ACL NETHERLANDS B.V. (AS SUCCESSOR TO AUTONOMY CORPORATION LIMITED), HEWLETT-PACKARD THE HAGUE BV (AS SUCCESSOR TO HEWLETT-PACKARD VISION BV), AUTONOMY SYSTEMS LIMITED, HEWLETT-PACKARD ENTERPRISE NEW JERSEY INC.

and

MICHAEL RICHARD LYNCH,
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13 March 2019

Supplemental Expert Report of Peter Holgate

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Glossary of terms and abbreviations

In this supplemental report, I use the same defined terms and abbreviations as set out in the glossary of Holgate 1 and the following additional defined terms and abbreviations.

Term or abbreviation	Definition
DTI	Department of Trade and Industry guidelines (2004)
First Instructions	My first instructions in respect of these proceedings, dated 29 November 2018
Holgate 1	My first report in these proceedings, dated 29 November 2018
Joint Statement	The joint statement in respect of these proceedings, dated 28 January 2019
MacGregor 1	Mr MacGregor's first report in these proceedings, dated 29 November 2018
RRAPoC	Re-Re Amended Particulars of Claim
Welham 1	Witness Statement of Lee Peter Welham dated 14 September 2018

1. Introduction

1.1. I am the same Peter Alan Holgate who prepared Holgate 1 for these proceedings. On 28 January 2019, I agreed the Joint Statement with Mr MacGregor.

1.2. A copy of my supplemental instructions can be found at Appendix 1. I have been instructed to prepare a supplemental report to:

1.2.1. Respond as I consider necessary and appropriate to MacGregor 1 including, having read Welham 1, any comment on paragraphs 6.14 to 6.22 of MacGregor 1;

1.2.2. Explain the extent to which the analysis presented in Holgate 1 needs to be revised/updated (if at all) as a result of my specific further instructions and/or the further (relevant) documents listed at paragraph 6 of my supplemental instructions; and

1.2.3. Review and comment on certain Excel workbooks, as more particularly described in my instruction letter.

1.3. I set out the remainder of my report under the following headings:

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2. <u>Response to MacGregor 1</u>

2.1. For a listed company such as Autonomy, GAAP means the requirements of IFRS, including the interpretations thereof (SICs and IFRICs), the 2006 Act and the UK Listing Rules. The following non-mandatory sources are also regarded as part of GAAP: the IASB's 1989 Framework and Conceptual Framework; statements and recommendations from professional bodies; and established practice at the relevant time.

2.2. Mr MacGregor and I agree on the above paragraph 2.1 (see 1(b) on page 3 of the Joint Statement). However, there are a number of places in MacGregor 1 where, in commenting on IFRS and the way in which it is applied, he overstates the case in my view. His comments concern: (i) the principles-based nature of IFRS; (ii) the extent of discretionary professional judgement; (iii) the wide (or broad) range of generally accepted accounting practices; and (iv) how to react when there is no explicit guidance in IFRS. I explain these points below.

The principles-based nature of IFRS

2.3. Mr MacGregor states the following: "*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 be reached from the same facts. I consider this to be widely accepted as a matter of form within the IFRS accounting industry.*" [1]

2.4. I agree with Mr MacGregor's wording in many respects. Certainly IFRS is described as being principles-based and professional judgement has to be used in its application. But IFRS does more than set out 'basic principles'. The book containing the full text of IFRS is about 3,000 pages long. This is not 3,000 pages of principles: IFRS contains a large number of rules. For example, as reproduced in Holgate 1, paragraphs 3.38 and 3.40, there are five specific criteria that must be met before revenue from the sale of goods may be recognised, and four

[1] MacGregor 1, para 4.16.

criteria that must be met before revenue from the rendering of services may be recognised. (IAS 18, paras 14 and 20).

The extent of discretionary professional judgement

2.5. Mr MacGregor makes comments in a number of places such as "*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.*" [2]

2.6. Mr MacGregor concludes a section of his report on the details of and commentary on IAS 18, 'Revenue' with: "*... 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*". [3]

2.7. It is true that professional judgement must be used in applying IFRS and in determining whether financial statements give a true and fair view.

2.8. It is true that, on some points of application of IFRS, two accountants may come to two different views. But (a) this does not apply to all of IFRS and (b) where it does apply, it applies within a range of reasonable views. That is, if there is a principle or rule (such as whether "*the significant risks and rewards of ownership of the goods*"[4] have been transferred from the seller to the buyer), there would be room for different reasonable judgements within a range (e.g. what if most of the risks and rewards had been transferred but not quite all of them?). But it would be a different situation where only a minority of risks and rewards had been transferred: here it would not be a reasonable professional judgement to conclude that the risks and rewards had been transferred.

2.9. I strongly disagree with Mr MacGregor's comment as reproduced in paragraph 2.6 above. Mr MacGregor suggests that differences of view in the proper application of the rules of IAS 18 rests on disagreement about subjective areas. To the contrary, in my view, and based on the assumptions that I have been asked

[2] MacGregor 1, para 1.41. Similar wording is used in paras 12.22, 15.59 and 16.59.
[3] MacGregor 1, para 4.88.
[4] IAS 18, para 14(a).

to make, the differences of view in areas such as Hardware, VARs, Reciprocals and Hosting are considerably more fundamental than that.

