notice of the Transcript of Proceedings of Mr S Truitt, Volume 17, page 3401 (lines 13 to 16).
[368] {POS00176888}, tab "(10) Vatican (Micro)".
[369] See paragraph 4.43 of my report.
[370] Re-Re-Amended Particulars of Claim, paragraph 79.2.
[371] {POS00168454}, page 2.

Although, for completeness, it is important for me to note here that an opinion based on any events that occurred subsequent to the transaction would involve, prima facie, the use of hindsight and would as such be inappropriate given that such information would not have been available to Autonomy at the time of the transaction. In my opinion, this is likely to form a basis as to why Deloitte would not have revisited the initial accounting, even if Autonomy was still involved with the Vatican Library and/or the Vatican Library still had not proceeded to confirm the underlying project.

10.45 At the time of the transaction, Autonomy had entered into a legally binding contract that specified that Autonomy would sell software to MicroTech. The master reseller agreement between Autonomy and MicroTech sets out that the "*Government Reseller shall assume all responsibility and liability to its customers with respect to the Autonomy Products.*"[372]

10.46 On the basis of this contract clause, ongoing Autonomy contact, communication and/or negotiation with an end-user of its software to the degree usually associated with ownership of that software was not an act which Autonomy was required to perform in the circumstances where Autonomy had already made a sale to MicroTech. Further, I understand that where Autonomy chose to maintain contact with an end-user subsequent to the sale of its software to a reseller designated for that end-user, this was for genuine commercial reasons. Accordingly, this was not considered by Autonomy management to undermine the accounting on the sale to the reseller.[373]

10.47 Dr Lynch explained in his witness statement the reasons why Autonomy would have continued to consult with end-users beyond recognition of a sale to a reseller, explaining that the commercial reality would have required input from various Autonomy departments (IT services, legal, technical, sales) to address an intended end-user's needs.[374]

10.48 Specifically in relation to this transaction with MicroTech, Dr Lynch noted "*This was only part of the much larger deal Autonomy continued to work to close*" and that Autonomy continued to conduct meetings with the Vatican.[375] As noted at paragraph 10.26 above, Dr Lynch did not consider that this subsequent involvement by Autonomy with the Vatican Library on the larger deal undermined the earlier sale to MicroTech as MicroTech were on risk.

10.49 While subsequent contact with a previously identified potential end-user may constitute managerial involvement (dependent on the exact facts, and in any event it must still relate

[372] {D000001951}, page 3, clause 3.6.
[373] Dr Lynch's First Witness Statement, paragraphs 268 to 269.
[374] Dr Lynch's First Witness Statement, paragraph 268.
[375] Dr Lynch's First Witness Statement, paragraph 305.

to a level of involvement associated with ownership over the goods sold), it is not necessarily determinative of the test within IAS 18.14(b).

10.50 In addition, whether Autonomy retained any managerial control was one of the issues specifically considered by Deloitte during its review of this transaction. As noted at paragraph 10.20 above, Deloitte concluded that Autonomy had not retained any managerial control under this transaction usually associated with ownership of the goods sold.

IAS 18.14(d) – transfer of economic benefits

10.51 IAS 18.14(d) requires that it is probable that the economic benefits associated with the transaction will flow to the entity.

10.52 In respect of the transactions with resellers that the Claimants allege were "*contrived*", which, as already noted, includes the transaction described in this section, the Claimants allege that:

"*In many cases the VAR did not have the means to pay the Autonomy group company in the absence of an onward sale of the relevant licence to the identified end user.*"[376]

"*At the time the revenue was recognised by Autonomy, it was not probable that the Autonomy group company would receive the economic benefits associated with the contrived VAR transaction. The Autonomy group company…agreed and/or understood that the VAR would not be required to satisfy any liability to Autonomy from its own resources. In many instances, the VAR did not have the resources to pay its accumulated purported obligations to the Autonomy group company unless the Autonomy group company completed a sale to the end-user and caused the end-user to pay the VAR or the Autonomy group company made a payment to the VAR for rights, goods or services that Autonomy did not need or use.*"[377]

10.53 Specifically in relation to this transaction between Autonomy and MicroTech, the Claimants allege that:

"*…after concluding the March 2010 purchase order under which it ostensibly assumed a liability to pay Autonomy Inc US$11.55 million within 90 days, MicroTech did not attempt to sell a licence to the Vatican Library*"[378]

10.54 This is a matter of fact. However, I note that the Government Reseller Agreement between Autonomy and MicroTech sets out that the "*Government Reseller shall not be relieved of*

[376] Re-Re-Amended Particulars of Claim, paragraph 74.3.4.
[377] Re-Re-Amended Particulars of Claim, paragraph 79.3.
[378] Re-Re-Amended Particulars of Claim, paragraph 78.5.

its obligations to pay fees owed to Autonomy hereunder by the non-payment of such fees by an End User".[379]

10.55 Therefore, I do not believe that this would have had an impact upon Autonomy's revenue recognition decision for this deal given it was after the event and the agreed payment terms were not such that MicroTech would only have to pay Autonomy when it had received payment itself from an end-user. In other words, in terms of the assessment of the probability that Autonomy would receive the future economic benefits associated with the sale undertaken at the time, it appeared that Autonomy's contractual position was that its recognition of revenue was not dependent on MicroTech making an onward sale in order to collect the amount due under this transaction. This is consistent with the revenue recognition approach that requires only the assessment of the immediate customer's ability to pay Autonomy in respect of any given sale. In other words, for an assessment of the probability of flow of economic benefit associated with a particular transaction, the onward sale of the goods sold is, generally speaking, of little or less interest than the assessment of the financial strength of the customer in general.

10.56 That Autonomy's recognition of revenue was not dependent on MicroTech making an onward sale in order to collect the amount due appears supported, by Mr Lucini's understanding, set out at paragraph 10.31 above, that there was no prospect of a deal with the Vatican Library in the 90 days agreed as payment terms between Autonomy and MicroTech.

10.57 As noted at paragraphs 10.16 to 10.19, Deloitte gave its own consideration to MicroTech's ability to pay Autonomy based on MicroTech's payment history and on the financial information of the company provided by Mr Esterrich.[380]

10.58 Deloitte concluded:

"*Given the financial data noted above, the strong cash collection in the quarter and the above industry awards, we consider that there are no indicators that this deal with Microtech is not recoverable.*"[381]

[379] {D000001951}, clause 5.5.
[380] {POS00146642}.
[381] {POS00176888}, tab "(10) Vatican (Micro)".

Alleged backdating

10.59 The Claimants also allege in regard to this particular transaction that the purchase order for the transaction was backdated to 31 March 2010.[382] I note the following regarding the date of the agreement for this transaction, again from the Hearsay Notice of the Transcript of Proceedings of Mr S Truitt:

"[Mr S Truitt:]…*I first heard about* [the Vatican Library deal] *sometime that week towards the end of the week, meaning 27th, 28th, 29th, in there…*

…March of 2010…

Q…Isn't it a fact, sir, you didn't get this notification of this Vatican deal until April 1st, 2010?

[Mr S Truitt:] *It is true, I did not.*

Q. So April 1st, 2010, is when you learned about the Vatican?

[Mr S Truitt:] *No. That's when I signed the purchase order, and it's when I first got something in writing about it…*

Q…when did MicroTech actually enter into this deal, Mr. Truitt?

[Mr S Truitt:] *April 1st, 2010.*

Q…when did MicroTech agree to do this?

[Mr S Truitt:] *I had expressed a willingness to do it to John* [Cronin] *that week. I put my signature on it April 1st."*[383]

"*THE COURT: Did you actually think that the deal had been agreed to before April 1st? Was that your - - was that your thought process? Did you think that? Or did you think that the deal wasn't done until you signed off on April 1st…*

[Mr S Truitt:] *To answer the question as you asked it, Your Honour, I believe that we had a deal in principle, and I was excited to get it and sign it, but, again, I didn't care what quarter that deal went into."*[384]

"Q. The Vatican. They say it's backdated by one day.

[Mr S Truitt:] *I agree it was backdated because I signed it on April 1st and it was dated March 31st.*

[382] Re-Amended Reply, paragraph 78.3.2(b).
[383] Hearsay Notice of the Transcript of Proceedings of Mr S Truitt, Volume 17, pages 3280 (lines 2 to 25) to 3281 (lines 1 to 18).
[384] Hearsay Notice of the Transcript of Proceedings of Mr S Truitt, Volume 17, page 3344 (lines 1 to 12).

Q. When was the agreement made?

[Mr S Truitt:] *The agreement in principle was in process that entire week and I was waiting for the paperwork, and as soon as I got it, I signed it."*[385]

10.60 As noted at paragraph 4.27, accounting guidance suggests that in certain circumstances it may be possible to recognise revenue on a transaction before a sales contract is signed. The example provided is that of a transaction where a master agreement exists and therefore all key terms and conditions are agreed upon by both parties prior to signature.

10.61 I note that Mr S Truitt's response to the Court's direct question (as I have set out above) appears to be confirming an agreement in principle in relation to the sale to MicroTech on or before 31 March 2010. I also note, as set out at paragraph 10.4, that the purchase order for this transaction was entered into *"Under Autonomy Government Reseller Agreement Dated as of June 29, 2006"*[386] i.e. a master agreement.

Other matters

10.62 In making allegations regarding the revenue recognised against this transaction, the Claimants also allege that:

(a) MicroTech failed to pay its debt to Autonomy under this transaction on time;[387]

(b) Autonomy subsequently purchased a three year licence to use MicroTech's "Advanced Technology Innovation Center" ("ATIC") for US$9.6 million in order to put MicroTech in funds to enable it to pay off a portion of its debt under this deal to Autonomy;[388]

(c) MicroTech made payments to Autonomy under this deal using funds received from Discover Technologies LLC ("DiscoverTech") who in turn received these funds from Autonomy who purchased DiscoverTech software;[389] and

(d) the remaining balance owed by MicroTech under this deal was written off on 30 September 2011 with no attempt to collect this sum.[390]

10.63 The Claimants have not specified which of the criteria for revenue recognition from the sale of goods under IAS 18 they consider have not been complied with in regards to these allegations. In any event, these allegations relate to events after the initial revenue recognition on the sale.

[385] Hearsay Notice of the Transcript of Proceedings of Mr S Truitt, Volume 17, page 3350 (lines 16 to 22).
[386] {D002807019}.
[387] Re-Re-Amended Particulars of Claim, paragraph 78.6.
[388] Re-Re-Amended Particulars of Claim, paragraph 78.7.
[389] Re-Re-Amended Particulars of Claim, paragraph 78.9.
[390] Re-Re-Amended Particulars of Claim, paragraph 78.10.

10.64 There are, of course, allegations that this revenue should never have been recognised at all on the basis of an alleged arrangement that MicroTech would never have had to pay for the goods delivered to it, but this is disputed.

Summary – MicroTech (identified end-user Vatican Library)

10.65 In respect of the overall allegation that this was a "*contrived*" transaction made in order to recognise revenue which could not otherwise have been recognised, my assessment of the decision made at the time based on the contemporaneous documentation I have reviewed indicates that the requirements of IAS 18 were met. These requirements were specifically reviewed by Deloitte and ultimately, on the basis of the evidence available at the time, Deloitte was satisfied that the accounting treatment applied by Autonomy was appropriate.

10.66 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

10.67 In particular, if based on the facts available at the time it is determined that a side agreement did exist such that MicroTech did not have an obligation to pay Autonomy from its own funds in respect of the transaction (assuming that this arrangement was known within Autonomy, as alleged), this could be a factor in determining whether or not the risks and rewards of ownership were transferred and/or it was probable that there would be a transfer of economic benefit and therefore whether or not the criteria for revenue recognition under IAS 18.14 had been met at the time that revenue was recognised by Autonomy. However on the face of it, for example, this is contradicted by Mr S Truitt conceding that it was not the case that MicroTech did not have to pay.

11 RESELLER COMERCIALIZADORA (END-USER TV AZTECA) – Q3 2010

Introduction

11.1 In section 8 of my report I consider the matter of transactions with resellers generally. In this section of my report I consider an example of a sale to Comercializadora (with identified end-user TV Azteca).

Initial observation

11.2 In disputing the accounting treatment for Autonomy's sale to Comercializadora, the Claimants appear to use hindsight as a basis for disputing the recognition of revenue by Autonomy at the time. In my opinion, information available only after the event does not ordinarily alter earlier accounting determinations.

Transaction details

11.3 Transaction 17 from Schedule 3 to the Re-Re-Amended Particulars of Claim relates to a transaction between Autonomy[391] and Comercializadora (the reseller) in Q3 2010. The end-user identified in the contract was TV Azteca.[392] The licence fee was US$1.5 million with first year support and maintenance priced at US$150,000.[393]

Autonomy's accounting treatment

11.4 Autonomy made a sale to Comercializadora that was the subject of a purchase agreement dated 30 September 2010.[394] The invoice was number 7773-ANA and was dated 30 September 2010.[395]

11.5 Autonomy recognised licence revenue of US$1.5 million on 30 September 2010, with revenue in respect of support and maintenance of US$150,000 deferred to be recognised over the following year.[396]

Claimants' allegations

11.6 Specifically in respect of this transaction, the Claimants allege that:

[391] The contracting party is Autonomy Inc. However, as explained in paragraph 1.19 of my report, I refer to Autonomy group companies as Autonomy throughout this section.
[392] {D007841406}, page 1.
[393] {D007841406}, page 1.
[394] {D007841406}, page 1.
[395] {D006992151}.
[396] Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 17.

"… by November 2010… [Mr] *Chamberlain was already aware of indications that the VAR in question (Comercializadora) might not exist and it is to be inferred that he would have relayed his concerns to* [Mr] *Hussain."*[397]

11.7 In line with the allegations in respect of reseller transactions more generally[398], the Claimants allege non-compliance with IAS 18.14(a) and (d)[399],[400] which are two of five conditions that must be satisfied for revenue to be recognised:[401]

(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods (IAS 18.14(a)); and

(b) it is probable that the economic benefits associated with the transaction will flow to the entity (IAS 18.14(d)).

11.8 For the avoidance of doubt, I note that Autonomy's Q3 2010 results were announced on 19 October 2010, that is, prior to November 2010.[402]

Deloitte's work

11.9 Deloitte reviewed this transaction as part of its Q3 2010 quarterly review procedures.

11.10 Deloitte reviewed the transaction including the invoice, purchase order and original contract with Comercializadora. Deloitte confirmed that:

(a) the invoice number was 7773-ANA;

(b) the value of the invoice was US$1.65 million;

(c) the date of the invoice and contract was 30 September 2010;

(d) the contract was signed;

(e) the maintenance period was for one year from 30 September 2010 to 29 September 2011 and the maintenance element had been carved out at 10%;

(f) there were no acceptance criteria to be met;

(g) the accounts receivable balance was US$1.65 million; and

(h) no terms were identified which might restrict revenue recognition.[403]

11.11 The Deloitte audit working paper also stated:

[397] Re-Re-Amended Particulars of Claim, paragraph 144B.3.3.
[398] See paragraph 8.11 of my report.
[399] Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 17.
[400] The Claimants do not allege non-compliance with IAS 18.14(b), as they do for the other example reseller transactions that I consider in my report.
[401] See section 4 for IAS 18.14 and relevant guidance.
[402] {POS00359193}.
[403] {POS00176890}, tab "(1)".

"We have reviewed the original signed VAR agreement to identify any terms which might restrict revenue recognition. No such terms were noted.

We have also obtained a revenue confirmation from the customer which confirms that the above invoice is valid and that there are no side agreements."[404]

11.12 Deloitte specifically considered whether the risks and rewards of ownership of the software had passed to Comercializadora at the time of the sale by requesting a letter from Comercializadora confirming that the invoices were proper and unpaid and no side agreements existed, testing delivery of the software at the relevant date and reviewing the contract for any terms which would have restricted revenue recognition.

11.13 As to the revenue confirmation referred to at paragraph 11.11, a letter signed by Comercializadora's managing director confirmed that the invoice in relation to this transaction was proper and unpaid as at 30 September 2010[405]. The letter also confirmed that the invoices listed were properly charged to Comercializadora's account and that there were no side letters or other agreements in effect.[406]

11.14 Deloitte tested delivery of the software as follows:

"*We have viewed an e-mail dated 30 Sept. 2010 (from rosied@autonomy.com to gilberto.alvarez@cobalsco.com.mx) stating that the software is available for download via Autonomy CSS. Note that we have then also agreed this through to evidence of shipment on the Autonomy system…We conclude that as at the email date, risk and rewards of the products have been transferred to the customer and the shipment date is considered to be the same as email date.*"[407]

11.15 Deloitte specifically considered the collectability of the amounts due from Comercializadora as follows:

"*Comercializadora Cobal's is a new customer and therefore there is no payment history available. Financial statements as at 31 Dec. 2009 shows that it has cash of $5.3m in hand and its net assets amount to around $16m. Total sales of 2009 is around $24m and net profit around $8.2m.*

The most up to date financial statement (as at 30 June 2010) shows that it has cash of $1.1m and net assets of $16.3m.

We also did…research on the End User…TV Azteca which is the second largest Mexican television network after Televisa. Revenue in 2009 reached $764.4m and net income

[404] {POS00176890}, tab "(1)".
[405] It is not clear whose signature is on this letter, but their title is "Managing Director".
[406] {POS00156725}.
[407] {POS00176890}, tab "(1)".

$107.5m. Although it is not directly relevant to our assessment on collectability [sic]*, it gives us some comfort that the risk of the end user not paying VAR is low and consequently the risk of VAR not paying Autonomy is to some extent lower.*

Per discussion with Sushovan Hussain (CFO) we note that management considers that there is strong financial information on the VAR to support revenue recognition at this stage. This is a $1.5 million licence deal and on the basis that the VAR has net assets of $16m at the last balance sheet date they consider the recoverability risk to be low." [408]

11.16 Deloitte concluded:

"*Given our review of the available financial information we conclude that there is no evidence that this amount is not recoverable. We therefore concur with management's conclusion with regards revenue recognition.*"[409]

11.17 In its working paper[410], Deloitte set out its consideration of the requirements of IAS 18.14 for the recognition of revenue and concluded that the criteria had been met to recognise revenue on the transaction with Comercializadora at the invoice date of 30 September 2010. This conclusion was based on the following (I have added in cross-references for the relevant paragraphs of IAS 18.14):

(a) "*The risks and rewards of ownership passed to the customer when the items were delivered. As all of Autonomy's obligations have been fulfilled the risks and rewards have been transferred.* [IAS 18.14(a)]

(b) *Autonomy has not retained any managerial control* [IAS 18.14(b)].

(c) *The revenue can be measured effectively as it is stated on both the invoice and in the contract* [IAS 18.14(c)]

(d) *It is probable that economic benefits will flow to Autonomy* [IAS 18.14(d)]

(e) *There are no costs incurred in this transaction* [IAS 18.14(e)]."[411]

11.18 I note that an adjustment was proposed in the Deloitte Audit Committee Report for the year ended 31 December 2010 (i.e. Q4 2010) to provide for the debt due on this transaction as follows:

"*We have proposed the following judgemental adjustments on the basis that there is limited evidence of collectability:*

…

[408] {POS00176890}, tab "(1)".
[409] {POS00176890}, tab "(1)".
[410] {POS00176890}, tab "(1)".
[411] {POS00176890}, tab "(1)".

[Comercializadora] *Cobal $2.7 million.*[412]

Although management is actively chasing the overdue balances, we have taken a more prudent view given the long overdue nature of the balance and lack of recent correspondence."[413]

Witness evidence

11.19 Other than Mr Welham, who was asked to assume that management was aware by November 2010 that Comercializadora might not exist[414], none of the initial Claimants' or Defendants' witnesses comments on this transaction in the initial witness statements submitted on or around 14 September 2018[415].

My analysis

Compliance with IAS 18

11.20 As set out in section 4 of this report, IAS 18 states that revenue from the sales of goods shall be recognised when the five conditions set out at paragraphs 14(a) to 14(e) have been satisfied[416]. I comment on the Claimants' allegation of non-compliance with IAS 18.14(a) and (d) in respect of this transaction below.

IAS 18.14(a) – transfer of significant risks and rewards of ownership

11.21 IAS 18.14(a) requires that the entity has transferred to the buyer the significant risks and rewards of ownership of the goods.

11.22 In respect of transactions with resellers generally, the Claimants allege that:

"*the relevant Autonomy group company did not transfer to the VAR the significant risks and rewards of ownership. Instead, it was agreed and/or understood between Autonomy and the VAR that the VAR would not be required to pay from its own resources for the software that it purported to licence.*"[417]

11.23 Notwithstanding this, it appears to me that the Claimants may be combining allegations concerning Transaction 17, with allegations concerning a separate transaction, Transaction

[412] This value includes a further transaction carried out with Comercializadora for circa US$1 million.
[413] {DEL1_003_1_00000154}, page 7.
[414] Mr Welham's Witness Statement, paragraph 402.
[415] At the time this report is submitted (29 November 2018) further witness statements have been exchanged (on 16 November 2018). I have not had enough time to deal with all of this information other than to carry out an initial consideration of the statements provided by those witnesses who identified as contemporaneous accountants or those charged with governance at Autonomy and also by certain other witnesses. Therefore, to the extent that this transaction is referred to in further witness statements, I will deal with it in my supplemental report.
[416] See paragraph 4.35 of my report.
[417] Re-Re-Amended Particulars of Claim, paragraph 79.1.

