

**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**

**Supplemental Expert Report by:
Gervase MacGregor**

**Report Dated:
23 March 2019**



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GLOSSARY

Also see Glossary in my first expert report in these proceedings dated 29 November 2018.

Amendment	Amendment to the THS Shirt Sponsorship Agreement
Amgen Hosting Services and License Addendum	Autonomy Hosting Services and License Addendum dated 21 December 2010
Amgen Master Software License and Services Agreement	Master Software License and Services Agreement between Autonomy and Amgen dated 13 December 2006
Auxilium	Auxilium Tech S.r.l.
Bank of America	Bank of America N.A.
BAV	Biblioteca Apostolica Vaticana (Vatican Library)
Capax EDD Sale 1	Sale transaction between Autonomy and Capax Discovery in Q1 2009
Capax EDD Sale 2	Sale transaction between Autonomy and Capax Discovery in Q4 2009
Capax EDD Sale 3	Sale transaction between Autonomy and Capax Discovery in Q1 2011
Capax Global	Parent company of Capax Discovery
CISEN	Centro De Investigacion Y Seguridad Nacional
CitiGroup	Citigroup Technology Inc.
COGS	Cost of goods sold
Credit Suisse	Credit Suisse Securities (USA) LLC
Dell	Dell Inc.
DiscoverEngine	DiscoverPoint Engine software
Mr Disilvestro	Brian Disilvestro of EMC
DKO	US Department of the Army Through Defense Knowledge Online
Dol	US Department of the Interior
Mr D Truitt	David Truitt, Microlink's majority owner and CEO
EAS	Enterprise Archive Solution
EDD Services	Electronic Data Discovery services
EMC	EMC Corporation
EMC Purchase	Purchase of hardware, software, services and maintenance by Autonomy from EMC on 30 September 2010



EMC Sale	Sale transaction between Autonomy and EMC in Q3 2010
FOB	Free on board
FileTek	FileTek Inc
FileTek Purchase 1	Purchase transaction between Autonomy and FileTek in Q4 2009
FileTek Purchase 2	Purchase transaction between Autonomy and FileTek in Q2 2010
FileTek Sale 1	Sale transaction between Autonomy and FileTek in Q4 2009
FileTek Sale 2	Sale transaction between Autonomy and FileTek in Q1 2010
FileTek Transactions	Transactions relating to Schedule 5, Transaction 3: FileTek Inc
My First Report	My first expert report in the proceedings dated 29 November 2018
GB	Gigabytes
Mr Geall	Marc Geall, Head of Corporate Strategy & IR, Autonomy
General Motors	General Motors Corporation
Mr Gersh	Andrew Gersh, Partner at KPMG LLP
HDS/Hitachi	Hitachi Data Systems Corporation
Mr Holgate	Peter Alan Holgate, Claimants' accounting expert
Holgate Assumptions 1 to 13 / Holgate Assumptions	The 13 general assumptions that Mr Holgate has been instructed to adopt in respect of the reseller transactions, as set out in section 5 of Mr Holgate's First Report
Holgate Capax Discovery Reciprocal Assumptions	Assumptions that Mr Holgate has been instructed to apply to the Capax Discovery reciprocal transactions
Holgate EMC Reciprocal Assumptions	Assumptions that Mr Holgate has been instructed to apply to the EMC reciprocal transactions
Holgate FileTek Reciprocal Assumptions	Assumptions that Mr Holgate has been instructed to apply to the FileTek reciprocal transactions
Mr Holgate's First Report	Mr Holgate's first expert report dated 29 November 2018
Holgate MicroTech Reciprocal Assumptions	Assumptions that Mr Holgate has been instructed to apply to the MicroTech reciprocal transactions
Holgate "Other" Amgen Assumptions	Assumptions that Mr Holgate has been instructed to apply to "Other" transaction set out in Schedule 7, Transaction 3
Holgate "Other" Iron Mountain Assumptions	Assumptions that Mr Holgate has been instructed to apply to "Other" transaction set out in Schedule 7, Transaction 4
Holgate "Other" PRISA Assumptions	Assumptions that Mr Holgate has been instructed to apply to "Other" transaction set out in Schedule 7, Transaction 2



Holgate "Other" THS Assumptions	Assumptions that Mr Holgate has been instructed to apply to "Other" transaction set out in Schedule 7, Transaction 1
Holgate Vidient Reciprocal Assumptions	Assumptions that Mr Holgate has been instructed to apply to the Vidient reciprocal transactions
Holgate VMS Reciprocal Assumptions	Assumptions that Mr Holgate has been instructed to apply to the VMS reciprocal transactions
Honeywell	Honeywell Aerospace
IAS 10	International Accounting Standard 10 'Events after the Reporting Period'
IAS 22	International Accounting Standard 22 'Business Combinations'
IAS 32	International Accounting Standard 32 'Financial Instruments - Presentation'
IAS 37	International Accounting Standard 37 'Provisions, Contingent Liabilities and Contingent Assets'
IFRIC	IFRS Interpretations Committee
IFRS 5	International Financial Reporting Standard 5 'Non-current Assets Held for Sale and Discontinued Operations'
IFRS 6	International Financial Reporting Standard 6 'Exploration for and Evaluation of Mineral Resources'
IFRS 11	International Financial Reporting Standard 11 'Joint Arrangements'
IFRS 13	International Financial Reporting Standard 13 'Fair Value Measurement'
Joint Statement	Joint statement of issues agreed and disagreed by Mr Holgate and me dated 28 January 2019
Mr Kalbag	Sam Kalbag, Autonomy's Vice President of Technology of the Federal Group
Mr Kalbag's Witness Statement	Witness statement of Mr Kalbag dated 13 September 2018
Mr Kanter	Andrew Kanter, Autonomy's Chief Operating Officer and General Counsel during the Relevant Period
Mr Krakoski	James Michael Krakoski, Senior account executive at Micro Focus
Logica	Logica plc
Dr Lynch's Second Witness Statement	Witness statement of Dr Lynch dated 16 November 2018
MAF	Marketing Assistance Fee
Manufacturers Life	Manufacturers Life Insurance Company



Mr Martin's Witness Statement	Witness statement of Mr Martin dated 16 November 2018
McAfee	McAfee Inc.
Dr Menell	Peter Menell of Autonomy
Merrill Lynch	Merrill Lynch & Co
Microlink	Microlink LLC
MicroTech Assignment	Assignment of rights under the MicroTech Assignment Agreement
MicroTech Assignment Agreement	Autonomy Maintenance and Support Services Agreement effective 30 March 2011
MicroTech Sale	Sale of software licences from Autonomy to MicroTech under MicroTech Sale Agreement
MicroTech Sale Agreement	End User Software License Agreement between Autonomy and MicroTech dated 30 March 2011
Misys	Misys plc
Mr Mooney	Mike Mooney of Autonomy
Morgan Stanley	Morgan Stanley & Co. Incorporated
Morgan Stanley Hardware Transaction	Sale of US\$6 million of hardware from Autonomy to Morgan Stanley in Q2 2009
Morgan Stanley Letter Agreement	Agreement between Autonomy and Morgan Stanley dated 30 June 2009
Morgan Stanley Master Purchase Agreement	Master Purchase Agreement dated 30 June 2009 between Autonomy and Morgan Stanley
Mr Murray	Tom Murray of Deloitte
Mr Pao's Witness Statement	Witness statement of Mr Pao dated 14 November 2018
Mr Pearson's Witness Statement	Witness statement of Mr Pearson dated 8 November 2018
PMI	Philip Morris International Management S.A.
PO1	Purchase order from Capax Discovery to Autonomy dated 30 June 2009
PO2	Purchase order from Capax Discovery to Autonomy dated 30 September 2009
Poste Italiane	Poste Italiane S.p.A.
Project Shockwave	Business plan dated 21 March 2009 prepared by Autonomy management in relation to the potential acquisition and integration of VMS data within Autonomy's products
Ms Raynal	Emily Raynal of Autonomy



Realise	Realise Limited
Red Ventures	Red Ventures S.r.l.
SaaS	Software-as-a-Service
Sage	The Sage Group plc
Sales Consulting	Sales Consulting S.R.L.
Mr Scott	Joel Scott, Autonomy's General Counsel and COO of the Americas throughout the Relevant Period
Shirt Sponsorship Agreement	Shirt Sponsorship Agreement between Autonomy and THS dated 5 July 2010
Sixth Amendment	Sixth amendment to the Verity OEM Agreement between Autonomy and EMC
SOP 97-2	Statement of Position 97-2 (US GAAP)
Mr Szukalski	Gary Szukalski, President of FileTek
ThinkTech	ThinkTech Inc.
THS	Tottenham Hotspur PLC
Tikit	Tikit Limited
Tikit Additional Agreement	Additional agreement between Autonomy and Tikit dated 31 December 2010
Transcript of Deposition	Transcript of the deposition on 15 August 2018 in the civil proceedings brought by MicroTech against Autonomy Inc. in the United States District Court, Northern District of California.
Travers Smith	Travers Smith LLP
TXU	TXU Energy
UBS	UBS AG
USDVA	United States Department of Veterans Affairs
USPS	United States Postal Service
Vidient Transactions	Transactions relating to Schedule 5, Transaction 4: Vidient
VMS Transactions	Transactions relating to Schedule 5, Transaction 2: VMS Inc
Voluntary Particulars	Voluntary particulars served by the Claimants on 26 September, 2 October, 10 October, 16 October, 24 October and 7 November 2018, corresponding to Schedule 4 and Schedule 6 to the Re-Re-Amended Particulars of Claim
Worksite Master Reseller Agreement	Worksite Alliance Program Agreement 'iResell Partner'



Xerox	Xerox Corporation
Mr Yan	Samuel Yan, senior member of the Digital Safe product development team at Micro Focus

1 INTRODUCTION AND TERMS OF REFERENCE

1.1 I am the same Gervase MacGregor who issued an expert report in these proceedings on 29 November 2018 (“my First Report”). Unless otherwise stated, all terms and definitions used in my First Report apply equally and have been adopted in this report.

1.2 My CV is attached as Appendix 1 to my First Report.

Instructions and scope of my work

1.3 My instructions and the scope of my First Report are set out in section 1 of that report. A brief background to this matter is set out in section 2 of my First Report.

1.4 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.

1.5 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.

Events since submission of my First Report

1.6 Since the submission of my First Report I have been provided with a copy of a report by Peter Alan Holgate (“Mr Holgate”) dated 29 November 2018 (“Mr Holgate’s First Report”). Mr Holgate is instructed by Travers Smith LLP (“Travers Smith”) on behalf of the Claimants to provide expert evidence on “*the appropriate accounting treatment for the impugned transactions, including as to their presentation in Autonomy’s published information*”¹.

1.7 Mr Holgate and I met to discuss our respective reports on 14 December 2018. We prepared a joint statement of issues agreed and disagreed dated 28 January 2019 (“the Joint Statement”).

1.8 For the purposes of my First Report, I was instructed to rely on the draft Re-Re-Amended Particulars of Claim provided by the Claimants on 23 July 2018.² Since the submission of my First Report the Claimants have updated the Re-Re-Amended Particulars of Claim. For the purposes of this report I have been instructed to rely on the Re-Re-Amended Particulars of Claim dated 15 February 2019 (the “Re-Re-Amended Particulars of Claim”)³.

¹ Mr Holgate’s First Report, Appendix 2, Annex 1, paragraph 1.

² My First Report, page 2, footnote 2.

³ Re-Re-Amended Particulars of Claim, page 1, footnote 2.

Scope of this report

- 1.9 I have been 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*”.⁴
- 1.10 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, which occurred during the Relevant Period.
- 1.11 I set out at paragraph 1.14 of my First Report the categories of alleged “*improper transactions and accounting practices*” as asserted by the Claimants. Mr Holgate provided his analysis of each of these categories of transactions, with the exception of the representation of IDOL OEM revenue in Autonomy’s published financial information, in his first report. As set out in my First Report⁵, the representation of IDOL OEM revenue in Autonomy’s published information is not an accounting issue and is not covered by IFRS.
- 1.12 This report includes my comments in response to Mr Holgate’s analysis, as well as my own further analysis, of:
- (a) Autonomy’s “[u]ndisclosed, loss-making hardware sales”⁶, specifically:
 - (i) the reporting of hardware sales in Autonomy’s published information;
 - (ii) the allocation of hardware costs between Cost of Goods Sold (“COGS”) and sales and marketing expenses;
 - (iii) disclosure of the accounting policy in relation to hardware costs allocation; and
 - (iv) the Morgan Stanley hardware transaction;
 - (b) the appropriate accounting treatment for all of the 37 reseller transactions impugned in this matter;
 - (c) the appropriate accounting treatment for the six alleged reciprocal transactions impugned in this matter;
 - (d) the alleged acceleration of hosting revenue;
 - (e) the appropriate accounting treatment for the four “other” transactions impugned in this matter; and

⁴ Order of Mr Justice Hildyard dated 14 July 2016, paragraph 17(1).

⁵ My First Report, paragraph 1.15.

⁶ Re-Re-Amended Particulars of Claim, paragraph 30.1.

(f) the Claimants' Voluntary Particulars in respect of the categories of transactions set out at 1.12(a) to 1.12(e) above.

1.13 I set out at section 2 below further details regarding my approach to analysing the impugned transactions and types of transactions in this matter.

1.14 Where I refer to 'Autonomy' in this report, I am referring to the group of Autonomy companies⁷, including any Autonomy subsidiary. Although a specific transaction may have been carried out by a specific subsidiary of Autonomy, this will also have been accounted for by Autonomy at the consolidated level.

1.15 Similarly, where I refer to Autonomy's published financial information in this report I use the terms 'Consolidated Income Statement' and 'Consolidated Balance Sheet' interchangeably with the terms 'Income Statement' and 'Balance Sheet'.

Factual matters and witnesses including Mr Welham of Deloitte

1.16 Both the Claimants and the Defendants have submitted a number of witness statements, some of which contain evidence which deal with accounting matters. While it is not my role as an accounting expert to opine upon 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.

1.17 Therefore, in setting out my analysis in this report, I refer to the factual evidence submitted by the parties where I believe it to be relevant from an accounting perspective. For the avoidance of doubt, I have not set out all of the evidence relating to each transaction, particularly if I believe it would be outside of my range of expertise to give an opinion on the implications of such evidence.

1.18 As noted in my First Report, Mr Welham of Deloitte deals with a number of accounting issues across a large number of transactions impugned in this matter. In many cases, based on his own knowledge he also comments on auditing matters.

1.19 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 matter which, he is asked to further assume, the Claimants will establish as facts.

1.20 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

⁷ 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.

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 Deloitte’s consideration of the accounting treatment judgements for a particular individual assumption within these overall alternative assumed circumstances or ‘facts’.

- 1.21 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.
- 1.22 In preparing this report I have relied upon the evidence Mr Welham has provided as a factual witness only. For the avoidance of doubt, where Mr Welham seeks to now give an opinion on Deloitte’s accounting treatment judgements reached at the time (and potentially the opinions that Deloitte formed) based on ‘assumed facts’, I have not considered these comments in preparing this report.

Confidentiality

- 1.23 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.
- 1.24 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

- 1.25 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.
- 1.26 As set out in my First Report, I understand that many of the facts, issues and/or circumstances relating to the transactions in dispute in this case are themselves disputed between the Claimants and Defendants, as is evidenced by the competing evidence provided in the parties’ witness statements.

- 1.27 I consider it probable that eventual determinations of each individual fact will, in most cases, 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.
- 1.28 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.
- 1.29 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 than for the application of accounting standards that have been issued more recently, and therefore may 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

- 1.30 In preparing some of the appendices to this report I have used spreadsheet programs on personal computers and minimal arithmetic errors may occur within the computer programs as a result of rounding.
- 1.31 Any opinions or views expressed in this report are subject to any further information which may be made available to me. To the extent that facts are subsequently determined that impact upon the accounting treatment in respect of the impugned transactions, it may be necessary for me to reconsider my opinions.

Sources of Information

- 1.32 The sources of information used for the purposes of preparing this report are set out in **Appendix 1** to this report.

Structure of my report

- 1.33 The structure of the remainder of my report is as follows:
- (a) in section 2, I set out my approach in this report and Mr Holgate's approach in preparing his first report in this matter;

- (b) in section 3, I provide further comments on the accounting standards and related guidance in relation to the recognition of revenue throughout the Relevant Period;
- (c) in section 4, I consider Mr Holgate's comments on hardware sales throughout the Relevant Period and provide further comments of my own;
- (d) in section 5, I consider Autonomy's Morgan Stanley hardware transaction including Mr Holgate's review of such;
- (e) in section 6, I provide my observations on Mr Holgate's approach in respect of the reseller transactions impugned in this matter and provide my comments on each of the 13 general assumptions Mr Holgate has been instructed apply to these transactions. In **Appendix 3.1 to 3.37**, I consider each of the 37 individual transactions with resellers impugned in this matter;
- (f) in section 7, I consider matters relating to the alleged reciprocal transactions. In **Appendix 5.1 to 5.6** I consider each of the six alleged reciprocal transactions impugned in this matter;
- (g) in section 8, I consider Mr Holgate's comments on the alleged acceleration of hosting revenue and provide further comments of my own;
- (h) in section 9, I consider the "other" transactions impugned in this matter. I consider these to be standalone transactions and therefore I do not make any overarching comments about them. In **Appendix 7.1 to 7.4** I consider the four "other" transactions impugned in this matter;
- (i) in section 10, I provide my comments on the Claimants' Voluntary Particulars in respect of the categories of transactions impugned in this matter;
- (j) in section 11, I provide a summary of my conclusions; and
- (k) in section 12, I provide my expert's declaration.