The wide (or broad) range of generally accepted accounting practice

2.10. Mr MacGregor states the following: "*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 …*"[5].

2.11. He goes on to state that: "*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]

2.12. I do not agree that the range of generally accepted accounting practices among accountants is wide or broad. There is a range of acceptable views on some matters but to speak of a wide or broad range gives an incorrect impression that, in IFRS, almost anything is permissible.

How to react when there is no explicit guidance in IFRS

2.13. Mr MacGregor discusses the example of the accounting for the expense 'cost of sales' (or 'cost of goods sold' ("**COGS**")). He notes that IFRS "*does not require that this expense [cost of sales] 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. 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.*"[7] He notes that "*[t]his accords with the approach agreed by Deloitte at the time…*"[8] and cites excerpts from Deloitte papers that include: (a) reference to "*absence of any specific accounting guidance*" and (b) the following from a Deloitte email: "*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***

[5] MacGregor 1, para 1.20.
[6] MacGregor 1, para 6.18.
[7] MacGregor 1, para 7.72-73.
[8] MacGregor 1, para 7.73.

breach of an accounting standard *nor are they in breach of the Companies Act …*"[9]

2.14. There is no explicit rule requiring (for example) that all revenue should be presented on the line called 'revenue'. It is too obvious for words. Likewise, it is entirely obvious that all of cost of sales should go on the line of that name. It does not require an accounting standard to tell us that.

Mr MacGregor's reliance on Deloitte

2.15. I am specifically asked to comment on paragraphs 6.14 to 6.22 of MacGregor 1 (see paragraph 7.1(a) of my supplemental instructions). In these paragraphs, Mr MacGregor states that he has:

"found [the Deloitte] 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 …"[10]

and that he considers

"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."[11]

2.16. Such reliance on the Deloitte working papers is in my view unsound. I have now read Welham 1. This statement is 113 pages long and deals with many points. However, a common theme is that the Claimants put to Mr Welham some assumed facts; these are similar to the facts which I have been asked to assume in this report and in Holgate 1. It is clear that Deloitte were not aware of the majority of the assumed facts. Mr Welham was asked, in a number of different contexts, whether his view would have been different if his understanding of the transactions at the time of the Deloitte audits and reviews had been as described in the assumed facts that were put to him at the time of making his witness statement. I quote here, as an example, his response regarding the DiscoverTech/Bank of America transactions in Q4 2010:

[9] MacGregor 1, para 7.74.
[10] MacGregor 1, para 6.14.
[11] MacGregor 1, para 6.16.

*"I am asked to assume that the DiscoverTech transactions were subject to a side agreement which meant that DiscoverTech had no obligation to pay Autonomy unless DiscoverTech achieved on-sales and that the confirmations given to us by DiscoverTech that the invoices were "proper and were unpaid" and that there were no side letters or other agreements were false and were known by senior members of Autonomy management to be so {**POS00160782**} and {**D001358094**}. I was not aware of this. I believe it would have raised serious issues about the recognition of revenue by Autonomy on the sales to DiscoverTech, since the significant risks and rewards of ownership would not have passed to DiscoverTech. It would also have raised an integrity issue and the points that I have previously made at paragraphs 66-70 would also apply."*[12]

2.17. In paragraphs 66-70 of Welham 1, Mr Welham refers to the wider implications that would arise *"if it had come to light ... that management and/or the board of Autonomy had deliberately withheld from us or misstated relevant information ..."*[13] He states that *"this would have been a matter of real concern for us"*[14] and that the implications could have been various up to and including *"whether it was possible for us to remain as auditors or whether we would need to resign or provide a heavily qualified audit opinion or review report".*[15]

2.18. Based on Welham 1, it is clear to me that if the assumed facts are proven, Deloitte did not have a proper or soundly-based understanding of many of the impugned transactions and therefore the Deloitte working papers are of little value as evidence of the contemporaneous circumstances surrounding the transactions or why Autonomy accounted for them in the way that it did. Mr MacGregor himself recognises this:

"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."[16]

2.19. I find it surprising that, in the light of this statement, Mr MacGregor nevertheless places so much weight and reliance on the Deloitte working papers.

[12] Welham 1, para 404.
[13] Welham 1, para 66.
[14] Welham 1, para 66.
[15] Welham 1, para 70.
[16] MacGregor 1, para 6.21.

3. <u>VARs</u>

Schedule 3, Transactions 17 and 22

3.1. Annex 1, paragraph 24.5 of my First Instructions listed certain assumptions which applied to Schedule 3, Transaction 17. I have been instructed that general assumptions 1 to 4 also applied to this transaction.

3.2. Annex 1, paragraph 29.4 of my First Instructions listed certain assumptions which applied to Schedule 3, Transaction 22. I have been instructed that general assumptions 1 to 4 also applied to this transaction.