22 (which is another, later Comercializadora sale) of Schedule 3 to the Re-Re-Amended Particulars of Claim.

11.24 Deloitte specifically considered whether the risks and rewards of ownership of the software had passed to Comercializadora at the time of this first sale and gathered the following evidence in this regard:

(a) a signed letter provided by the managing director at Comercializadora, as described at paragraph 11.13;

(b) an email confirming delivery of the software and evidence of shipment on the Autonomy system at 30 September 2010, as described at paragraph 11.14; and

(c) the signed contract, and specifically whether it contained any terms which restricted the recognition of revenue, as described at paragraph 11.11.

11.25 Deloitte concluded that, *"The risks and rewards of ownership were passed to the customer when the items were delivered. As all of Autonomy's obligations have been fulfilled the risks and rewards have been transferred"*.[418]

IAS 18.14(d) – transfer of economic benefits

11.26 IAS 18.14(d) requires that it is probable that the economic benefits associated with the transaction will flow to the entity.

11.27 In respect of transactions with resellers generally, the Claimants allege that:

"*In many cases the VAR did not have the means to pay the Autonomy group company in the absence of an onward sale of the relevant licence to the identified end user.*"[419]

"*At the time revenue was recognised by Autonomy, it was not probable that the Autonomy group company would receive the economic benefits associated with the contrived VAR transaction. The Autonomy group company…agreed and/or understood that the VAR would not be required to satisfy any liability to Autonomy from its own resources. In many instances, the VAR did not have the resources to pay its accumulated purported obligations to the Autonomy group company unless the Autonomy group company completed a sale to the end-user and caused the end-user to pay the VAR or the Autonomy group company made a payment to the VAR for rights, goods or services that Autonomy did not need or use.*"[420]

11.28 As noted at paragraph 11.15, Deloitte specifically considered the collectability of the amounts due by reviewing Comercializadora's latest available financial statements and

[418] {POS00176890}, tab "(1)".
[419] Re-Re-Amended Particulars of Claim, paragraph 74.3.4.
[420] Re-Re-Amended Particulars of Claim, paragraph 79.3.

considering its financial resources. Also as to collectability, although not relevant to the transaction between Autonomy and Comercializadora, Deloitte undertook research regarding the end-user's (TV Azteca) ability to pay the reseller and concluded that the risk it would not pay Comercializadora was low.

11.29 Overall, as a result, Deloitte concluded (as at Q3 2010):

"*Given our review of the available financial information we conclude that there is no evidence that this amount is not recoverable. We therefore concur with management's conclusion with regards revenue recognition.*"[421]

11.30 As set out in paragraph 11.18, a judgemental adjustment was only subsequently proposed in the Deloitte Audit Committee Report for the following quarter, i.e. as at the full year end audit for the year ended 31 December 2010 relating to the debt due from Comercializadora due to the fact the debt was then overdue and there had been a lack of recent correspondence.[422] This was included in a list of what Deloitte described as "*uncorrected misstatements*"[423] and I understand that this adjustment was not made in the 2010 Consolidated Financial Statements as Deloitte further stated "*There are no booked adjustments or any disclosure deficiencies to report at this stage*"[424].

11.31 In my opinion, and in any event, such a judgemental adjustment in respect of the US$1.5 million licence sale in Q3 2010 would have been appropriately only classified as a "*Provision for doubtful debts*"[425] in the Deloitte Audit Committee Report for the year ended 31 December 2010, in line with IAS 18.18 (as set out in paragraph 4.53 of my report). This appears entirely consistent with Deloitte's opinion at the time that an uncertainty had only subsequently arisen over the collectability of the amount that had previously been recognised as revenue. In highlighting this proposed adjustment and defining it as a provision against prior recognised revenue Deloitte also stated that it had taken a "*more prudent view*"[426] than, I assume, Autonomy management, of the collectability of this debt.

11.32 I do not consider further the Claimants' assertions in Schedule 3, Transaction 17, to the Re-Re-Amended Particulars of Claim that no payments were received from Comercializadora in relation to this transaction or that the associated invoice was subsequently written off as to do so would involve hindsight which is inappropriate as this information was not available at the time of the initial revenue recognition. It is also

[421] {POS00176890}, tab "(1)".
[422] {DEL1_003_1_00000154}, page 7.
[423] {DEL1_003_1_00000154}, page 31.
[424] {DEL1_003_1_00000154}, page 33.
[425] {DEL1_003_1_00000154}, page 7.
[426] {DEL1_003_1_00000154}, page 7.

consistent with Deloitte's own proposal of the subsequent accounting referred to immediately above.

11.33 Insofar as it is then still pertinent, the Claimants also allege:

"… by November 2010… [Mr] *Chamberlain was already aware of indications that the VAR in question (Comercializadora) might not exist and it is to be inferred that he would have relayed his concerns to* [Mr] *Hussain."*[427]

11.34 The Claimants provide no further detail on this allegation and I note the following from the First Defendant's Amended Defence:

"*With regard to the collectability of a Q3 2010 deal with Comercializadora, the Claimants' allegation that Autonomy management knew Comercializadora "did not exist" as of November 2010 is denied. Autonomy signed a deal with Comercializadora dated 31 December 2010, and Comercializadora returned a signed debtor confirmation letter that was dated 11 January 2011, and accordingly was clearly operational into 2011. If Comercializadora ultimately went bankrupt, this does not undermine the original accounting for this deal. The Claimants' approach involves an illegitimate use of hindsight.*"[428]

11.35 I have seen the letter referred to in the First Defendant's Amended Defence which appears to show that Deloitte received a confirmation of outstanding invoices from a "*Legal Representative*" of Comercializadora signed and dated 11 January 2011.[429] In any event, this would not have been relevant to the proper assessment of the revenue to be recognised as at 30 September 2010.

Summary – Comercializadora (identified end-user TV Azteca)

11.36 In respect of the allegations made by the Claimants, I do not agree, based on the evidence that I have currently seen and assessed, that Autonomy did not comply with IAS 18.14(a) and (d). As set out in my analysis above, the contemporaneous documentation I have reviewed indicates that these requirements of IAS 18 were met. These requirements were, in my opinion, specifically reviewed by Deloitte at the time and ultimately, on the basis of the contemporaneous evidence available, Deloitte was satisfied that the accounting treatment applied by Autonomy was appropriate.

11.37 The Claimants make the point that the debt associated with this transaction was provided for and eventually the invoice was written off.[430] However, this is of no relevance to initial

[427] Re-Re-Amended Particulars of Claim, paragraph 144B.3.3.
[428] First Defendant's Amended Defence, paragraph 190B.4.9.
[429] {D001414523}.
[430] Re-Re-Amended Particulars of Claim, Schedule 3, Transaction 17.

recognition of revenue. In line with IAS 18.18, in the event that an uncertainty arises over the collectability of a debt associated with a sale subsequent to recognising that sale, the appropriate treatment is to recognise this as an expense i.e. a bad debt, or bad debt provision, and therefore Autonomy's accounting treatment appears reasonable. This applies to a sale and a bad debt in the same accounting period i.e. the bad debt does not mean that the sale is reversed.

11.38 The Claimants also allege that Autonomy's senior management was aware that Comercializadora might not exist at November 2010, and while I have seen no further evidence or explanation of this assertion, again any evidence in support of this would appear to postdate initial revenue recognition, and is only, if determined to be the case, of relevance after November 2010.

11.39 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

12 ALLEGED RECIPROCAL TRANSACTIONS

Introduction

12.1 As noted at paragraphs 1.13 to 1.14, the Claimants assert that Dr Lynch and Mr Hussain "*caused Autonomy group companies to engage in improper transactions and accounting practices*"[431] including *"Improper revenue recognition"*, which itself is said to comprise *"VAR transactions"*, *"Reciprocal transactions"* and *"Acceleration of hosting revenue"*.[432]

12.2 In this section of my report I consider matters relating to the alleged reciprocal transactions.

12.3 First I set out what is meant in the revenue recognition standard IAS 18 by a "reciprocal" transaction (paragraphs 12.5 to 12.12). I then set out the Claimants' overall allegations in respect of the alleged reciprocal transactions (paragraphs 12.13 to 12.17).

12.4 In the following sections I consider the allegations made by the Claimants in the context of two example alleged reciprocal transactions taken from the Claimants' schedules to the Re-Re-Amended Particulars of Claim. These example transactions are:

(a) Video Monitoring Services of America, Inc ("VMS") (section 13 of my report); and

(b) Vident Systems Inc ("Vident") (section 14 of my report).

Background

What is meant by a reciprocal transaction

12.5 As set out in section 4, the applicable accounting standard for recognising revenue from the sale of goods is IAS 18. Revenue from the sale of goods is recognised when the criteria set out in IAS 18.14 are met.[433]

12.6 IAS 18.13 deals with the identification of the transaction to which IAS 18 applies. Usually the recognition criteria in IAS 18 are applied to each separate transaction. However, sometimes separate transactions are linked and the recognition criteria under IAS 18.14 are then applied to the linked transactions as a whole.

12.7 The requirement under IAS 18.13 states:

[431] Re-Re-Amended Particulars of Claim, paragraph 26.
[432] Re-Re-Amended Particulars of Claim, paragraph 30.2.
[433] See paragraph 4.35 of my report.

"… the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole."[434]

12.8 As set out in paragraph 4.65, an example of a linked transaction is given in IAS 18.13 as follows:

"… an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together."[435]

12.9 As with other aspects of IAS 18, whether transactions are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole is fact specific and the actual accounting may require the application of accounting judgement.

12.10 IAS 18.13 also requires recognition criteria to be applied in such a way as reflects the substance of the transaction.[436]

12.11 If transactions are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole, then it is necessary to consider whether the goods or services exchanged are of a similar nature and value. IAS 18 does not provide any guidance on how to determine whether goods or services are of a similar nature. Accordingly, in my opinion, this is an area of judgement to be exercised having regard to all the circumstances.[437]

12.12 Under IAS 18.12, if the goods or services are considered to be similar, the exchange is not regarded as a transaction which generates revenue.[438] If they are considered to be dissimilar goods or services, revenue is recognised at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred.[439]

The overall dispute regarding reciprocal transactions in this case

12.13 The Claimants have identified in Schedule 5 to the Re-Re-Amended Particulars of Claim a series of transactions with a number of counterparties accounted for separately by Autonomy. The Claimants assert that, in respect of transactions with the same counterparty, the sales transactions were linked with purchase transactions and should have been considered together as one overall transaction.

[434] **Exhibit F** - IAS 18.13.
[435] See paragraph 4.65 of my report.
[436] See paragraph 4.78 of my report.
[437] See paragraph 4.71 of my report.
[438] IAS 18.12 – see paragraph 4.69 of my report.
[439] IAS 18.12 – see paragraph 4.71 of my report.

Claimants' allegations

12.14 The Claimants allege that in the case of each alleged reciprocal transaction, an Autonomy group company sold a software licence to a counterparty and purchased products (including software), rights and/or services from that counterparty, whereby the purchase(s) and the sale(s) were linked such that their commercial effect could not be understood without reference to the series of transactions as a whole.[440]

12.15 The Claimants allege that the products, rights and/or services purchased by Autonomy were of no discernible value to Autonomy or that the goods or services were purchased at sums in excess of their fair value.[441]

12.16 The Claimants further allege that the transactions individually lacked economic substance. In particular, the Claimants assert that the purpose of the purchase from the counterparty was to provide the counterparty with both the incentive and the funds to acquire a licence to Autonomy software that the counterparty would not otherwise have acquired.[442]

12.17 Also, the Claimants allege, these transactions meant that the Autonomy group was funding the purchase by counterparties of its own software in order to allow Autonomy to inappropriately report revenue and profits.[443]

12.18 To put the matters into context, I consider these allegations by reference to two example transactions, as noted previously.

Conclusions

12.19 I have provided my conclusions in respect of each of the example transactions in this category in sections 13 and 14.

12.20 The specific circumstances of each of the alleged reciprocal transactions of course differs, as does the contemporaneous information and documentation that was available to Autonomy (and Deloitte) at the time that each transaction took place. As such, my conclusions in respect of each of the example transactions described in sections 13 and 14 cannot be assumed to apply to other alleged reciprocal transactions in the absence of a detailed review of each.

12.21 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the

[440] Re-Re-Amended Particulars of Claim, paragraph 30.2.2.
[441] Re-Re-Amended Particulars of Claim, paragraph 30.2.2.
[442] Re-Re-Amended Particulars of Claim, paragraph 30.2.2.
[443] Re-Re-Amended Particulars of Claim, paragraph 30.2.2.

competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

12.22 In particular, I refer to my earlier comments that the application of certain accounting standards, and in particular some past accounting standards, requires or required the use of more discretionary professional accounting judgement and therefore may or could result in two different accountants (neither of whom is wrong) arriving at two different conclusions. In such a scenario, a difference in the conclusions reached would not, or does not, indicate that either of them was necessarily inappropriate but rather that they formed part of a range of possible conclusions, each or all of which might be, or could be appropriate.

13 ALLEGED RECIPROCAL TRANSACTIONS: VMS - Q2 2009/Q4 2010

Introduction

13.1 In section 12 of my report, I consider the matter of alleged reciprocal transactions generally. In this section of my report I consider an example where Autonomy bought and sold software in the context of its commercial relationship with VMS.

Initial observation

13.2 This is a clear example of a dispute on the facts as to the commercial effect or rationale of certain sales and purchases of goods, in this case between Autonomy[444] and VMS. In my opinion, the accounting necessarily follows the determined commerciality.

Transaction details and Autonomy's accounting treatment

13.3 Transaction 2 from Schedule 5 to the Re-Re-Amended Particulars of Claim relates to five individual transactions with VMS[445] in Q2 2009 and Q4 2010.

13.4 The transactions in respect of VMS comprise three sales and two purchases as follows:

(a) a sale from Autonomy to VMS and a purchase from VMS by Autonomy that both took place on 30 June 2009 - together these are described by the Claimants as *"the first VMS reciprocal transaction"*[446]; and

(b) two sales from Autonomy to VMS (a software sale and a hardware sale) and a purchase from VMS by Autonomy, which all took place on 31 December 2010 - together these are described by the Claimants as *"the second VMS reciprocal transaction"*[447].

Sale 1 ("VMS Sale 1")

13.5 This sale was for a software licence for US$9.0 million (including support and maintenance) from Autonomy to VMS on 30 June 2009. The sale was pursuant to "*Product Schedule No. 5*"[448], which was subject to the Autonomy Software Licence Agreement between Autonomy and VMS ("VMS Software Licence Agreement") dated 31 December 2002.[449]

[444] The contracting party is Autonomy Inc. However, as explained in paragraph 1.19, I refer to Autonomy group companies as Autonomy throughout this section.
[445] Where I refer to VMS, I am also referring to "VMS LP" in accordance with Schedule 5, Transaction 2 to the Re-Re Amended Particulars of Claim.
[446] Re-Re-Amended Particulars of Claim, paragraph 85.
[447] Re-Re-Amended Particulars of Claim, paragraph 86.
[448] {D003987223} Product Schedule No. 5 is dated 29 June 2009.
[449] {D003987223}.

13.6 Product Schedule No. 5 was for a personal, non-exclusive, non-transferable, non-assignable and non-sub-licensable perpetual licence for VMS internal use only for the purpose of indexing audio and video content from its various newsfeeds and other audio/video sources.[450]

13.7 Autonomy recognised licence revenue of US$8.6 million on 30 June 2009 and US$428,571 in respect of support and maintenance revenue was deferred to be recognised over the following year.[451]

Purchase 1 ("VMS Purchase 1")

13.8 On 30 June 2009, Autonomy entered into a Data Licensing Agreement with VMS ("VMS Data Licensing Agreement").[452] Autonomy agreed to pay US$13.0 million in advance for a three year licence ("VMS Data Licence") for the provision of data which included broadcast content, advertising content and internet content from VMS.[453]

13.9 The VMS Data Licensing Agreement was *"to provide Autonomy with an application service that will enable Autonomy to search, retrieve and display VMS content based on specific search criteria provided by Autonomy pursuant to the terms hereof."*[454]

13.10 On 31 July 2009, Autonomy capitalised the amount of US$13.0 million in respect of the licence on its balance sheet as an intangible asset to be recognised over its useful economic life of three years.[455]

Sale 2 ("VMS Sale 2")

13.11 On 31 December 2010, Autonomy sold VMS a further software licence for US$5.0 million (including support and maintenance) pursuant to "*Product Schedule No. 6*".[456]

13.12 The software included in this sale consisted of "*Special Use Software, IDOL Connectors, Virage Plug-ins and EDGE Server Software*".[457]

13.13 Autonomy recognised licence revenue of US$4.8 million on 31 December 2010 and US$250,000 in respect of support and maintenance revenue was deferred to be recognised over the following year.[458]

[450] {D003987223}, page 1 and page 3.
[451] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 2, page 6.
[452] {D003997524}.
[453] 'Exhibit A, Schedule 2.2' of {D003997524}.
[454] {D003997524} page 1.
[455] {DEL1_003_1_00000200} (Q2 2009 Deloitte Audit Committee Report).
[456] {D001451567}.
[457] {D001451567}, page 1.
[458] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 2.

Sale 3 ("VMS Sale 3")

13.14 On 31 December 2010, Autonomy sold hardware of US$6.0 million to VMS subject to the Second Amendment[459] to the VMS Software Licence Agreement and detailed in 'Exhibit A' to the amendment.

13.15 Autonomy recognised US$6.0 million as hardware revenue on 31 December 2010.[460]

Purchase 2 ("VMS Purchase 2")

13.16 On 31 December 2010, Autonomy purchased data licences from VMS for US$8.4 million, under the First Amendment[461] to the VMS Data Licensing Agreement ("VMS First Amendment") that granted additional data and licensing rights to Autonomy. Specifically, the consideration of US$8.4 million paid by Autonomy was broken down as follows:

"Annual Fee for year 4 of the Term	*$3,800,000.00*
Data Rights Fee (25 years at $1,340,000.00/year)	*$3,350,000.00*
AdSight corporate subscription (2.5 years at $250,000.00/year)	*$625,000.00*
Insight corporate subscription (2.5 years at $250,000.00/year)	*$625,000.00"*[462]

13.17 The VMS First Amendment also increased the term of the 30 June 2009 VMS Data Licensing Agreement (referred to in paragraphs 13.8 to 13.9 above) from the original three years to five years.[463]

13.18 Autonomy capitalised the amount of US$8.4 million on 20 January 2011 in respect of the licences.[464]

Claimants' allegations

13.19 The Claimants allege:

"*The value of the purchase is overstated; Autonomy paid $13,000,000 to VMS for the data feed, but had previously received substantially the same service from Moreover* [Moreover Technologies Inc] *for free. The payments to VMS allowed VMS to meet its payment obligations in relation to the purchases made from Autonomy Inc. Autonomy Inc paid VMS on 29 July 2009 and received payment from VMS on 30 July 2009. However, the VMS data*

[459] {D006127170}.
[460] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 2.
[461] {D001451566}.
[462] {D001451566}, page 3.
[463] {D001451566}.
[464] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 2, page 6.

was not used by Autonomy for at least eight months after the first VMS transaction was signed and had no discernible value to it.

In total, Autonomy Inc recognised revenue of $20,004,067 in relation to three sales to VMS and was paid $12,000,000. Autonomy Inc made payments to VMS of $17,000,000 and received rights of no discernible value to the Autonomy group. Overall Autonomy Inc paid VMS more than it received.

Given the existence of factors indicating that these transactions are linked (as set out at paragraph 94B of the Amended Particulars of Claim), it is necessary to consider them together. IAS 8, paragraph 10 and IAS 18, paragraph 13 require that transactions be reported in accordance with their economic substance. Autonomy purchased products which it did not need and which had no discernible value to the Autonomy group company, such that the purchases lacked substance. In consequence, the linked sales made by Autonomy to the counterparty also lacked substance and the revenue recorded for those sales should not have been recognised…".[465]

13.20 In summary, therefore, the Claimants make allegations regarding:

(a) the value of the purchase(s) by Autonomy from VMS being overstated;

(b) the funding of payments from VMS;

(c) the use of the VMS data feed; and

(d) the transactions individually lacking economic substance.