2 MY APPROACH IN THIS REPORT AND MR HOLGATE'S APPROACH IN HIS FIRST REPORT

My approach in this report

- 2.1 As set out above at paragraph 1.9, I have been 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*”.⁸
- 2.2 As set out above, in this report I provide my comments in response to Mr Holgate’s analysis, as well as my own analysis, of:
- (a) Autonomy’s “[u]ndisclosed, loss-making hardware sales”⁹, specifically:
 - (i) the reporting of hardware sales in Autonomy’s published information;
 - (ii) the allocation of hardware costs between COGS and sales and marketing expenses;
 - (iii) disclosure of the accounting policy in relation to hardware costs allocation; and
 - (iv) the Morgan Stanley hardware transaction;
 - (b) the appropriate accounting treatment for all of the 37 reseller transactions impugned in this matter;
 - (c) the appropriate accounting treatment for the six alleged reciprocal transactions impugned in this matter;
 - (d) the alleged acceleration of hosting revenue;
 - (e) the appropriate accounting treatment for the four “other” transactions impugned in this matter¹⁰; and
 - (f) the Claimants’ Voluntary Particulars in respect of the categories of transactions set out at 2.2(a) to 2.2(e) above.
- 2.3 In setting out my analysis of Autonomy’s hardware sales and the recognition of revenue on hosting transactions in the Relevant Period, I do not consider each transaction involving the sale of hardware or hosting products on an individual basis. Rather, I deal with these

⁸ Order of Mr Justice Hildyard dated 14 July 2016, paragraph 17(1).

⁹ Re-Re-Amended Particulars of Claim, paragraph 30.1.

¹⁰ Re-Re-Amended Particulars of Claim, Schedule 7.

issues generally. However, I do provide my analysis of the individual hardware transaction referred to by Mr Holgate, being the sale to Morgan Stanley in Q2 2009¹¹.

- 2.4 My overall methodology for examining the appropriate accounting treatment for the 37 impugned reseller transactions, the six alleged reciprocal transactions and the four “other” transactions in this case is to consider each transaction on an individual basis. As set out in the Joint Statement, both I and Mr Holgate agree that the facts relating to each transaction must be considered on an individual basis as they are highly relevant to its accounting treatment.¹²
- 2.5 I start by providing a general description of each of the impugned transactions and I set out how they were accounted for by Autonomy at the time of the transaction. For the avoidance of doubt, I have not had access to Autonomy’s accounting records or ledgers and, therefore, my comments in respect of the accounting treatment applied by Autonomy is my best understanding from the pleadings and extracts from Autonomy’s accounting records included in the voluntary particulars served by the Claimants on 26 September, 2 October, 10 October, 16 October, 24 October and 7 November 2018, corresponding to Schedule 4 and Schedule 6 to the Re-Re-Amended Particulars of Claim (the “**Voluntary Particulars**”).
- 2.6 I then consider the facts surrounding each transaction as they were known at the time. In this respect, my most commonly used source of information for this purpose has been the contemporaneous Deloitte audit and review working papers, and also the underlying documents referred to therein where I consider relevant. For those transactions which Deloitte tested, the Deloitte working papers generally contain the facts, the accounting treatment, an explanation of the accounting treatment and Deloitte’s commentary and challenge on the accounting treatment.
- 2.7 For the avoidance of doubt, I have not been provided with access to Deloitte’s audit software, AS2. Therefore, I cannot be certain that the version of the Deloitte working paper I have referred to is the final version saved on Deloitte’s audit file. In some cases I have seen a number of versions of the working papers, some in Microsoft Excel format and some saved as PDF copies of the Microsoft Excel document.
- 2.8 I then provide my view on Autonomy’s accounting treatment based on the contemporaneous information contained in Deloitte’s working papers.

¹¹ Mr Holgate’s First Report, paragraphs 4.52 to 4.54.

¹² Joint Statement, page 12, “Agreed view” on “Agenda Item” 3(a) and (b).

- 2.9 Next I consider the “*Factual summaries*” and assumptions on which Mr Holgate has been instructed to base his opinions, and Mr Holgate’s analysis and conclusions in respect of the accounting treatment for each transaction.
- 2.10 I then provide my own opinion on the accounting treatment adopting the assumptions Mr Holgate has been instructed apply to each transaction, without any consideration of the underlying facts.
- 2.11 Next I set out my understanding of the facts applicable to the assumptions Mr Holgate has been instructed apply to each transaction by reference to the evidence contained in the documents disclosed in this case (by way of targeted searches of the disclosure database), including underlying transaction specific documentation, the parties’ witness statement and hearsay notice evidence and evidence contained in the Transcripts of Proceedings from the U.S. trial. While it is not my role as an accounting expert to opine upon the facts as stated in witness statements and trial testimony, 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. Therefore, I have referred to facts and disputed facts in my analysis.
- 2.12 Finally, I conclude on how this analysis of the factual evidence impacts my earlier opinion regarding the appropriate accounting treatment for the impugned transactions based on the facts as they were known at the time.

Mr Holgate’s approach

- 2.13 Mr Holgate has been instructed to consider the appropriate accounting treatment for the impugned transactions in this case on the basis of numerous assumptions and against a background of certain assumed, but in many cases disputed, “*Factual summaries*”, provided to him by Travers Smith, his instructing solicitors.
- 2.14 It appears that Mr Holgate has not sought to look for evidence that would corroborate or challenge any of his instructed assumptions or assumed facts, nor has he carried out any analysis to determine whether the assumptions he has been provided with do in fact apply to the transactions he is opining on. Rather, Mr Holgate has been instructed to assume that the assumptions he has been provided with apply, in various combinations, to the transactions he has considered.

Mr Holgate’s sources of information

- 2.15 For the purposes of preparing his report, Mr Holgate has been provided with a limited set of documents by Travers Smith as listed at Annex 2 to Appendix 2 to his report.

- 2.16 Mr Holgate's sources of information include the industry standard practical guides for UK users of IFRS published by PwC¹³, KPMG and Ernst & Young which include guidance on the application of the accounting standards. Mr Holgate has not been provided with similar guidance prepared and published by Deloitte during the Relevant Period. I refer to Deloitte's 2009 Guidance in my First Report as well as the guidance published by PwC, KPMG and Ernst & Young.¹⁴
- 2.17 Similarly, the list of documents supplied to Mr Holgate does not include the working papers prepared by Deloitte in carrying out its quarterly and interim reviews and year end audits throughout the Relevant Period and Mr Holgate has not seen these Deloitte working papers¹⁵. As set out in my First Report, I consider that these contemporaneous working papers prepared by Deloitte provide extremely valuable evidence of the contemporaneous circumstances surrounding the transactions themselves and why Autonomy accounted for them in the way it did, as well as the contemporaneous views of Autonomy's auditor on each of the transactions.¹⁶
- 2.18 Deloitte also reviewed and provided its opinion on the underlying contractual documentation for many of the impugned transactions. Mr Holgate was apparently provided with "*Contractual documentation in respect of the VAR transactions*"¹⁷, but it is not clear what, if any, consideration Mr Holgate has given to these documents. It appears that Mr Holgate has not been provided with any contractual documentation in respect of the remaining categories of transactions impugned in this matter, as these are not included in the list of documents provided to Mr Holgate.¹⁸
- 2.19 The list of documents provided to Mr Holgate also includes only four of the 64 witness statements and makes no reference to any of the 10 hearsay notices submitted by the Claimants and Defendants in this case. It is unclear whether Mr Holgate has considered any of the information contained in these other witness statements and hearsay notices when forming his opinions. As he makes no reference to this evidence in his report, I presume he has not.

¹³ Mr Holgate states he edited and was responsible for PwC's 'Manual of accounting - IFRS for the UK' (Mr Holgate's First Report, paragraph 1.2).

¹⁴ My First Report, section 4.

¹⁵ Joint Statement, page 8, "*Mr Holgate's view*" on "*Agenda Item*" 2(a).

¹⁶ My First Report, paragraph 6.16.

¹⁷ Mr Holgate's First Report, Appendix 2, Annex 2, page 38.

¹⁸ Mr Holgate's First Report, Appendix 2, Annex 2, page 38.

3 IFRS ACCOUNTING STANDARDS AND GUIDANCE - FURTHER COMMENTARY

Introduction

- 3.1 In my First Report I set out, by way of background:
- (a) an overview of the key accounting matters, accounting and disclosure standards relevant to this case¹⁹;
 - (b) an overview of IFRS accounting industry guidance produced by the 'Big 4' accounting firms²⁰; and
 - (c) the background to IFRS and Autonomy's financial reporting requirements, including comparing IFRS with US GAAP and explaining the principles based nature of IFRS²¹.
- 3.2 I also previously set out a detailed review of the sections of IAS 18 that I consider relevant to the Claimants' allegations²², along with some more general matters relevant to the accounting issues in this case²³.
- 3.3 In most cases, Mr Holgate and I are in agreement in regards to the accounting principles which are relevant and applicable to the issues in this case. Where we do not agree, or where Mr Holgate has referred to an accounting principle I have not considered in my First Report, I set out my comments in this section. I also set out any further references to IFRS or guidance which I consider relevant to the accounting issues in this case but which I did not include in my First Report.
- 3.4 Below I provide:
- (a) an overview of the guidance contained in IFRS regarding the appropriate accounting treatment for events after the reporting period;
 - (b) my comments on Mr Holgate's analysis of the relevant accounting principles set out in his first report, including:
 - (i) an assessment of the economic substance of a transaction and the appropriate accounting treatment for a transaction which lacks or has no economic substance; and
 - (ii) Mr Holgate's interpretation of certain requirements of IAS 18;

¹⁹ My First Report, paragraphs 4.4 to 4.7.

²⁰ My First Report, paragraphs 4.8 to 4.10.

²¹ My First Report, paragraphs 4.11 to 4.21.

²² My First Report, paragraphs 4.22 to 4.88.

²³ My First Report, paragraphs 4.89 to 4.102.

- (c) my comments on Mr Holgate's view, as set out in the Joint Statement, regarding my conclusions on the principles based nature of IFRS; and
- (d) the transition between IAS 18 and IFRS 15.

Events after the reporting period

- 3.5 As set out in the Joint Statement, Mr Holgate and I agree the following with regard to the relevance of hindsight to an accountant:

*"Financial statements are necessarily prepared, approved and audited after the relevant reporting date. For example, Autonomy's year end (annual reporting date) was 31 December and it generally approved and published its accounts towards the end of the following February (the signing date). Financial statements are based on transactions and events up to the reporting date and conditions as at the reporting date. Information coming to light between the reporting date and the signing date is taken into account only insofar as it sheds light on circumstances prevailing at the reporting date. Information coming to light in that period is disregarded insofar as it describes transactions and other events that arise after the reporting date. Information that comes to light after the signing date can be taken into account only at the next reporting date."*²⁴

IAS 10 'Events after the Reporting Period'

- 3.6 I set out below the references to the accounting standard, IAS 10 'Events after the Reporting Period' ("IAS 10"), which prescribes the accounting treatment described above.

- 3.7 IAS 10 defines events after the reporting period as:

"...those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. Two types of events can be identified:

- (a) *those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and*
- (b) *those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period)."*²⁵

²⁴ Joint Statement, pages 6 to 7, "Agreed view" on "Agenda Item" 1(g).

²⁵ Exhibit AA - IAS 10.3.

- 3.8 IAS 10 sets out that, “[e]vents after the reporting period include all events up to the date when the financial statements are authorised for issue, even if those events occur after the public announcement of profit or of other selected financial information.”²⁶
- 3.9 IAS 10 also states:
- “The process involved in authorising the financial statements for issue will vary depending upon the management structure, statutory requirements and procedures followed in preparing and finalising the financial statements.”²⁷*
- 3.10 For the avoidance of doubt, where I refer to Autonomy’s quarterly, interim or annual financial information being ‘signed’, ‘dated’, ‘published’, ‘released’, or use similar wording, I use these terms interchangeably with the term ‘authorised for issue’ and they should be interpreted as having the same meaning.
- 3.11 IAS 10 prescribes the treatment for events after the reporting period as follows:
- (a) *“an entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period”²⁸; and*
 - (b) *“an entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period”²⁹.*
- 3.12 IAS 10 provides examples of adjusting events after the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised.³⁰ One such example is *“the discovery of fraud or errors that show that the financial statements are incorrect”³¹.*
- 3.13 IAS 10 also provides the following example of a non-adjusting event after the reporting period:
- “...a decline in market value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The decline in market value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Therefore, an entity does not adjust the amounts recognised in its financial statements for the investments.”³²*

²⁶ Exhibit AA - IAS 10.7.

²⁷ Exhibit AA - IAS 10.4.

²⁸ Exhibit AA - IAS 10.8.

²⁹ Exhibit AA - IAS 10.10.

³⁰ Exhibit AA - IAS 10.9.

³¹ Exhibit AA - IAS 10.9(e).

³² Exhibit AA - IAS 10.11.

IAS 8 ‘Accounting Policies, Changes in Accounting Estimates and Errors’

- 3.14 In my First Report I set out my comments on the use of hindsight when amending comparative information for prior periods by reference to IAS 8.³³
- 3.15 IAS 8 prescribes the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors.³⁴
- 3.16 For the avoidance of doubt, IAS 8 sets out that restatements of prior period figures within financial statements are required solely for changes in accounting policies, or for the correction of material errors in the prior period figures, as these are the only two changes which are required to be applied retrospectively, as follows:

“...when an entity changes an accounting policy upon initial application of an IFRS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.”³⁵

And

“...an entity shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:

- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or*
- (b) if the error occurred before the earliest period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.”³⁶*

Mr Holgate’s analysis of the relevant accounting principles

- 3.17 Mr Holgate set out, in section 3 of his first report, his analysis and interpretation of the accounting principles which he considered relevant to this case. Where I disagree with Mr Holgate’s comments or wish to provide further comments, I do so below.

Economic substance of a transaction

- 3.18 Both I and Mr Holgate have referred to the guidance set out in the Framework which requires that transactions should be accounted for and presented in accordance with their substance and economic reality and not merely their legal form.³⁷

³³ My First Report, paragraphs 4.99 to 4.102.

³⁴ Exhibit N to my First Report - IAS 8.1.

³⁵ Exhibit N to my First Report - IAS 8.19(b).

³⁶ Exhibit N to my First Report - IAS 8.42.

³⁷ My First Report, paragraph 4.90 and Mr Holgate’s First Report, paragraph 3.16.

- 3.19 As set out in my First Report, PwC's 2009 Guidance³⁸ states that the substance will *"have to be analysed based on all the transaction's contractual terms, or the combination of the contractual terms of linked transactions"* and that *"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"*.³⁹ This guidance highlights that while it is important to consider the substance of a transaction, the contract terms should not be ignored as they can drive the accounting treatment. However, Mr Holgate's approach, by definition, includes no such analysis.
- 3.20 For example, in respect of each of the reseller transactions, while Mr Holgate's conclusions do not refer to anything more than a high level analysis of the economic substance (or otherwise) of the transactions - because it appears that he has not undertaken the relevant detailed analysis - he has nonetheless opined on the overall issue and stated, for 34 out of 37 of the impugned reseller transactions, that they *"lacked economic substance"*.⁴⁰
- 3.21 Mr Holgate also concluded that the sales and purchases which took place under four of the six alleged reciprocal transactions were *"artificial and lacked substance"*⁴¹ and that the sales element of the remaining two transactions lacked⁴² or had no substance⁴³.
- 3.22 Again, Mr Holgate provides very little analysis of the contractual documentation in respect of each of the impugned transactions in this matter in order to reach his conclusions regarding the substance of these transactions.
- 3.23 As set out in my First Report, it is clear that a consideration of revenue recognition under IAS 18 has to be based on a fact heavy analysis. Indeed, as PwC's 2009 Guidance sets out: *"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 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."*⁴⁴
- 3.24 In addition to any analysis of economic substance, Mr Holgate's opinion that the reseller and alleged reciprocal transactions lacked economic substance means that the impugned

³⁸ Mr Holgate states that he edited and was responsible for PwC's 'Manual of accounting - IFRS for the UK' (Mr Holgate's First Report, paragraph 1.2) and the writing team of PwC's 2009 Guidance was co-led by Mr Holgate (Exhibit KK - PwC's 2009 Guidance, page P003).

³⁹ Exhibit G to my First Report - PwC's 2009 Guidance, page 9006, paragraph 9.30.

⁴⁰ Paragraph 10.135 of this report and footnotes 844 and 845.

⁴¹ Mr Holgate's First Report, paragraphs 6.21, 6.38, 6.56 and 6.73.

⁴² Mr Holgate's First Report, paragraph 6.85.

⁴³ Mr Holgate's First Report, paragraph 6.96.