3.3. In my analysis of Transactions 17 and 22 in Holgate 1, without the instruction at that stage that general assumptions 1 to 4 applied to them, I had in any case concluded in each case, based on the assumed information given to me, that "*it is hard to see that this transaction had any substance*".[17] I also concluded that the specific criteria in IAS 18.14 were not met and that the recognition of revenue was not valid.[18] Taking into consideration now my instruction that general assumptions 1 to 4 also apply does not change my conclusion: it merely strengthens it, as general assumptions 1 to 4 are further factors that indicate the lack of substance in a transaction (as explained at paragraphs 5.9-5.10 of Holgate 1).

3.4. For completeness, I have updated the spreadsheet at Appendix 4 of Holgate 1 (showing which assumption apply to which transactions) to reflect paragraphs 3.1 and 3.2 above. That revised spreadsheet is at Appendix 6 of this report.

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[17] Holgate 1, page 132, para 2.1 and page 140, para 2.1.
[18] Holgate 1, page 132, para 3.1 and page 140, para 3.1.

4. <u>Reciprocals</u>

Schedule 5, Transaction 6: MicroTech

4.1. Annex 1, paragraph 55 of my First Instructions included a factual summary for the MicroTech Reciprocal Transaction (Schedule 5, Transaction 6). I have been instructed to consider the following additional facts (shown underlined):

"Schedule 5, Transaction 6: MicroTech:

> 55.1 On 30 March 2011: (1) Autonomy Inc sold a software licence to MicroTech for $4,053,491 (including $193,023 in respect of support and maintenance for one year), payable in 6 instalments over a two year period from June 2011 to March 2013; and (2) Autonomy Inc and MicroTech entered into an agreement by which Autonomy Inc assigned the right to MicroTech to issue support invoices to, and collect related fees from Bank of America on its behalf (in a total of $4,503,880). <u>Under the agreement, MicroTech was to provide "*backline*" support services to Autonomy Inc for the benefit of, or directly to, Bank of America, as requested by Autonomy Inc and Autonomy Inc was to provide "*front-line*" support services to Bank of America."[19]</u>

4.2. Annex 1, paragraph 56 of my First Instructions listed certain assumptions which applied to this transaction. I have been instructed that the following assumptions also applied:

4.2.1. Assumption 3: The Autonomy group company had no independent need for the services that it purchased from the counterparty and such services had no discernible value to the Autonomy group company.

4.2.2. Assumption 4: The amount paid by the Autonomy group company for the counterparty's services was in excess of the fair value (if any) for such services.

[19] I am instructed that, per the assignment agreement, "front-line" support shall be deemed to consist of receiving telephone, email, or web-based support requests from Bank of America and distributing those requests to MicroTech (paragraph 2 of the assignment agreement). "Backline" support services shall include troubleshooting in conjunction with Bank of America in order to assist Bank of America with its support requests, coordinating with Autonomy to respond thereto, and timely responding to Bank of America's requests for telephone, email, or web-based support Services (paragraph 2.2 of the assignment agreement).

4.2.3. Assumption 5: The Autonomy group company did not even attempt to obtain or utilise the services that it had purchased.

4.3. I note from the underlined words in paragraph 4.1 above that, compared to the instructions given to me when I was preparing Holgate 1, there now appear to be additional features (the ‘backline’ and ‘frontline’ support services) to this transaction. Autonomy now appears to have purchased something from MicroTech and this feature gives the overall transaction more of the characteristics of a reciprocal arrangement, compared with the features put to me for the purposes of Holgate 1. As with the other reciprocal arrangements discussed in chapter 6 of Holgate 1, paragraph 13 of IAS 18 applies: the sale and purchase were linked and need to be considered together to determine the substance. It appears from the additional assumptions 3, 4 and 5 that Autonomy had no need for, and did not use, the ‘backline’ support services; this indicates that the purported ‘purchase’ by Autonomy of ‘backline’ services from MicroTech had no substance. Considering these points in the light of paragraphs 6.1 to 6.8 of Holgate 1, it is clear that Autonomy’s accounting treatment should have been to recognise the purchase from MicroTech at nil and likewise to recognise no revenue.

4.4. The additional information now provided to me therefore does not affect the conclusion that I reached relating to the accounting for this transaction in Holgate 1, namely that the software licence should not have been recognised as revenue by Autonomy.

5. SPE

5.1. I have been referred to paragraphs 52A-52H.6 of the RRAPoC and have been instructed to consider paragraphs 10.1-10.5 of my supplemental instructions.

5.2. A successful claim to research and development (R&D) tax relief in respect of 75% of System Engineers' time is not relevant to the determination of whether the costs of that time can be capitalised as R&D under IAS 38. The fact that Autonomy might have held a meeting "*with HMRC where it was established that 75% was an accurate measure of the proportion of time that an SE spends on his or her "technical" time*"[20] does not affect this.