13.21 In respect of accounting standards, the Claimants allege non-compliance with IAS 8.10, IAS 18.13 and IAS 18.14(d).[466]

13.22 In section 4 of this report, I have set out IAS 18.13 at paragraph 4.78 and IAS 18.14(d) at paragraph 4.35. From the allegations set out at paragraph 13.19, it appears that the Claimants also seek to rely on IAS 8.10 in considering the substance of a transaction. The requirement to consider the substance of a transaction in the context of revenue recognition is included at IAS 18.13, and more generally in the Framework and the Conceptual Framework.[467]

[465] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 2, pages 6 and 7.
[466] Schedule 5 to Re-Re-Amended Particulars of Claim, Transaction 2, page 6.
[467] See paragraphs 4.78, 4.89 and 4.90 of my report.

Witness evidence[468]

Dr Lynch's First Witness Statement

13.23 In his witness statement, Dr Lynch discusses the background to the relationship between VMS and Autonomy. He notes that Moreover Technologies Inc (Autonomy's previous data feed supplier) ("Moreover") had switched off Autonomy's access to its data feed[469] and that Autonomy made a decision to purchase a data feed from VMS.[470]

13.24 In respect of the "*longstanding*" relationship between Autonomy and VMS, Dr Lynch states:

"Potential customers and industry analysts often approached VMS as a reference on Autonomy's products. Thus, we were keen for VMS to continue using Autonomy's most advanced offerings, so that VMS would integrate these products into their own offerings and further market Autonomy's software."[471]

13.25 As to the background to Autonomy's decision to purchase the data feed provided by VMS, Dr Lynch states:

"*Autonomy was interested in buying the data feed from VMS because VMS's product was built on Autonomy software. This was an important feature given that the data feeds would be used in product demonstrations, to show the power of Autonomy's software. VMS's offering was much more sophisticated than Moreover's.*"[472]

13.26 Dr Lynch notes that Autonomy had no right to sell the newsfeed data to customers under its agreement with Moreover[473]; however, this right, which Dr Lynch states was "*a valuable add-on*", was subsequently negotiated by Autonomy in respect of the VMS data feed when in Q4 2010 Autonomy entered into an amendment to the Q2 2009 agreement with VMS.[474]

13.27 Dr Lynch also mentions that Autonomy and VMS issued a press release on 14 July 2009 announcing their strategic partnership.[475]

13.28 In relation to Autonomy having created its own data feed following the termination of Moreover's data feed, he states, "*Autonomy created a temporary workaround … to*

[468] In terms of witness evidence relating to the VMS transactions, see inter alia, the witness statement of Eloy Avila ("Mr Avila") dated 15 November 2018, but unsigned, paragraphs 51 to 55. I will consider this evidence in detail in my supplemental report.
[469] Dr Lynch's First Witness Statement, paragraph 406.
[470] Dr Lynch's First Witness Statement, paragraph 408 to 409.
[471] Dr Lynch's First Witness Statement, paragraph 404.
[472] Dr Lynch's First Witness Statement, paragraph 408.
[473] Dr Lynch's First Witness Statement, paragraph 405.
[474] Dr Lynch's First Witness Statement, paragraph 410.
[475] Dr Lynch's First Witness Statement, paragraph 409.

continue demonstrating Autonomy's software to customers", noting that this workaround was problematic and "*not a permanent solution.*"[476]

Other witness evidence

13.29 The Claimants have provided a number of witness statements that comment on the VMS transactions. These witness statements were made by Autonomy technical personnel including:

(a) Mr Lucini, Autonomy head of pre-sales and chief architect;

(b) Sean Mark Blanchflower, Autonomy's head of R&D during the Relevant Period ("Mr Blanchflower");

(c) Phillip Howard Greenwood, Autonomy head of connectors ("Mr Greenwood"); and

(d) Christopher James Robin Goodfellow, Autonomy's director of global accounts and chief technology officer of infrastructure throughout the Relevant Period ("Mr Goodfellow").

13.30 They address, amongst other matters, Autonomy's use (or purported lack thereof) of the VMS data feed[477], the alleged poor quality of the VMS data feed[478] and Autonomy's creation of its own data feed (which they assert was adequate for Autonomy's needs).[479]

The detailed consideration by Deloitte in respect of VMS Sale 1 and VMS Purchase 1

13.31 Deloitte's working papers provide a detailed analysis of the accounting consideration behind the way this transaction was accounted for. In this case, the working papers also set out why the two transactions were not linked.

13.32 In a working paper in respect of testing of the licence revenue of US$9.0 million during its Q2 2009 interim review, Deloitte specifically considered whether VMS Sale 1 and VMS Purchase 1 were linked, noting:

"*Autonomy has also entered into a contract with VMS, to purchase a software licence for $13m. We have considered the accounting treatment for this specifically at <8190A>. We note that both transactions have been carried out on an arms-length basis and form two separate legal agreements. As such, Autonomy is correct to recognise* [the] *$9m revenue for the licence that they have sold to VMS.*"[480]

[476] Dr Lynch's First Witness Statement, paragraph 407.
[477] See for example, the witness statement of Mr Greenwood dated 13 September 2018, paragraph 14.
[478] See for example, Mr Lucini's Witness Statement, paragraph 49.
[479] See for example, Mr Lucini's Witness Statement, paragraph 48.
[480] {DEL1_002_1_00000124}.

13.33 Additionally, the Deloitte audit partners and audit team exchanged emails dated 6 July 2009 discussing the VMS transactions. Mr Barden, a member of NAA team was included in the discussion that was sent from Mr Knights to the Deloitte audit team. Mr Knights' email summarises his discussion with Mr Barden as follows:

"Background Summary

- *Autonomy have sold $9m of software to 3rd party VMS*
- *VMS have separately sold to Autonomy $13m of services/license for a 3 year provision of their services to Autonomy*
- *We have reviewed the commercial substance of both deals*
- *We are satisfied that these are not similar items of exchange*
- *We have reviewed the contractual terms of both transactions*
- *It is clearly demonstratable* [sic] *that what Autonomy has bought from VMS is entirely different from what it has sold to VMS. …*

Accounting principles

[Mr Barden] *has agreed that the accounting principles are around revenue recognition and are directly tied into the audit judgements around:*

- *Establishment of fair value of both transactions*
- *The determination that these transactions are or are not for similar items*
- *The judgement for business rationale for these transactions – to underline the separate nature of both transactions.*

On the basis that the audit team can conclude satisfactorily on these areas of judgement then revenue recognition and the separate recording of revenues and costs is appropriate.

Revenue and costs would be recognised at fair value."[481]

13.34 In response Mr Barden stated:

"I *agree with* [Mr Knights'] *summary. Even in a barter transaction, revenue will be recognised at fair value unless the items exchanged are 'similar'. If we are happy that each sale could each have taken place without the other, and that the items exchanged are not 'similar', then I would expect revenue to be recognised at fair value."*[482]

[481] {DEL1_002_1_00000071}.
[482] {DEL1_002_1_00000071}.

13.35 In addition, a memorandum to file prepared by Mr Welham (the audit senior manager at the time), sets out Deloitte's objective in respect of VMS Sale 1 and VMS Purchase 1 as:

"To document the commercial rationale for two separate transactions … in order to assess whether the two deals are at arms length and can be recognised separately in accordance with IFRS." [483]

13.36 In the same memorandum, Deloitte concluded:

"*Based on the information which we have obtained, we concur that the accounting for both the purchase of VMS software and the sale of Autonomy software to VMS is appropriate as management has clearly assessed and accounted for the fair value of each of the two independent transactions which are not deemed to be similar in nature. We have, from a high level, reviewed the requirements under* [US GAAP] *and note that the accounting treatment would be consistent in that the two separate transactions should be accounted for individually at fair value.*"[484]

13.37 Deloitte's overall considerations are set out in the Q2 2009 Deloitte Audit Committee Report:

"Given that there is clear commercial rationale for the separate transactions, separate contractual arrangements and evidence that both transactions have been made at fair value, management has confirmed and concluded that there are no links between the contracts that would impact the accounting. Licence revenue of $8.5 million has been recognised with $0.5 million being deferred as fair value on support and maintenance. The cost of the software purchased by Autonomy has been capitalised on the balance sheet as an intangible asset and is to be amortised to the income statement over its useful economic life of 3 years."[485]

13.38 Therefore, Deloitte concurred with Autonomy's accounting treatment of both VMS Sale 1 and VMS Purchase 1.

The detailed consideration by Deloitte in respect of VMS Sale 2, VMS Sale 3 and VMS Purchase 2

13.39 In respect of VMS Sale 2, Deloitte tested, inter alia, the agreement details, collectability, assessment of commercial rationale and fair value, delivery and revenue recognition under this sale in accordance with IAS 18.14, concluding that the criteria to recognise revenue were satisfactory.[486]

[483] {POS00148641}.
[484] {POS00148641}.
[485] {DEL1_003_1_00000200}, (Q2 2009 Deloitte Audit Committee Report, page 3).
[486] {POS00167992}, tab "9".

13.40 On VMS Sale 3, Deloitte reviewed the agreement details, payment terms, assessment of the cost and fair value of the hardware, collectability and revenue recognition under this sale in accordance with IAS 18.14 and concluded that it was satisfied with the revenue recognised by Autonomy.[487]

13.41 Deloitte also considered VMS Purchase 2 in the same working paper[488]. In considering the commercial rationale of this purchase, Deloitte sought the views of Ben Johnstone of Deloitte (manager, ERS[489], Information & Technology Risk) and concluded as follows:

"Per conversation with Ben Johnstone, our in house IT specialist, the value gained from this purchase is considerable and has a defined market opportunity. As a result, the amount to be paid of approximately $8.4 million is deemed to be reasonable and at fair value for the purposes of our assessment of the two transactions made with VMS during the quarter.

Satisfactory".[490]

13.42 Deloitte's overall considerations are set out in the Deloitte Audit Committee Report for the year ended 31 December 2010:

"***VMS***

This is a $4.8 million deal for [an] *Autonomy explore licence. Support and maintenance has been carved out at the fair value of 5%. In conjunction with this deal Autonomy has also sold $6.0 million of infrastructure hardware to this customer. The overall gross margin on the two sales is 73%.*

In addition to us receiving third party confirmations[491]*, management has confirmed that no revenue deals contained side letters or ongoing Autonomy performance requirements that were excluded from the signed sales contracts."*[492]

13.43 There is no specific reference to VMS Purchase 2 in the Deloitte Audit Committee Report for the year ended 31 December 2010.

My analysis

13.44 In my analysis below, I first address the allegations made by the Claimants as set out in paragraphs 13.19 and 13.20 above. I then follow with my assessment of the transactions in

[487] {POS00167992}, tab "10".
[488] i.e. working paper {POS00167992} tab "9".
[489] I understand from Deloitte's website that this refers to 'Enterprise Risk Services'.
[490] {POS00167853} referenced as '5761' in Deloitte's working paper on revenue testing {POS00167992}, tab "9".
[491] Deloitte obtained a revenue confirmation letter in respect of VMS Sale 2 and VMS Sale 3 dated 31 December 2010 {POS00160696}.
[492] {DEL1_003_1_00000154}, page 4.

relation to the particular accounting standards, which the Claimants allege Autonomy has not complied with (as set out at paragraphs 13.21 and 13.22 above).

Claimants' allegations

Allegation that the value of the purchase is overstated

13.45 The Claimants assert that the purchase price of US$13.0 million paid to VMS in respect of VMS Purchase 1 was overstated.[493] The Claimants also state, "[Autonomy] *had previously received substantially the same service from Moreover for free.*"[494]

13.46 I understand that Moreover offered to provide Autonomy with a demonstration licence for £50,000[495], but would have charged more for additional rights to its data.[496] Additionally, I understand that the comparability of Moreover's data feed to that provided by VMS is a disputed matter.[497]

13.47 In a memorandum prepared by Autonomy management and reviewed by Deloitte[498], Autonomy noted that it considered quotes from other suppliers and their suitability to provide an alternative data feed to Moreover. The memorandum states:

"*Bloomberg and Thomson Reuters do not allow distribution of content except via their own labelled terminals and so were dismissed as unsuitable. LexisNexis was deemed a competitor. Newsedge indicated an offer in the $9.5m to $10m range but this did not include TV and radio and also did not include advertising content.*"[499]

13.48 Deloitte took steps to ensure that it was satisfied that the consideration of US$13.0 million paid by Autonomy to VMS for its data feed was reasonable. In a memorandum prepared by Mr Welham (previously referred to at paragraph 13.35), he noted:

"*VMS supported their price to Autonomy by giving an example of a similar style transaction with a customer, Neilson for which they quoted $7.5 million from 2006 — 2008 and $12 million to renew this for 2009 — 2011. Autonomy have effectively been given a licence to all of the services which VMS offers which is over and above what Neilson would have acquired.*

Sushovan Hussain has also held a discussion with Acquire Media Limited, a media company based in London, UK, for a similar style purchase but for just news not advertisements access, for a proposed cost of $9.5 million - $10 million. We have reviewed the e-mail

[493] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 2, page 6.
[494] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 2, page 6.
[495] {D0003920125} (email dated 16 July 2009 from Mark Denn (Moreover) to Ian Black (Autonomy)).
[496] Dr Lynch's First Witness Statement, paragraph 406.
[497] First Defendant's Amended Defence, paragraph 121.9A.
[498] As set out in Deloitte's memorandum dated 6 July 2009 {POS00148641}.
[499] {POS00131230}.

offer received on 3 July 2009. Although this is dated after the purchase from VMS, it is still persuasive evidence that ***the purchase price from VMS of $13 million is not unreasonable.*****"**[500] [emphasis added]

13.49 It is not clear to me if the Claimants' allegation in respect of the 'overstatement' of the purchase price extends to VMS Purchase 2. I note however, in considering the fair value of the VMS Purchase 2 (as discussed at paragraph 13.41), Deloitte consulted with its in-house IT specialist and concluded that the amount paid of US$8.4 million was "*reasonable and at fair value*".[501]

13.50 Therefore, for both VMS Purchase 1 and VMS Purchase 2, there is contemporaneous evidence that indicates that the purchases were considered to be at fair value at the time of the transactions. On this basis, the allegation that the value of the purchase is overstated is not supported by the contemporaneous evidence.

Allegation regarding the funding of payments from VMS

13.51 In respect of VMS Sale 1 and VMS Purchase 1, the Claimants allege the payments from Autonomy to VMS (regarding purchases by Autonomy from VMS) allowed VMS to meet its payment obligations to Autonomy (in respect of sales by Autonomy to VMS).[502]

13.52 As part of its Q2 2009 interim review, Deloitte considered the collectability of VMS Sale 1 and documented this a working paper, wherein it noted:

"*We note that as Autonomy is contractually obliged to pay VMS $13m, then this $9m is considered as fully recoverable. This is on the basis that Autonomy owe $4m more than VMS owe Autonomy.*"[503]

13.53 As such, Deloitte took into consideration the fact that Autonomy would pay VMS more than VMS owed Autonomy and this fact did not change the accounting treatment of VMS Sale 1 and VMS Purchase 1.

13.54 On 6 July 2009, VMS's CFO, Laila Syed ("Ms Syed") forwarded a revenue confirmation letter by email[504] to Mr Chamberlain, copying Deloitte (Mr Welham, then the senior manager on the audit team). The signed revenue confirmation states that US$9.0 million[505] in respect of VMS Sale 1 was payable by VMS.

[500] {POS00148641}.
[501] See paragraph 13.41 of my report.
[502] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 2, page 6.
[503] {DEL1_002_1_00000124}.
[504] {D003975696}.
[505] I note that the invoice number shown on the revenue confirmation letter is 5599-ANA which is for VMS Sale 1.

13.55 In addition, the revenue confirmation letter also states:

> *"… this purchase of software is a genuine, standalone transaction at arms length and there are no side agreements related to this acquisition.*
>
> *We also confirm that the sale to Autonomy under the Data Licensing Agreement dated 30 June 2009 is a separate transaction completed on an arms length basis."*[506]

13.56 I am not aware of any allegations which suggest that the revenue confirmation letter provided by VMS was false in any way.

13.57 In my opinion, the contemporaneous evidence provided by VMS, as well as Deloitte's work in respect of the transactions with VMS, supported the collectability of the amounts due from VMS to Autonomy in respect of VMS Sale 1.

13.58 It is not clear to me if the Claimants' allegation in respect of the funding of payments extends to VMS Sale 2 and VMS Sale 3.

Allegations regarding the use and value of the VMS data feed

13.59 The Claimants make two points in respect of the VMS data feed purchased by Autonomy:

(a) it was not used by Autonomy for at least eight months after the first VMS transaction was signed; and

(b) it had no discernible value.[507]

13.60 As I have noted at paragraph 13.29 above, the Claimants have provided witness evidence from technical personnel in support of their allegations concerning when Autonomy first accessed the data feed and its use. I understand that the timing of when Autonomy first accessed and the value of the data feed to Autonomy are disputed matters.[508]

13.61 In any case, I consider that the timing of when Autonomy used the VMS data feed does not have a bearing on the accounting treatment of the purchase from VMS at the time of the transaction. This is because consideration of the subsequent use of the data feed (or any purported lack thereof) after the transaction had taken place relies on hindsight, i.e. on information that would not have been known at the time of the transaction.

13.62 In respect of the 'discernible value' of the purchase, Dr Lynch states that VMS's data feed was built on Autonomy's software, which was "*an important feature*", that "*VMS's offering was much more sophisticated than Moreover's*", and that the right to sell the VMS

[506] {D003975697}.
[507] See paragraph 13.19 of my report.
[508] Second Defendant's Amended Defence, paragraph 190 (a) (1).

newsfeed data to Autonomy's customers (which right was absent from Autonomy's previous agreement with Moreover) was "*a valuable add-on*".[509]

13.63 Further, I note that Mr Hussain states that the VMS data feed bought in VMS Purchase 1 was used for demonstration purposes, social media aggregation services and Autonomy Explore[510] and that Autonomy used the rights granted under VMS Purchase 2, including by giving customers access to VMS data[511].

13.64 In addition, I note that Deloitte considered the value of Autonomy's purchases from VMS at the time they were made, including by reference to a memorandum prepared by Autonomy, and was satisfied that the consideration paid by Autonomy in respect of each of VMS Purchase 1 and VMS Purchase 2 was not unreasonable. [512]

13.65 In my opinion, the Claimants inappropriately use hindsight in their assessment of the accounting treatment of the transactions by taking into consideration the subsequent use (or purported lack thereof) of the purchased goods, and by concluding on this basis that the purchases had no value. The accounting treatment should be based only on the information that was known at the time.

Substance of the transactions

13.66 The Claimants allege that "*the purchases lacked substance. In consequence, the linked sales made by Autonomy to the counterparty also lacked substance*"[513]. IAS 18.13 requires revenue recognition criteria to be applied in such a way as reflects the substance of the transaction[514].

13.67 As described at paragraphs 13.54 to 13.55, VMS confirmed that both VMS Sale 1 and VMS Purchase 1 were standalone, separate and at arm's length.

13.68 VMS had been an Autonomy customer since 2002 and Autonomy's software was used by VMS[515] in its own products. Additionally, Deloitte documented the business relationship between Autonomy and VMS in a memorandum, noting:

"*Autonomy had previously considered purchasing VMS, approximately 2 years ago, indeed Deloitte USA performed some due diligence on the company. This demonstrates that Autonomy have recognised that VMS applications in combination with Autonomy products might provide an improved value added product offering. It provides further evidence*

[509] See paragraphs 13.25 and 13.26 of my report.
[510] Mr Hussain's Witness Statement, paragraph 154.
[511] Mr Hussain's Witness Statement, paragraph 158.
[512] See paragraphs 13.47 to 13.49 of my report.
[513] See paragraph 13.19 of my report.
[514] See paragraph 12.10 of my report.
[515] {D003163858} (Email chain dated 20 January 2010 where Autonomy staff discuss the details of VMS using Autonomy software).

that commercially this is a business that would meaningfully need to purchase and sell to Autonomy."[516]

13.69 Deloitte's work at the time (as set out in 13.31 to 13.43), for example in consultation with its NAA team, supports the fact that Deloitte considered the matter of whether or not the transactions were linked. I emphasise Mr Barden's view on the matter, where he states:

"If we are happy that each sale could each have taken place without the other, and that the items exchanged are not 'similar', then I would expect revenue to be recognised at fair value."[517]

13.70 As to VMS Purchase 2, Deloitte sought the views of its in house IT specialist and concluded that the amount of US$8.4 million paid by Autonomy was "*reasonable and at fair value for the purposes of our assessment of the two* [sale] *transactions made with VMS during the quarter"*[518].

13.71 The Claimants' assertion that the individual transactions *"lacked substance"*[519] is a matter to be determined on the facts but it appears to me that the contemporaneous evidence that I have seen (provided by VMS) as well as Deloitte's work in respect of the transactions with VMS support a finding that the transactions individually had substance.