⁴⁴ Exhibit G to my First Report - PwC's 2009 Guidance, page 9007, paragraph 9.31.

transactions were not genuine transactions. Clearly, the correct way to account for a transaction which is not genuine is not to account for it at all, or if it has been accounted for, to reverse it. To put it another way, the transaction should be accounted for in accordance with its economic substance and if there is none, it should not be accounted for.

- 3.25 However, as set out in section 10 of this supplemental report, Mr Holgate's opinion regarding a lack of economic substance is contrary to his agreement with the accounting treatment suggested by the Claimants in their Voluntary Particulars. The treatment of the transaction suggested by the Claimants is to defer the revenue recognised on the sale to the reseller, rather than to reverse the entire transaction. This proposed treatment means the Claimants' consider the impugned transactions to have economic substance at the time the transaction took place.

Mr Holgate's IAS 18 analysis

- 3.26 As set out in the Joint Statement, both I and Mr Holgate agree that IAS 18 is the relevant accounting standard dealing with the recognition of revenue in financial statements under IFRS⁴⁵ throughout the Relevant Period.
- 3.27 However, in a number of areas we disagree, or I provide further comments, as follows.

Measurement of revenue - fair value

- 3.28 IAS 18 requires that revenue is measured "*at the fair value of the consideration received or receivable*"⁴⁶, which in most cases "*is in the form of cash or cash equivalents*"⁴⁷.
- 3.29 Mr Holgate did not provide the definition of fair value in his first report, but, as set out in the Joint Statement, both I and Mr Holgate agree that fair value is defined in IFRS as "*the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction*".⁴⁸
- 3.30 Mr Holgate referred to circumstances in which determining fair value may be problematic and provided the example of an asset being sold with associated services where there is a desire to recognise the revenue in respect of the asset up front. He stated that in this case "*it is necessary to be able to determine the fair value of the asset*".⁴⁹

⁴⁵ Joint Statement, page 5, "*Agreed view*" on "*Agenda Item*" 1(e).

⁴⁶ Exhibit F to my First Report - IAS 18.9.

⁴⁷ Exhibit F to my First Report - IAS 18.11.

⁴⁸ Exhibit F to my First Report - IAS 18.7 and Joint Statement, page 5, "*Agreed view*" on "*Agenda Item*" 1(f).

⁴⁹ Mr Holgate's First Report, paragraph 3.34.4.

- 3.31 However, IAS 18 does not say this. Instead, the amount allocated to the asset, to be recognised up front, is a residual amount after the deduction from the total consideration received or receivable of a cost based amount for the subsequent services. The guidance in the Appendix to IAS 18 is as follows:
- “When the selling price of a product includes an identifiable amount for subsequent servicing (for example, after sales support and product enhancement on the sale of software), that amount is deferred and recognised as revenue over the period during which the service is performed. The amount deferred is that which will cover the **expected costs** of the services under the agreement, together with a reasonable profit on those services.”*⁵⁰[emphasis added]
- 3.32 IAS 18 is silent on what might constitute a reasonable profit which introduces an element of judgement to determining the amount of revenue which should be deferred under this scenario.
- 3.33 Further, Mr Holgate stated, *“If, for example, the asset was sold to various customers at different prices, it may not be possible to determine its fair value. If so, then it would not be permissible to recognise revenue in respect of it at the time of the sale”*.⁵¹ Mr Holgate does not explain, given these circumstances, when revenue should be recognised, if not at the time of the sale. Mr Holgate referenced this statement to IAS 18.9, as set out at paragraph 3.28 above. It is not clear to me why Mr Holgate referred to IAS 18.9 when making this statement as there is no requirement under IAS 18.9 to determine the fair value of the asset being sold; rather the fair value is based on the consideration received or receivable.
- 3.34 There are plenty of situations where the same asset is sold at different prices to different customers.
- 3.35 Mr Holgate’s reference to the requirement to determine the fair value of the asset being sold appears to be a reference to new guidance that is included in International Financial Reporting Standard 15 ‘Revenue from Contracts with Customers’ (“IFRS 15”)⁵². The requirement in IFRS 15 that would appear more relevant to Mr Holgate’s analysis is the potential use of a residual approach when determining the selling price of a good or service that is included in a bundle. A residual approach is only permitted when either the same (residual) good or service is sold to different customers for a broad range of amounts, at or near the same time, (meaning that the selling price is highly variable) or the selling

⁵⁰ Exhibit F to my First Report - IAS 18 Illustrative Examples, paragraph 11.

⁵¹ Mr Holgate’s First Report, paragraph 3.34.4.

⁵² I note however, that the IFRS 15 references are to the stand-alone selling prices of items, and not their fair values.

price for the item has not yet been established and the good or service has not previously been sold on a standalone basis (i.e. the selling price is uncertain).⁵³

- 3.36 IFRS 15, as explained further below, has an effective date of 1 January 2018 for annual periods beginning on or after 1 January 2018, and, as such, was not applicable during the Relevant Period. If this is the source of Mr Holgate's contention, I do not know why he thinks it is relevant. In my view the test at the relevant time was whether the revenue was measured at the fair value of the consideration received or receivable, not at the fair value of the asset being sold.

Sale of goods

- 3.37 As set out in the Joint Statement, both I and Mr Holgate agree that one of the most important parts of IAS 18 is paragraph 14 which sets out the five criteria for the recognition of revenue on the sale of goods.⁵⁴ I set out below my comments on IAS 18.14(a) (Transfer of significant risks and rewards of ownership) and (d) (Probable that economic benefits will flow to the entity) where I disagree with Mr Holgate's comments in his first report, and on (b) (Entity retains neither continuing managerial involvement nor effective control) where I expand upon the comments made by Mr Holgate.

IAS 18.14(a) - Transfer of significant risks and rewards of ownership

- 3.38 Mr Holgate provided his comments on consideration of each of the five criteria separately. When considering the requirement that the entity has transferred to the buyer the significant risks and rewards of ownership of the goods (IAS 18.14(a)), Mr Holgate stated that:

“The point in time when the seller has transferred to the buyer the significant risks and rewards of ownership of the goods will often coincide with when all significant performance obligations have been met. This was reflected in the guidance that KPMG issued at the time. Consistent with this, IAS 18 gives an example of where the seller retains significant risks of ownership because not all significant performance obligations have been met: “an entity may retain the significant risks and rewards of ownership...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.” [IAS 18.16(c)]”⁵⁵

⁵³ Exhibit BB - IFRS 15.79(c).

⁵⁴ Joint Statement, page 5, “Agreed view” on “Agenda Item” 1(e).

⁵⁵ Mr Holgate's First Report, paragraph 3.39.1.

- 3.39 Firstly, I note that the term “*performance obligation*” was not a term used explicitly in IAS 18, and was in fact introduced in IFRS 15⁵⁶, which, as described above, was not applicable during the Relevant Period. In my view, the test at the time of when an entity had transferred the significant risks and rewards of ownership to a buyer required an examination of the circumstances surrounding a transaction and, in most cases, coincided with the transfer of legal title and passing of possession, as set out in IAS 18.15⁵⁷.
- 3.40 Further, as set out at paragraph 3.38, Mr Holgate states that the situation described in IAS 18.16(c) provides an example of where a seller retains significant risks and rewards of ownership, when in fact, this situation is explicitly stated to be an example of where a seller may retain the significant risks and rewards of ownership⁵⁸ and therefore, is not definitive.

IAS 18.14(b) - Entity retains neither continuing managerial involvement nor effective control

- 3.41 In considering this limb of IAS 18.14, Mr Holgate refers to guidance produced by PwC in 2011 on the concepts of control and continuing managerial involvement.⁵⁹

- 3.42 Similarly, PwC’s 2009 Guidance sets out:

“The concept of control is relatively straightforward, since, the definition of an asset in the Framework is: “...a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity”. [Framework para 49]. It follows that if an entity retains effective control over the goods sold, the transaction is not a sale and revenue is not recognised.

“Continuing managerial involvement to the degree usually associated with ownership” is less straightforward, although it is highly unlikely that an entity would retain such involvement without retaining the economic benefits of the asset. Nor is it likely that a buyer would accept continuing involvement where it had acquired the asset for fair consideration. Commercially, continuing involvement to the degree envisaged would not normally occur where a genuine sale has taken place. If it does, it is likely that there are other features of the arrangement that need to be considered.”⁶⁰

⁵⁶ Exhibit BB - IFRS 15.4.

⁵⁷ Exhibit F to my First Report - IAS 18.15.

⁵⁸ Exhibit F to my First Report - IAS 18.16.

⁵⁹ Mr Holgate’s First Report, paragraph 3.39.6.

⁶⁰ Exhibit KK - PwC’s 2009 Guidance, pages 9021 to 9022, paragraphs 9.81 to 9.82.

3.43 In my First Report I set out the potential indicators of continuing managerial involvement or retention of effective control provided by PwC.⁶¹

3.44 Further, I note that PwC's 2009 Guidance provides the following example of "Ongoing involvement":

"Entity A sells a racehorse to entity B. As part of the arrangement entity A continues to house and train the horse, determine which races the horse will enter and set stud fees for the horse. Should entity A recognise revenue on the sale of the horse to entity B?

*If a proper training agreement is in place that provides a market fee for the services that entity A provides and any winnings or fees achieved by the horse going to the buyer, it may be appropriate to recognise revenue on the sale. However, it would also be necessary to consider whether entity A had given any guarantees or incurred other obligations that may indicate it had not disposed of the significant risks and rewards of ownership of the horse."*⁶²

3.45 Clearly, it is difficult to apply this type of situation involving a unique physical asset to a software licence that is an intangible asset that can be infinitely reproduced.

IAS 18.14(d) - Probable that economic benefits will flow to the entity

3.46 When considering the requirement that it is probable that the economic benefits associated with the transaction will flow to the entity (IAS 18.14(d)), Mr Holgate states that while the Claimants' acknowledge that the meaning of the term "probable" in IFRS is taken to mean more likely than not which translates, numerically, to over 50%, in his experience, "entities tend to require a significantly higher probability than 51% before they will consider it appropriate to recognise revenue".⁶³

3.47 I do not agree with Mr Holgate's comment above. As set out in my First Report, "probable" is not defined under IAS 18. There is a definition of "probable" provided in International Accounting Standard 37 'Provisions, Contingent Liabilities and Contingent Assets' ("IAS 37"), but as explicitly noted, the interpretation of this term in IAS 37 does not necessarily apply in other standards.⁶⁴

3.48 International Financial Reporting Standard 5 'Non-current Assets Held for Sale and Discontinued Operations' ("IFRS 5") also defines the term as meaning "More likely than

⁶¹ My First Report, paragraph 4.45.

⁶² Exhibit G to my First Report - PwC's 2009 Guidance, page 9022, "Example 1 - Ongoing involvement".

⁶³ Mr Holgate's First Report, paragraph 3.39.9.

⁶⁴ My First Report, paragraph 4.51.

not” and defines “highly probable” as “Significantly more likely than probable”.⁶⁵ IFRS 5 does not state that the interpretation of “probable” in this standard does not necessarily apply in other standards and is the standard referred to in the IFRS glossary for the term “probable”⁶⁶. IFRS 5 was effective for annual periods beginning on or after 1 January 2005⁶⁷, and, as such, was applicable during the Relevant Period.

3.49 If the standard was intended to convey a threshold higher than “probable”, then it would say so, as it was considered necessary to refer to this higher level of probability in other standards in IFRS, such as IFRS 5.

3.50 Furthermore, PwC’s 2009 Guidance provides a threshold for the term “more likely than not” in relation to the requirements of IAS 37, as follows:

*“‘more likely than not’ means a probability of more than 50 per cent...”*⁶⁸

3.51 I note from the Foreword to PwC’s 2009 Guidance that this view has support from across PwC:

*“...this IFRS Manual of Accounting...gives preparers and practitioners the benefits of the extensive experience and professional judgement of PricewaterhouseCoopers.”*⁶⁹

3.52 The view is consistent with my own experience, including where IFRS “probable” has been contrasted with US GAAP “probable”.⁷⁰

3.53 By referring to “a significantly higher probability than 51%” as the threshold for recognising revenue on the basis that it is considered probable that economic benefits will flow, it seems to me that Mr Holgate is attempting to introduce the meaning of probable as applied in US GAAP.

3.54 Statement of Position 97-2 (“SOP 97-2”) which set out the principles of software revenue recognition in US GAAP throughout the Relevant Period required that revenue was recognised when, among other criteria, “collectability is probable”⁷¹. SOP 97-2 also stated:

*“The term probable is used in this SOP with the same definition as used in FASB Statement No. 5, Accounting for Contingencies.”*⁷²

⁶⁵ Exhibit CC - IFRS 5, Appendix A - Defined Terms (this appendix is noted as being “an integral part of the IFRS”).

⁶⁶ Exhibit LL - glossary of terms in IFRS and the definition of probable.

⁶⁷ Exhibit CC - IFRS 5.44.

⁶⁸ Exhibit KK - PwC’s 2009 Guidance, pages 21016 to 21017, paragraph 21.82.

⁶⁹ Exhibit KK - PwC’s 2009 Guidance, Foreword, page P005.

⁷⁰ For the avoidance of doubt, I am not an expert in, although I have some familiarity with, accounting under US GAAP.

⁷¹ Exhibit MM - SOP 97-2, paragraph 8.

⁷² Exhibit MM - SOP 97-2, footnote 5.

- 3.55 FASB Statement No. 5, 'Accounting for Contingencies' defines probable as "[t]he future event or events are likely to occur".⁷³ In their normal meanings "likely to occur" has a higher threshold than "more likely than not".
- 3.56 Guidance published by PwC in 2014⁷⁴ setting out similarities and differences between IFRS and US GAAP regarding revenue recognition explains that:
- "The term "probable" has a different meaning under US GAAP (where it is generally interpreted as 75-80% likelihood) and IFRS (where it means more likely than not—that is, greater than 50% likelihood)."*⁷⁵
- 3.57 The higher threshold, "likely to occur" was not the threshold required to be met when considering collectability under IAS 18. The correct threshold was "more likely than not".

Principles-based nature of IFRS

Clarification of comments in my First Report

- 3.58 Mr Holgate's view, as set out in the Joint Statement, is that, in commenting on IFRS and the way in which it is applied, I overstate:
- (a) the principles-based nature of IFRS;
 - (b) the extent of discretionary professional judgement;
 - (c) the range of generally accepted accounting practices; and
 - (d) how to react when there is no explicit guidance in IFRS.⁷⁶
- 3.59 As set out in my First Report, IFRS sets out the basic principles of accounting for transactions, rather than specific rules that relate to every situation.⁷⁷ I reiterate my agreement 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'."*⁷⁸

⁷³ Exhibit NN - FASB Statement No. 5, 'Accounting for Contingencies', paragraph 3a.

⁷⁴ I note that while this guidance was not published in the Relevant Period, similar guidance published by PwC in 2010 sets out the same comparison of the term probable (albeit in relation to the recognition of a provision) - Exhibit OO - PwC guidance 'US GAAP, IFRS and Indonesian GAAP similarities and differences, 2010 edition', page 97.

⁷⁵ Exhibit PP - PwC guidance 'IFRS and US GAAP: similarities and differences, October 2014', page 25.

⁷⁶ Joint Statement, page 3, "Mr Holgate's view" on "Agenda Item" 1(b).

⁷⁷ My First Report, paragraph 4.16.

⁷⁸ Mr Welham's Witness Statement, paragraph 56.

3.60 Mr Holgate also appears to agree with this statement as he notes in his first report:

“It is important to note that the requirement is that the accounts should give ‘a true and fair view’, not ‘the true and fair view’. This is widely understood to mean that there may be more than one accounting policy or treatment that is able to result in a true and fair view.”⁷⁹

3.61 However, I would take this opportunity to clarify that my reference to the principles-based nature of IFRS and a range of possible conclusions on the accounting treatment of transactions should not be interpreted as a suggestion that there was latitude for more discretion in determining the appropriate accounting treatment for a transaction than actually existed i.e. it is not my opinion that under IFRS, the range of possible accounting treatments is so wide that any and all accounting treatments could be considered permissible. I simply intended to highlight the fact that it is possible that two accountants may or could treat a transaction differently but this does not mean one is correct and one is not.

3.62 Further, I highlighted in my First Report, that within IFRS generally, IAS 18 was considered to be *“one of the few truly principles-based standards in the IFRS literature”⁸⁰*. The guidance in IAS 18 was general in nature and there was no specific guidance provided on revenue recognition for software-related transactions⁸¹, which resulted in companies that reported under IFRS being able to adopt a relatively wide range of possible approaches⁸² to revenue recognition while still complying with the requirements of the standard. These limitations were noted in IFRS accounting industry guidance produced by the ‘Big 4’ accounting firms, for example:

“IFRSs contain general principles for revenue recognition that apply to all entities. There is limited industry-specific guidance in IFRSs on revenue recognition. For example, there is no specific guidance for the recognition of revenue and costs by entities in the software industry.”⁸³

and

“...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...this very principled-based

⁷⁹ Mr Holgate’s First Report, paragraph 3.10.

⁸⁰ My First Report, paragraph 4.18.

⁸¹ My First Report, paragraph 4.30.

⁸² Relative to the approaches permissible under other standards in IFRS.