5.3. The broader underlying point is that consideration of whether expenditure qualifies for R&D tax relief is not relevant to its accounting treatment under IAS 38. There are a number of reasons for this:

(1) In many circumstances, the tax treatment of an item follows its accounting treatment. However, for some items – R&D expenditure being a case in point – there is a desire for the tax treatment to be different from the accounting treatment and so a specific provision is introduced into the tax rules to achieve this. That is, a different approach is taken as between the accounting treatment and the treatment for tax purposes and so one is not relevant in determining the other.[21]

(2) A significant example of the difference between the tax and accounting treatment in the case of R&D is that the tax legislation refers to and grants tax relief on expenditure on both *research* and *development*; whereas IAS 38 requires capitalisation of qualifying *development cost* only (that is, all research cost has to be written off as an immediate expense for accounting purposes).

(3) Moreover the detailed definitions of R&D in the tax and accounting regimes differ significantly from each other.

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[20] R&D memo set out at para 10.3 of my supplemental instructions – see Appendix 1.

[21] The most common example of this is that expenditure on tangible fixed assets (property, plant and equipment) is accounted for by capitalising the expenditure as a fixed asset and depreciating it over its estimated useful economic life. In contrast, for tax purposes, such assets generally attract capital allowances and the rate of these allowances is not based on the estimated useful economic life but rather on government fiscal objectives. For example, in some years and for some types of asset and/or for certain types of entity, capital allowances of 100% of the cost of the asset are or were available in the year of the expenditure even though the asset might have a useful life of (say) 10 years.

6. <u>Review of certain workbooks</u>

6.1. As I explain in chapter 9 of Holgate 1, I agree with the adjustments contained in the Voluntary Particulars ("**VPs**") that were served by the Claimants in these proceedings in relation to their case as set out in Schedules 4 and 6 of the RRAPoC.

6.2. I have now been instructed to review and comment on the methodologies and execution of two Excel workbooks, known as the Restated Profit Schedule and the Restated Balance Sheets Schedule, which draw on the VPs. These workbooks are exhibited to Mr Bezant's Report dated 29 November 2018. I have also been asked to review and comment on the methodology and execution of an Excel workbook known as the Reciprocal/MAF Analysis, which is a version of the Restated Profit Schedule that considers the impact of adjustments to certain costs set out in the VPs.

6.3. I have conducted my work assisted by FTI Consulting employees working under my direction and review. I have supervised all the work undertaken and am responsible for it and, for that reason, in the remainder of this chapter of my report, generally use "I" when describing the work undertaken by either me or members of my team. The opinions expressed are, however, my own.

6.4. In order to familiarise myself with the nature and format of the workbooks before conducting my detailed review of them, I took the opportunity to receive introductions to them from personnel at PwC who I understand assisted the Claimants with their production. I understand that I am required to set out in my report the substance of all material instructions, whether written or oral. Such explanations as I have received from PwC or Travers Smith have not gone beyond an introduction to the workbooks and I have not been given any additional information beyond that which is set out in the workbooks themselves, or my instruction letters or reports. I do not consider, therefore, that I have received any further material instructions as regards my consideration of the workbooks that I otherwise need to set out in this report.

The workbooks and their intended purpose

<u>Restated Profit Schedule</u>

6.5. The VPs set out a number of adjustments to the costs reported by Autonomy. As set out in the "**Notes**" worksheet, the Restated Profit Schedule is intended:

6.5.1. In the "**Gross Margin Analysis**" worksheet (supported by the "**Detail**" worksheet), to (a) identify which of the costs adjustments set out in the VPs apply to reported COGS, and which to reported operating expenses. This is done in order to estimate restated gross margins during the period from Q1 2009 to Q2 2011 (the "**Relevant Period**"); (b) reflect the reallocation of hardware costs from sales and marketing expenses to COGS set out in Schedule 2 to the RRAPoC; and (c) set out restated gross and operating margins both including and excluding the revenue and costs of hardware in Autonomy Inc.;

6.5.2. In the "**Restated Profit Measures**" worksheet, to restate certain financial measures published by Autonomy, using the outputs of the "**Gross Margin Analysis**" worksheet (including hardware revenue and costs); and

6.5.3. In the "**Detail**" worksheet, to show adjustments to revenue and profit transaction-by-transaction.

<u>Reciprocal/MAF Analysis</u>

6.6. As set out in the "**Notes**" worksheet, it is intended:

(1) That this Analysis makes further adjustments to the restated income statement entries set out in the Restated Profit Schedule, in order to reverse the impact on the income statement of two categories of transaction:

a) Transactions including a reciprocal sale and purchase, and any associated reciprocal net costs, including both Reciprocal transactions (as set out at Schedule 5 RRAPoC) and Reciprocal VAR transactions (as set out at Schedule 3 RRAPoC); and

b) Payments of marketing assistance fees ("**MAFs**") to VARs in respect of the Schedule 3 VAR transactions;

(2) That the "**Claim Detail**" worksheet reproduces the "**Detail**" worksheet from the Restated Profit Schedule;

(3) That the "**Revised Detail**" worksheet sets out the revised accounting treatments for the transactions described in point (1) above;

(4) That the "**Difference**" worksheet sets out the impact on the income statements of the adjustments set out in Note 2; and

(5) That related adjustments to the balance sheet have not been considered as part of this exercise.