Whether VMS Sale 1 and VMS Purchase 1, and VMS Sale 2, VMS Sale 3 and VMS Purchase 2 should have been accounted for as two linked transactions under IAS 18.13

13.72 In considering reciprocal transactions generally, the Claimants allege that factors exist that indicate that the transactions are linked, as set out at paragraph 94B of the Re-Re-Amended Particulars of Claim. The Claimants go on to state that, therefore, it is necessary to consider the transactions together.[520]

13.73 IAS 18.13 sets out the scenario in respect of when transactions should be considered as linked:

"… the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.

[516] {POS00148641}.
[517] {DEL1_002_1_00000071}.
[518] See paragraph 13.41 of my report.
[519] Schedule 5 to the Re-Re Amended Particulars of Claim, Transaction 2.
[520] Schedule 5 to the Re-Re Amended Particulars of Claim, Transaction 2.

For example, an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together."[521]

13.74 Based on the documents I have seen, and in particular the Deloitte working papers, each of the transactions which Autonomy entered into with VMS can be understood without reference to the series of transactions as a whole. In particular, there were separate contracts in each of the sales made to VMS and in each of the purchases from VMS in both 2009 and 2010.[522] The example set out in IAS 18.13 at paragraph 13.73 is not applicable to the context of these transactions.

13.75 Additionally, as set out in paragraph 13.37 in respect of VMS Sale 1 and VMS Purchase 1, Deloitte noted the following in its Q2 2009 Audit Committee Report:

(a) the clear commercial rationale for the separate transactions;

(b) the separate contractual arrangements in place;

(c) the evidence that both transactions have been made at fair value; and

(d) Autonomy management's confirmation and conclusion that there were no links between the contracts that would impact the accounting treatment.

13.76 Even if the VMS transactions were to be considered linked, it would then be necessary to consider whether the goods or services exchanged are of a similar nature and value.[523] If the goods are not considered to be similar, revenue is recognised at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred.[524] Again, in this regard, I draw attention to the comments provided by Mr Barden of Deloitte's NAA team set out at paragraph 13.34.

VMS Sale 1 and VMS Purchase 1

13.77 VMS Sale 1 related to a software licence (for US$9.0 million) and VMS Purchase 1 related to a licence for the provision of data including broadcast, advertising and internet content (for US$13.0 million).[525] While, prima facie, these would not appear to be similar goods (albeit both are licences), the exact nature of these products is a matter outside of my expertise. I note, however, that Deloitte considered that "*We are satisfied that these are not similar items of exchange*".[526]

[521] **Exhibit F** - IAS 18.13.
[522] See paragraphs 13.5 to 13.18 of my report.
[523] See paragraphs 12.11 and 12.12 of my report.
[524] See paragraphs 12.11 and 12.12 of my report.
[525] See paragraphs 13.5 to 13.10 of my report.
[526] See paragraph 13.33 of my report.

13.78 Having undertaken detailed consideration of the accounting for these transactions, including consultation with its NAA team, Deloitte concluded that the transactions were stated at fair value.[527]

VMS Sale 2, VMS Sale 3 and VMS Purchase 2

13.79 VMS Sale 2 related to a software licence (for US$5.0 million), VMS Sale 3 related to hardware (US$6.0 million) and VMS Purchase 2 related to data licences that granted additional data and licensing rights to Autonomy (for US$8.4 million).[528] While, again, prima facie, these would not appear to be similar goods, the exact nature of these products is a matter outside of my expertise.

13.80 Again, I note that Deloitte considered these transactions in detail, including giving consideration to the commercial rationale of VMS Purchase 2, before concluding that the transactions were stated at fair value.[529]

Whether each of VMS Sale 1, VMS Sale 2 and VMS Sale 3 meets the recognition criteria under IAS 18.14(d)

13.81 According to Schedule 5 to the Re-Re-Amended Particulars of Claim, the Claimants allege non-compliance with IAS 18.14(d) only and not the criteria under IAS 18.14(a), (b), (c) and (e). As such, I also consider only IAS 18.14(d) in respect of this transaction.

13.82 Prima facie, I disagree with the Claimants that the sales transactions to VMS did not meet the criteria of IAS 18.14(d), which requires that, for revenue to be recognised, the probable economic benefits associated with the transaction will flow to the entity. This is an assessment that can only be taken at the time.

13.83 As previously discussed at paragraph 13.54, VMS confirmed that it owed the amount payable in respect of VMS Sale 1 at the time. In addition, VMS also confirmed amounts owed to Autonomy in respect of VMS Sale 2 and VMS Sale 3 in a confirmation letter[530] dated 31 December 2010.

13.84 Deloitte also specifically considered collectability of all three sales (VMS Sale 1, VMS Sale 2 and VMS Sale 3) in accordance with IAS 18.14 as documented in the working papers related to these sales, noting in each working paper that, *"It is probable that* [the] *economic benefits will flow to Autonomy"*. [531]

[527] See paragraphs 13.31 to 13.36 of my report.
[528] See paragraphs 13.11 to 13.18 of my report.
[529] See paragraphs 13.39 to 13.41 of my report.
[530] {POS00160696}.
[531] {DEL1_002_1_00000124} and {POS00167992} tab "9" and tab "10".

Summary - VMS

13.85 As set out at paragraph 13.20, the Claimants make four separate allegations in relation to the above example transaction regarding:

(a) the value of the purchase(s) by Autonomy from VMS being overstated;

(b) the funding of payments from VMS;

(c) the use of the VMS data feed; and

(d) the transactions individually lacking economic substance.

13.86 The Claimants set out the accounting standards to which they consider these allegations relate under Transaction 2 of Schedule 5 to the Re-Re-Amended Particulars of Claim being IAS 8.10, IAS 18.13 and IAS 18.14(d).

13.87 In summary, I consider that:

(a) for both VMS Purchase 1 and VMS Purchase 2, there is contemporaneous evidence that indicates that the purchases were considered to be at fair value at the time of the transaction, therefore, the allegation that the value of the purchase(s) was overstated is not supported by the contemporaneous evidence;

(b) the contemporaneous evidence provided by VMS (the revenue confirmation letter), as well as Deloitte's work in respect of the transactions with VMS, supported the collectability of the amount due from VMS to Autonomy in respect of VMS Sale 1. It is not clear to me if the Claimants' allegation in respect of the funding of payments extends to VMS Sale 2 and VMS Sale 3;

(c) the use (or purported lack thereof) by Autonomy of the goods purchased is not relevant to the accounting treatment of the transactions because it relies on hindsight; and

(d) the Claimants' assertion that the individual transactions lacked substance is a matter to be determined on the facts but it appears to me that the contemporaneous evidence that I have seen (provided by VMS) as well as Deloitte's work in respect of the transactions with VMS support a finding that the transactions individually had substance.

13.88 I am aware, however, that other witnesses have now provided evidence on the VMS transactions which I shall consider in my supplemental report.

13.89 In respect of the other allegations specific to accounting standards, in summary, I consider that:

(a) based on the contemporaneous documents I have seen, each of the transactions which Autonomy entered into with VMS can be understood without reference to the series of transactions as a whole. Therefore, I do not consider that the transactions should be considered linked under IAS 18.13;

(b) even if the transactions were to be considered linked, on the assumption that the goods were not similar in nature, and provided that the sale price and purchase price were considered to be at fair value, no adjustment was required to the revenue recognised by Autonomy on these transactions; and

(c) on the basis that the transactions are not linked, IAS 18.14 would apply to each of the sales and revenue would be recognised on each sale providing the criteria from IAS 18.14 were met. Specifically in relation to IAS 18.14(d), the contemporaneous evidence provided by VMS (the revenue confirmation letters), as well as Deloitte's work in respect of the transactions with VMS, supported the collectability of the amounts due from VMS to Autonomy.

13.90 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

14 ALLEGED RECIPROCAL TRANSACTIONS: VIDIENT – Q4 2009/Q3 2010

Introduction

14.1 In section 12 of my report, I consider the matter of alleged reciprocal transactions generally. In this section of my report I consider an example where Autonomy bought and sold software in the context of its commercial relationship with Vidient.

Initial observation

14.2 In addition to issues in dispute as to the commercial rationale for the disputed sales and purchases, in my opinion the Claimants do not address obvious issues affecting the appropriate period in which issues in dispute might impact subsequent accounting judgements.

Transaction details and Autonomy's accounting treatment – Vidient

14.3 Transaction 4 from Schedule 5 to the Re-Re-Amended Particulars of Claim relates to four individual transactions with Vidient in Q4 2009 and Q3 2010.

14.4 The transactions in respect of Vidient comprise two sales and two purchases, which the Claimants group as follows:[532]

(a) a sale from Autonomy[533] to Vidient that took place on 31 December 2009 and a purchase from Vidient by Autonomy that took place on 1 January 2010; and

(b) a sale from Autonomy to Vidient that took place on 30 September 2010 and a purchase from Vidient by Autonomy that took place on 26 October 2010.

Sale 1 ("Vidient Sale 1")

14.5 This sale was for a software licence for US$2.5 million (plus US$125,000 for support and maintenance for one year) from Autonomy to Vidient on 31 December 2009[534]. The sale was pursuant to an agreement entitled *"OEM Agreement"* between Vidient and Autonomy, which was also dated 31 December 2009.[535]

14.6 Autonomy recognised licence revenue of US$2.5 million on 31 December 2009, with US$125,000 in respect of support and maintenance revenue deferred to be recognised over the following year.[536]

[532] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 4, pages 10 to 11.
[533] As noted at paragraph 1.19, where I refer to Autonomy, I am referring to the group of Autonomy companies, including any Autonomy subsidiary.
[534] VSI 2009-01.
[535] {D003229194}.
[536] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 4, pages 11 and 12.

Purchase 1 ("Vidient Purchase 1")

14.7 On 1 January 2010, Autonomy entered into an agreement with Vidient entitled "*Vidient OEM Agreement*".[537] Under this agreement, Autonomy agreed to pay US$3.0 million for a three year licence to 'SmartCatch' software, together with US$150,000 in support fees for the first year.[538] The invoice for the purchase is also dated 1 January 2010.[539]

14.8 For the avoidance of doubt, Vidient Sale 1 and Vidient Purchase 1 were transactions entered into in different Autonomy reporting periods.

14.9 I understand from the witness statement of Mr Blanchflower dated 14 September 2018 ("Mr Blanchflower's Witness Statement") that Vidient's 'SmartCatch' software was a video surveillance product which automatically looked for and flagged suspicious incidents captured on CCTV.[540]

14.10 On 4 February 2010, Autonomy capitalised the amount of US$3.0 million in respect of the licence on its balance sheet as an intangible asset to be amortised over its initially assessed useful economic life of three years[541], which in the case of this licence agreement was consistent with the term of the agreement. The support fees of US$150,000 were included in prepaid maintenance on 4 February 2010 to be expensed over the following year.[542]

Sale 2 ("Vidient Sale 2")

14.11 On 30 September 2010, Autonomy and Vidient entered into an amendment to the 31 December 2009 agreement discussed in paragraph 14.5 above.[543] This extended the term of the original agreement by one year and also added additional functionality and extra licensed software in exchange for a fee of US$2.1 million (including support and maintenance for one year).[544] The invoice for the sale is also dated 30 September 2010.[545]

14.12 Autonomy recognised licence revenue of US$2.0 million on 30 September 2010, with US$100,000 in respect of support and maintenance revenue deferred to be recognised over the following year.[546]

[537] {D003227935}. I note that this copy of the agreement is not signed by Vidient.
[538] {D003227935}, page 12.
[539] VSI 2009-08.
[540] Mr Blanchflower's Witness Statement, paragraph 73.
[541] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 4, page 11.
[542] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 4, page 11.
[543] {D001856478}.
[544] {D001856478}.
[545] VSI 2010-01.
[546] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 4, page 11.

Purchase 2 ("Vidient Purchase 2")

14.13 On 26 October 2010, Autonomy and Vidient entered into two further agreements; one entitled *"Software Distributor Agreement"*[547] and one entitled *"Vidient Software License Agreement"*[548]. Under these agreements, Autonomy agreed to pay:

(a) US$2.0 million in respect of distribution rights for 'SmartCatch' (including US$100,000 of development software fees and US$14,000 of support fees)[549]; and

(b) US$285,000 in respect of 'SmartCatch' analytics software (including US$35,000 in respect of support fees)[550].

14.14 The invoices for the purchases are both dated 26 October 2010.[551]

14.15 On 29 December 2010, Autonomy capitalised the amount of US$2.3 million in respect of the two purchases.[552]

Claimants' allegations

14.16 The Claimants allege:

"On 26 January 2010, Autonomy Corporation plc and Vidient issued a press release announcing a strategic partnership to develop and market next-generation intelligent video surveillance solutions, combining Autonomy's Intelligence Data Operating Layer and Vidient's SmartCatch software. There had been no discussions between the parties regarding a joint development until a few days before the transaction was entered into. Autonomy did not use the SmartCatch software and did not pursue the development with Vidient of a joint product. The licences and services purchased by Autonomy Inc and ASL were of no discernible value to the Autonomy group.

Given the existence of factors indicating that these transactions are linked (as set out at paragraph 94B of the Amended Particulars of Claim), it is necessary to consider them together. IAS 8, paragraph 10 and IAS 18, paragraph 13 require that transactions be reported in accordance with their economic substance. Autonomy purchased products which it did not need and which had no discernible value to the Autonomy group company, such that the purchases lacked substance. In consequence, the linked sales made by Autonomy to the counterparty also lacked substance and the revenue recorded for those sales should not have been recognised."[553]

[547] {D001758878}.
[548] {D001758879}.
[549] {D001758878}, pages 2 and 6, and VSI 2010-08, page 1.
[550] {D001758879}, page 5, and VSI 2010-08, page 2.
[551] VSI 2010-08.
[552] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 4, page 11.
[553] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 4, pages 11 and 12.

14.17 In respect of accounting standards, the Claimants allege non-compliance with IAS 8.10, IAS 18.13 and IAS 18.14(d).[554]

14.18 In section 4 of this report, I have set out IAS 18.13 at paragraph 4.65 and 4.78 and IAS 18.14(d) at paragraph 4.35. From the allegations set out at paragraph 14.16 above, it appears that the Claimants also seek to rely on IAS 8.10 in considering the substance of a transaction. The requirement to consider the substance of a transaction in the context of revenue recognition is included at IAS 18.13, and more generally in the Framework and the Conceptual Framework.[555]

Witness evidence

Dr Lynch's First Witness Statement

14.19 Dr Lynch's First Witness Statement states that:

"Vident developed and offered SmartCatch video analysis software which was used by a number of high-profile customers, including at a number of international airports. I recall that Vident software was sold by Autonomy as part of a classified solution for use in Afghanistan. To my knowledge, the purchase made good commercial sense."[556]

Mr Welham's Witness Statement

14.20 In respect of Vident Sale 1, Mr Welham's Witness Statement states that Deloitte:

"… considered the commercial rationale for the transaction, sought confirmation that the software had been delivered to Vident and considered whether payment could be recovered from Vident. We had also obtained a confirmation letter signed by the CEO of Vident in respect of Vident Sale 1 which confirmed the absence of any side letters or other agreements … We concluded that Autonomy could recognise the licence revenue from Vident Sale 1 in accordance with IAS 18, paragraph 14."[557]

14.21 Mr Welham's Witness Statement goes on to state that Deloitte did *"have a concern about the recovery of the payment due from Vident to Autonomy under Vident Sale 1"*[558] but that, ultimately, following confirmation that a payment had been received, and on the basis of the audit team's other work, Deloitte was *"satisfied that the licence revenue was correctly recognised in Q4 2009"*.[559]

[554] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 4, pages 11 and 12.
[555] See paragraphs 4.78, 4.89 and 4.90 of my report.
[556] Dr Lynch's First Witness Statement, paragraph 431.
[557] Mr Welham's Witness Statement, paragraph 246.
[558] Mr Welham's Witness Statement, paragraph 247.
[559] Mr Welham's Witness Statement, paragraph 248.

14.22 In respect of Vidient Sale 2, Mr Welham's Witness Statement similarly states that:

"in view of the review work we undertook … [Deloitte] *concluded that it was appropriate for Autonomy to recognise revenue on the licence element of Vidient Sale 2."*[560]

Other witness evidence

14.23 The Claimants have also provided witness statements from certain Autonomy technical personnel that comment on the Vidient transactions. These statements were made by Mr Blanchflower and David Humphrey ("Mr Humphrey"), chief technology officer of Virage Inc (an Autonomy group company) during the Relevant Period.

14.24 I understand from Mr Blanchflower's Witness Statement that Mr Blanchflower (together with another Autonomy employee) was asked *"to analyse"* the 'SmartCatch' software prior to Vidient Purchase 1.[561] Mr Blanchflower states that he identified from this analysis that although there were *"two minor additional features"* in 'SmartCatch' there *"was significant overlap between* [Autonomy's] *product offerings and SmartCatch"* [562].

14.25 Along similar lines, Mr Humphrey states in his witness statement dated 14 September 2018 ("Mr Humphrey's Witness Statement") that *"Autonomy had no need for the SmartCatch software"*[563] and that to the best of his knowledge *"Autonomy did not at any time license SmartCatch software to any third party or use SmartCatch for any internal (or other) purpose"*[564].

14.26 I understand that a witness statement has now been adduced from Frank Pao ("Mr Pao"), CEO of Vidient at the time, as well as supplemental witness statements from each of Mr Blanchflower and Mr Humphrey that may refer to these transactions. However, consistent with my observation at paragraphs 1.20 to 1.33, my review of this evidence has not, in the limited time available, been comprehensive. I make these references only for the purposes of illustration of certain facts. Therefore, where this transaction is referred to in further witness statements, I will deal with it in my supplemental report.

[560] Mr Welham's Witness Statement, paragraph 373.
[561] Mr Blanchflower's Witness Statement, paragraph 73.
[562] Mr Blanchflower's Witness Statement, paragraph 74, as set out in contemporaneous email dated 30 December 2009 {D010874727}.
[563] Mr Humphrey's Witness Statement, paragraph 20.
[564] Mr Humphrey's Witness Statement, paragraph 21.

Deloitte's work

The detailed consideration by Deloitte in respect of Vidient Sale 1 and Vidient Purchase 1

14.27 In respect of Vidient Sale 1, Deloitte tested, inter alia, the agreement details, the maintenance element of the transaction, collectability, delivery and revenue recognition.[565]

14.28 Deloitte set out its consideration of the requirements of IAS 18 for the recognition of revenue and concluded that the criteria had been met to recognise revenue on this transaction for the following reasons:

(a) the risks and rewards of ownership passed to the customer when the items were delivered as all of Autonomy's obligations had been fulfilled;

(b) Autonomy had not retained any managerial control;

(c) the revenue could be measured effectively as it was stated on both the invoice and in the contract;

(d) it was probable that economic benefits would flow to Autonomy; and

(e) there were no costs incurred in the transaction.[566]

14.29 In arriving at these conclusions, Deloitte noted that:

(a) the relevant software was made available to Vidient by Autonomy for download in the appropriate period; and

(b) on 29 January 2010, Autonomy had received US$500,000 against the invoice in advance of the payment terms noted on the invoice which evidenced intent to pay and Vidient's liquidity.[567]

14.30 Also, as stated by Mr Welham in his witness statement (see paragraph 14.20 above), a confirmation letter was obtained from Vidient, signed by its CEO, which stated the amount due to Autonomy and confirmed the absence of any side letters or other agreements[568].

14.31 There is no indication within the Deloitte working paper for Vidient Sale 1 that the sale was considered by Deloitte to be in any way linked to Vidient Purchase 1 (or to any other purchase from Vidient by Autonomy).[569] This is even though, as confirmed by the Claimants, the date of the press release concerning the partnership between Autonomy

[565] {DEL1_003_1_00000225}.
[566] {DEL1_003_1_00000225}.
[567] {DEL1_003_1_00000225}.
[568] {POS00140438}.
[569] {DEL1_003_1_00000225}.

and Vidient (including reference to Autonomy's distribution of 'SmartCatch') was 26 January 2010[570], which was prior to Deloitte's audit testing of Vidient Sale 1.

The detailed consideration by Deloitte in respect of Vidient Sale 2 and Vidient Purchase 2

14.32 In respect of Vidient Sale 2, Deloitte tested, inter alia, the agreement details, the maintenance element of the transaction, collectability, delivery and revenue recognition.[571]

14.33 As for Vidient Sale 1, Deloitte set out its consideration of the requirements of IAS 18 for the recognition of revenue in respect of Vidient Sale 2 and concluded that the criteria had been met on this transaction for the following reasons:

(a) the risks and rewards of ownership passed to the customer when the items were delivered as all of Autonomy's obligations had been fulfilled;

(b) Autonomy had not retained any managerial control;

(c) the revenue could be measured effectively as it was stated on both the invoice and in the contract;

(d) it was probable that economic benefits would flow to Autonomy; and

(e) there were no costs incurred in the transaction.[572]

14.34 In arriving at these conclusions, Deloitte noted that:

(a) the relevant software was made available to Vidient by Autonomy for download in the appropriate period; and

(b) Vidient was an existing customer with a good payment history.[573]

14.35 As was the case in respect of Vidient Sale 1, a confirmation letter was obtained from Vidient for Vidient Sale 2, signed by its CEO, which stated the amount due to Autonomy and confirmed the absence of any side letters or other agreements[574].