⁸³ Exhibit QQ - KPMG’s 2008/9 Guidance, page 791, paragraph 4.2.10.10.

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.”⁸⁴ [emphasis added]

Transition from IAS 18 to IFRS 15

- 3.63 As set out at paragraph 3.58, Mr Holgate’s view is that, in my First Report I have overstated the principles-based nature of IFRS. I have provided clarification of my comments above.
- 3.64 I do not believe that I have overstated the principles-based nature of IFRS, particularly by reference to IAS 18, which, as also noted above, was truly principles based and the result of this limited guidance was the requirement for a higher level of judgement and, consequently, a greater variation of acceptable accounting treatments. An indication of how revenue recognition has moved on from a principles-based approach is the recent transition from IAS 18 to IFRS 15, which I describe below.
- 3.65 IAS 18 was originally issued in December 1993 by the IASB’s predecessor, the IASC and was adopted by the newly constituted IASB in April 2001.⁸⁵ Minor consequential amendments were subsequently made as a result of the issue of new IFRSs⁸⁶. Apart from these, the only substantive change was the addition of an illustrative example in a 2009 amendment, for the determination of whether an entity is acting as a principal or as an agent, the background to which I describe below.
- 3.66 IAS 18 is therefore a relatively old standard, and was developed at a time when accounting standards were typically much shorter, with less precise requirements, than more recent accounting standards. The IASB acknowledged the deficiencies of the requirements in IFRS for revenue recognition as follows:

“In International Financial Reporting Standards (IFRSs), the principles underlying the two main revenue recognition standards (IAS 18 Revenue and IAS 11 Construction Contracts) are inconsistent and vague, and can be difficult to apply beyond simple transactions. In particular, those standards provide limited guidance for transactions involving multiple components or multiple deliverables.”⁸⁷

and

⁸⁴ Exhibit C to my First Report - EY’s 2008 Guidance, page 2070, section 7.12.

⁸⁵ Exhibit F to my First Report - IAS 18, page 1.

⁸⁶ For example, International Financial Reporting Standard 11 ‘Joint Arrangements’ (“IFRS 11”) issued in 2011 and International Financial Reporting Standard 13 ‘Fair Value Measurement’ (“IFRS 13”) issued in 2013.

⁸⁷ Exhibit DD - IASB Discussion Paper ‘Preliminary Views on Revenue Recognition in Contracts with Customers’, dated December 2008, page 7, paragraph S2.

“In IFRSs, diverse revenue recognition practices have arisen because IAS 18 Revenue and IAS 11 Construction Contracts contain limited guidance on some topics and the guidance that is provided can be difficult to apply to complex transactions. Some companies also supplement the limited guidance in IAS 18 by selectively applying US GAAP.”⁸⁸

- 3.67 If, as would appear to be the case, IAS 18 was deficient then a follow on question is why the accounting standard setter did not take action more swiftly to deal with the lack of guidance, and did not take steps to improve IAS 18. The explanation provided was as follows:

“Why not amend IASs 18 and 11?

Making amendments to IASs 18 and 11 would not resolve the fundamental weaknesses in those standards - ie that a company could recognise revenue in different ways depending on which standard it applies. The effect of such inconsistency is pronounced because IFRSs do not clearly distinguish between goods and services and, consequently, it can be difficult to determine whether to account for some transactions in accordance with IAS 18 or IAS 11.

...

Amending IASs 18 and 11 would also not achieve convergence between IFRSs and US GAAP in the recognition of revenue.”⁸⁹

- 3.68 If the IASB has a project to develop a new standard for a particular topic, then it will typically not make any changes to existing guidance (as this guidance is expected to be replaced in the relative short term) or, if it does, will make only very limited changes. This is illustrated for IAS 18 where the only changes made since issuance were those noted at paragraph 3.65 above which were minor.
- 3.69 In relation to the principal/agent example, the amendment to IAS 18 originated from a submission to the IFRS Interpretations Committee (“IFRIC”). While the IFRIC debated whether it should issue an Interpretation⁹⁰ it ultimately concluded that it should not⁹¹ and instead referred the issue to the IASB for consideration⁹². The IASB subsequently discussed

⁸⁸ Exhibit EE - IFRS Revised Exposure Draft, ‘Snapshot: Revenue from Contracts with Customers’ dated November 2011, page 2.

⁸⁹ Exhibit EE - IFRS Revised Exposure Draft, ‘Snapshot: Revenue from Contracts with Customers’ dated November 2011, page 3.

⁹⁰ Exhibit FF - IASB IFRIC Update, May 2007, page 3, ‘IAS 18 - Revenue - Guidance on identifying agency arrangements’.

⁹¹ Exhibit GG - IASB IFRIC Update, July 2007, pages 4 to 5, ‘Tentative agenda decisions - IAS 18 - Revenue Recognition - Guidance on identifying agency arrangements’.

⁹² Exhibit HH - IASB IFRIC Update, September 2007, page 3, ‘IFRIC agenda decisions - IAS 18 - Revenue - Guidance on identifying agency arrangements’.

the request at its October 2007 meeting and directed the staff to develop high level guidance based on existing guidance issued in some jurisdictions⁹³ (for example, US GAAP).

- 3.70 By putting the project into the Annual Improvements project, the IASB acknowledged that the change to the Appendix was narrow in scope and relatively minor. The IASB's archive website notes that:

*"The Annual Improvements project contains amendments to IFRS Standards or Interpretations that are minor or narrow in scope that are packaged together and exposed in one document even though the amendments are unrelated. These amendments are limited to changes that either clarify the wording in an IFRS or correct relatively minor unintended consequences, oversights or conflicts between existing requirements of IFRS Standards. Because of their nature, it is not necessary to undertake consultation or outreach for annual improvements beyond the comment letter process."*⁹⁴

- 3.71 In my First Report I set out that IAS 18 was eventually replaced by IFRS 15 for annual reporting periods beginning on or after 1 January 2018.⁹⁵ The following reasons were provided for issuing IFRS 15:

*"Previous revenue recognition requirements in IFRS provided limited guidance and, consequently, the two main revenue recognition Standards, IAS 18 and IAS 11, could be difficult to apply to complex transactions. In addition, IAS 18 provided limited guidance on many important revenue topics such as accounting for multiple-element arrangements."*⁹⁶

- 3.72 When IFRS 15 was issued in May 2014, there was a substantial period of time allowed before it was required to be adopted, which was for annual reporting periods beginning on or after 1 January 2017, subsequently extended to 1 January 2018 after clarifications were made to IFRS 15.⁹⁷

- 3.73 In setting the effective date, the IASB acknowledged in the Basis for Conclusions to IFRS 15 that the new requirements would bring potentially very significant changes to the accounting by some entities. These significant changes also illustrate that a significantly wider range of approaches could have been followed under IAS 18 than under IFRS 15. Again, this illustrates the weakness of IAS 18.

⁹³ Exhibit II - IASB Update, October 2007, page 3, 'Annual improvements process - Determining whether an entity is acting as a principal or as an agent'.

⁹⁴ Exhibit JJ - IFRS Website - Annual Improvements to IFRS - <http://archive.ifrs.org/Current-Projects/IASB-Projects/Annual-Improvements/Pages/Annual-Improvements-Landing.aspx>.

⁹⁵ My First Report, paragraph 4.20.

⁹⁶ Exhibit BB - IFRS 15.IN4. While this standard was not in effect in the Relevant Period, it refers to the revenue standards in IFRS at the time.

⁹⁷ Exhibit BB - IASB 'Effective Date of IFRS 15', page 1.

3.74 IFRS 15 states:

“...many respondents, including respondents in industries for which there could be significant process and systems changes required to comply with IFRS 15 (for example, in the telecommunication and software industries), indicated that the proposed formula [an effective date of 1 January 2016] would not provide them with adequate time...”⁹⁸

and

“The boards [IASB and FASB] acknowledged that the period of time from which IFRS 15 is issued until its effective date is longer than usual. However, in this case, the boards decided that a delayed effective date is appropriate because of the unique attributes of IFRS 15, including the wider range of entities that will be affected and the potentially significant effect that a change in revenue recognition has on other financial statement line items.”⁹⁹

3.75 Based on the comments set out above, I do not believe that I have overstated the principles-based nature of IFRS, particularly by reference to IAS 18 and the substantial judgement required to apply this standard to software-related transactions in particular. The reasons provided by the IASB for the issuance of a new standard on revenue recognition highlight the fact that IAS 18 contained limited guidance and that companies reporting under IFRS could adopt a relatively wide range of possible approaches to revenue recognition, while still complying with the requirements of the standard.

3.76 However, despite the limited guidance in IAS 18, it is not appropriate for Mr Holgate to give any consideration, whether explicitly or implicitly, to the subsequent revenue recognition guidance contained in IFRS 15 to remedy any deficiencies in IAS 18 when considering transactions carried out between 2009 and 2011. What is relevant to the accounting treatment of these transactions is what was accepted, or acceptable, generally at the relevant time in the reporting jurisdiction.

⁹⁸ Exhibit D to my First Report - IFRS 15.BC447.

⁹⁹ Exhibit D to my First Report - IFRS 15.BC450.

4 HARDWARE SALES AND DISCLOSURES

Introduction

4.1 In chapter 4 of Mr Holgate's First Report, Mr Holgate considers "*the various accounting issues that arise in relation to Autonomy's hardware transactions*".¹⁰⁰ Mr Holgate states that he has been asked to consider four issues in this regard as follows:

- (a) the reporting of hardware sales in Autonomy's published information;
- (b) the allocation of hardware costs between COGS and sales and marketing expenses;
- (c) disclosure of the accounting policy in relation to hardware costs allocation; and
- (d) the Morgan Stanley hardware transaction.

4.2 I consider each of these in turn, with the disclosure and cost allocation issues considered in this section, and the Morgan Stanley hardware transaction in section 5 of this report.

4.3 As is the case throughout Mr Holgate's First Report, Mr Holgate has been asked to make a number of assumptions including in relation to the issue of hardware sales. The assumptions Mr Holgate has been asked to proceed upon in relation to hardware sales are as follows:

- (a) "*Insofar as relevant to any consideration of paragraph 32 of IFRS 8, please assume that information relating to the revenues from Autonomy's hardware sales was available.*"¹⁰¹;
- (b) "*Please assume that Schedule 1 to the draft Re-Re-Amended Particulars of Claim ("RRAPoC") is accurate.*"¹⁰²; and
- (c) "*Please assume, for the purposes of the [Morgan Stanley hardware transaction], the following:*

3.3.1 *In Q2 2009 Autonomy recognised US\$6 million of revenue in relation to a sale by Autonomy Inc of hardware to Morgan Stanley pursuant to an agreement dated 30 June 2009.*

3.3.2 *The (Hitachi) hardware that was sold to Morgan Stanley pursuant to the 30 June 2009 agreement was, contrary to a representation given to Deloitte by Autonomy management, despatched to Morgan Stanley during August and September 2009, and thus in Q3 2009 rather than Q2 2009.*"¹⁰³

¹⁰⁰ Mr Holgate's First Report, paragraph 4.1.

¹⁰¹ Mr Holgate's First Report, Appendix 2, page 5.

¹⁰² Mr Holgate's First Report, Appendix 2, page 5.

¹⁰³ Mr Holgate's First Report, Appendix 2, page 5.

- 4.4 I refer to these as necessary throughout the remainder of this section, and in regard to the Morgan Stanley transaction in section 5 of this report.

Reporting of hardware sales in Autonomy's published information

- 4.5 In my First Report, I concluded that sales of hardware did not need to be separately or individually, disclosed, either under IAS 18.35 or IFRS 8.32. I remain of that opinion after considering Mr Holgate's First Report. I note Mr Holgate refers also to IAS 1, and I now consider IAS 1 in this section. My comments in this section in respect of IAS 18 and IFRS 8 are made in response to Mr Holgate's opinions on those accounting standards.
- 4.6 In support of my opinion, I now also exhibit other examples of published financial statements for software companies who reported their financial results during the period 2009-2011 under IFRS in the same way as Autonomy. These software companies clearly confirmed that they sold hardware alongside software, but, like Autonomy, did not make any such hardware sales disclosures of the type that Mr Holgate indicates that Autonomy was required to. I consider these in further detail below.
- 4.7 Mr Holgate's First Report states that, in his view, IAS 18, IAS 1 and IFRS 8 required Autonomy "to disclose its hardware sales separately in its annual financial statements if they were material"¹⁰⁴. I consider this opinion only by reference to Autonomy's 2009 and 2010 Consolidated Financial Statements, as I understand Mr Holgate to acknowledge that no disclosures in relation to hardware sales would be required in any quarterly or interim financial statements.¹⁰⁵
- 4.8 As a preliminary point, I note that Mr Holgate states that:
- "The remaining sources reviewed (that is the 2006 Act, the Code and the DTR) would also strongly suggest that disclosure of the hardware sales should have been given, but in my view those requirements are not sufficiently specific as to require such disclosure."*¹⁰⁶
- 4.9 On the basis that Mr Holgate clearly confirms the position that such other reporting frameworks are also not sufficiently specific enough to require such disclosure (even if Mr Holgate contends by his "strongly suggest" such disclosures could have been made), I do not comment further on the requirements of these sources except to make a general observation, which in my opinion is extremely relevant to this issue.

¹⁰⁴ Mr Holgate's First Report, paragraph 4.6.

¹⁰⁵ Mr Holgate's First Report, paragraphs 4.26 and 4.27.

¹⁰⁶ Mr Holgate's First Report, paragraph 4.7.

- 4.10 This is the observation, confirmed by Mr Holgate in the Joint Statement¹⁰⁷, that he does not consider any of the Deloitte year end audit or quarterly review working papers. I referred to these in my First Report at section 7 of this report.
- 4.11 To put the issue in context, consideration of these audit and review working papers is needed. If Mr Holgate had considered them, he would have observed that Deloitte considered whether disclosure of the hardware sales would be appropriate. Ultimately - as Mr Holgate also does in relation to all but Autonomy's 2009 and 2010 Consolidated Financial Statements - Deloitte concluded that the overall accounting standard disclosure requirements were not sufficiently specific enough as to require Autonomy to make disclosure of hardware sales and separately costs, including (and contrary to Mr Holgate's opinion) in the context of the disclosures within Autonomy's 2009 and 2010 Consolidated Financial Statements. If that were not the case, the result, in the absence of such disclosure by Autonomy, could have been a Deloitte qualification of the respective audit opinion.
- 4.12 To put this another way, while the disclosure of hardware sales could have been made voluntarily, the relevant accounting standards did not make disclosure of such hardware related information compulsory.
- 4.13 Concerning the cost allocations that I discuss in more detail later on in this section, again a different allocation and disclosure could have been made voluntarily, but again the relevant accounting standards did not make disclosure of such hardware related information compulsory.

Reporting of hardware sales: IAS 18 'Revenue'

- 4.14 Mr Holgate references IAS 18.35¹⁰⁸, which I set out in full in my First Report¹⁰⁹. For ease of reference, the relevant extract of IAS 18.35, quoted by Mr Holgate, is as follows:
- “(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 ...”¹¹⁰
- 4.15 Mr Holgate considers that “sales of hardware are ... significantly different in their nature and economic effect from other sales of 'goods' such as software”¹¹¹. On this basis,

¹⁰⁷ Joint Statement, page 1, point 2.

¹⁰⁸ Mr Holgate's First Report, paragraph 4.5.1.

¹⁰⁹ My First Report, paragraph 7.11.

¹¹⁰ Exhibit F to my First Report - IAS 18.35.

¹¹¹ Mr Holgate's First Report, paragraph 4.5.1.

Mr Holgate considers that, in his view, sales of hardware are “*significant*” enough to require separate disclosure.¹¹²

- 4.16 I do not agree with this interpretation of IAS 18.35. As set out in my First Report, in my opinion, the category “*the sale of goods*” is solely that, one of the five types of defined revenue referred to in IAS 18.¹¹³ Disclosure by category of revenue entails disclosure of the overall sale of all goods (if significant), there being no additional requirement under IAS 18 for it to be broken down further.¹¹⁴
- 4.17 This is irrespective of whether hardware sales are “*significantly different*” from software sales as Mr Holgate asserts and relies upon, contrary to the disclosure of revenue category only included in the accounting standard itself. I have seen no guidance to indicate that the disclosures required under IAS 18.35 are required to be made at sub-level categories below the five categories listed in IAS 18.35.
- 4.18 In addition, again as set out in my First Report, Autonomy’s disclosure in this regard was audited/reviewed by Deloitte and unqualified audit and/or review opinions were issued throughout the Relevant Period.¹¹⁵

Reporting of hardware sales: IAS 1 ‘Presentation of financial statements’

- 4.19 Mr Holgate also references IAS 1.29¹¹⁶ which states as follows:
- “An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.”*¹¹⁷
- 4.20 I deal with this below as follows:
- (a) IAS 1 is a presentational accounting standard dealing with the basis for presentation of general purpose financial statement; other IFRSs deal with disclosure requirements for specific transactions and events;
 - (b) The dissimilarity of hardware sales, and the issue of classification of ‘nature’ and ‘function’ in IAS 1; and
 - (c) Materiality and aggregation (in IAS 1).

¹¹² Mr Holgate’s First Report, paragraph 4.5.1.

¹¹³ My First Report, paragraphs 7.15.