Restated Balance Sheets Schedule

6.7. As set out in the "**Notes**" worksheet, the Restated Balance Sheets Schedule is intended to restate the consolidated balance sheets reported on a quarterly basis by Autonomy during the Relevant Period.

6.8. Specifically, as set out in the Notes, it is intended:

(1) To adjust the reported figures to correct (only) for the false accounting alleged by the Claimants of the transactions that the Claimants contend were improper, by applying the adjustments set out in the VPs;[22]

(2) That the "**Detail from VPs**" worksheet reproduces all of the individual adjustments to balance sheet (and income statement) entries set out in the VPs and then collates, on a quarterly basis, the total adjustments in respect of each general ledger account;[23]

(3) That the "**Hosting – VP Detail**" worksheet reproduces all of the individual adjustments to the balance sheet (and income statement) entries set out in the VP that relates to Hosting transactions ("**Hosting VP**"), and then collates, on a quarterly basis, the total adjustments in respect of each general ledger account. The "**Hosting – VP Detail**" worksheet also sets out additional adjustments relating to Q3 2011 to Q2 2012. The purpose of the additional adjustments is to calculate the split between short-term and long-term deferred revenue;

(4) That the "**Restated Balance Sheets**" worksheet sets out the restated balance sheets in the format used by Autonomy in its published balance sheets for each quarter (the formulae in the "Restated Balance Sheets" worksheet show how the net total adjustment for each balance sheet general ledger account, shown in the "**Detail from VPs**" worksheet, has been allocated to the relevant balance sheet category in the Restated Balance Sheets);[24] and

(5) That in the "**Restated Balance Sheets**" worksheet, all adjustments to deferred revenue drawn from the "**Detail from VPs**" worksheet are applied to the short-term deferred revenue balance, save in respect of adjustments relating to hosting deals, in respect of which the "**Hosting – VP Detail**"

[22] Note 1.
[23] Note 2.
[24] Note 3.

worksheet computes a transfer of deferred hosting revenue from short-term to long-term deferred revenue.[25]

6.9. As stated above, I have been instructed to review and comment on the methodologies by which these three workbooks were prepared, and the way in which they were executed.

Methodology

Restated Profit Schedule

6.10. The Restated Profit Schedule considers separately each relevant quarter and sets out adjustments to revenue and to various cost lines.

6.11. The adjustments to revenue reflect primarily deferrals of revenue: i.e., revenue that Autonomy recognised up front but that is, in the VPs, either recognised in a subsequent period or spread over a number of periods. In a number of cases, the adjustments in the VPs result in revenue not being recognised at all: this is the case, for example, with certain reciprocal transactions, on the ground that there is no sale of substance. The lines of business affected can be seen in lines 10 to 13 of the "Gross Margin Analysis" worksheet. They are primarily VAR transactions, Reciprocal transactions, Hosting arrangements, and 'Other transactions'.

6.12. The adjustments to various cost lines primarily reflect the consequences of the adjustments to revenue. For example, in the case of a reciprocal transaction where the adjustment removes the revenue on the grounds that there is no sale of substance, it is also logical that certain related expenses are also removed, such that only the net cost remains.

6.13. Hardware revenue and related costs are treated separately. There are three aspects to this:

6.13.1. Pure hardware sales. See cells N14, O14, X14 and Y14 of the "Gross Margin Analysis" worksheet. This represents the deferral of the revenue and related cost of a sale to Morgan Stanley from one quarter to the next.[26]

[25] Notes 4 and 5.
[26] I discuss this in paragraphs 4.52 to 4.54 of Holgate 1.

6.13.2. Allocation of some of the cost of hardware revenue to operating expenses. See, for example, cells Y15 and AC15 of the "Gross Margin Analysis" worksheet. The adjustment here is to remove part of the cost of hardware from operating expenses (specifically, sales and marketing expense) and include it in cost of revenues.

6.13.3. Calculation of alternative numbers that exclude hardware sales and related costs. The numbers presented on lines 20, 22 and 26 of the "Gross Margin Analysis" worksheet show the results (a) after making the adjustments described in paragraphs 6.11 to 6.13.2 above and (b) further adjusted to remove revenue and costs relating to undisclosed hardware sales in Autonomy Inc. This further adjustment, unlike the earlier adjustments, is not made to correct an inappropriate accounting treatment, and I understand that the Claimants do not contend that Autonomy was required to report the consequent adjusted figures. Rather, I understand that the adjusted figures are presented in order to inform the Court and the work of the valuation experts.

6.14. I commented on the appropriate accounting treatment for each of the above categories of transaction in Holgate 1. The adjustments made in the Restated Profit Schedule are consistent with the opinions I expressed in Holgate 1.

6.15. In my view, the layout and logical approach taken in the design of the Restated Profit Schedule is sound. It is not the only way in which it could be done, but it is appropriate and works well.

Specific issues relating to the Restated Profit Schedule

No reliable audit trail: three examples

6.16. I note the statement in Note 1 to the Restated Profit Schedule that there is no reliable audit trail from figures originally posted to the general ledger to the figures in the published Quarterly Reports. I understand this statement to mean that the Claimants were unable to determine whether certain costs incurred were reported as part of costs of revenue or operating expenses in the published financial statements.