14.36 There is no indication within the Deloitte working paper for Vidient Sale 2 that the sale was considered by Deloitte to be in any way linked to Vidient Purchase 2 (or to any other purchase from Vidient by Autonomy).[575]

[570] Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 4, page 11.
[571] {DEL1_003_1_00000189}.
[572] {DEL1_003_1_00000189}.
[573] {DEL1_003_1_00000189}.
[574] {POS00140438}.
[575] {DEL1_003_1_00000189}.

My analysis

Whether Vidient Sale 1 and Vidient Purchase 1, and Vidient Sale 2 and Vidient Purchase 2 should have been accounted for as two linked transactions under IAS 18.13

14.37 As stated in Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 4, the Claimants allege that factors exist that indicate that the Vidient transactions are linked. The Claimants therefore go on to state that it is necessary to consider the transactions together.[576]

14.38 The Claimants, however, do not in any way address the issue of the different reporting periods in which Vidient Sale 1 and Vidient Purchase 1 fell, and what impact this would have had, or may have had, on the relevant, appropriate accounting for each transaction in each period (as applicable).

14.39 IAS 18.13 sets out the scenario in respect of when transactions should be considered as linked:

> *"… the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.*
>
> *For example, an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together."*[577]

14.40 The Claimants' allegation of non-compliance with IAS 18.13 in respect of the Vidient transactions appears to me to be based on the assertion that Autonomy did not need the products it purchased from Vidient and that they therefore had no *"discernible value"* such that the purchases *"lacked substance"*[578]. This is a matter of allegation, and disputed.

14.41 For example, whereas Mr Blanchflower and Mr Humphrey state that Autonomy did not need or use the 'SmartCatch' software purchased from Vidient[579], Dr Lynch states that to his knowledge *"the purchase made good commercial sense"* and also that *"Vidient software was sold by Autonomy as part of a classified solution for use in Afghanistan"* [580].

[576] Schedule 5 to the Re-Re Amended Particulars of Claim, Transaction 4.
[577] **Exhibit F** - IAS 18.13.
[578] See paragraph 14.16 of my report.
[579] Paragraphs 14.24 and 14.25 of my report.
[580] See paragraph 14.19 of my report.

14.42 In addition, Mr Welham states that Deloitte was aware of the rationale behind the Vident Purchase 1 during its Q1 2010 quarterly review.[581] This was by reference to an email from Mr Chamberlain to Deloitte dated 16 April 2010[582] that forwarded both the analysis of the 'SmartCatch' software prepared by Autonomy (see paragraph 14.24 above) together with the overall rationale for Vident Purchase 1. The rationale states:

"By way of executive conclusion and summary the key technology of strategic interest to us is 'actionable intelligence' capability that SmartCatch can provide …"[583]

14.43 Moreover, based on the contemporaneous documents I have considered to date, each of the transactions that Autonomy entered into with Vident can be understood without reference to the series of transactions as a whole (see paragraph 14.39 above in relation to IAS 18.13). In particular:

(a) there were separate contracts in respect of each of the sales and purchases made to and from Vident; and

(b) there is nothing in the Deloitte working papers indicating that (in the knowledge of the other transactions, or at least my assumption that Deloitte ought to have been aware of any earlier transaction) Deloitte considered that the transactions were, or could have been, linked.

14.44 I note that the example set out in IAS 18.13 at paragraph 14.39 is not applicable to the context of these transactions.

14.45 In any event, even if the Vident transactions were to be considered linked, it would then still be necessary to consider whether the goods or services exchanged were of a similar nature and value.[584]

14.46 The exact nature of the products bought and sold in the Vident transactions is a matter outside of my expertise. On the basis that the products are not similar, and provided that the sale and purchase prices were each considered to be at fair value, no adjustment would have been required to the revenue recognised by Autonomy on the sale transactions.

[581] Mr Welham's Witness Statement, paragraph 249.
[582] {POS00147646}.
[583] {POS00147646}.
[584] See paragraphs 12.11 and 12.12 of my report.

Whether each of Vident Sale 1 and Vident Sale 2 meet the recognition criteria under IAS 18.14(d)

14.47 According to Schedule 5 to the Re-Re-Amended Particulars of Claim, the Claimants allege non-compliance with IAS 18.14(d) only and not the criteria under IAS 18.14(a), (b), (c) and (e). As such, I also consider only IAS 18.14(d) in respect of this transaction.

14.48 Prima facie, I disagree with the Claimants that the sales transactions to Vident did not meet the criteria of IAS 18.14(d), which requires that, for revenue to be recognised, the probable economic benefits associated with the transaction will flow to the entity. This is an assessment that can only be taken at the time.

14.49 As previously identified at paragraphs 14.30 and 14.35, Vident confirmed at the time that it owed the amounts payable in respect of Vident Sale 1 and Vident Sale 2 by way of audit confirmation letters. Hence Deloitte specifically considered collectability of both sales in accordance with IAS 18.14 (by reference to the confirmation letters and Vident's payment history[585]), noting in each of the relevant working papers that, *"It is probable that* [the] *economic benefits will flow to Autonomy"*[586].

14.50 Further, in the absence of any determination, or consideration, that any transaction formed part of a linked transaction, then the assessment of collectability would not in any event be assessed on anything but the terms of the individual transaction, and as noted above, it appears to me that Deloitte were in a position to make this assessment.

14.51 I also note that the terms of the respective Vident Sale 1 and Vident Purchase 1 agreements, foreshadowed that Autonomy was scheduled to pay Vident for its licensed software before Vident was due to pay Autonomy.

Summary - Vident

14.52 In summary, I consider that:

(a) based on the contemporaneous documents I have seen, each of the transactions which Autonomy entered into with Vident can be understood without reference to the series of transactions as a whole. Therefore, based on what I understand at this point in time, in my opinion, I do not consider that the transactions should be considered linked under IAS 18.13. In any event, no apparent consideration has been undertaken by the Claimants of the fact that different transactions fell into different reporting periods;

[585] See paragraphs 14.29 and 14.30 of my report in respect of Vident Sale 1, and paragraphs 14.34 and 14.35 of my report in respect of Vident Sale 2.
[586] {DEL1_003_1_00000225} and {DEL1_003_1_00000189}.

(b) even if the transactions were to be considered linked (which I do not consider to be the case), on the assumption that the goods were not similar in nature, and provided that the sale and purchase prices were each considered to be at fair value, no adjustment would in any event be required to the revenue recognised by Autonomy on these transactions; and

(c) on the basis that the transactions are not linked, IAS 18.14 would apply to each of the sales, and revenue would be recognised on each sale providing the criteria from IAS 18.14 were met. Specifically in relation to IAS 18.14(d), the contemporaneous evidence provided by Vident (the revenue confirmation letters) and Deloitte's work in respect of the transactions supported the collectability of the amounts due from Vident to Autonomy, as well as, for example with Vident Sale 1 and Vident Purchase 1, the terms of the respective agreements.

14.53 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

15 HOSTING TRANSACTIONS

Introduction

15.1 As noted at paragraphs 1.13 to 1.14, the Claimants assert that Dr Lynch and Mr Hussain "*caused Autonomy group companies to engage in improper transactions and accounting practices*"[587] including *"Improper revenue recognition"*, which itself is said to comprise *"VAR transactions"*, *"Reciprocal transactions"* and *"Acceleration of hosting revenue"*. [588]

15.2 In this section of my report I consider the matter of the alleged acceleration of hosting revenue.

15.3 First I set out a brief background to the matter (paragraphs 15.7 to 15.9) and Autonomy's accounting treatment (paragraphs 15.10 to 15.12).

15.4 I then set out the Claimants' overall allegations in respect of hosting transactions (paragraphs 15.13 to 15.18) and consider these allegations generally (paragraphs 15.20 to 15.60).

Initial observation

15.5 My initial observations here relate both to the allegation of the acceleration of hosting revenue in general, as well as the allegations in relation to the hosting arrangements identified in Schedule 12D to the Re-Re-Amended Particulars of Claim.

15.6 It appears to me, when considering hosting as a particular arrangement, that it is not appropriate for all hosting to be grouped together for the purposes of the Claimants' allegations. As with other transactions, and forms of transactions, each transaction needs to be considered from an accounting perspective on its own terms and substance.

Background

15.7 In 2007 Autonomy purchased Zantaz Inc ("Zantaz"). Zantaz was a global market leader in content archiving and electronic discovery products (e-Discovery software) and sold data hosting software known as Digital Safe.[589] Digital Safe allowed a business to archive its data, to access the data remotely, and then to search and retrieve desired material. The e-Discovery software was used for the purposes of the review and disclosure of material in litigation.[590]

[587] Re-Re-Amended Particulars of Claim, paragraph 26.
[588] Re-Re-Amended Particulars of Claim, paragraph 30.2.
[589] First Defendant's Amended Defence, paragraph 29.15 to 29.15.2.
[590] Witness statement of Mr Yelland dated 14 September 2018, paragraph 54.

15.8 As a result of the Zantaz acquisition, one aspect of Autonomy's business became the hosting of customer data on hardware owned or controlled by Autonomy group companies (principally Zantaz) using Autonomy software and managed by Autonomy personnel.[591]

15.9 Where I refer to Autonomy below, I am referring to the group of Autonomy companies, including Zantaz as an Autonomy subsidiary. Although a specific transaction may have been carried out by Zantaz, this will also have been accounted for by the Autonomy group at the consolidated level.

Autonomy's accounting treatment

15.10 According to the Re-Re-Amended Particulars of Claim, hosting transactions under the Zantaz model were originally accounted for by Autonomy as a stream of revenue over the period of the hosting contract and recognised rateably over this period.[592] This was due to the functionality of the software at the time being mainly focused on the storage of information, not its analysis.[593]

15.11 From around summer 2008[594] Autonomy restructured the Zantaz hosting offering to develop a "hybrid" model which included a licence for customers to own Autonomy's IDOL software, as part of the reworked Zantaz Digital Safe software[595], which Autonomy would host. Under this model, the customer had the option to relocate its data elsewhere without the loss of its archive, and without the loss of the software functionality, if it chose to terminate the hosting (storage) contract with Autonomy. In other words, customers had the option to take the software licence elsewhere.[596]

15.12 Broadly, Autonomy accounted for the revenue arising from these "hybrid" transactions in two separate parts:

(a) the value of the licence component was recognised upfront, providing the sale met the conditions required by IAS 18.14,[597] I assume by reference to Autonomy's sale of goods accounting policy for revenue generated from software licence sales; and

(b) the data hosting (storage) component (and any other services) was recognised rateably over the period of provision[598], I assume by reference to the archiving element of its sale of goods accounting policy for the hosting business.

[591] Re-Re-Amended Particulars of Claim, paragraph 30.2.3.1.
[592] Re-Re-Amended Particulars of Claim, paragraph 30.2.3.1.
[593] First Defendant's Amended Defence, paragraph 137.1.
[594] Mr Sullivan's Witness Statement, paragraph 24.
[595] First Defendant's Amended Defence, paragraph 29.15.2.
[596] First Defendant's Amended Defence, paragraph 48.4.0.
[597] First Defendant's Amended Defence, paragraphs 141 to 141.2.
[598] First Defendant's Amended Defence, paragraph 141.

Claimants' allegations

15.13 The Claimants allege that the hosting arrangements were restructured by Autonomy for the purpose of "*accelerating the recognition of revenues*", "*by charging a substantial upfront fee ostensibly for a licence to use Autonomy's Digital Safe or e-Discovery software and a greatly reduced fee for data hosting and related services over the term of the hosting relationship.*"[599]

15.14 The Claimants assert that, under IAS 8.10, IAS 18.13, 18.20 and 18.25, both the Digital Safe and e-Discovery hosting arrangements were, in substance, transactions for the provision of services that should have been accounted for as such, with all revenue recognised over the period that Autonomy hosted the customer's data.[600]

15.15 Further, as to Digital Safe, the Claimants assert that the licence of the software had no independent value to the hosting (storage) arrangement customer in the absence of additional support from Autonomy (which did not form part of the licensing or hosting arrangements provided by Autonomy to the customer), and that customers were incentivised to enter into such arrangements by the overall reduction in fees over the term of the arrangement.[601] The Claimants state therefore that, since, for these reasons, Digital Safe software licences were not separately identifiable components of hosting arrangements, the requirements of IAS 18.13 (for the recognition of revenue from licence fees separately from hosting services) were not met.[602]

15.16 As to Autonomy's e-Discovery software, the Claimants acknowledge that it was capable of operating independently of the hosting service provided by Autonomy.[603] However, the Claimants assert that the fair value of the revenue on a sale of a licence for e-Discovery software could not be reliably measured because:

(a) "*The e-Discovery hosting arrangements involved the provision of a variety of possible services over a period of time, the combination of which was not known at the outset of the arrangements*"[604]

(b) "*Autonomy did not have a consistent approach to pricing the various components of its e-Discovery hosting arrangements, which would have been necessary for an analysis of the fair value of the licence to be performed based on prices charged for the licence or the other components of the arrangement*"[605]

[599] Re-Re-Amended Particulars of Claim, paragraphs 30.2.3.2.
[600] Re-Re-Amended Particulars of Claim, paragraphs 30.2.3.3 and 109.
[601] Re-Re-Amended Particulars of Claim, paragraph 30.2.3.3 and 110.1.
[602] Re-Re-Amended Particulars of Claim, paragraph 30.2.3.3 and 110.1.
[603] Re-Re-Amended Particulars of Claim, paragraph 110.2.
[604] Re-Re-Amended Particulars of Claim, paragraph 110.2.1.
[605] Re-Re-Amended Particulars of Claim, paragraph 110.2.2.

(c) "*There was insufficient management information relating to the cost of providing the various components of the e-Discovery hosting arrangements for an analysis of fair value to be performed using a "cost plus" approach.*"[606]

15.17 The Claimants assert that the requirements of IAS 18.14 were therefore not met.[607] The Claimants do not appear, however, to address or consider Autonomy's disclosed accounting policy for hosting arrangements.

Accounting standards referred to by Claimants

15.18 The accounting standards referred to by the Claimants in respect of their allegations regarding hosting transactions are set out in full in section 4. In summary, these are:

(a) IAS 8.10 – it appears that the Claimants seek to rely on IAS 8.10 in considering the substance of a transaction. The requirement to consider the substance of a transaction in the context of revenue recognition is included at IAS 18.13 (see (b) below), and more generally in the Framework and the Conceptual Framework, as noted at paragraph 4.90;

(b) IAS 18.13 – in particular, the requirement that, "*in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction*";[608]

(c) IAS 18.14 – which sets out the conditions that must be satisfied for revenue to be recognised from the sale of goods;[609]

(d) IAS 18.20 – which sets out the conditions that must be satisfied for revenue to be recognised from the rendering of services;[610] and

(e) IAS 18.25 – which deals with how revenue arising from the rendering of services is recognised over the period in which the services are provided (for example, on a straight line basis).[611]

[606] Re-Re-Amended Particulars of Claim, paragraph 110.2.3.
[607] Re-Re-Amended Particulars of Claim, paragraph 110.2.
[608] Section paragraphs 4.78 to 4.88.
[609] Section paragraphs 4.35 to 4.55.
[610] Section paragraphs 4.56 to 4.57.
[611] Section paragraphs 4.60 to 4.63.

Deloitte's analysis

15.19 Deloitte reviewed the accounting treatment for each "hybrid" hosting transaction on an individual transaction basis, provided these transactions had a value over US$1.0 million or fell into its sample of transactions over US$100,000.[612]

My analysis

15.20 In my opinion, the key issue in dispute between the parties in relation to the hosting transactions is whether or not the components of these "hybrid" transactions could, and therefore should, be separately identified in accordance with IAS 18.13. In my opinion, the answer to this question then determines whether the revenue in respect of such transactions should be recognised:

(a) in part in accordance with revenue recognition for a sale of goods by reference to IAS 18.14 (in respect of the software licence component) and in part as a sale by reference to IAS 18.20 (and 18.25, in respect of the storage and other services),[613] which is the accounting treatment adopted by Autonomy during the Relevant Period; or

(b) as a sale from the rendering of services over time only, by reference to IAS 18.20 and 18.25, as asserted by the Claimants.

IAS 18.13 – substance of the Digital Safe transactions

15.21 The Claimants assert that sales of Digital Safe licences could not be separated from the data storage also provided by Autonomy as, the Claimants claim, the licences had no independent value to the customer.[614] Therefore, the revenue recognition criteria could not be applied separately to a Digital Safe licence sale as a separately identifiable component of a data archiving Digital Safe transaction by reference to IAS 18.13, i.e. because the substance of a Digital Safe sale was, per se, archival data storage in nature only, and not capable of being independently implemented outside of Autonomy without Autonomy's further involvement.

15.22 IAS 18.13 requires recognition criteria to be applied in such a way as reflects the substance of the transaction.[615]

15.23 IAS 18 provides limited guidance on the identification of separately identifiable components, and it particularly does not provide guidance on how revenue should be

[612] See paragraph 6.6 of my report.
[613] Notwithstanding the observation that all hosting product revenues were covered by Autonomy's accounting policy for the sale of goods.
[614] See paragraph 15.15 of my report of my report.
[615] See paragraph 4.78 of my report of my report.

allocated to separate components once they have been identified.[616] Therefore, individual and/or collective professional judgement is key when determining an appropriate accounting treatment for transactions with separate components. Where the treatment of a transaction requires such professional judgement to be applied, it is obvious that different accountants could arrive at (a number of) different accounting treatments, each one individually permissible under IFRS.

15.24 As set out in section 4, PwC's 2009 Guidance on the issue suggests that in order to assess the substance of a transaction with multiple elements the transaction should be viewed from the perspective of the customer, and not the seller.[617] In other words, in the extant case, if the customer perceives there to be different elements to a transaction then the revenue recognition criteria can, and should be applied to each such element, i.e. separately.

15.25 It is my understanding that under a "hybrid" hosting arrangement a customer considered that it had acquired the right to a Digital Safe licence, and therefore, had the option to take the storage system in-house to archive its data itself at any time during the licence term, if it chose to do so. This is highlighted by Dr Lynch as follows:

"*Customers owned the licences and could choose where to host their data, whether with Autonomy, onsite or with third-party providers.*"[618]

15.26 A number of witnesses[619] highlight, in my opinion, evidence relevant to the Claimants' assertion regarding whether or not the Digital Safe licence had an independent value to the hosting arrangement customer.

15.27 For example, Dr Lynch states:

"*Digital Safe licences had value to customers and could be used without significant Autonomy support. Digital Safe licences were used by customers onsite and at third-party data centres, where they were operated by the customers and third-party providers. This is unsurprising to me given that Digital Safe was written in industry standard language and protocol, and Autonomy offered training courses and manuals to customers on how to operate the software.*"[620]

15.28 Similarly, Mr Hussain notes:

[616] See paragraphs 4.79 to 4.80 of my report.
[617] See paragraph 4.85 of my report.
[618] Dr Lynch's First Witness Statement, paragraph 443(b).
[619] See inter alia, the witness statements of Mr Avila, Alastair James Martin ("Mr Martin"), Donald Leonard Avant, Jr ("Mr Avant") and Ms Gustafsson, exchanged on 16 November 2018. Consistent with my approach referred to elsewhere in this report, I will consider any and all further relevant evidence in my supplemental report.
[620] Dr Lynch's First Witness Statement, paragraph 448(a).

"the Digital Safe software had value independent of the hosting services provided by Autonomy and could operate on a standalone basis. On many occasions Digital Safe was used by customers independently of those hosting services, for example by Merck, BNPP, CIBC, Rand and Air Liquide.