¹¹⁴ My First Report, paragraphs 7.15.

¹¹⁵ My First Report, paragraph 7.20.

¹¹⁶ Mr Holgate’s First Report, paragraph 4.5.2.

¹¹⁷ Exhibit P to my First Report - IAS 1.29.

IAS 1 as a presentational accounting standard

- 4.21 I did not address IAS 1 in my First Report because it is a presentation standard concerned with the overall presentation of financial statements rather than concerned with, specifically, disclosure stipulations.
- 4.22 Having reached, as I did, the conclusion that disclosure of hardware sales did not require its own disclosure under the much more specific requirements of either IAS 18 or IFRS 8, then in my experience, it follows that compliance with specific financial reporting standard disclosure obligations is sufficient for the purposes of meeting IAS 1 presentation requirements. This is also clear from the text of IAS 1. As stated at IAS 1.17¹¹⁸, in virtually all circumstances, an entity achieves a fair presentation by compliance with applicable IFRSs.
- 4.23 IAS 1 also does not contain disclosure requirements for specific transactions and events. This is because the disclosure requirements in IAS 1 are 'entity wide'.
- 4.24 The entity wide requirements mean that, for example, in addition to the disclosure of accounting policies (IAS 1.117 onwards), there are requirements for the disclosure of judgements that have been made in applying the accounting policies (IAS 1.122), as well as disclosures pertaining to the sources of estimation uncertainty (IAS 1.125 onwards).
- 4.25 As noted above at paragraph 4.22, as per IAS 1.17¹¹⁹, in virtually all circumstances, an entity achieves a fair presentation by compliance with applicable IFRSs, and whereas the remainder of the same paragraph does refer to a non-entity wide disclosure, that is for the circumstance where there is no IFRS that specifically applies to an item, which is not the case here where IAS 18 and IFRS 8 specifically apply.
- 4.26 Similarly, IAS 1 is defined by its objective in paragraph 1¹²⁰.
- 4.27 Paragraph 1 confirms that IAS 1 prescribes the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. In particular, paragraph 1 then confirms that IAS 1 sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. What IAS 1 does not do is stipulate the accounting for specific transactions or events.

¹¹⁸ Exhibit P to my First Report - IAS 1.17.

¹¹⁹ Exhibit P to my First Report - IAS 1.17.

¹²⁰ Exhibit P to my First Report - IAS 1.1.

4.28 In this context, IAS1 paragraphs 2 and 3 state that:

“An entity shall apply this Standard in preparing and presenting general purpose financial statements in accordance with International Financial Reporting Standards (IFRSs).” (IAS 1 paragraph 2)

“Other IFRSs set out the recognition, measurement and disclosure requirements for specific transactions and other events.” (IAS 1 paragraph 3)

Dissimilarity of hardware sales - the issue of nature and function

4.29 Notwithstanding my consideration as laid out above, by contrast Mr Holgate concludes that hardware sales *“are dissimilar from sales of software and of services”* and so should have been separately disclosed if they were a material class of revenue.¹²¹

4.30 However, in distinction to Mr Holgate’s view, IAS 1 does not define similar (or dissimilar) items for the purposes of paragraph 29 of IAS 1. This contention by its character is therefore a matter of accounting judgement.

4.31 By way of illustration, whereas Mr Holgate does not elaborate on his reasoning for concluding that hardware sales are *“dissimilar”* from other sales under IAS 1.29 he does state earlier in his chapter 4 that *“sales of hardware are, in my view, significantly different in their nature and economic effect from other sales of ‘goods’ such as software”*¹²² [emphasis added].

4.32 On this basis, I would understand that Mr Holgate’s conclusion that hardware sales are not similar to Autonomy’s other sales to be based simply on his own judgement, including his assessment of their ‘nature’. He points to no standard or accounting rule on this point, and separately in any event, the ‘nature’ to which he refers, is not the same as the issue of ‘nature’ referred to in IAS 1.

4.33 By way of explanation of this point, IAS 1 deals expressly with the explanation of ‘nature’ and ‘function’ (in the context of IAS 1) in IAS 1.102 and IAS 1.103. The clear implication being that when IAS 1.29 talks about disclosure under IAS 1 by ‘nature or function’, it is with reference to the level of aggregation set out in IAS 1.102 and IAS 1.103. If a greater degree of analysis is required over and above what is determined to be their ‘nature or function’ in the context of IAS 1, then that analysis will be required in the context of any specific standards that apply (in this case IAS 18 and/or IFRS 8). This explanation is

¹²¹ Mr Holgate’s First Report, paragraph 4.5.2.

¹²² Mr Holgate’s First Report, paragraph 4.5.1.

different from Mr Holgate's use of the word 'nature' when he says that 'sales of hardware are, in my view, significantly different in their nature and economic effect'.¹²³

4.34 Accordingly, in my view, Mr Holgate's adaptation of IAS 1.29 for his own purposes is based on his own judgement, and his own assessment of their nature, outside of the meaning of that term in IAS 1.29, and the wider IAS 1.

4.35 This can also be shown further.

4.36 For example, in the context of the statement of financial position, IAS 1.59 refers to the use of different measurement bases for different classes of assets as being suggestive that their 'nature' or 'function' would differ, and hence separate line item presentation be required.¹²⁴

Materiality and aggregation (in IAS 1)

4.37 Similarly, in respect of the statement of profit or loss which is addressed from IAS 1.81 onwards, IAS 1.97 states that when items of income or expense are material, an entity shall disclose their nature and amount separately, with a number of examples of circumstances of separate disclosure of items of income and expense then laid out in IAS 1.98.¹²⁵

4.38 However, none of the items laid out in IAS 1.98 identifies a requirement to disclose different categories of income, either explicitly or implicitly. That is because that requirement is more specifically considered in IAS 18 (and hence not required under the higher level presentational issues to which IAS 1 applies).

4.39 Notwithstanding the above though, and even if I am wrong regarding what Mr Holgate means when referring to a compliance required under IAS 1.29 in terms of hardware sales, then I would still further disagree with Mr Holgate's reliance on IAS 1.29 for a second reason.

4.40 This is because at the time of the Relevant Period the guidance in IFRS for materiality in IAS 1.29 was regarded generally as vague, and hence could be poorly applied during this period, while still resulting in compliance with IFRS; and the best way to explain this is by reference to what subsequently happened to IAS 1 in 2016.

¹²³ For the avoidance of doubt, in any event during the Relevant Period Autonomy presented its financial statements under IAS 1 using a function of expense approach, with for example expense classifications on the face of its financial statements rather than separately in the notes to those financial statements.

¹²⁴ Exhibit P to my First Report - IAS 1.59.

¹²⁵ Exhibit P to my First Report - IAS 1.97 and 1.98.

- 4.41 Effective for annual periods commencing on or after 1 January 2016, the IASB amended IAS 1 with the addition of IAS 1.30A.
- 4.42 In response to widespread comments about the length and complexity of many IFRS financial statements, and the difficulties that users could have in understanding them, the IASB added a Disclosure Initiative Project to its agenda. As part of this, the IASB held a ‘Discussion Forum - Financial Reporting Disclosure’ in January 2013. A number of the observations made at that Discussion Forum focussed on the fact that the guidance on materiality in IFRS was not clear, meaning that materiality might not have been applied well in practice.
- 4.43 As a result, paragraph 30A was added to IAS 1.
- 4.44 IAS 1.30A added the following text:
- “When applying this and other IFRSs an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements, which includes the notes. An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information, or by aggregating material items that have different natures or functions.”¹²⁶*
- 4.45 By making this addition to IAS 1, the IASB was explicitly acknowledging that additional guidance was needed for the application of materiality in the context of the immediately preceding paragraphs (i.e. including IAS 1.29), and that it had been possible for a range of views to be taken about the extent to which information - by its nature or function - should be combined or disaggregated in financial statements.

Reporting of hardware sales: IFRS 8 ‘Operating segments’

- 4.46 Mr Holgate references IFRS 8.32¹²⁷, which requires an entity to “*report the revenues from external customers for each product and service, or each group of similar products and services*”¹²⁸. I set out this paragraph in full in my First Report^{129 130}.
- 4.47 On the basis of IFRS 8.32, Mr Holgate’s view is that:

¹²⁶ Exhibit RR - IAS 1.30A.

¹²⁷ Mr Holgate’s First Report, paragraph 4.5.3.

¹²⁸ Exhibit T to my First Report - IFRS 8.32.

¹²⁹ My First Report, paragraph 7.35.

¹³⁰ IFRS 8.32 allows for an exemption to the required disclosure where the necessary information is not available. Mr Holgate has assumed that the relevant information was available (see paragraph 4.3 above). This is a matter of fact on which I do not express an opinion. However, for the purposes of this section of my report, I also adopt this assumption.

“Given that hardware was dissimilar to Autonomy’s other products and services, this provision of IFRS 8 clearly requires, in my view, separate disclosure of revenues from sales of hardware if the information was available (which I am asked to assume it was) and the sales were material (which I discuss below).”¹³¹

- 4.48 As IFRS 8 does not define similar (or dissimilar) products for the purposes of paragraph 32, this is again a matter of judgement. As was the case in paragraph 4.31 above, Mr Holgate does not elaborate on his reasoning for concluding that hardware was “*dissimilar*” under IFRS 8.32 but from the comments at paragraph 4.5.1 of Mr Holgate’s First Report I understand this to be based on his own judgement. Again, he points to no standard or accounting rule on this point.
- 4.49 Again, therefore, I consider that based on the same facts, different judgements could be reached by different accountants in relation to this issue. In particular, as set out in detail in paragraphs 7.40 to 7.58 of my First Report, both Autonomy and Deloitte considered that hardware sales were not a different product or service requiring separate disclosure under IFRS 8.32.

Reporting of hardware sales: materiality

- 4.50 I have already touched on the issue of materiality in the context of IAS 1.29 above.
- 4.51 In paragraphs 4.8 to 4.18 of Mr Holgate’s First Report, Mr Holgate discusses whether the hardware sales were material to Autonomy. I considered the concept of materiality in paragraphs 4.94 to 4.98 of my First Report including setting out the relevant paragraphs from the Framework and the subsequent Conceptual Framework.
- 4.52 Mr Holgate also references IAS 1.7, which states:

“Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement, judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.”¹³²

¹³¹ Mr Holgate’s First Report, paragraph 4.5.3.

¹³² Exhibit P to my First Report - IAS 1.7.

4.53 Mr Holgate sets out three tables (A, B and C) in relation to Autonomy's hardware sales which he states:

*"... taken together, demonstrate that information about sales of hardware was 'material' in the sense described in IAS 1 and the Conceptual Framework (as well as the 1989 Framework)."*¹³³

4.54 Mr Holgate continues:

*"In my view, the sales of hardware became material from Q3 2009 and should have been disclosed in the 2009 and 2010 annual financial statements ... This view is based on: the absolute amounts of hardware sales, the amounts of hardware sales relative to total revenues, the significant effect that hardware sales have on growth percentages, the vastly different gross profit percentages on hardware and software and the fact that Autonomy continued to describe itself as a pure software company ..."*¹³⁴

4.55 Mr Holgate concludes as follows:

*"... in my view, information about Autonomy's sales of hardware not only 'could' have influenced the decisions of users, but would have done so."*¹³⁵[original emphasis]

4.56 I am unclear on what basis Mr Holgate is able to make this last comment. It seems to me to go beyond the accounting concept of materiality into an area of fact.

4.57 Regarding the issue of materiality, I note that Mr Holgate does not specify the level/s of materiality he is applying when reaching his conclusions. As set out in my First Report:

*"Judgement is necessarily required [when considering materiality], given that IFRS does not specify how a materiality threshold should be arrived at."*¹³⁶

4.58 For the avoidance of doubt I do, however, add to my opinions on materiality in general, and in respect of hardware specifically, in response to matters arising in Mr Holgate's First Report.

4.59 Notwithstanding this, I remain of the opinion that based on the same facts, different judgements could be reached by different accountants in relation to this issue. Had Mr Holgate considered Deloitte's year end audit and quarterly review working papers he would have understood that Deloitte was aware of all the factors to which Mr Holgate¹³⁷

¹³³ Mr Holgate's First Report, paragraph 4.17.

¹³⁴ Mr Holgate's First Report, paragraph 4.17.

¹³⁵ Mr Holgate's First Report, paragraph 4.17.

¹³⁶ My First Report, paragraph 4.98.

¹³⁷ For background, I note that one of the Claimant's witnesses of fact, Mr Welham, was part of the Deloitte audit team, and was involved in the discussions at the time in relation to these same disclosure issues.

now refers but reached a different conclusion as regards the sales being material to Autonomy (as Mr Holgate does now, seven to nine years later).

4.60 A working paper prepared during the course of the 2010 year end audit stated:

“Since Q3 2009, Autonomy has been selling hardware products at an overall loss as part of a wider strategic move to secure additional licence revenue from major Digital Safe customers. The level of these sales has continued to increase on a quarterly basis and now contribute approximately 12% of the group’s revenue in FY 2010.”¹³⁸

4.61 This is just one small example of Autonomy’s disclosure being audited, reviewed and considered by Deloitte in the presence of the relevant facts. Other examples are provided in my First Report.

4.62 On the basis of the relevant facts disclosed to Deloitte and discussed at the time, Deloitte issued unqualified audit and/or review opinions throughout the Relevant Period.

4.63 Of course, it is open to Mr Holgate to hold a contrary opinion, since it is a matter of judgement, but it appears to me that Deloitte was in possession of all material information in respect of the hardware sales, notwithstanding the assumption Mr Holgate is instructed to make.

Example IFRS software company hardware disclosures

4.64 To put the above into some further context, in respect of the disclosure of sales of hardware, it is also possible to demonstrate first hand that the technical issues and accounting judgements are not anywhere near as clear cut as Mr Holgate asserts.

4.65 I refer here to a 2010/11 PwC published survey entitled ‘Global Software Leaders, Key players and market trends’, which appears to me to rank software selling companies based on revenues from around 2008, although it is not clear how the revenue figures used to rank the software selling companies are compiled. Autonomy is one of the companies listed in the survey.¹³⁹

4.66 I have reviewed a number of the 2010 financial statements of the IFRS reporting entities identified in this survey and comment as follows.

4.67 The survey identified the leading software companies globally, and regionally. In the UK, The Sage Group plc (“Sage”) was recognised as the largest software vendor in the UK, and the second largest software vendor in Europe.

¹³⁸ {POS00168126}, page 6.

¹³⁹ Exhibit VV.

Sage

4.68 In Sage's financial statements to the year ended 30 September 2010¹⁴⁰, it is clear that Sage sold hardware alongside software. Relevant aspects of Sage's revenue recognition policy was disclosed as follows:

“Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes.

The Group reports revenue under two revenue categories:

- Subscription revenues, which are recurring in nature and include combined software/support contracts, maintenance and support, transaction services (payment and health insurance claims processing) and hosted products; and*
- Software and software-related services revenue, which includes software licences, sale of professional services, business forms, hardware and training.*

...

Other products (which includes business forms and hardware) - revenue is recognised as the products are shipped.”¹⁴¹

4.69 So clearly, as outlined above, Sage recognised hardware as part of “software revenues” (i.e. software related services) and “other products”.

4.70 In its 2010 financial statements, Sage disclosed that it adopted IFRS 8 for the first time. According to Sage's 2010 financial statements IFRS 8 “replaced IAS 14, “Segment Reporting”, and aligns operating segments reported to those segments reported internally to senior management. The basis for the segments under IFRS 8, is set out in note 1. The standard does not change the recognition, measurement, or disclosure of transactions in the consolidated financial statements.”¹⁴² It also disclosed that total revenues for software and software related services were £481.5m and total subscription revenues were £953.5m¹⁴³, and that “the operating segments are reported in a manner which is consistent with the operating segments produced for internal management reporting”.¹⁴⁴

4.71 Hardware was also sold by Sage in the year to 30 September 2009.¹⁴⁵

¹⁴⁰ Exhibit TT.

¹⁴¹ Exhibit TT - pages 67-68.

¹⁴² Exhibit TT - pages 72-73.

¹⁴³ Exhibit TT - page 74.

¹⁴⁴ Exhibit TT - page 72.

¹⁴⁵ Exhibit UU - see for example page 64.

- 4.72 As noted above, Sage described hardware in its revenue recognition policy as a ‘product’, and separately noted that such product revenue was recognised when the product was shipped.
- 4.73 Sage’s 2010 financial statements were audited by PwC (UK), who confirmed that they were properly prepared in accordance with IFRSs as adopted by the European Union.¹⁴⁶
- 4.74 Sage’s segment information note was set out at note 1 to Sage’s 2010 financial statements.¹⁴⁷ Sage’s 2010 financial statements do not disclose any split out of sales revenue for products and services below the identified segment level of respectively ‘subscription revenues’ and ‘software and software-related services revenue’.
- 4.75 There is also no disclosure that the information relating to below segment level revenues for products and services was not available or that the cost to develop it too excessive. Sales revenue is however split out by geographical areas, consistent with IFRS 8.33, another of the IFRS 8 entity-wide disclosures.
- 4.76 In other words, Sage made no separate disclosures in conformance with IFRS 8.32, notwithstanding that it identified that it sold hardware as part of its software-related services.
- 4.77 In many aspects, Sage applied the same approach to its IFRS 8 disclosures when adopting IFRS 8 as Autonomy did, and though it also sold hardware (but labelled it as ‘software and software-related services revenue’), it did not separately disclose hardware product revenue. It did note that its operating segment disclosures were consistent with the manner of information produced for internal management, and did separately disclose entity-wide geographical information (as Autonomy did).