6.17. I have been provided with evidence of three instances where the Claimants were unable to establish an audit trail from individual cost transactions to the published figures. Appendix 1 to my supplemental instruction letter describes the three examples, highlights certain discrepancies between the supporting documents, and concludes that a complete audit trail does not exist in these instances. The evidence includes trial balances, consolidation packs and reported results covering three quarters.

6.18. I have reviewed the documents referred to in Appendix 1 to my supplemental instruction letter. Assuming that no material information has been omitted, I confirm that a complete audit trail does not exist in respect of these three examples.

6.19. I have considered the implications of this lack of reliable audit trail. I am instructed that, without performing extensive amounts of further analysis, it is not possible to be sure how many instances there are where the audit trail is not reliable, but that there are one or more instances in each of the relevant quarters. Moreover, whilst the three instances brought to my attention all relate to discrepancies as between amounts reported as cost of revenues (COGS) and amounts reported as operating expenses, it does not necessarily follow that all the instances where there is a lack of a reliable audit trail relate to the same point. This lack of an audit trail in Autonomy's accounting processes is unsatisfactory. However, I consider that a practical response to it is to assume that the appropriate accounting categorisation for a particular item is that which was used on its initial recording in the company's general ledger (rather than that used in any subsequent adjustments that were made). Therefore, I have adopted the Claimants' assumption (set out in Note 1 to the Restated Profit Schedule) that the categorisation of reported costs followed the posting to the general ledger.

6.20. In this context I note that the Schedule assumes that general ledger accounts beginning with the number 5 represent costs of revenue, and general ledger accounts beginning with the number 6 represent operating expenses (Note 1). This assumption seems reasonable to me based on the descriptions of the general ledger codes.[27]

[27] The following, drawn from lines 591-614 of the "Detail from VPs" worksheet of the Restated Balance Sheet Schedule, sets out the relevant codes and descriptions.

Income statement	
COGS	
520000	Cost - royalty expense
542000	User manual
542500	Cost - manufacturing product
545000	Finder / GSA fees
570000	Cost - COGS hardware
572000	COGS – other
573000	COGS - discount on sale
Operating expense	
643000	Promotional costs
654000	Cost - expensed equipment

6.21. Adjustments to revert to the initial categorisation of costs, such as those shown in cells Y15 and AC15 of the "Gross Margin Analysis" worksheet, are therefore appropriate.

6.22. The lack of an audit trail may also have other implications (see, for example, paragraph 6.25 below).

Calculation of gross margins

6.23. As stated in Note 5, the restated gross margins, after the removal of hardware revenues and costs on the above basis, range between 96.2% and 99.7% for the quarters Q4 2010 – Q2 2011, and exceed 100% for Q3 2010.

6.24. The first two percentages are commercially unrealistic and for the gross margin to exceed 100% is logically impossible (because it would mean that cost of revenues was negative). While these numbers result from the exercise described above, I am not in a position to explain why they are so high.

6.25. Based on my instructions, the work I have done is limited to the impugned transactions. It is possible that the high level of certain of the restated gross margin figures is attributable to matters that I have not been asked to consider, for example Autonomy's approach to accounting for transactions that are not in issue in these proceedings, or discrepancies that may have arisen from the lack of an audit trail, or other accounting errors that have not been identified.[28]

6.26. Accordingly, whilst these gross margins are puzzling, they do not invalidate the 'Adjustments in respect of improper transactions' shown in lines 10 to 16 of the "Gross Margin Analysis" worksheet.

6.27. The two issues just described (lack of an audit trail and issues relating to the calculation of gross margin) and the fact that the analysis in the Schedule is limited to the impugned transactions and the hardware sales, may mean that the adjustments made in lines 10 to 16 of the "Gross Margin Analysis" worksheet are incomplete for the purpose of fully restating Autonomy's published accounts.

660800	Cost - Finder / GSA fees
661011	Billable 3rd party engagements
665600	Collection fees
667000	Cost - maintenance contracts
676000	Bad debt
690000	Cost – depreciation
691000	Cost – amortisation

[28] I have considered Appendix 2 to my supplemental instruction letter, but it does not alter the views I express here.

Further investigation would be required to determine what additional adjustments would be necessary to arrive at Autonomy's actual gross margin, and whether sufficient information to identify such adjustments was available. Nevertheless, this does not affect the view I expressed in paragraph 6.15 above in relation to the Restated Profit Schedule.

Reciprocal/MAF Analysis

6.28. The Reciprocal/MAF Analysis shows the effect on the income statement, at the end of each relevant quarter, of the adjustments made by the Claimants in respect of the same transactions as discussed in paragraph 6.11 above. It also makes the adjustments set out in paragraph 6.6(1), which I understand are intended to reflect the impact on the restated income statement measures of Mr Giles' proposed valuation approach, as follows.