Configuration of Digital Safe for use on a customer's own premises did not require proprietary knowledge and resources. It was not necessary that any customisation be done by Autonomy itself. Autonomy sought to involve partners to undertake this work, in line with the company's "pure software" model."[621]

15.29 By contrast, Mr Goodfellow, Autonomy's director of global accounts and chief technology officer of infrastructure throughout the Relevant Period, stated in his witness statement dated 14 September 2018 ("Mr Goodfellow's Witness Statement"):

"*Whether or not a customer who purchased a licence to the Digital Safe software could set up and make use of Digital Safe without Autonomy's managed services boils down to a debate between the technically possible and the practically possible. Technically speaking, if I and a group of ex-Autonomy employees that I carefully selected got together, we could make use of the Digital Safe software to set up Digital Safe without any input from Autonomy. However, practically speaking, if you dumped the Digital Safe software on someone with no knowledge of Digital Safe…that person could not set up and use Digital Safe.*"[622]

15.30 However, Mr Goodfellow further states, "*hypothetically speaking, if you gave the Digital Safe software to me and I had no prior knowledge of Digital Safe, in time, given my technical abilities, I could probably work out what to do with it*".[623]

15.31 I find these statements by Mr Goodfellow to be inconsistent.

15.32 Similarly, Mr Goodfellow then lists a number of Autonomy customers who utilised Digital Safe on-premise including American Express, AXA, BNP Paribas, Citibank, Manufacturers Life, Merck, the Serious Fraud Office, UBS and VA Vaco, although he seeks to distinguish these instances, mostly on the basis that "managed services" would need to have been provided by Autonomy.[624] It does, however, appear that a number of Autonomy's customers did have a Digital Safe licence on-premise and were able to archive their own data independently from Autonomy's storage capability, and in many cases paid additionally for managed services as required.[625]

[621] Mr Hussain's Witness Statement, paragraphs 215 to 216.
[622] Mr Goodfellow's Witness Statement, paragraph 18.
[623] Mr Goodfellow's Witness Statement, paragraph 18.
[624] Mr Goodfellow's Witness Statement, paragraph 25(a) to 25(l).
[625] For example, it appears that Manufacturer's Life ({D000161474}) and the Serious Fraud Office ({D001420337}) operated Digital Safe on-premise and paid Autonomy for managed services such as monitoring.

15.33 In my opinion, the mere existence of a potential requirement to provide managed services would not necessarily undermine the independent value of the Digital Safe licence to Autonomy's customers.

15.34 It also appears that there were instances of hosted customers moving Digital Safe in-house during the term of the contract, as explained by Roger Wang, Autonomy's vice president of product development for Digital Safe throughout the Relevant Period, ("Mr Wang") in his witness statement dated 20 September 2018 ("Mr Wang's Witness Statement") as follows:

"*I was involved at the beginning of the large project to transition Citi*[group] *on-premise in 2008. Citi*[group] *was one of the few customers who removed its data from Autonomy's data centers to put into its own.*"[626]

15.35 In addition, Michael Sullivan, Autonomy's CEO of Autonomy protect ("Mr Sullivan") set out in his witness statement dated 13 September 2018 ("Mr Sullivan's Witness Statement") that:

"*the license model also had the theoretical benefit for the customer that it now owned a license to the* [Digital Safe] *software. A few customers did express some interest in having the ability to bring their* [Digital Safe] *archives in-house in the future, if for example, Autonomy were to go bankrupt*".[627]

15.36 Further, Mr Sullivan noted:

"*I understand that the cost of amortizing the licence fee over time was not included in the customer's EBITDA figure.*"[628]

15.37 While Mr Sullivan does not explain where this understanding came from, and while it is open to interpretation, this comment itself might suggest that Autonomy's customers were themselves recognising the licences purchased from Autonomy under these "hybrid" hosting transactions as assets on their own balance sheets, with associated amortisation recognised in the profit and loss over the term of the licence, supporting that the customers considered this a purchase of a licence.[629]

15.38 Notwithstanding the above, what, in my opinion, Mr Sullivan's Witness Statement seems to support is that there was, from a customer perspective, independent value to the customer in owning a Digital Safe licence, separate from the value of the data storage service Autonomy was providing. This is, however, a question of fact to be determined,

[626] Mr Wang's Witness Statement, paragraph 34.
[627] Mr Sullivan's Witness Statement, paragraph 32.
[628] Mr Sullivan's Witness Statement, paragraph 26.
[629] To be clear, amortisation would not be included in the EBITDA measure as it is 'Earnings before interest, tax, depreciation and amortisation'.

but on the basis that it is found that Autonomy customers themselves ascribed a value to the licence rights, then prima facie, from an accounting perspective, the Digital Safe licence was separable from the underlying archiving of customer data.

15.39 By way of illustration, I note that in Q1 2011 Morgan Stanley & Co. Incorporated chose to cancel the services associated with its Digital Safe licence but specified that it did not want to cancel the licence, suggesting that Morgan Stanley & Co. Incorporated considered the licence and hosting to be separate components of the transaction.[630]

15.40 Supplemental witness statements have now been provided by Mr Wang, Mr Goodfellow, James Michael Krakowski and Samuel Hald Yan that refer to the issue of hosting transactions generally and/or, more specifically, Digital Safe. However, consistent with my observation at paragraphs 1.20 to 1.33, my review of this evidence has not, in the limited time available, been comprehensive. Therefore, where this issue is referred to in further witness statements, I will deal with it in my supplemental report.

IAS 18.14 – reliable measurement of revenue – e-Discovery licences

15.41 In regards to another hosted product, the Claimants allege that no reliable fair value could be attributed to an e-Discovery licence. The Claimants' full allegations in this regard are set out at paragraph 15.16.

15.42 The Claimants assert that while e-Discovery software licences could be operated by a customer independently of the hosting services Autonomy provided, the attribution of revenue to the licence could not be measured reliably.

15.43 In measuring revenue, IAS 18.9 stipulates that revenue should be measured at the fair value of the consideration received or receivable, and it is the Claimants' case that fair value of the revenue on a sale of a licence for e-Discovery software could not be reliably measured.[631] Therefore, on this basis, the sale of an e-Discovery licence did not, according to the Claimants, satisfy the requirements of IAS 18.14 and could not be recognised at the time of the licence agreement.[632]

15.44 Fair value is defined in IAS 18 as "*the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.*"[633]

[630] {DEL1_004_1_00002242}.
[631] See paragraph 15.16 of my report.
[632] See paragraph 15.17 of my report.
[633] **Exhibit F** - IAS 18.7.

15.45 IAS 18 also states:

"*The amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discount and volume rebates allowed by the entity.*"[634]

15.46 The identification of the transaction (or its separate components) is addressed in IAS 18.13, as I have previously referred to.[635]

15.47 In this regard, PwC's revenue recognition guidance set out in section 4 highlights that, while revenue should be recorded based on the substance not the form of a transaction, the signed contracts are usually a good starting point when seeking to determine the substance of a transaction as follows:

"Contracts, while inherently form-driven, often provide strong evidence of the intent of the parties involved, as parties to a transaction generally protect their interests through the contract." [636]

"*In the majority of situations, the criteria for recognition of revenue will only be met once a signed contract is in place between the vendor and the customer. This is because the contract drives key issues such as measurement of consideration, costs and the probability of economic benefits flowing to the vendor.*"[637]

15.48 The revenue recognised on Autonomy's licence sales was based on the price agreed in the contract between Autonomy and the customer, on an arm's length basis, as discussed below.

15.49 Dr Lynch sets out in his witness statement that:

"*Autonomy often priced EDD services using rate cards. There was a lively market in EDD services and many third parties would provide rate cards. Thus the fair value of the services could be distinguished from the value of the licence, based on the market price of the services.*"[638]

15.50 Further, Mr Hussain notes:

"*… a reliable fair value could be (and was) attributed to the licence to use the eDiscovery software and the hosting and related services provided together with the eDiscovery software, on the basis of (i) a per-data unit price for hosting services; (ii) man-hour rates*

[634] **Exhibit F -** IAS 18.10.
[635] See paragraph 4.78 of my report.
[636] **Exhibit G -** PwC's 2009 Guidance, page 9006, paragraph 9.30.
[637] **Exhibit G -** PwC's 2009 Guidance, page 9008, paragraph 9.38.
[638] Dr Lynch's First Witness Statement, paragraph 472.

for services; and (iii) a maintenance charge of 5 per cent. of the licence fee. So far as I am aware, the unit prices and rates were set out in Autonomy's rate card and/or recorded in each contract for eDiscovery services. Each licence also set out the parameters of use within the terms of the licence in relation to, for example, the amount of data covered by the licence and the number of authorised users."[639]

15.51 Dr Lynch provides an example of a contract with Phillip Morris International for e-Discovery software and related services entered into on 18 November 2010. The contract contains a rate card at "Attachment J" which appears to set out the applicable fees for the components and possible services associated with e-Discovery, priced on the basis described by Mr Hussain.[640]

15.52 Furthermore, this transaction was reviewed by Deloitte as part of the 2010 year end audit, with Deloitte concluding that the separate e-Discovery licence sale satisfied the requirements of IAS 18.14 and could be recognised at the time of the agreement.[641]

IAS 18.20 and IAS 18.25 – revenue recognised on rendering of services

15.53 As noted at paragraph 15.12(b), Autonomy accounted for what it considered to be the separate storage element of the "hybrid" hosting transactions by recognising the revenue over the term of the agreement, by reference to IAS 18.20 and IAS 18.25, as set out in detail in section 4.

15.54 The Claimants assert that the full value of each of the "hybrid" hosting transactions, including the value of the licence and services as set out in the contract, should have been accounted for, not in accordance (where applicable) with IAS 18.14, but by reference to IAS 18.20 and IAS 18.25, as these transactions were, in substance, no more than a continuing provision of a service, which should have been recognised over the term of the agreement.[642] This appears to me to be a departure from accounting for an e-Discovery licence that is separately identifiable from future ad hoc actions that are governed by a rate card.

Conclusions

15.55 The Claimants assert that sales of Digital Safe licences were not separable from the storage services provided by Autonomy by reference to IAS 18.13, and while sales of e-Discovery licences were separable from the storage services, the revenue associated with the licence could not be estimated reliably in accordance with IAS 18.14, because other services

[639] Mr Hussain's Witness Statement, paragraph 219.
[640] {D001457677}, page 21.
[641] {POS00176529}, tab "2".
[642] See paragraph 15.14 of my report.

potentially required to manage the e-Discovery process were not known at the outset of the arrangement.

15.56 By reference to PwC's Guidance regarding the separation of components based on the customer's perception, and the evidence set out at paragraphs 15.21 to 15.39 above, it would appear to me that Digital Safe licences were capable of being separated from the hosting services provided by Autonomy by reference to IAS 18.13. In these circumstances, providing the criteria of IAS 18.14 and/or IAS 18.20 were met where applicable, Autonomy was entitled to recognise the revenue generated on Digital Safe licence sales at the date of the sale agreement, and the separate storage services revenue over the term of the agreement by reference to IAS 18.25.

15.57 The evidence above also suggests that there was information available to assist in arriving at a fair value for e-Discovery assistance (as needs be), which could then be used to arrive at a residual fair value for an e-Discovery licence (the latter being the remainder of the total value of the transaction). In these circumstances, providing the other four criteria of IAS 18.14 were met, Autonomy was entitled, and arguably required, to recognise the revenue generated on e-Discovery licence sales at the date of the sale agreement, and the separate data storage revenue over the term of the agreement by reference to IAS 18.25 (notwithstanding the identification of all such related revenue as hosting product revenue in Autonomy's accounting policy note dealing with these specific issues).

15.58 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

15.59 In particular, I refer to my earlier comments that the application of certain accounting standards, and in particular some past accounting standards, requires or required the use of more discretionary professional accounting judgement and therefore may or could result in two different accountants (neither of whom is wrong) arriving at two different conclusions. In such a scenario, a difference in the conclusions reached would not, or does not, indicate that either of them was necessarily inappropriate but rather that they formed part of a range of possible conclusions, each or all of which might be, or could be appropriate.

15.60 If the facts are not as I have set them out above and understand them to be, it is possible that the full value of the "hybrid" hosting transactions, including the value of the licence and services set out in the contract, might be accountable by reference more to IAS 18.20 and IAS 18.25, where potentially such transactions were, if so determined, more the provision of a single service, to be recognised over the term of the agreement.

16 OTHER TRANSACTIONS

Introduction

16.1 The Claimants refer to four "*other*" transactions that they assert resulted in the improper recognition, or accelerated recognition, of revenue by Autonomy, for which details are set out in Schedule 7 to the Re-Re-Amended Particulars of Claim. These are:

(a) Tottenham Hotspur Plc ("Spurs") in Q2 2010 and Q1 2011 ('Transaction 1');

(b) PRISA Digital S.L. ("PRISA") in Q4 2010 ('Transaction 2');

(c) Amgen Inc ("Amgen") in Q4 2010 ('Transaction 3'); and

(d) Iron Mountain Information Management Inc ("Iron Mountain") in Q2 2011 ('Transaction 4').

16.2 I consider that the main area of disagreement between the parties is essentially the same for Transactions 1, 2 and 3, in respect of Spurs, PRISA and Amgen respectively, as set out at paragraphs 16.4 to 16.7. To put the matter into context, I consider the Claimants' allegations by reference to an example transaction – Transaction 2, in respect of PRISA – at paragraphs 16.9 to 16.61.

16.3 I consider Transaction 4 in respect of Iron Mountain separately at paragraphs 16.62 to 16.93 as the allegations and accounting matters raised by the Claimants differ to those relating to the other three transactions in this category.

Claimants' allegations in respect of "other" Transactions 1, 2 and 3

16.4 The Claimants allege:

"*In respect of Schedule 7, Transactions 1, 2 and 3, Autonomy entered into contracts for the delivery of licences and related support and professional services to customers, which were in practice the delivery of customer-specific tailored versions of the relevant software, and required significant implementation. The economic substance of the transactions was that of the provision of a "solution", to which the provision of services was integral. Autonomy should have accounted for each transaction accordingly.*

For Transactions 1 and 2, the terms of these contracts were vague. It was not possible to reliably estimate the costs to complete the projects, nor the outcome of the transactions. Autonomy accounted for these contracts as if they had separate elements, recognising revenue relating to the licence element upfront. IFRS required that for contracts involving the rendering of services where the outcome cannot be estimated reliably, revenue should be recognised only to the extent that costs are recoverable. In both instances, no services had been provided to the customer at 31 December 2010. As at 30 June 2011, neither

customer had received a working solution. Accordingly, revenue should have been recognised only to the extent that costs were recoverable.

For Transaction 3, Autonomy entered into a Hosting Services and License Addendum to provide Amgen Inc. ("Amgen") with a software licence, and related infrastructure and support services in relation to the implementation and hosting of a "solution", namely the Digital Safe system. Any software licences and infrastructure provided to Amgen in relation to the Digital Safe system were of no independent value to Amgen and were not separable from the other components of the solution. The Digital Safe system had not been successfully implemented as at 31 December 2010 or by the end of the Relevant Period (30 June 2011), and no hosting services had been provided to Amgen prior to this date. Accordingly, no revenue should have been recognised in relation to this transaction at 30 June 2011."[643]

My breakdown of Claimants' allegations

16.5 As I understand it, the main claim by the Claimants, and hence the main area of disagreement between the parties in this action regarding the "other" transactions with Spurs, PRISA and Amgen, is that the economic substance of these transactions was that of the provision of a "solution", to which the provision of services was integral. Where the Claimants say these transactions involve the provision of a "solution", they claim the nature of the contract was a services contract, and secondly that the outcome of the contract could not be estimated reliably, and hence revenue should have been recognised only to the extent that costs were recoverable.

16.6 To put the matter into context, I consider these allegations by reference to an example transaction. The example discussed relates to PRISA in Q4 2010, which is Transaction 2 from Schedule 7 to the Re-Re-Amended Particulars of Claim.

16.7 I consider the PRISA example to be representative of the transactions with Spurs and Amgen as the main area of disagreement between the parties is essentially the same in each case. The specific circumstances of each of the other transactions of course differs, as does the contemporaneous information and documentation that was available to Autonomy (and Deloitte) at the time that each transaction took place. As such, my conclusions in respect of the transaction with PRISA cannot be assumed to apply to the other transactions in the absence of a detailed review of each.

[643] Re-Re-Amended Particulars of Claim, paragraphs 115.2 to 115.2.2.

PRISA - Q4 2010

Initial observation

16.8 According to my understanding of the Claimants' allegations in regard to PRISA, as for "other" transactions, the Claimants' position is that the substance of the transaction was the provision of a "solution" for PRISA, as a service. This would not be my understanding of the arrangement agreed contractually between PRISA and Autonomy, where PRISA was granted access to a suite of Autonomy software, and the provision for certain off-take services to be provided by Autonomy at later dates at agreed rates. These services were available upon subsequent request by PRISA, based on PRISA's own determination of what software it might elect to use from Autonomy's suite of software. At all times, however, the contractual arrangement demonstrates that PRISA retained the right to elect use for its future purposes none, some, or all of the Autonomy software made available, with the subsequent software elections to be communicated to Autonomy and the fees for the agreed use subsequently of the Autonomy software chosen to be determined at that later date.

Background

16.9 On 10 December 2010, Autonomy Spain S.L. (a subsidiary of Autonomy and hereafter referred to as Autonomy) entered into the first amendment to an End User Software Licence agreement dated 31 March 2010 with Ediciones El Pais, S.L., a subsidiary of PRISA (the "PRISA First Amendment"),[644] for the following goods, and services:

(a) agreed access rights and rights of use, on an as needed customer choice basis[645], to a suite of software licences comprising Autonomy's Power and Promote suite of products, including IDOL functionalities, TeamSite, OpenDeploy, LiveSite Server, Optimisation software, Virage and Videologger.[646] This access to the suite of products was provided for the agreed price of €6.75 million[647] for a finite period of approximately three years[648], on an unlimited basis during that period, and was granted to PRISA for the purposes of PRISA's own digitisation project[649]. PRISA's sole right to refund of the licence fee was under the limited and conditional provisions of the 45-day warranty.[650] It appears that PRISA had no right of termination after

[644] {D001544739}, page 1.
[645] {D001544739}, page 1, clause 4.
[646] {D001544739}, pages 4 to 5, clause A.
[647] {D001544739}, page 8, clause C.1.
[648] The date of the PRISA First Amendment, 10 December 2010, to 31 December 2013 was approximately three years.
[649] {D001544739}, page 5, clause A.
[650] {D001544739}, pages 1 to 2, 6.a.

the date of the PRISA First Amendment[651], however, Autonomy was entitled to terminate the agreement in the event that Autonomy was not able to support or replace the software under the warranty provision[652];

(b) a one off fee for a one month extension and 24x7 support priced at €243,208;

(c) three years' support and maintenance priced at €337,000 per annum;

(d) 2,640 days of professional services, commencing on 15 December 2011, priced at €850 per day, or €2.24 million, increasing to €900 for further services required in excess of 2,640 days;

(e) managed services for a period of three months from the date of the PRISA First Amendment, upon expiration of which Autonomy would provide a further three months of assistance to PRISA to migrate its specific rules and data to PRISA's onsite servers. These managed services were included within the licence fee at no extra charge; and

(f) 15 days of training for 10 employees priced at €52,000.[653]

16.10 Whether PRISA deployed any software, or not, the annual support fee remained payable by PRISA during the three year deployment period to 31 December 2013.[654]

16.11 The PRISA First Amendment also provided for the following services which were to commence on the date of the PRISA First Amendment, and were to be provided at no extra charge:

"*Scoping of the Federation 'Seed' - documentation of the effort required to deliver a 'seed' of the Federation solution i.e. a simple extension of the existing POC with 3 or 4 business* [unit] *sources. PRISA will not be charged any additional fees for such services.*

Autonomy will configure and further develop its current TeamSite interface which will address workflow requirements. Such standard user interface will be provided as part of the professional services. PRISA will not be charged any additional fees for such services."[655]

16.12 Accordingly, in general terms, under the terms of the PRISA First Amendment, PRISA was being granted the potential rights to "*deploy and put into production, on an as needed*

[651] The agreement stipulates that Autonomy will invoice PRISA for the full amount of the licence and first year's maintenance on 15 December 2010 unless PRISA provides written notice on or before 28 November terminating the agreement ({D001544739}, page 9, clause E.5). Therefore, I have assumed the date referred to is 28 November 2010.
[652] {D001544739}, page 1, clause 6.a.
[653] {D001544739}, pages 8 and 9, clauses C.1 to C.6.
[654] {D001544739}, page 1, clause 4.
[655] {D001544739}, page 8, clause C.4.

basis, perpetual licences of the Software products listed in above"[656] during the period up to 31 December 2013. This is clear from the fact that it was PRISA's choice as to how it proceeded, agreed as it was that "*PRISA may deploy…*".[657]

16.13 The PRISA First Amendment also states:

"*For clarity, "put into production" shall mean the Software, as described above, is placed in operational use by PRISA for access by PRISA's* users [during the Deployment Period, i.e. the period to 31 December 2013]…

At the end of the Deployment Period, PRISA may not deploy any additional Software licenses, and PRISA and Autonomy will agree in writing on the final quantities of the Software that PRISA will be thereafter authorized to use in production. Within thirty (30) days from the expiration of the Deployment Period, PRISA shall provide Autonomy with a written document signed by an authorized officer of PRISA which documents the final quantities of the Software licenses deployed and put into production."[658]

16.14 In other words, it was for PRISA to determine, and subsequently account for, the software elections it made, and it had an opportunity of three years within which to do so.

16.15 Under the PRISA First Amendment dated 10 December 2010, Autonomy invoiced PRISA on 31 December 2010 for the licence fee relating to the grant of access to the suite of Autonomy's software, the one off one month extension fee and the first year's support and maintenance charge, totalling €7.33 million.[659]

16.16 It appears fees for the agreed unit rates for subsequent professional services and training were invoiced (on a per unit basis) as and when the services were provided, as envisaged generally by the contract[660] and set out in the relevant invoices[661].