Logica

- 4.78 In the same PwC 2010 survey ‘Global Software Leaders, Key players and market trends’, Logica plc (“Logica”) was ranked as the eighth largest European software vendor by software revenue, and fourth largest in the UK.¹⁴⁸ Despite being identified by PwC as a global software leader, its software sales represented less than 7% of its total revenue according to the same survey.
- 4.79 Logica, like Sage, prepared its financial statements under IFRS and was audited by PwC.
- 4.80 Logica’s financial reporting period was to 31 December, and its 2009 financial statements confirmed that in the year to 31 December 2009 Logica adopted IFRS 8.

¹⁴⁶ Exhibit TT - page 108.

¹⁴⁷ Exhibit TT - pages 74-77.

¹⁴⁸ Exhibit VV - PwC 2010 Survey.

- 4.81 Like Sage, Logica also disclosed in its revenue recognition accounting policy that it sold hardware.
- 4.82 In its revenue and profit recognition accounting policy note, Logica states that it generates revenue from the supply of consulting and professional services, software and hardware products, and that “*the Group may ... source software and hardware products*” as part of its contracts. Further, revenue from hardware is recognised, inter alia, on delivery or a percentage of completion method where modification, integration or customisation is required.¹⁴⁹ In the same accounting policy note Logica disclosed that the main components within the Group’s contracts are product sales and contracts to supply professional services.
- 4.83 Like Sage (and Autonomy), Logica identified its operating segments as being reported in a manner consistent with the operating segments produced for internal management reporting.¹⁵⁰ As in the case of Sage, Logica identified these as geographical segments.
- 4.84 In Logica’s accounting note relating to segment information, it does include separately an ‘analysis of revenue by product and services’. This is broken down into ‘sales of goods’ and ‘revenue from services’.¹⁵¹
- 4.85 This note, however, (in the relevant part) appears to be a mixture of the requirements of IFRS 8.32 and IAS 18.35, in that it refers in its title to ‘analysis of revenue by product and services’ (IFRS 8), but in the actual disclosure refers to ‘sales of goods’ and ‘revenue from services’ (IAS 18). Nowhere, though, do Logica’s 2009 financial statements disclose sales of hardware separately.
- 4.86 The same is true for Logica’s 2010 financial statements.¹⁵²
- 4.87 Logica in its successive 2009 and 2010 financial statements disclosed together the combined revenue from its separate software and hardware product sales, for the purpose of its IFRS 8 disclosures.
- 4.88 These examples of other entity IFRS 8 disclosures, again suggest to me, that at least when first implemented, the entity-wide IFRS 8 disclosures were the subject of a range of approaches and disclosure judgements.

¹⁴⁹ Exhibit WW - Logica 2009, page 85.

¹⁵⁰ Exhibit WW - Logica 2009, page 86.

¹⁵¹ Exhibit WW - Logica 2009, page 89.

¹⁵² Exhibit XX - Logica 2010.

- 4.89 Autonomy's absence of a IFRS 8.32 disclosure relating to hardware product sales separately disclosed from software product sales¹⁵³ appears not to have been an uncommon or exceptional approach for UK IFRS-reporting entities selling both software and hardware products.
- 4.90 In addition, on the one-hand Sage disclosed that it recognised the sale of hardware within 'services', whereas Logica appeared to recognise the sale of hardware within 'products', which in turn appears to be within sales of goods. As a result, these further examples, in my view, suggest that different approaches and disclosure judgements were acceptable during the Relevant Period, and Autonomy was by no means out of the ordinary in not disclosing separately sales of hardware.

Misys

- 4.91 For fullness, I also highlight the range of disclosure practices evidenced from this period (from software selling companies similarly identified in the PwC survey and reporting financial statements under IFRS 8).
- 4.92 Across the range of practice, it appears to me that in other cases disclosures made regarding an entities' revenue streams and/or revenue by products and services appear to include the disclosure of immaterial matters. This would be too much disclosure and is the other side of the subsequent amendment requirement to IAS 1 (i.e. IAS 1.30A, for which see paragraph 4.44).
- 4.93 Misys plc ("Misys") first adopted IFRS 8 in its financial statements for the year ended 31 May 2010.¹⁵⁴ Misys was ranked in the PwC survey as the fifth largest software seller in Europe, and the second largest in the UK.
- 4.94 Misys' segmental reporting accounting policy note noted its segmental analysis was by business sector and that the business sectors were defined by distinctly separate product offerings or markets e.g. Allscripts, Banking, or Treasury and Capital Markets.¹⁵⁵
- 4.95 Separately, the revenue recognition accounting policy note listed out the revenue recognition policies for all different revenue streams, including sales of hardware.¹⁵⁶ A comparison against the Misys 2009 financial statements shows that in general terms the

¹⁵³ Where according to Mr Holgate, in the context of his overall opinions on the issue, sales of hardware would be significantly different in their nature and economic effect from other sales of 'goods' such as software such as to require disclosure.

¹⁵⁴ Exhibit YY - Misys 2010 financial statements, page 76.

¹⁵⁵ Exhibit YY - Misys 2010 financial statements, page 83.

¹⁵⁶ Exhibit YY - Misys 2010 financial statements, page 78.

segmental disclosures did not change in format between the two years irrespective of the changing segmental reporting IFRS requirements.

- 4.96 In Misys' 2010 financial statements, notwithstanding the adoption for the first time of IFRS 8, in the segmental analysis note, disclosures relating to revenue streams, by segment, were included. Hardware revenue in the year to 31 May 2010 was disclosed as being £27.8 million out of total revenue of £782.3 million, equivalent to less than 3.6% of total revenue, and £20.0 million out of £692.4 million in the year to 31 May 2009, or approximately 2.9% of the total annual revenue for the year.
- 4.97 As the apparent opposite of the disclosure approach taken by Sage, Logica, and Autonomy, Misys's approach was to include potentially immaterial disclosures.
- 4.98 By way of illustration, according to Mr Holgate, Autonomy's sales of hardware were material from Q3 2009 onwards¹⁵⁷, but not in Q2 2009. In Q2 2009, sales of hardware by Autonomy represented 3.2% of total quarterly revenue. Thereafter, the lowest quarterly amount they represented was 4.1% in Q4 2009.¹⁵⁸ In other words, the hardware disclosures made by Misys in its 2010 financial statements segmental analysis note would have been of the order of magnitude regarded as immaterial by Mr Holgate and therefore not requiring of separate disclosure.

Reporting of hardware sales: conclusions

- 4.99 In my First Report, I concluded that sales of hardware did not need to be separately or individually disclosed, either under IAS 18.35 or IFRS 8.32. I remain of that opinion after considering Mr Holgate's First Report.
- 4.100 I note Mr Holgate refers also to IAS 1. In my opinion, the references to IAS 1 do not take the issue any further. Indeed, in relation in particular to IAS 1.29, the fact that the IASB decided to take action to tighten the requirements (while it has no bearing on what Autonomy was required or not required to do), demonstrates that the IASB did subsequently acknowledge that improvements were required in how IAS 1 was applied in practice.
- 4.101 Similarly, in my view, for the purposes of Autonomy's 2009 and 2010 financial statements, it also indicates clearly that there was scope for different, alternative views, i.e. both Mr Holgate's view and Autonomy's position taken during the Relevant Period, of the level of aggregation (of transactions) considered acceptable for the purposes of IAS 1.

¹⁵⁷ Mr Holgate's First Report, paragraph 4.17.

¹⁵⁸ Mr Holgate's First Report, Table A, paragraph 4.12.

- 4.102 This can also be seen separately from the different disclosures across the sets of financial statements of the software selling companies that I refer to.
- 4.103 In my opinion, I consider therefore that based on the same facts, different judgements could be reached by different accountants in relation to IAS 1 presentational matters within financial statements. In this same context, I consider Mr Holgate's reference to the need for disclosure of hardware sales under IAS 1.29 by virtue of their nature to be flawed.
- 4.104 This is all the more the case where Deloitte specifically considered Autonomy's presentation in its financial statements of these matters as part of its audit and review work, and was satisfied that no additional disclosure was required.
- 4.105 In particular, Deloitte concluded that Autonomy's presentation of its classification of transactions on a functional basis was allowable, and as such any nature of different sales within income or revenue was not in any event required to be split out in the way Mr Holgate asserts.
- 4.106 Overall, I consider that Mr Holgate is seeking to use IAS 1 as a disclosure standard rather than its true purpose as a presentation standard; this being so, his reliance on IAS 1.29 is inappropriate (as also shown by the subsequent amendment of IAS 1.30A).

Accounting for hardware costs: allocation of hardware costs between COGS and sales and marketing expenses

- 4.107 I now turn to Mr Holgate's views on how in his opinion Autonomy's hardware sales costs should have been accounted for.
- 4.108 Mr Holgate's view on how such hardware costs should have been accounted for is that:
- "... all the cost of the hardware should have been accounted for as COGS. No part of it should have been accounted for as sales and marketing expenses."*¹⁵⁹
- 4.109 Furthermore, Mr Holgate is of the opinion that this is the case irrespective of Autonomy's rationale for the hardware sales.¹⁶⁰
- 4.110 Below, I consider and respond to:
- (a) comments made by Mr Holgate in respect of IAS 2 'Inventory'¹⁶¹;

¹⁵⁹ See Mr Holgate's First Report, paragraph 4.29, albeit stated with a very limited, conditional exception.

¹⁶⁰ Mr Holgate's First Report, paragraph 4.29.

¹⁶¹ Mr Holgate's First Report, paragraphs 4.30 to 4.32.

- (b) comments made by Mr Holgate regarding Autonomy's COGS accounting policy¹⁶² in its 2009 and 2010 Consolidated Financial Statements¹⁶³; and
- (c) the assertion by Mr Holgate that costs allocation does not involve "*choices or different judgements or disputed theories*"¹⁶⁴.

4.111 In respect of the last of these points, I make the point again that as Autonomy presented its financial statements, and in particular classified its expenses, on a functional basis rather than by their nature, it was open to management judgement as to how to allocate costs to functions. This is how Autonomy approached the exercise i.e. in the language of IAS 1.103 "*allocating costs to functions may require arbitrary allocations and involve considerable judgement*"¹⁶⁵.

Accounting for hardware costs: IAS 2 'Inventory'

4.112 Mr Holgate refers to the provisions of IAS 2 'Inventory' in relation to the allocation of the hardware costs, and in particular, IAS 2.38, which 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 ..."*¹⁶⁶

4.113 I considered this paragraph in my First Report and concluded that:

*"[IAS 2.38] 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."*¹⁶⁷

4.114 In addition, 'cost of sales' is specifically one of the line items identified under IAS 1 as relating to the functional presentation of expenses.¹⁶⁸

4.115 Mr Holgate has interpreted IAS 2.38 to mean that the amount of a previously measured inventory item recognised as an expense must be presented as COGS or some similar permutation of this category.¹⁶⁹

4.116 In line with my position in my First Report, I do not concur that this has to be the only approach, and that no other approach is allowable. Further, the wording of IAS 2.38 is

¹⁶² Autonomy actually refers to "COGS" as "*cost of revenues*" in its Consolidated Financial Statements. However, for ease, I use the term COGS throughout this section.

¹⁶³ Mr Holgate's First Report, paragraphs 4.33 to 4.37.

¹⁶⁴ Mr Holgate's First Report, paragraphs 4.38 to 4.42.

¹⁶⁵ Exhibit P to my First Report - IAS 1.103.

¹⁶⁶ Exhibit X to my First Report - IAS 2.38.

¹⁶⁷ My First Report, paragraph 7.72.

¹⁶⁸ See Exhibit P to my First Report - IAS 1.103.

¹⁶⁹ Mr Holgate's Report, paragraphs 4.32, 4.38.

such that the requirement relates solely to the expense recognised consisting of costs previously included in the measurement of inventory. Irrespective of the reference to an often referred “*cost of sales*” within IAS 2.38, there is no indication that the expense recognised must be presented as such.

4.117 As set out in my First Report:

“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.”¹⁷⁰

4.118 Clearly Mr Holgate does not agree with this approach, since it is based not on what is set out in IFRS (which, as I have noted above, can by itself result in different conclusions being reached by different accountants), but on what is not prohibited within IFRS (where IFRS is as I have stated not a rules based set of accounting standards¹⁷¹).

4.119 Whereas Mr Holgate considers that the rationale for the hardware sales has no impact on the appropriate accounting treatment of the costs of the hardware¹⁷², it is my view that given that it is clear that management’s accounting judgement is required when determining how the costs should be presented¹⁷³ it is in fact necessary to consider the rationale behind the sales. As IAS 1 states, this is an area of “*considerable judgement*”.¹⁷⁴

4.120 As also set out in my First Report, I understand that Autonomy considered that the hardware sales were incidental sales made to drive its core software business.¹⁷⁵ While this rationale appears to be disputed by the Claimants¹⁷⁶, I note that Deloitte considered, and accepted, Autonomy’s explanation for the pursuit of these hardware sales at the time¹⁷⁷.

4.121 In conclusion, therefore, Deloitte expressly considered whether the accounting treatment applied by Autonomy in respect of the hardware costs was allowable or permissible in accordance with IFRS.¹⁷⁸ As set out in my First Report, Deloitte concluded at the time that the allocation of the cost of the hardware sold was materially allowable.¹⁷⁹ This was the case whether or not it was a usual approach, as expressly conceded by Mr Welham (where

¹⁷⁰ My First Report, paragraph 7.73.

¹⁷¹ My First Report, paragraph 4.16.

¹⁷² Mr Holgate’s First Report, paragraph 4.29.

¹⁷³ To illustrate other entity accounting judgement approaches to loss making sales, Rolls Royce on the sale of aircraft engines at below cost, capitalised the loss as an intangible asset, in the expectation that aftersales services relating to the engine would result in future economic benefits (although there was no guarantee on the future sales). See Exhibit SS - Extract from Rolls Royce Annual Report 2009.

¹⁷⁴ Exhibit P to my First Report - IAS 1.103.

¹⁷⁵ My First Report, paragraphs 7.43 to 7.45.

¹⁷⁶ Re-Re-Amended Particulars of Claim, paragraph 54A.

¹⁷⁷ See for example, Mr Welham’s Witness Statement, paragraphs 188, 262, 310, 347, 348 and 424.

¹⁷⁸ My First Report, paragraph 7.74.

¹⁷⁹ My First Report, paragraph 7.75.

he recorded that “... whilst what they are doing does not appear correct, they are not technically in breach of an accounting standard ...”¹⁸⁰) and Deloitte at the time¹⁸¹.

Disclosure of Autonomy’s ‘cost of goods sold’ accounting policy

4.122 In its 2010 financial statements, Autonomy disclosed that hardware costs constituted an element of the costs associated with Autonomy’s revenue recognised.

4.123 By virtue of this disclosure in 2010, it can be assumed that the absence of the disclosure in 2009 meant that in 2010 the disclosure was made because that disclosure was considered material. That does not mean that the cost of hardware itself had necessarily become material; the only assumption that can be made is that the hardware cost had become more significant enough to warrant narrative disclosure.

4.124 At paragraphs 4.33 and 4.34 of Mr Holgate’s First Report, Mr Holgate quotes Autonomy’s COGS policy from each of its 2009 and 2010 Consolidated Financial Statements, conceding that in 2010 the wording of the disclosed COGS accounting policy changed to include specific reference to the cost of hardware within COGS.

4.125 Mr Holgate goes on to state that:

*“Two points arise from these two disclosures. First, Autonomy disclosed that there was some hardware cost in 2010, but there was no equivalent disclosure in 2009. Yet there must have been some hardware cost in 2009, because there were significant sales of hardware in 2009 ... Second, a reader would be entitled to assume from the 2010 wording, in the absence of other references to the treatment of hardware costs, that all of the cost of hardware was accounted for in ‘Cost of revenues’, whereas this was not in fact the case.”*¹⁸²

4.126 With regard to Mr Holgate’s first point, I do not know the decision making process behind the situation and, therefore, I am not aware of the reason for the change to the wording of the stated policy in the 2010 Consolidated Financial Statements as compared to the 2009 Consolidated Financial Statements. However, in my view the more relevant observation is that in general terms such changes in wording are made in respect of the period when it becomes, or is considered to become, significant. This does not mean that there were no such hardware sales in 2009, only that they were considered to fall below some threshold for disclosure (because they were not regarded as significant).

¹⁸⁰ See my First Report, paragraph 7.74, and the references to Mr Welhams’s contemporaneous conclusions. See also **Exhibit ZZ** - Transcript of Proceedings Vol. 20, and the evidence of Mr Welham at pages 160 to 164, 174 to 178.

¹⁸¹ My First Report, paragraphs 7.73 to 7.75.

¹⁸² Mr Holgate’s First Report, paragraph 4.35.