6.29. The restated income statement measures set out in the Restated Profit Schedule reflect my conclusions in Holgate 1 concerning the appropriate accounting treatment of the Reciprocal and VAR transactions. I concluded that no revenue should have been recognised on those transactions, and that any net costs should have been expensed.

6.30. I understand that Mr Giles contends that, for valuation purposes, loss-making transactions should be reversed. At the income statement level, that involves removing the net costs expensed in the Restated Profit Schedule.

6.31. Those net costs are removed in the Reciprocal/MAF Analysis in respect of both Reciprocal and VAR transactions. Specifically, both MAFs and any net losses on Reciprocal transactions are removed.

6.32. In my view, the layout and logical approach taken in the design of the Reciprocal/MAF Analysis is sound. It is not the only way in which it could be done, but it is appropriate and works well.

Restated Balance Sheets Schedule

6.33. The Restated Balance Sheets Schedule shows the effect on the balance sheet, at the end of each relevant quarter, of the adjustments discussed in paragraph 6.11 above.

6.34. The restated balance sheet shows the aggregate effect of the adjustments to individual transactions set out in the VPs. The worksheet "Detail from VPs" itemises the adjustments to various balance sheet items from these transactions. In the case of Hosting arrangements, total numbers are shown at lines 580 to 586 and the detail underlying these numbers is set out on the worksheet "Hosting –

VP Detail". The aggregate effect of all the transactions (including the Hosting arrangements) on the income statement and the balance sheet is brought together in lines 592 to 614, and lines 616 to 642, respectively, of the "Detail from VPs" worksheet; and in turn the balance sheet effects shown in lines 616 to 642 are allocated, in the "Restated Balance Sheets" worksheet, to the appropriate balance sheet heading and to the 'Adjustment' column in the appropriate quarter.

6.35. The "Restated Balance Sheets" worksheet shows, for each quarter, 'Reported', 'Adjustment', and 'Restated' figures in respect of each balance sheet category reported by Autonomy. The 'Reported' numbers are drawn from the published balance sheets. The 'Adjustment' numbers are as just discussed. And the 'Restated' numbers are the result of adding/subtracting the 'Adjustment' to/from the 'Reported' numbers.

6.36. The principal adjustments to the balance sheet are (a) an increase in deferred revenue, some of which is shown within current liabilities and some within non-current liabilities; and (b) a reduction in retained earnings. These reflect the reduction or deferral of revenue from the lines of business described in paragraph 6.11. Significant reductions are also seen in 'Other intangible assets', reflecting principally the reversal of software purchases that were part of reciprocal transactions. Smaller adjustments are made to other assets and liabilities.

6.37. I commented on the appropriate accounting treatment for each of the above categories of transaction in Holgate 1. The adjustments made in the Restated Balance Sheets Schedule are consistent with the opinions I expressed in Holgate 1.

6.38. In my view, the layout and logical approach taken in the design of the Restated Balance Sheets Schedule is sound. It is not the only way in which it could be done, but it is appropriate and works well.

Conclusion - Methodology

6.39. As already noted, there is more than one method by which Schedules of this sort can appropriately be prepared, and as such there is no one right way. However, in my view, the methodologies by which the Restated Profit Schedule, Reciprocal/MAF Analysis and Restated Balance Sheets Schedule have been prepared are appropriate and they achieve their intended purpose as described above.

6.40. I now turn to whether these appropriate methodologies have been properly put into practice at the detailed implementation level, that is: have they been executed properly?

My detailed verification work

6.41. The work I have undertaken to verify the execution of the Restated Profit Schedule, Reciprocal/MAF Analysis and Restated Balance Sheets Schedule comprised the following:

(1) Understanding the sources of information used to compile the figures, including:

a. Other worksheets within the workbooks;

b. Publicly available reported figures;

c. Exhibits to the Schedules and Analysis referred to above;

d. Relevant Schedules to the RRAPoC; and

e. the VPs.

(2) Tracing figures between worksheets;

(3) Confirming methodology and consistency with the spreadsheet formulae that have been used;

(4) Tracing figures from worksheets to underlying schedules or source documentation (e.g. reported figures, VPs and Schedules to the RRAPoC);

(5) Identifying information which cannot be traced back to the VPs, Schedules to the RRAPoC or available underlying source documentation;

(6) Identifying figures that appear to be inaccurate; and

(7) Identifying any assumptions.

6.42. In order to assist with the work undertaken, I was provided with certain documentation set out at Appendix 2 to this report.

6.43. I have not been instructed to trace the adjustments set out in the VPs back to underlying source documentation as part of this exercise. Similarly, I have relied on the data contained in the Schedules to the RRAPoC.

6.44. Further detail of the work undertaken is set out at Appendix 3. I note that my verification exercise was undertaken on a 100% (rather than a sampling) basis.

6.45. In summary, the Restated Profit Schedule, Reciprocal/MAF Analysis and Restated Balance Sheets Schedule have been executed to a high standard. I have found no material errors. In the course of my detailed verification work, I identified a limited number of rounding errors and other minor inaccuracies; but these had no material effect on the numbers presented in the Schedules and Analysis.