Autonomy's accounting treatment

16.17 As per Schedule 7 to the Re-Re-Amended Particulars of Claim, the software product and support and maintenance revenue was accounted for as follows:

(a) Licence revenue of €6,820,208[662] was recognised on 31 December 2010;

(b) Support and maintenance revenue of €337,000 was deferred on 31 December, to be recognised over the following year;

[656] {D001544739}, page 1, clause 4.
[657] {D001544739}, page 1, clause 4.
[658] {D001544739}, page 1, clause 4a. and 4b.
[659] {D000524587}.
[660] {D001544739}, page 8, clause C.4 and C.6.
[661] Examples of these invoices have been provided in the Draft Claimants' Voluntary Particulars referenced as PR 2010-11, PR 2010-12 and PR 2010-17.
[662] Comprising of licence fee of €6.75 million plus €75,208 carved out of the one month extension fee.

(c) A further €150,000 for support and maintenance carved out of the one month extension fee included in the PRISA First Amendment was deferred on 31 December, to be recognised over the following three years; and

(d) Revenue for hosting services of €18,000 carved out of the one month extension fee was deferred on 31 December 2010, to be recognised in Q1 2011.[663]

16.18 I note that the €18,000 the Claimants describe as hosting services carved out of the one month extension fee was described by Deloitte in its testing as a carve out for the managed services described at paragraph 16.9(e) above.[664]

16.19 The sum of the separate components above equate to €7.33 million, which is the value of the invoice Autonomy raised on 31 December 2010, as set out at paragraph 16.15 above.

16.20 The Claimants do not refer to the accounting treatment for the Professional Services and training but I assume, in the absence of evidence to the contrary, that these services were recognised as and when invoiced and there is no dispute in this regard.

16.21 Based on the accounting treatment applied, Autonomy prima facie accounted for this transaction as the sale of software products, to be accounted for by reference to the criteria set out in IAS 18.14, and, where applicable, the separate provision of support and maintenance by reference to the criteria set out in IAS 18.20. In addition, it appears professional services and training were accounted for when provided and invoiced, as agreed, in accordance with the assumed terms of the PRISA First Amendment (i.e. 'agreed Milestone'). I further assume these components were accounted for by reference to IAS 18.20. As Mr Hussain states:

"*Certain software was sold to…PRISA (Q4 2010) pursuant to contracts that envisaged the separate provision of support and other professional services in respect of such software…*

In respect of the…PRISA [transaction] *Autonomy accounted for these contracts as if they had separate elements, recognising revenue relating to the licence element upfront. This was the appropriate accounting treatment…*"[665]

Claimants' allegations in respect of transaction with PRISA

16.22 The Claimants' allegations in relation to the Q4 2010 transaction with PRISA are set out at paragraph 16.4 above.

[663] Re-Re-Amended Particulars of Claim, Schedule 7, Transaction 2.
[664] {DEL1_003_1_00000144}, page 2.
[665] Mr Hussain's Witness Statement, paragraphs 228 to 230.

16.23 More specifically, the Claimants allege non-compliance with IAS 8 paragraph 10, IAS 18 paragraphs 13, 14(a), (b), (c), (d), and (e), 20 and 26. I set out the narrative of these accounting standards in section 4 and therefore do not repeat these here.[666]

16.24 The Claimants assert that the sale to PRISA was the delivery of customer specific tailored versions of the software, therefore, in substance, the sale of a 'solution' to be accounted for by reference to IAS 18.20 and 18.26, as, in their view, the provision of services was integral and therefore it could not be separated into individual components.[667]

16.25 On the face of the PRISA First Amendment, as I have stated, I would not understand this to be the case.

My analysis

16.26 At the heart of these transactions is whether or not the transaction could be split into separately identifiable components (by reference to IAS 18.13), and whether the costs to complete the project or the outcome of the transaction could be estimated reliably (by reference to IAS 18.26) if the contract could not be separated into separately identifiable components.

16.27 In my opinion, in the PRISA example, the Claimants fundamentally appear to misunderstand the customer agreement.

IAS 8.10 and IAS 18.13 - Substance of the transaction

16.28 In my opinion, IAS 8.10 is not relevant since it applies where there is no IFRS that specifically applies to a transaction, other event or condition[668], and hence provides a framework to otherwise determine an appropriate accounting policy in this scenario. Since the Claimants allege issues within the framework of IAS 18, and the recognition of revenue under that reporting standard, I disagree with any suggestion that there was no appropriate accounting standard which could be applied to these transactions.

16.29 The Claimants allege that in accounting for this transaction, the sale made to PRISA was that of the provision of a "solution" to which the provision of services to implement the software was integral[669], rather than a contract with separately identifiable components, to be accounted for under the umbrella of IAS 18.13.

16.30 As noted in section 4, IAS 18.13 provides limited example guidance for the purpose of identifying the components of a transaction. The aim of the standard is to reflect the

[666] Re-Re-Amended Particulars of Claim, Schedule 7, Transaction 2.
[667] See paragraph 16.4 of my report.
[668] **Exhibit N** - IAS 8.10.
[669] Re-Re-Amended Particulars of Claim, Schedule 7, Transaction 2.

substance of the transaction. Therefore, individual and/or collective professional judgement is required and management judgement is particularly relevant. Where the treatment of a transaction requires such professional judgement to be applied, it is obvious that different accountants could arrive at (a number of) different accounting treatments, each one individually possible, and permissible, under IFRS.

16.31 PwC's guidance set out in section 4 highlights that, while revenue should be recorded based on the substance not the form of a transaction, it remains the case that the signed contracts are often a good starting point when seeking to determine the substance of a transaction (for the following reasons):

"*The substance will not only be based on the transaction's visible economic effect; it will also have to be analysed based on all the transaction's contractual terms, or the combination of the contractual terms of linked transactions. Contracts, while inherently form-driven, often provide strong evidence of the intent of the parties involved, as parties to a transaction generally protect their interests through the contract.*"[670]

"*…In the majority of situations, the criteria for recognition of revenue will only be met once a signed contract is in place between the vendor and the customer. This is because the contract drives key issues such as measurement of consideration, costs and the probability of economic benefits flowing to the vendor.*"[671]

And

"*…When considering how to account for a service contract, it is essential to understand the contractual terms. By agreeing to the terms in the contract, the buyer specifies at what point the contract has value to them. This will then indicate when the criteria for revenue recognition are met.*"[672]

16.32 The contract between Autonomy and PRISA set out the different components of the transaction as listed at paragraph 16.9 above.

16.33 PwC's guidance also sets out that:

"*in assessing the transaction's substance, the transaction should be viewed from the perspective of the customer and not the seller; that is, what does the customer believe they are purchasing? If the customer views the purchase as one product, then it is likely that the recognition criteria should be applied to the transaction as a whole. Conversely,*

[670] **Exhibit G -** PwC's 2009 Guidance, page 9006, paragraph 9.30.
[671] **Exhibit G** - PwC's 2009 Guidance, page 9008, paragraph 9.38.
[672] **Exhibit G** - PwC's 2009 Guidance, page 9030, paragraph 9.109.

if the customer perceives there to be a number of elements to the transaction, then the revenue recognition criteria should be applied to each element separately."[673]

16.34 Clearly it could be difficult for an entity to evidence what its customer perceived it was purchasing, beyond what is detailed in the contract between the parties. However, in this example, I note that Rahul Puri, managing director of innovation and chief software architect at PRISA in the Relevant Period ("Mr Puri") stated in his witness statement dated 13 September 2018 ("Mr Puri's Witness Statement"):

"[PRISA] *entered into an agreement with* [Autonomy] *involving the purchase by Prisa of certain* ***Autonomy software licences, three years' support and maintenance and 2,640 days of professional services and training****, for use on El Páis and Prisa's website, audio, video and other digital products. The agreement provided for fees totalling approximately €9.6m,* ***including €6.8m in respect of software licences. Autonomy was to provide the underlying technology for many of the components required for the project, as well as provide services for the implementation of those products for Prisa.***"[674] [emphasis added]

16.35 This comment suggests that the customer perceived that it was purchasing both software licences, i.e. the underlying technology, and, separately, additionally priced services for the implementation of the software products.

16.36 Mr Puri also noted:

"*Prisa had no use for the software it had purchased from Autonomy beyond the scope of the project and it was not possible for us to use any of the software for the project without the involvement and support of Autonomy personnel…Autonomy's expertise and implementation services were integral to the project's successful deployment*".[675]

16.37 This supports the inclusion of the agreed service element of the PRISA First Amendment, and in my opinion supports the conclusion that the transaction had separately identifiable components, as well as confirming the premise that it was for PRISA to determine its own deployment requirements, and for Autonomy to separately and subsequently assist PRISA in implementing PRISA's choices.[676]

[673] **Exhibit G** - PwC's 2009 Guidance, page 9037, paragraph 9.132.
[674] Mr Puri's Witness Statement, paragraph 7.
[675] Mr Puri's Witness Statement, paragraph 9.
[676] In terms of witness evidence relating to this transaction see, inter alia, the witness statement of Mr Avant dated 9 November 2018 (paragraphs 21 to 27) and the witness statement of Mr Martin dated 16 November 2018 (paragraphs 19 to 25). Consistent with my approach stated elsewhere in my report, I will consider any and all further relevant evidence in my supplemental report.

IAS 18.26 – Outcome of a transaction involving the rendering of services cannot be estimated reliably

16.38 The Claimants assert that the terms of the agreement with PRISA were vague, that the fair value of the services (and thus also the value of the residual software licence component of the contract, I assume) could not be determined and it was not possible to reliably estimate the costs to complete the project, nor the outcome of the transaction, and therefore, that the revenue should have been recognised only to the extent that recoverable costs had been incurred, by reference to IAS 18.26.[677]

16.39 This assumes that the whole agreement was nothing other than a service agreement, which would result in the Claimants assertion relying on the assumption that the elements of the PRISA contract could not be separated, contrary to the position which I describe above.

16.40 Mr Puri stated that:

"*at the outset* [PRISA] *made very clear to Autonomy the scope of the project and what we were trying to accomplish*" but goes on to say "*the scope of the project was not agreed as at December 31, 2010 and no work on the project had begun before that date*".[678]

16.41 I find these statements by Mr Puri to be contradictory but my interpretation of these comments is that the overall scope of PRISA's intention, or hoped for project, was understood at the outset but the specifics were a matter for PRISA's subsequent consideration. This appears clear from the contract as it sets out that Autonomy was providing access to its suite of software products, but that it was for PRISA to conclude on an 'as needed' basis what it deployed from that suite (and had a period of three years to do so) as well as the fact that the separately priced professional services were not foreseen to commence before 15 December 2011, a year after the contract was signed, before which Autonomy would provide a short period of managed and transition services (included within the licence fee) and potentially product training (priced separately as per the PRISA First Amendment).[679]

16.42 I have seen no evidence to suggest that the fair value of the separately identifiable services or the outcome of the transaction were required to be estimated at the outset. Similarly, it is difficult to foresee why there was a need to assess the costs to complete when the contract agreed unit rates for future professional services, including the provision for the future incremental increase in these service rates after the exhaustion of the contractual number of man day services initially agreed. As per the agreement signed on 10 December 2010, Autonomy was obligated to provide 2,640 days of professional services at a rate of

[677] Re-Re-Amended Particulars of Claim, Schedule 7, Transaction 2.
[678] Mr Puri's Witness Statement, paragraphs 6 and 10.
[679] {D001544739}, pages 8 to 9, C.4 to C.6.

€850 per day, at a total charge of €2.24 million, after which, Autonomy agreed to provide any further professional services at the request of PRISA at €900 per day, if so required.[680] The component for professional services was not, therefore, a fixed price, but instead was a minimum Autonomy commitment which would appear reasonable, given the scope of the work at the time of the transaction was dependent on PRISA's subsequent actions.

16.43 As noted at paragraph 16.16, Autonomy appears to have invoiced for, and recognised, professional services revenue as and when these services were performed, in line with Autonomy's accounting policy for the rendering of (consulting) services. Therefore, it does not appear there would have been uncertainty as to a reliable estimate of costs to complete the project, and hence a measure of the revenue at the time it was recognised, given that the associated costs at that point were priced on an agreed future per unit basis (as foreseen to be requested by the customer).

16.44 Considering further the fair value of the software licence component of the contract, I note that two specific services were expressly anticipated in the contract and it was noted that "*PRISA will not be charged any additional fees for such services*"[681] and that up to six months (as I have noted previously) of managed services were included in the licence fee[682]. The value of these services, and whether the outcome of providing these services could be estimated reliably, is a matter outside of my expertise, and as such I do not seek to comment on it. However, if found to be the case that these services were material and the outcome could not be estimated reliably, this could have an impact on the permitted accounting treatment for the separately identifiable licence fee in this contract, as an amount for services would need to be carved out of the fee at the outset of the transaction (again, only if considered material).

16.45 I note that Deloitte tested an amount of €18,000 carved out of the upfront one month extension fees to cover three months of managed services and concluded that the fair value of this carve out was reasonable based on the charge to another customer for a similar offering of managed services.[683]

16.46 The Claimants have not explained how they believe the professional services revenue should be accounted for if the components of the transaction were not considered separable, given that these services were invoiced and recognised as and when such services were performed, and are therefore (it must be assumed) matched to the cost of the service being performed.

[680] {D001544739}, page 8, C.4.
[681] {D001544739}, page 8, C.4.
[682] {D001544739}, page 8, C.5.
[683] {DEL1_003_1_00000144}, page 2.

16.47 The Claimants assert that no services had been provided to PRISA at 31 December 2010 and that, accordingly, no revenue should have been recognised in the year ended 31 December 2010.[684] As noted above, this ignores the actual substance of the agreement. In terms of other revenue from the agreement, Autonomy recognised revenue on professional services as and when those services were performed and, accordingly, only the licence revenue and a portion of the one month extension fee was recognised at 31 December 2010, as set out by the Claimants. I note that it is detailed in the contract that the professional services were estimated to commence on 15 December 2011.[685] Therefore, I would not expect that Autonomy would have recognised any further revenue for professional services at 31 December 2010, as it appears no professional services were to be provided by this date.

16.48 The Claimants assert that at 30 June 2011, PRISA had not received a working solution incorporating Autonomy's software and accordingly, Autonomy should only have recognised revenue to the extent recoverable costs had been incurred. The Claimants assert that an estimated 592 days of professional services had been provided to PRISA at a cost of US$947,200, which should have been the amount recognised as revenue at 30 June 2011.[686]

16.49 Again, the Claimants do not explain how this estimate has been calculated. However, as it appears clear that Autonomy (as foreseen under the PRISA First Amendment) were invoicing PRISA for the professional services as and when they performed such services (at the request of PRISA given that these services were being provided in advance of the agreed date within the PRISA First Amendment), the amount of professional services provided at the year end did not need to be estimated, it was detailed in the invoices sent to PRISA.[687]

IAS 18.14 and IAS 18.20 – Conditions for recognising revenue from the sale of goods and rendering of services

16.50 The Claimants do not specify how they consider the accounting for this transaction did not comply with IAS 18.14 (a) to (e), or IAS 18.20. I note that Deloitte reviewed this transaction at the time and concluded that the five criteria for revenue recognition by reference to IAS 18.14 had been satisfactorily met.[688] PRISA provided a signed confirmation to Deloitte on 18 January 2011, confirming that the invoice for this transaction was "*proper*

[684] Re-Re-Amended Particulars of Claim, Schedule 7, Transaction 2.
[685] {D001544739}, page 8, C.4.
[686] Re-Re-Amended Particulars of Claim, Schedule 7, Transaction 2.
[687] For example, see PR 2010-12 which appears to be an invoice from Autonomy to PRISA for 660 hours of "*Consultancy Services*" at a rate of €106.25 per hour, or €850 per day, based on an eight hour day.
[688] {DEL1_003_1_00000144}.

and…unpaid at 31st December, 2010" suggesting that PRISA had accepted the software at this date, and the risks and rewards of ownership.[689]

16.51 I note that the PRISA First Amendment does not include a provision for a refund of the licence fee if PRISA was dissatisfied with the outcome of the transaction[690], which would further suggest that the risks and rewards of ownership of the licence component of the transaction had passed to PRISA at the time of the sale.

16.52 It is also clear from the face of the PRISA First Amendment agreement that it was for PRISA to make its own elections during the deployment period, and hence it could not have been contemplated as to what the stage of completion at any given point in time might have been during that period. This itself, in addition to the unit pricing for services under the PRISA First Amendment, mitigates against the substance of the transaction being as the Claimants assert.

Autonomy's accounting policy

16.53 I note that Autonomy accounted for this transaction in line with its separate accounting policies for the sale of goods (the software licence component) and the rendering of services. In particular, it appears Autonomy considered the revenue associated with the professional services was consulting revenue.[691] The policy set out in Autonomy's Consolidated Financial Statements for consulting revenue was as follows:

"*Consulting revenues are primarily related to implementation services performed on a time and materials basis under separable service arrangements related to the installation of the group's software products.* ***Revenues from consulting and training services are recognised as services are performed. If a transaction includes both license and service elements, license fee revenue is recognised upon shipment of the software, provided services do not include significant customisation or modification of the base product and the payment terms for licenses are not subject to acceptance criteria.*** *In cases where license fee payments are contingent upon the acceptance of services, revenues from both the license and the service elements are deferred until the acceptance criteria are met.*"[692] (emphasis added)

16.54 Prima facie, I do not understand the agreement with PRISA to include the modification of the base product as envisioned in the accounting policy, and the payment terms in the contract do not appear to be subject to acceptance criteria. Further, Deloitte concluded

[689] {DEL1_002_1_00000129}.
[690] {D001544739}.
[691] The invoices provided in the Draft Claimants' Voluntary Particulars referenced as PR 2010-11, PR 2010-12 and PR 2010-17 refer to "*Autonomy - Consulting*".
[692] See paragraph 5.18 of my report.

that no terms were noted in the agreement which restricted the ability to recognise revenue.[693]

Summary

16.55 In my opinion, the key issues in dispute between the parties in relation to this transaction are whether or not the transaction could be split into separately identifiable components by reference to IAS 18.13, and whether the costs to complete the project or the outcome of the transaction could be estimated reliably by reference to IAS 18.26.

16.56 IAS 18 provides limited guidance on the identification of separately identifiable components. Therefore, determining the separate elements of a transaction is a matter of professional judgement dependent on the facts available at the time, including the customer's perspective and the terms agreed, which necessarily can lead to a number of different opinions from professional accountants, and therefore a number of different outcomes, each permissible under IFRS.

16.57 By reference to PwC's guidance regarding the separation of components based on the customer's perception, and the evidence set out at paragraphs 16.34 to 16.35 above, it would appear to me that PRISA considered that it was purchasing access to the suite of Autonomy software and separate services for assistance with the implementation of that software once it had determined what it might need for its own purposes over an extended period of time. In these circumstances, providing the criteria of IAS 18.14 were met, in my opinion Autonomy was entitled, and arguably, required to recognise revenue on the sale of its software rights. In my opinion, Autonomy was then separately further required to recognise revenue related to the called for (i.e. on demand) professional services component of the arrangement upon delivery of these services, provided the criteria of IAS 18.20 were met.

16.58 I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed, as is evidenced by the competing evidence provided in the parties' witness statements. I reiterate my comments at paragraphs 1.38 to 1.41 in this regard.

16.59 In particular, I refer to my earlier comments that the application of certain accounting standards, and in particular some past accounting standards, requires or required the use of more discretionary professional accounting judgement and therefore may or could result in two different accountants (neither of whom is wrong) arriving at two different conclusions. In such a scenario, a difference in the conclusions reached would not, or does not, indicate that either of them was necessarily inappropriate but rather that they formed

[693] {DEL1_003_1_00000144}, page 2.

part of a range of possible conclusions, each or all of which might be, or could be appropriate.

16.60 If the facts are not as I have set them out above and understand them to be, it is potentially the case that the revenue associated with the transaction may be more appropriately accounted for in an alternative manner, although this is by no means a given.

16.61 However, even if the facts are not as I have set them out above and understand them to be, I do not believe that the professional services under this contract should have been accounted for on any basis other than in line with the called for provision of those services where the onus was on PRISA to elect its own needs; in so doing, any alleged requirement to estimate the outcome of the transaction or the costs to complete PRISA's own digitisation project is a matter for PRISA's own accounting treatment rather than Autonomy's recognition of revenue judgement.

Iron Mountain Information Management Inc – Q2 2011

16.62 Autonomy[694] sold a software licence to Iron Mountain in Q2 2011.

Initial observation

16.63 The Claimants' allegations in respect of this transaction relate to a judgemental issue concerning the fair value of the licence sold to Iron Mountain by Autonomy in Q2 2011. It is clear that the judgement exercised by Autonomy's management on this matter was considered in detail by Deloitte at the time.