4.127 For example, based on the information presented in Schedule 2 to the Re-Re-Amended Particulars of Claim¹⁸³, even though the proportion of COGS attributable to hardware was 24% in 2009 and 48% in 2010 as set out below, it was still the case that hardware represented only a small percentage (7%) of Autonomy’s overall revenue in 2009 compared to the percentage in 2010 (12%). As a result, functionally, hardware revenues appear not to be material, or regarded as material, in 2009, and hence associated disclosures were likely considered immaterial.

Table 1: Proportions of revenue and COGS attributable to hardware in 2009 and 2010

US\$'000	Total reported revenue ¹⁸⁴ [A]	Hardware revenue ¹⁸⁵ [B]	Hardware revenue as percentage of total revenue [B]/[A]	Total reported COGS ¹⁸⁶ [C]	Hardware costs included as COGS ¹⁸⁷ [D]	Hardware COGS as percentage of total COGS [D]/[C]
Year ended 2009	739,688	53,693	7%	137,397	33,108	24%
Year ended 2010	870,366	105,557	12%	168,793	81,656	48%

4.128 In any case, there is no explicit standard within IFRS stipulating disclosure requirements for COGS. Mr Holgate himself confirms that “*many companies do not state an accounting policy for COGS*”¹⁸⁸. It follows that Autonomy was not under any obligation to disclose the categories of content let alone an exhaustive list of the nature of the costs comprising COGS in its 2009 or 2010 Consolidated Financial Statements. Autonomy’s disclosure in this regard was similarly audited/reviewed by Deloitte which issued unqualified audit and/or review opinions whether it had strong views on the issue or not.

4.129 With regard to Mr Holgate’s second point, that “*... a reader would be entitled to assume from the 2010 wording, in the absence of other references to the treatment of hardware costs, that all of the cost of hardware was accounted for in ‘Cost of revenues’, whereas this was not in fact the case*”¹⁸⁹, I do not consider that this follows at all.

¹⁸³ I have assumed for the purposes of this section of my report that Schedule 2 to the Re-Re-Amended Particulars of Claim is accurate. I have not however verified the figures included in Schedule 2 and therefore my calculations are illustrative.

¹⁸⁴ Re-Re-Amended Particulars of Claim, Schedule 2, page 2.

¹⁸⁵ Re-Re-Amended Particulars of Claim, Schedule 2, page 1.

¹⁸⁶ Re-Re-Amended Particulars of Claim, Schedule 2, page 2.

¹⁸⁷ Re-Re-Amended Particulars of Claim, Schedule 2, page 1.

¹⁸⁸ Mr Holgate’s First Report, paragraph 4.38.

¹⁸⁹ Mr Holgate’s First Report, paragraph 4.35.

4.130 Mr Holgate offers no reason why the disclosure on hardware means that the cost of hardware was only accounted for in COGS.

4.131 Mr Holgate states that, in his view:

“... it is clear to accountants from IAS 2 and obvious to accountants and other business people from a common sense perspective that:

4.38.1 The costs of items that are sold are accounted for in COGS;

4.38.2 Expenses incurred on sales and marketing activities are accounted for in sales and marketing expenses.

This seems clear and it is not one of those matters in accounting where there are choices or different judgements or disputed theories. It is quite straightforward.”¹⁹⁰

4.132 However, the situation is not “clear” or “straightforward”. If it were, the treatment conceded by Deloitte, in full knowledge of the issues, would not have been allowed, the more so where Mr Holgate believes the matters now to be material.

4.133 In particular, as set out at paragraphs 4.112 to 4.116 above, Mr Holgate and I differ in our interpretations of IAS 2.38, Mr Holgate’s view being that the amount of inventories recognised as an expense must be presented as COGS whereas my view is that this overstates the case.

4.134 IAS 2.34 requires only that:

“When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised.”

4.135 There is therefore no requirement for the expense to be presented in any particular line item. The related requirements in IAS 18.19 are consistent:

“Revenue and expenses that relate to the same transaction or event are recognised simultaneously; this process is commonly referred to as the matching of revenue and expenses...”

4.136 IAS 2.39 then requires that:

“Some entities adopt a format for profit or loss that results in amounts being disclosed other than the cost of inventories recognised as an expense during the period. Under this format, an entity presents an analysis of expenses using a classification based on the nature of expenses. In this case, the entity discloses the costs recognised as an expense

¹⁹⁰ Mr Holgate’s First Report, paragraphs 4.38 to 4.39.

for raw materials and consumables, labour costs and other costs together with the amount of the net change in inventories for the period.”

4.137 Consequently, IAS 2 explicitly acknowledges that the allocations of expenses might not result in disclosure of the amount of inventory recognised as an expense in the period and, if that is the case, requires this information to be disclosed in the notes. This did not apply, however, to Autonomy.

4.138 As set out at paragraph 4.121 above, Deloitte considered at the time whether the accounting treatment applied by Autonomy in respect of the associated costs of hardware was permitted by, and therefore in accordance with, IFRS and concluded that the allocation was materially allowable - a conclusion different to that which Mr Holgate now arrives at.

4.139 Therefore, again, while to Mr Holgate the issue is obvious and one of common sense, it is apparent that based on the same circumstances different opinions have been reached by different accountants in relation to this issue. If the matter involved no accounting judgement as Mr Holgate suggests, no one could expect such different approaches to occur.

4.140 In relation to including hardware costs in sales and marketing expenses, Mr Holgate’s states that:

“... generally there would not necessarily be a need to disclose the accounting policy relating to what is included in sales and marketing expenses.”¹⁹¹

4.141 Mr Holgate then goes on to state:

“However, in this particular case, as the accounting treatment adopted was non-compliant with IFRS, and given the materiality of the amounts concerned, there was a need for disclosure so as to alert users to the invalidity of the understanding that they would otherwise have derived from the numbers presented.”¹⁹²

4.142 Below, I consider and respond to:

- (a) comments made by Mr Holgate regarding Autonomy’s sales and marketing expenses disclosure in its 2009 and 2010 Consolidated Financial Statements and the compliance of this disclosure with IAS 1 ‘Presentation of financial statements’; and
- (b) comments made by Mr Holgate regarding the materiality of the hardware costs.

¹⁹¹ Mr Holgate’s First Report, paragraph 4.51.

¹⁹² Mr Holgate’s First Report, paragraph 4.51.

Disclosure of accounting policy in relation to sales and marketing expenses

4.143 At paragraph 4.45 of Mr Holgate's First Report, Mr Holgate quotes from Autonomy's 2009 and 2010 Consolidated Financial Statements in respect of sales and marketing expenses. The relevant accounting policy quotation is as follows:

*"... sales and marketing costs comprise the costs of the sales force, commissions and costs of promoting new products and entering into new markets ..."*¹⁹³

4.144 Mr Holgate highlights that this wording does not make reference to hardware costs whereas (as discussed in paragraphs 4.122 to 4.129 above) Autonomy's COGS policy in its 2010 Consolidated Financial Statements does make reference to hardware costs.¹⁹⁴ Mr Holgate's conclusion is that this:

*"... clearly gives the incorrect impression that all hardware cost was included in cost of revenue and none was included in sales and marketing expenses."*¹⁹⁵

4.145 This comment applies only to the 2010 Consolidated Financial Statements, there being no reference to hardware costs in Autonomy's COGS policy in the 2009 Consolidated Financial Statements.

4.146 Based on the information again presented in Schedule 2 to the Re-Re-Amended Particulars of Claim, in 2010 the proportion of COGS attributable to hardware was 48%¹⁹⁶, which was significantly higher than the equivalent proportion of the sales and marketing expenses attributable to hardware, which was 15%¹⁹⁷.

4.147 This difference may be a potential reason for the inclusion of a reference to hardware in the COGS policy wording in the 2010 Consolidated Financial Statements and not in the sales and marketing expenses disclosure. Although equally it may not have formed any part of the decision making process as to what was considered a disclosure necessity and what was considered not to require disclosure by way of additional insertion into the already voluntary policy note. Here I would agree with Mr Holgate that Autonomy was not under any obligation to disclose an exhaustive list of costs comprising sales and marketing expenses in its 2009 or 2010 Consolidated Financial Statements.¹⁹⁸

¹⁹³ Exhibits I and J to my First Report- Autonomy's Consolidated Financial Statements 2009, page 43, and Autonomy's Consolidated Financial Statements 2010, page 52.

¹⁹⁴ Mr Holgate's First Report, paragraph 4.46.

¹⁹⁵ Mr Holgate's First Report, paragraph 4.46.

¹⁹⁶ See paragraph 4.127 of this report.

¹⁹⁷ US\$31,211,018 / US\$204,109,000 (Re-Re-Amended Particulars of Claim, Schedule 2, pages 1 and 2).

¹⁹⁸ Mr Holgate's First Report, paragraph 4.51.

4.148 It is very clear, though, that in both 2009 and 2010, Autonomy expressly disclosed that sales and marketing costs included expenses relating to ‘promoting new products and entering into new markets’, which Mr Holgate acknowledges.¹⁹⁹

4.149 The reality was that Autonomy adopted an approach of presenting its income statement by function. By definition, where it was a function of hardware sales to promote sales of new products and/or sales into new markets²⁰⁰ then the exact nature of the costs was capable in the circumstances of being argued as secondary to their purpose. This is of course a judgemental accounting area wherein management could consider its position, as was allowable, and arguably required; and as I have noted above, also in any event once you get beyond the line items set out in IAS 1.102 and IAS 1.103, then it is the requirements of specific IFRSs that take over for more detailed disclosures (unless a conclusion is reached that additional line items or sub totals on the face of the financial statements were required by IAS 1.85, which is not the case contended by Mr Holgate).

Compliance with IAS 1 ‘Presentation of financial statements’

4.150 Based on his analysis of IAS 1²⁰¹, and specifically what is included in the standard in respect of disclosure requirements for accounting policies, Mr Holgate states that:

“It would have been ‘relevant to an understanding of the financial statements’ for a user to have known that gross profit had been increased by moving part of COGS to a heading (sales and marketing expenses) that was presented below gross profit. Likewise, ‘disclosure would have assisted users in understanding’ the accounting treatment and the underlying business undertaken and margins achieved. In addition, disclosure of the accounting policy would assist users in understanding the ‘judgement’ that ‘management [had] made’...”²⁰²

4.151 Much of this commentary focusses on the impact that the allocation of part of the cost of hardware sales as sales and marketing expenses would have had on Autonomy’s gross profit margin.²⁰³

4.152 The requirement to disclose accounting policies in IAS 1, is in comparison, a requirement to disclose significant accounting policies. However, Mr Holgate has not commented at all on the extent or magnitude of this impact of hardware expenses included in sales and

¹⁹⁹ Mr Holgate’s First Report, paragraph 4.45.

²⁰⁰ My First Report, paragraphs 7.43 to 7.45.

²⁰¹ By reference to IAS 1.117, 1.119 and 1.122.

²⁰² Mr Holgate’s First Report, paragraph 4.49.

²⁰³ Mr Holgate also seeks to make the point by reference to the relevance to the single ‘user’ of the financial statements, which is conceptually wrong in any event.

marketing. Ignoring the Claimant's allegations, as a percentage of overall revenue, total sales and marketing expenditure fell in 2009²⁰⁴, and was stable at the lower level in 2010²⁰⁵.

4.153 Based on the information presented by the Claimants in Schedule 2 to the Re-Re-Amended Particulars of Claim, the impact on Autonomy's gross profit margin of allocating a proportion of the hardware costs to sales and marketing expenses as compared to allocating all hardware costs to COGS during the Relevant Period is as follows (as calculated):

Table 2: Impact on Autonomy's gross profit margin of allocating a proportion of hardware costs to sales and marketing expenses as compared to allocated all hardware costs to COGS

	Reported gross profit margin according to Claimants' Schedule 2 ²⁰⁶ [A]	Restated gross profit margin according to Claimants' Schedule 2 ²⁰⁷ [B]	Difference [A]-[B]
Q3 2009	78.0%	63.2%	14.8%
Q4 2009	82.8%	79.5%	3.3%
Year ended 2009	81.4%	76.6%	4.8%
Q1 2010	81.4%	78.7%	2.8%
Q2 2010	79.5%	71.7%	7.8%
H1 2010	80.4% ²⁰⁸	75.0% ²⁰⁹	5.4%
Q3 2010	80.9%	78.6%	2.3%
Q4 2010	80.7%	79.1%	1.6%
Year ended 2010	80.6%	77.0%	3.6%
Q1 2011	82.2%	81.2%	0.9%
Q2 2011	81.1%	80.1%	1.0%
H1 2011	81.6%	80.6%	0.9%

4.154 As the above table shows, in reality the impact of the hardware cost allocation to sales and marketing in terms of the year end and interim (i.e. mid-year) gross profit margins

²⁰⁴ See my First Report, Exhibit I, page 11.

²⁰⁵ See my First Report, Exhibit J, page 16.

²⁰⁶ Re-Re-Amended Particulars of Claim, Schedule 2, page 2.

²⁰⁷ Re-Re-Amended Particulars of Claim, Schedule 2, page 2.

²⁰⁸ (US\$158,104,000 + US\$175,904,000) / (US\$194,180,000 + US\$221,125,000).

²⁰⁹ (US\$152,748,000 + US\$158,651,000) / (US\$194,180,000 + US\$221,125,000).

ranged from 0.9% for H1 2011 to 5.4% for H1 2010²¹⁰. In the context of Autonomy's average reported gross profit margin for these interim and full year results of 81.0%²¹¹, I consider these differences to represent less of a material issue compared to Mr Holgate.

4.155 The same average 'restated' gross profit margin for these interim and year end results would have been 77.3%²¹². This represents a difference in average margin of 3.7% and less than 5% of the restated average margin; which restated average margin is already depressed by the fact of the hardware sales (which I understand the Claimants are not contending did not constitute proper sales, other than a US\$6 million sale in Q2 2009, which I consider in further detail in section 5 of this report).

4.156 I note in addition that, in accordance with this issue above, Mr Bloomer's Witness Statement states:

*"If you compare Autonomy to a company that operates on very tight margins, such as a supermarket, the impact of reported margins is very different. A supermarket which might have margins of 2-3%. In a business like that, a 1-2% fall is very significant. For a company with margins around 80% or 90% that fluctuated by a few percentage points up and down every quarter, movements in margin are less relevant."*²¹³

4.157 Similarly, Mr Pearson states in his witness statement dated 8 November 2018 ("Mr Pearson's Witness Statement") that:

*"I would have been concerned if gross margins fell substantially, but I would not have been concerned if they fell by a few percentage points because all that would have told me was that the company was selling some low-margin products."*²¹⁴

4.158 Given such an impact on Autonomy's gross margin (and, as explained in my First Report, the fact that there was no impact at all on net profit/margin²¹⁵), I would not agree with Mr Holgate that for a user of the Consolidated Financial Statements to have known that a proportion of hardware costs had been allocated to sales and marketing expenses would have been determinative.

4.159 Moreover, it remains that Autonomy's disclosure in this regard was audited/reviewed by Deloitte and unqualified audit and/or review opinions were issued throughout the Relevant Period (in circumstances that it appears that Mr Holgate has determined are not relevant

²¹⁰ Albeit I note that there are two instances where the difference in the quarterly gross profit margins is higher than this.

²¹¹ $(81.4\% + 80.4\% + 80.6\% + 81.6\%) / 4 = 81.0\%$.

²¹² $(76.6\% + 75.0\% + 77.0\% + 80.6\%) / 4 = 77.3\%$.

²¹³ Mr Bloomer's Witness Statement, paragraph 97.

²¹⁴ Mr Pearson's Witness Statement, paragraph 65.

²¹⁵ My First Report, paragraph 7.69.

for the purposes of his instructions, notwithstanding it was open to him to request access to the relevant working papers).

Materiality of the hardware costs in the context of the disclosures

4.160 Finally, Mr Holgate considers that:

“... the treatment of part of the hardware costs as sales and marketing cost is inherently material qualitatively by virtue of it being non-compliant [with IAS 2]”²¹⁶

4.161 Mr Holgate goes on to state that the treatment of the hardware costs:

“... is also material quantitatively as shown by the amounts set out in Schedule 2 to the [Re-Re-Amended Particulars of Claim]”²¹⁷

4.162 In relation to Mr Holgate’s first point, given that I do not consider that the treatment was non-compliant with IAS 2 (see paragraphs 4.112 to 4.121 above), I do not agree that the treatment of part of the hardware costs as sales and marketing cost is *“inherently material qualitatively”*. I do not believe I need to say anymore on this point.

4.163 In relation to Mr Holgate’s second point, I note that Mr Holgate does not specify his level of materiality he is applying in respect of the hardware costs. As set out in my First Report (and reiterated at paragraph 4.57 above):

“Judgement is necessarily required [when considering materiality], given that IFRS does not specify how a materiality threshold should be arrived at.”²¹⁸

4.164 In my opinion, it is difficult in relation to hardware accounting and disclosure to get away from the facts and circumstances that Autonomy’s disclosure in this regard was audited/reviewed by Deloitte and unqualified audit and/or review opinions were issued throughout the Relevant Period.

4.165 As such, it is clear that Deloitte did not feel sufficiently moved to mandate that the hardware costs accounted for as sales and marketing expenses be disclosed by virtue of them being material, or even an accounting policy note be disclosed to this effect.