6.46. All the errors and inaccuracies I have identified in respect of the Restated Profit Schedule, Reciprocal/MAF Analysis and Restated Balance Sheets Schedule are set out at Appendix 4. In particular:

(1) Appendices 4A, 4B and 4C set out the types of errors and inaccuracies identified for the Restated Profit Schedule, Reciprocal/MAF Analysis and Restated Balance Sheets Schedule respectively; and

(2) Appendices 4Ai and 4Ci set out details of the cells affected by the errors and inaccuracies identified in Appendix 4A and 4C respectively.

6.47. I refer specifically to the numbers on the two Schedules in respect of the Hosting line of business. As I explain in chapter 7 of Holgate 1, total contract revenues should be recognised over the period in which the services were provided. Because Autonomy reported quarterly, it was necessary to allocate contract revenues to each quarter. For example, a three-year contract would typically affect 12 quarters.[29] In the Schedules, the allocation is carried out with a high degree of accuracy: the relevant revenues are not just divided by 12 but this is refined to take account of the fact that the first quarter of the year contains 90 days, the second contains 91 days and the third and fourth quarters contain 92 days each. I regard this as a high, but appropriate, level of sophistication.

6.48. It would have been possible to be even more accurate. I note that calculations in the Restated Balance Sheets Schedule do not take account of the fact that 2012 was a leap year. The 'leap year effect' adds a day to the first quarter of the year and so affects the Claimants' calculation of the Hosting Revenue which should be allocated to each quarter in 2012.[30]

6.49. As a consequence, the split of Deferred Revenue between current and non-current liabilities in the balance sheet at the end of Q1 and Q2 2011 is affected. I recalculated these balances, correcting them for the leap year effect. In each case, the differences represented less than 0.11% of the total balance, as set out in the table below.[31]

Table 1 – Changes in Deferred Revenue resulting from leap year effect

[29] I assume here, for simplicity, that the contract starts on the first day of a quarter. Three year contracts that start on other days will affect 13 quarters.

[30] These consequences are referred to as 'Direct effects' in Appendix 5i.

[31] These consequences are referred to as 'Follow on effects' in Appendix 5i.

	Q1 2011 (USD)	Q2 2011 (USD)
'Current liabilities – Deferred Revenue' (per Restated Schedule)	159,217,180	185,190,063
'Current liabilities – Deferred Revenue' (recalculated)	159,285,493	185,245,004
'Current liabilities – Deferred Revenue' difference	**(68,313)**	**(54,941)**
'Non-current liabilities – Deferred Revenue' (per Restated Schedule)	66,802,736	75,732,232
'Non-current liabilities – Deferred Revenue' (recalculated)	66,734,423	75,677,291
'Non-current liabilities – Deferred Revenue' difference	**68,313**	**54,941**

6.50. The impact of the leap year effect on individual figures in the Restated Balance Sheet Schedule is referenced in Appendix 5.

6.51. I do not consider the failure to take into account the leap year effect as an error. Rather, taking account of the leap year effect is a possible further refinement that could have been adopted.[32] Even if not taking account of the leap year effect were regarded as an error, its numerical effect is well below the threshold of materiality. Indeed neither the leap year effect nor any of the errors and inaccuracies identified have a material impact on either of the Schedules.

Conclusion - Detailed verification

6.52. In the Restated Profit Schedule, the Reciprocal/MAF Analysis, and the Restated Balance Sheets Schedule, I found a number of small errors and inaccuracies. Neither individually nor in aggregate are they numbers that are anywhere close to having a material effect on the measures of profit and balance sheet items that are under consideration. Indeed the overall quality of the workbooks is in my view high.

[32] It would be possible to be even more sophisticated and detailed in considering the effects of the additional day in the leap year of 2012. That is, it could be argued that the need to allocate revenue to the additional day affects the allocation of revenue across the whole of the periods in which the services were provided. I have not calculated what this effect might be because I consider it to be unnecessary as I believe it would have a negligible effect on revenue allocated to different periods.

7. **Declaration**

7.1. I confirm that I have made clear which facts and matters referred to in this supplemental 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. I understand that my duty in providing written reports and giving evidence is to help the Court on matters within my expertise and that this duty overrides any obligation to my employer or any other person. I have complied with my duty and will continue to comply with it in this matter. I am aware of the requirements of CPR Part 35, the Practice Direction to Part 35 and the Guidance for the Instruction of Experts in Civil Claims 2014.

7.2. I have included 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.

7.3. I have indicated the sources of all information I have used.

7.4. I have not, without forming an independent view, included or excluded anything which has been suggested to me by others (in particular my instructing lawyers).

7.5. I will notify those instructing me immediately and confirm in writing if for any reason this supplemental report requires correction or qualification.

7.6. I understand that (1) my report, subject to any corrections before swearing as to its correctness, will form the evidence to be given under oath or affirmation; (2) I may be cross-examined on my report by a lawyer assisted by an expert; and (3) I am likely to be the subject of public adverse criticism if the Court concludes that I have not taken reasonable care in trying to meet the standards set out above.

7.7. 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.

Signature...

Name PETER ALAN HOLGATE

Date 13 March 2019