Sale of licence to Iron Mountain - Autonomy's accounting treatment

16.64 On 3 June 2011 Autonomy acquired certain trade and assets of the digital division of Iron Mountain Inc ("Iron Mountain Digital").[695]

16.65 On the same day Autonomy sold an unlimited user, perpetual IDOL software licence to Iron Mountain for US$1.5 million.[696] It is this latter transaction that is the subject of this section of my report.

16.66 A consolidation adjustment for the licence sale was posted in Autonomy's accounts on 30 June 2011, which increased the fair value of the licence sold (and, accordingly, the amount of revenue recognised by Autonomy) from US$1.5 million to US$7.0 million[697] ("IM Licence FVA").

16.67 Mr Hussain explains the IM Licence FVA as follows:

> "*Because the licence transaction was linked to the acquisition of Iron Mountain Digital by Autonomy, it was appropriate to "fair value" the asset transferred pursuant to paragraphs 38 and B50 of IFRS 3. Autonomy applied its judgement in determining an appropriate fair value by comparison with 7 other similar transactions.*"[698]

[694] The contracting party is Autonomy Inc. However, as explained in paragraph 1.19, I refer to Autonomy throughout this section.
[695] Re-Re-Amended Particulars of Claim, paragraph 115.1; {DEL1_003_1_00000066}.
[696] Re-Re-Amended Particulars of Claim, paragraph 115.1; {DEL1_003_1_00000066}.
[697] Dr Lynch's First Witness Statement, paragraph 522.
[698] Mr Hussain's Witness Statement, paragraph 227.

Claimants' allegations

16.68 The Claimants allege that:

"*…there was no justification for increasing the revenue recognised with respect to this transaction over the amount agreed upon by the parties to the transaction. The relevant software had no standard price and no established fair value. It was sold to different customers at very different prices based upon the individual customer's perception of the value of the software to that customer in the customer's particular environment.*"[699]

16.69 The Re-Amended Reply asserts that there was no reliable determination of fair value[700] and the figure of US$7.0 million was arrived at by taking the average price of "*just four*[701] *transactions which must have been selected for the specific purpose of the purported fair value determination*": two OEM licences sold to EMC, one OEM licence sold to Verdasys Systems and one Enterprise Licence Agreement sold to HP.[702]

16.70 Further, "*when Iron Mountain was subsequently asked in March 2012 to pay for maintenance in respect of the software, it declined to do so on the grounds that it was not using the software.*"[703]

Accounting guidance

16.71 The accounting guidance specific to this matter is set out in IAS 18.7 and 18.9, and IFRS 3.37 to 3.38 and 3.B50. These paragraphs are substantially set out in a Deloitte working paper referred to at paragraph 16.73 and **Appendix 3**, so I do not repeat them here.

Analysis of the transaction based on Deloitte's audit working papers

16.72 A useful summary of the transaction is included in the Q2 2011 Deloitte Audit Committee Report:

"*Management has … performed a fair value analysis on a $1.5 million IDOL licence sale made by Autonomy to Iron Mountain at the time of the acquisition, which was deemed to be at less than fair market value. In accordance with paragraph B50 of IFRS 3 (2008) management has determined that this transaction is linked to the business combination. Therefore, in accordance with paragraph 38 of IFRS 3 (2008), the asset transferred must be fair valued and included as part of the consideration paid to Iron Mountain. This has*

[699] Re-Re-Amended Particulars of Claim, paragraph 115.1.
[700] Re-Amended Reply, paragraph 170.5.
[701] It appears that the difference between the seven transactions referred to by Mr Hussain at paragraph 16.67 and the four transactions referred to by the Claimants relates to deals with three customers "*used only as representative deal sizes*" and excluded from the valuation calculation – see paragraph 3.4 of **Appendix 3**.
[702] Re-Amended Reply, paragraph 171.2.
[703] Re-Amended Reply, paragraph 171.3.

resulted in a $5.5 million increase to the fair value of the consideration paid (and therefore goodwill) and total post acquisition revenue of $7.0 million recognised. Management has determined fair value with reference to seven similar sized licence deals. An average licence value was calculated for sales where IDOL search was the core product offering. This generated a value of $10.6 million, but did include one significant outlier. Excluding this outlier the revised average was $7.4 million. Management has therefore determined that an appropriate estimation of fair value is $7.0 million."[704]

16.73 Deloitte included the sale of the licence to Iron Mountain in a sample of transactions greater than US$1.0 million that it sought to test as part of its Q2 2011 interim review work.[705] In its working papers Deloitte states:

"*We also noted that the acquisition in the period was for part of Iron Mountain on the 3 June 2011. Nothing has been noted in the agreement that refers to the acquisition. However it needs to be considered whether this sale appears to be completely separate and at arm's length. Given the software acquired for unlimited users with a perpetual licence it is felt that the fee for this deal is* [significantly] *below fair value - this has been discussed with management. Please refer to Q2-8131 for more details with regard to the consideration of the fair value of the deal.*"[706]

16.74 Another working paper prepared by Deloitte (presumably the working paper reference Q2-8131 referred to at paragraph 16.73) considers the IM Licence FVA in detail, as set out in **Appendix 3**. In summary this working paper notes that:

(a) the sale of the licence to Iron Mountain was at less than fair value;

(b) the sale needed to be measured at fair value; and

(c) the fair value was based on comparators, as there was no identical transaction that could be used to arrive at a fair value for the Iron Mountain licence sale.[707]

Mr Welham's Witness Statement

16.75 In his witness statement, Mr Welham has been asked by the Claimants' lawyers to make multiple assumptions relating to matters he is asked to assume the Claimants will establish as facts. None of the assumptions that Mr Welham has been asked to make in this witness statement appears to relate to the IM Licence FVA.

[704] {DEL1_003_1_00000185} (Q2 2011 Deloitte Audit Committee Report, page 3).
[705] {POS00175313}, tab "Summary".
[706] {POS00175313}, tab "1".
[707] {DEL1_003_1_00000066}.

Comments from other witnesses

Dr Lynch

16.76 Dr Lynch notes that the IM Licence FVA was arrived at by Autonomy by reference to "*four similar licence deals*".[708] As to the comparable transactions referred to by Autonomy, Dr Lynch notes that the most recent is a licence sale to HP of US$8.0 million, which is in excess of the valuation assumed by Autonomy in respect of the Iron Mountain transaction.[709]

My analysis of the IM Licence FVA by reference to the Claimants' allegations

16.77 The Claimants' allegations in respect of the IM Licence FVA are set out in paragraphs 16.68 to 16.70. In summary, the Claimants allege that:

(a) there was no justification for increasing the revenue recognised over the amount agreed upon by the parties to the transaction;

(b) the relevant software had no standard price and no established fair value; and

(c) when Iron Mountain was subsequently asked in March 2012 to pay for maintenance in respect of the software, it declined to do so on the grounds that it was not using the software.

16.78 I consider these allegations in turn below.

Requirement for fair value adjustment

16.79 Autonomy increased the revenue recognised in respect of the licence sold to Iron Mountain in Q2 2011 by way of a fair value adjustment.

16.80 IAS 18 requires that "*Revenue **shall** be measured at the fair value of the consideration received or receivable*"[710] [emphasis added]. As the emphasised language indicates, such measurement is not a matter of choice or judgement, but a requirement.

16.81 Autonomy considered that the licence sale to Iron Mountain in Q2 2011 was linked to its acquisition of Iron Mountain Digital in the same period, and that the sale of the licence was at less than fair value. In this particular case, the relevant accounting guidance states that:

"*The consideration transferred in a business combination **shall** be measured at fair value … The consideration transferred may include assets or liabilities of the acquirer that have*

[708] Dr Lynch's First Witness Statement, paragraph 522.
[709] First Defendant's Amended Defence, paragraph 159.1B.
[710] **Exhibit F** - IAS 18.9.

*carrying amounts that differ from their fair values at the acquisition date … If so, the acquirer **shall** remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in profit or loss."* [711] [emphasis added]

16.82 Again, the emphasised language indicates that measurement by reference to fair value is a requirement and not a matter of choice or judgement.

16.83 IFRS 3.B50 sets out criteria for the acquirer to consider in determining whether a transaction is part of a business combination. Deloitte considered each of these criteria in its contemporaneous working papers as part of its Q2 2011 interim review and concurred with Autonomy's accounting treatment.[712]

"Standard price" and fair value

16.84 My understanding is that the fact that there was no "standard price", or price list, for Autonomy's products is not in dispute between the parties. I note that an email from Mr Chamberlain to Mr Welham (then the audit senior manager) dated 13 April 2011 states:

"*… it is not uncommon for the same software to be sold to different customers for very different prices. The buying decision is all around ROI and different organizations can achieve different returns with the same software. The negotiations are complex and lead to very different answers from time to time.*"[713]

16.85 However, in my opinion it is not appropriate for the Claimants to assert that the software had "*no established fair value*".[714]

16.86 "Fair value" is an accounting term that is defined as "*the amount for which an asset **could** be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction*"[715] [emphasis added]. Accordingly, fair value is not necessarily the same as the price actually paid for a particular product, or any related or similar product, and needs to be considered on a case by case basis. Further, as the emphasised text ("*could*") indicates, arriving at a fair value will require a degree of judgement in a hypothetical scenario. Simply because arriving at a fair value is difficult does not mean that it should not be done; in fact, international accounting standards require that it must be done in certain circumstances.[716]

[711] **Exhibit Z -** IFRS 3.37 to 38.
[712] See Appendix 3.
[713] {D000972451}.
[714] Re-Re-Amended Particulars of Claim, paragraph 115.1.
[715] **Exhibit F** - IAS 18.7. The same definition of "fair value" is included in Appendix A to IFRS 3.
[716] See paragraphs 16.80 and 16.81 of my report.

16.87 Autonomy arrived at the IM Licence FVA by reference to an average of what it considered to be comparable transactions.[717] Absent any indication of "standard price" or price list, such an approach, i.e. by reference to comparable transactions, is, in my opinion, reasonable. Autonomy's valuation exercise was reviewed by Deloitte and Deloitte concluded that it was "*a prudent estimate of fair value*"[718]. Deloitte also brought the matter to the attention of Autonomy's Audit Committee.[719]

16.88 Of course, views may (and, in my experience, often do) differ as to what constitutes a "comparable" transaction, as there are often so many different characteristics to be considered as well as the relative weight given to each. This will be a matter of judgement, based on the information that is available at the time.

16.89 The Claimants also appear to be critical of the fact that Autonomy's valuation was based on a relatively small number of transactions.[720] In my opinion the number of transactions used for such a comparison is less important than ensuring that the transactions can be reasonably compared. Dr Lynch notes that the IM Licence FVA was arrived at by Autonomy by reference to "*four similar licence deals*", and that the most recent of the transactions used as comparables was a licence sale to HP of US$8.0 million, which is in excess of the fair value assumed by Autonomy in respect of the Iron Mountain transaction.[721]

16.90 Further, in my opinion, where transactions are not considered comparable, adjustments should be made accordingly. This appears to have been the case when the Eli Lilly transaction was disregarded and certain other transactions excluded from Autonomy's valuation calculation as the amount specific to the IDOL licence could not be separately identified.

Use of hindsight

16.91 As noted at paragraph 16.70, the Claimants assert that, "*when Iron Mountain was subsequently asked in March 2012 to pay for maintenance in respect of the software, it declined to do so on the grounds that it was not using the software.*"[722] In my opinion this is irrelevant and an attempt to use hindsight: the amount of revenue that was recognised in respect of the Iron Mountain licence in Q2 2011 should have been (and, I understand from my review of the available evidence, was) only based on information that was available at the time.

[717] See **Appendix 3**, paragraph 3.4.
[718] {DEL1_003_1_00000066}.
[719] See paragraph 16.72 of my report.
[720] See paragraph 16.69 of my report.
[721] See paragraph 16.76 of my report.
[722] Re-Amended Reply, paragraph 171.3.

Summary

16.92 In summary:

(a) Autonomy increased the revenue recognised in respect of the licence sold to Iron Mountain in Q2 2011 by way of a fair value adjustment, which adjustment was required under certain circumstances by IAS 18 and, more specifically, IFRS 3. Arriving at a fair value will require a degree of judgement in a hypothetical scenario. Deloitte also reviewed, and concurred with, Autonomy's accounting treatment. In my opinion it is not appropriate for the Claimants to assert that the software had "*no established fair value*"[723].

(b) Autonomy arrived at the IM Licence FVA by reference to an average of what it considered to be comparable transactions, based on information available at the time. Absent any indication of "standard price" or price list, such an approach, i.e. by reference to comparable transactions, is, in my opinion, reasonable. Further, adjustments were made for transactions that were not considered comparable and again, in my opinion such an approach is reasonable. Autonomy's valuation exercise was reviewed by Deloitte and Deloitte concluded that "*management has used a representative sample of deals and that the average used (excluding the one exception outlier) provides a prudent estimate of fair value*"[724].

(c) I do not agree with the Claimants' suggestions that:

(i) the valuation was deficient due to the use of a relatively small number of comparable transactions because, in my opinion, the number of transactions used for such a comparison is less important than ensuring that the transactions can be reasonably compared. As Dr Lynch notes, the IM Licence FVA was arrived at by Autonomy by reference to "*four similar licence deals*"; further, the most recent of the transactions used as comparables for the IM licence FVA was a licence sale to HP of US$8.0 million, which is in excess of the fair value assumed by Autonomy in respect of the Iron Mountain transaction[725]; and

(ii) there is any relevance to Iron Mountain declining to pay Autonomy for maintenance in March 2012 on the basis that it was not using the licence software, as, in my opinion, this inappropriately uses hindsight.

[723] Re-Re-Amended Particulars of Claim, paragraph 115.1.
[724] {DEL1_003_1_00000066}, tabs "PBC FV calculation" and "Tickmarks".
[725] See paragraph 16.76 of my report.

16.93 Finally, I note that none of the assumptions that Mr Welham has been asked to make in his witness statement appears to relate to the IM Licence FVA.

17 SUMMARY OF CONCLUSIONS

17.1 My approach in this report has been to highlight the accounting issues from the allegations made by the Claimants, apply them to example transactions, where appropriate, based on earlier fact evidence, but highlight that my opinion may change dependent on particular determinations of fact. The example transactions I have reviewed are as follows:

Table 1: Summary of example transactions reviewed in my report

Transaction	Category	Section
Capax Discovery (end-users Kraft and FSA) – Q1 2010 and Q3 2009	Sales to resellers	9
MicroTech (end-user Vatican Library) – Q1 2010	Sales to resellers	10
Comercializadora (end-user TV Azteca) – Q3 2010	Sales to resellers	11
VMS – Q2 2009/Q4 2010	Alleged reciprocal transactions	13
Vidient – Q4 2009/Q3 2010	Alleged reciprocal transactions	14
PRISA – Q4 2010	"Other" transactions	16
Iron Mountain – Q2 2011	"Other" transactions	16

17.2 In this matter, the Claimants allege that Dr Lynch and Mr Hussain caused Autonomy to enter into improper transactions and accounting practices. The relevant accounting framework under which these transactions and accounting practices should be considered is IFRS.

17.3 The principles-based nature of IFRS is such that its application is a matter of judgement given particular facts and circumstances. IFRS sets out the basic principles of accounting for transactions rather than specific rules that relate to every situation. Therefore, while accountants will normally agree on the accounting treatment of an item, given the same or similar facts, in other cases, different accountants using their professional judgement can validly form different conclusions when applying IFRS. That is not to say that any one accountant is wrong and the other is right; instead it is a recognised feature of IFRS and other principles-based accounting frameworks that different accounting judgements can be reached from the same facts. I consider this to be widely accepted as a matter of form within the IFRS accounting industry.

17.4 For the purposes of preparing this report, my overall methodology for dealing with the accounting matters has been to look at the facts as they were known at the time, and, in this respect, my most common source of information for this purpose has been the contemporaneous Deloitte audit working papers. These essentially contain, for any

individual transaction, the facts, the accounting, an explanation of the accounting and Deloitte commentary and challenge on the accounting.

17.5 I do appreciate that it is the overall contention of the Claimants that Deloitte were misled as to the relevant facts; that seems to me to be implicit in the assumptions given to Mr Welham. Here as well consideration needs to be given to the Deloitte working papers.

17.6 Finally, the Deloitte working papers contain the information that was contemporaneously available, untainted by any hindsight. They will also reflect information that was obtained by and made available to Deloitte at the time.

17.7 Many of the accounting matters which form a large part of this dispute and on which I have been asked to opine in this report depend on the application of accounting principles to commercial facts. The application of the revenue recognition rules under international GAAP, which is pertinent to the majority of the allegations in respect of accounting matters in this case, is often highly fact dependent. In referring to GAAP I note that there may be a wide range, at any given point in time, of generally accepted accounting practices among accountants and that what constitutes accepted practice can change over time, as well as from jurisdiction to jurisdiction. What is relevant therefore is what was accepted, or acceptable, generally at the relevant time in the reporting jurisdiction.

17.8 At the time of preparing this report, I understand that many of the facts, issues and/or circumstances relating to the transactions in this case are disputed. Both the Claimants and the Defendants have submitted a number of witness statements, some of which contain evidence which deals with accounting matters. In particular, Mr Welham's Witness Statement deals with the accounting for a large number of transactions impugned in this case based on his own knowledge.

17.9 At the time this report is submitted (29 November 2018) further witness statements have been exchanged (on 16 November 2018). These witness statements in large part consist of evidence responsive to prior witness statements. Accordingly I do not consider the assumptions made in Mr Welham's Witness Statement in detail in this report or any rebuttal of those assumed factual matters. To the extent that this information has a bearing on my opinions in this report, I will deal with those in my supplemental report.

17.10 While it is not my role as an accounting expert to comment on the facts as stated in a witness statement, in a case where the facts are (or may be) critical to the accounting as applicable at the time, a fact and whether it is disputed or not may be highly relevant to the way in which it can be accounted for.

17.11 Accordingly, it is possible that my analysis of the accounting treatment applied and disclosures made by Autonomy at the time of these transactions might change depending on my further consideration of points made in factual evidence, including Mr Welham's Witness Statement and what the parties' reply witness statements have to say in relation to factual issues which underlie the assumptions he has been asked to make. To the extent that this is the case, I intend to address it in my supplemental report.

18 EXPERT'S DECLARATION

I Gervase MacGregor DECLARE THAT:

18.1 I understand that my duty in providing written reports and giving evidence is to help the Court, and that this duty overrides any obligation to the party by whom I am engaged or the person who has paid or is liable to pay me. I confirm that I have complied and will continue to comply with my duty.

18.2 I confirm that I have not entered into any arrangement where the amount or payment of my fees is in any way dependent on the outcome of the case.

18.3 I know of no conflict of interest of any kind, other than any which I have disclosed in my report.

18.4 I do not consider that any interest which I have disclosed affects my suitability as an expert witness on any issues on which I have given evidence.

18.5 I will advise the party by whom I am instructed if, between the date of my report and the trial, there is any change in circumstances which affect my answers to points 18.3 and 18.4 above.

18.6 I have shown the sources of all information I have used.

18.7 I have exercised reasonable care and skill in order to be accurate and complete in preparing this report.

18.8 I have endeavoured to include in my report those matters, of which I have knowledge or of which I have been made aware, that might adversely affect the validity of my opinion. I have clearly stated any qualifications to my opinion.

18.9 I have not, without forming an independent view, included or excluded anything which has been suggested to me by others, including my instructing lawyers.

18.10 I will notify those instructing me immediately and confirm in writing if, for any reason, my existing report requires any correction or qualification.

18.11 I understand that:

(a) my report will form the evidence to be given under oath or affirmation;

(b) questions may be put to me in writing for the purposes of clarifying my report and that my answers shall be treated as part of my report and covered by my statement of truth;

(c) the court may at any stage direct a discussion to take place between experts for the purpose of identifying and discussing the expert issues in the proceedings,

where possible reaching an agreed opinion on those issues and identifying what action, if any, may be taken to resolve any of the outstanding issues between the parties;

(d) the court may direct that following a discussion between the experts that a statement should be prepared showing those issues which are agreed, and those issues which are not agreed, together with a summary of the reasons for disagreeing;

(e) I may be required to attend court to be cross-examined on my report by a cross-examiner assisted by an expert;

(f) I am likely to be the subject of public adverse criticism by the judge if the Court concludes that I have not taken reasonable care in trying to meet the standards set out above.

18.12 I have read Part 35 of the Civil Procedure Rules, the accompanying practice direction and the Guidance for the instruction of experts in civil claims and I have complied with their requirements.

18.13 I am aware of the practice direction on pre-action conduct. I have acted in accordance with the Code of Practice for Experts.

STATEMENT OF TRUTH

18.14 I confirm that I have made clear which facts and matters referred to in this report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.

Gervase MacGregor
For and on behalf of BDO LLP