4.166 In the circumstances of this issue, therefore, I believe that Mr Holgate’s position now is at odds with what was known, evaluated and considered at the time, including in the context of the relevant time.

4.167 The disclosures that Mr Holgate asserts should have been made represent only one side of the possible approaches to the issue at the time, i.e. were not the only possible approach.

²¹⁶ Mr Holgate’s First Report, paragraph 4.50.

²¹⁷ Mr Holgate’s First Report, paragraph 4.50.

²¹⁸ My First Report, paragraph 4.98.

As such, while I do not consider Mr Holgate's opinions wrong per se, I do not consider them to be the only possible opinions that could be arrived at on such judgemental calls. My opinions therefore that I have set out in my First Report have not been altered by my consideration of Mr Holgate's views on this matter.

Disclosure of hardware cost related accounting: conclusions

- 4.168 By way of conclusion, where Autonomy presented its financial statements, and in particular classified its expenses, on a functional basis rather than by their nature, it was open to Autonomy management judgement as to how to allocate costs to functions.
- 4.169 This is how Autonomy approached the exercise. In the language of IAS 1.103 "*allocating costs to functions may require arbitrary allocations and involve considerable judgement*"²¹⁹.
- 4.170 Whereas Mr Holgate considers that the rationale for the hardware sales has no impact on the appropriate accounting treatment of the costs of the hardware²²⁰, it is my view that given that it is clear that management's accounting judgement is required when determining how the costs should be presented, it is in fact necessary to consider the rationale behind the sales.
- 4.171 This separately also goes to the heart of the different presentations and the understanding of them by users of financial statements. Both presentations (by nature or function) are allowable and neither has primacy over the other, as set out in IAS 1.
- 4.172 Further, purely because it is disclosed that cost of revenues includes hardware, it does not then necessarily mean that a hardware expense can only exclusively be included in cost of revenues.
- 4.173 Similarly, while there was only a high level disclosure of what constituted sales and marketing expenses (including costs of entering into new markets²²¹), and no line-by-line disclosure of the nature of item costs included in sales and marketing expenses, I do not consider that it necessarily follows that a reader must assume that all of the cost of hardware was accounted for only in COGS.
- 4.174 As I have explained elsewhere, costs that were considered to fall below some threshold for disclosure (because for example they were not regarded as significant or functionally

²¹⁹ Exhibit P to my First Report - IAS 1.103.

²²⁰ Mr Holgate's First Report, paragraph 4.29.

²²¹ See, for example, the 'Profit from operations' accounting policy notes in Exhibits I and J to my First Report, pages 43 and 52 respectively.

significant in a wider context) would not in any event be separately identified, and it would then be likely quite opaque as to where such costs were recognised.

- 4.175 While to Mr Holgate the issue of hardware accounting disclosure is ‘obvious’ and one of ‘common sense’, it is apparent that based on the same circumstances different opinions have been reached by different accountants in relation to this issue (i.e. Deloitte and Mr Holgate). If the matter involved no accounting judgement as Mr Holgate suggests, no one could expect such different approaches to occur.
- 4.176 Indeed, because of the very fact that this was a judgemental accounting area wherein Autonomy management could consider its position, as was allowable, and arguably required, then once you get beyond the line items set out in IAS 1.102 and IAS 1.103, then it is the requirements of specific IFRSs that take over for more detailed disclosures. That is unless a conclusion is reached that additional line items or sub totals on the face of the financial statements were required by IAS 1.85, which is not the case I understand contended by Mr Holgate.
- 4.177 Given that the impact on Autonomy’s gross margin of recognising hardware expenses in sales and marketing was a matter of a few percentage points only against an average gross margin of approximately 81% during the Relevant Period, I do not agree with Mr Holgate that for a user of the Autonomy’s financial statements to have known that a proportion of hardware costs had been allocated to sales and marketing expenses would have been determinative.
- 4.178 Moreover, it remains that Autonomy’s disclosure in this regard was considered by Deloitte as part of its audits/reviews and unqualified audit and/or review opinions were issued throughout the Relevant Period (in circumstances that it appears that Mr Holgate has determined are not relevant for the purposes of his instructions, notwithstanding it was open to him to request access to the relevant working papers).
- 4.179 In the circumstances of this issue, therefore, I believe that Mr Holgate’s position now is at odds with what was known, evaluated and considered at the time, including in the context of the relevant time. Accordingly, my overall opinions have not changed on this matter from those expressed in my First Report.

5 HARDWARE SALES - MORGAN STANLEY TRANSACTION

Introduction

5.1 In this section I set out, in respect of the sale of US\$6 million of mass storage hardware to Morgan Stanley that was recognised by Autonomy as revenue in Q2 2009 (the “Morgan Stanley Hardware Transaction”):

- (a) a general description of the transaction (paragraphs 5.2 to 5.4);
- (b) an explanation of Autonomy’s accounting treatment in respect of the transaction (paragraphs 5.5 to 5.8);
- (c) a detailed description of Deloitte’s audit and review work in respect of the transaction and consideration of the underlying documents (paragraphs 5.9 to 5.37);
- (d) my view of the accounting treatment based on the information contained in Deloitte’s working papers and underlying documents (paragraphs 5.38 to 5.39);
- (e) the Claimants’ general allegations regarding the accounting treatment of this transaction as asserted in the Re-Re-Amended Particulars of Claim (paragraph 5.40);
- (f) the general assumptions that Mr Holgate has been instructed to apply to this transaction (also referred to as “Holgate-Morgan Stanley Assumptions”), together with my comments (paragraphs 5.41 to 5.45);
- (g) an overview of Mr Holgate’s analysis and conclusions in respect of the accounting treatment for this transaction (paragraphs 5.46 to 5.54);
- (h) my opinion on the accounting treatment adopting the Holgate-Morgan Stanley Assumptions, without any consideration of the underlying facts (paragraphs 5.55 to 5.71); and
- (i) my understanding of the facts applicable to the Holgate-Morgan Stanley Assumptions, and my conclusion on the accounting treatment (paragraphs 5.72 to 5.188).

General description of the transaction

5.2 The transaction was for the sale of US\$6.0 million of mass storage hardware to Morgan Stanley on 30 June 2009, recognised by Autonomy as revenue in Q2 2009.²²²

²²² Voluntary Particulars, spreadsheet “00_Further particulars - Morgan Stanley Q2 2009”.

- 5.3 I understand that the sale was entered into pursuant to the terms of a Master Purchase Agreement also dated 30 June 2009 between Autonomy and Morgan Stanley (“Morgan Stanley Master Purchase Agreement”²²³). Pursuant to this agreement, and subject to certain conditions, the parties to the Morgan Stanley Master Purchase Agreement agreed that Autonomy was entitled to resell equipment to Morgan Stanley.²²⁴
- 5.4 My understanding referred to immediately above, is drawn from the fact that the specific transaction, and the timing of the transaction, was made a condition of a separate equipment purchase commitment between Autonomy and Morgan Stanley.²²⁵ This separate commitment by Morgan Stanley to Autonomy was also dated 30 June 2009, related to performance by the respective parties over the following 12 months to 30 June 2010, and was said to be subject to the terms of the Morgan Stanley Master Purchase Agreement.²²⁶ As a result, I have assumed that the 30 June 2009 condition precedent US\$6 million sale of hardware to Morgan Stanley was also subject to the terms of the Morgan Stanley Master Purchase Agreement.²²⁷

Autonomy’s accounting treatment

- 5.5 On 30 June 2009 Autonomy recognised hardware revenue of US\$6 million.²²⁸
- 5.6 Insofar as it is relevant, US\$6 million cost of goods sold was recognised at the same time via an accounting journal entry.²²⁹
- 5.7 The cost of goods sold was revised to US\$5,997,303 in the following quarter.²³⁰
- 5.8 From this point onwards, I consider the accounting treatment of the hardware revenue in Autonomy’s consolidated income statement only, except where I consider other accounting entries relating to the transaction to be relevant.

Deloitte’s work and underlying documents

- 5.9 Below I set out Deloitte’s consideration of the revenue recognition issues related to this transaction. From what I have been able to observe, Deloitte considered the revenue recognition issues on the hardware transaction separately from its audit testing on general sales of licences in the quarter. However, it was also the case that Autonomy made a sale

²²³ {D008500518}.

²²⁴ {D006567608}.

²²⁵ {D006567608}.

²²⁶ {D006567608}.

²²⁷ I have seen an unsigned purchase order {D010800423} dated 30 June 2009, that refers to the Morgan Stanley Master Purchase Agreement, but note that the purchase order ultimately sent electronically by Morgan Stanley does not make this reference; see {DEL1_003_1_00000110}.

²²⁸ See ledger extract in voluntary particulars, document “MS 2009-01”.

²²⁹ See ledger extract in voluntary particulars, document “MS 2009-02”.

²³⁰ Voluntary Particulars, spreadsheet “00_Further particulars - Morgan Stanley Q2 2009”.

- of a software license to EMC in the quarter, which was considered at the time by Deloitte in the context of the hardware transaction and whether the two transactions were linked.
- 5.10 For reasons that will become clear, I do not consider the sale of the license to EMC in the context of the hardware transaction.
- 5.11 I refer below to the contemporaneous Deloitte working papers and also the underlying documents referred to therein where I consider them relevant. For the avoidance of doubt, I do not consider here the disputed facts and/or allegations that have arisen subsequently.
- 5.12 A Deloitte memo dated 12 July 2009 prepared in relation to the Q2 2009 review considers the accounting treatment for the contracts entered into with EMC on 29 June 2009 and Morgan Stanley on 30 June 2009.²³¹
- 5.13 In particular, the memo considers whether it was appropriate for Autonomy to recognise revenue of US\$6 million for the hardware sale, along with the associated costs of sales.²³² The memo makes reference to the Morgan Stanley and EMC purchase agreements and supporting documents (which appear to have been attached to Deloitte's review working papers at the time).
- 5.14 At the same time, a second Deloitte memo dated 13 July 2009 prepared in relation to the Q2 2009 review also refers to the Autonomy purchase of hardware from EMC, albeit more generally in the context of the sale of a software license to EMC that occurred in the same quarter.²³³
- 5.15 Neither Deloitte memo was broken down into specific sections addressing respectively each of the five limbs or conditions of IAS 18.14.
- 5.16 Due to the size of the software license sale to EMC in the quarter (US\$4.345 million including support and maintenance), a separate revenue testing sheet was prepared by Deloitte which considered all aspects of IAS 18.14 and the question of software license revenue recognition. This review sheet refers to an original agreement involving EMC dated 22 February 2002. It also refers to the separate consideration given to the purchase of hardware from EMC in the quarter.²³⁴
- 5.17 In the memo dated 13 July 2009, Deloitte noted that:
- “On 29 June 2009 Autonomy entered into the contract with EMC to purchase \$9.0m of hardware. The payment terms meant that Autonomy would purchase an initial \$5.0m*

²³¹ {DEL1_003_1_00000036}.

²³² {DEL1_003_1_00000036}.

²³³ {POS00132586}.

²³⁴ {POS00148730}.

upfront, and would then purchase \$1.0m in November 2009 and \$3.0m in February 2009. The \$5.0m was paid pre year end [sic] and we have agreed that to bank statements as being paid on 30/06/09.

On 30 June 2009, Autonomy entered an agreement with Morgan Stanley Corporation (“Morgan Stanley”) to purchase \$6.0m of hardware from Hitachi Data Systems Corporation (“HDS”) and sell it onto Morgan Stanley at cost. Autonomy had entered into an agreement with HDS on 27 June 2009, to purchase the relevant \$6.0m of hardware, but HDS were unable to deliver it in time for the quarter-end. As such, Autonomy entered the above agreement with EMC to purchase the \$5.0m (which EMC could deliver in time) and they would use a further \$1.0m from their own reserve of new stock about to be integrated into the Digital Safe facility.”²³⁵

- 5.18 However, the principal Deloitte working paper on the issue appears to be the 12 July 2009 memo, entitled “*Commitment to purchase hardware from EMC and sell to Morgan Stanley*”.²³⁶
- 5.19 The objective of the memo was to consider the accounting treatment for the contracts entered into with EMC on 29 June 2009 and Morgan Stanley on 30 June 2009, and in particular, whether it was appropriate to recognise a trade debtor and revenue of US\$6 million with associated costs of sales as at the 30 June 2009 balance sheet date.
- 5.20 Deloitte raised three questions in the memo: how much of the US\$9 million of hardware purchased from EMC was delivered to Autonomy before 30 June 2009, and what proportion of this was subsequently sold on to Morgan Staley for US\$6 million.
- 5.21 Second, did the terms of the agreements stipulate when title and risks and rewards of ownership passed between EMC, Autonomy and Morgan Stanley.
- 5.22 Third, did title and risks and rewards of ownership pass prior to the period end; if not, then Deloitte considered that it may not be appropriate to recognise the revenue as generated within the Q2 2009 period.

“Review of the agreements and supporting schedules”

- 5.23 Deloitte reviewed the fully signed agreement between EMC and Autonomy dated 29 June 2009. The agreement referred to Autonomy purchasing hardware manufactured by EMC, for the consideration of US\$9 million. This would involve a payment plan of a US\$5 million upfront down payment, followed by instalments of US\$1 million payable on 1 November 2009 and US\$3 million payable on 1 February 2010.

²³⁵ {POS00132586}, page 1.

²³⁶ {DEL1_003_1_00000036}.

- 5.24 While Deloitte discussed the instalment plan in its working paper, I do not address the reasons for this subsequent instalment payment profile, or the mechanics of it, as it related to subsequent unrelated financing arrangements that I do not consider relevant to the transaction at hand. Deloitte did record, however, that the payment to EMC for US\$5 million was agreed to bank statements as having been paid on 30 June 2009.²³⁷
- 5.25 Deloitte also recorded that it considered that the US\$5 million of hardware was fully paid for and delivered to Autonomy. Deloitte then recorded that the hardware “*can then be sold to Morgan Stanley*”.
- 5.26 Having confirmed that Autonomy paid EMC for US\$5 million of hardware pre-quarter end, Deloitte’s next consideration was the sale and purchase of hardware with Morgan Stanley.
- 5.27 According to Deloitte, they “*reviewed the fully signed agreement between Autonomy and Morgan Stanley (dated 30 June 2009)*” and highlighted the key areas for discussion which would determine the accounting treatment for the recognition of US\$6 million revenue related to the sale of hardware to Morgan Stanley on 30 June 2009.
- 5.28 These audit discussion areas were recorded as several clauses within the agreement over the delivery of the hardware, its acceptance by Morgan Stanley, and at what point the risks and rewards of ownership are transferred. The agreement was the Morgan Stanley Master Purchase Agreement²³⁸ to which I referred above.
- 5.29 The following clauses were noted:
- “The Products shall be deemed accepted upon delivery to the address(es) specified in an applicable Purchase Order, which may be Seller’s warehouse...”*²³⁹
- “Title and risk of loss for the Product(s) shall transfer to Morgan Stanley upon shipment from the Product(s)’ manufacturer: provided, however, Seller shall indemnify and hold harmless Morgan Stanley and its affiliates from and against any and all claims, liabilities, losses and damages to the Products until the Products are installed by Morgan Stanley or pursuant to Morgan Stanley’s instruction ...”*²⁴⁰
- 5.30 Based on these clauses, Deloitte determined that they needed to obtain audit evidence of where Morgan Stanley ‘specified the delivery point per the purchase order and the amount of consideration paid for it’. They also needed ‘assurance over when the hardware was shipped from EMC and received by Autonomy’.

²³⁷ {POS00132586}, page 2.

²³⁸ {D008500518}.

²³⁹ {D008500518}, paragraph 2.

²⁴⁰ {D008500518}, paragraph 5.

5.31 According to what Deloitte recorded, they were told that the full US\$5 million of hardware paid for up front from EMC was received by Autonomy on 30 June 2009 and was all sold on to Morgan Stanley. They also examined correspondence between Autonomy and Morgan Stanley over the completion of the order and Morgan Stanley's acceptance and beginning of the payment process as evidence of delivery of the hardware (and hence that shipment from EMC has taken place). Further, they reviewed the Morgan Stanley Purchase Order dated 30 June 2009, which specified that US\$6 million of hardware was to be purchased from Autonomy, and examined the invoice raised by Autonomy to Morgan Stanley on 30 June 2009 for the associated US\$6 million. They noted, however, that the Purchase Order specified Morgan Stanley's New York offices as the point for delivery of the hardware.

5.32 Deloitte's overall conclusion was therefore:

"The above clauses in the master agreement with Morgan Stanley make clear that title of the goods transfers to Morgan Stanley when the products are shipped from the manufacturer (i.e. EMC), and the delivery note proves that this has occurred. We can therefore be comfortable that ownership is with Morgan Stanley as at 30 June 2009, regardless of the fact that the goods are not formally 'accepted' until delivery to the Morgan Stanley New York offices. The clause regarding liabilities, losses and damages to the products remaining Autonomy's until installed by Morgan Stanley is simply a standard commercial arrangement to allow Morgan Stanley to send the equipment back if it is faulty (and in turn Autonomy would return it to EMC, thus this is a standard warranty situation which has no impact upon revenue recognition here). Deloitte have also noted that a \$1m accrual is in place for the \$1m additional assets needed for the Morgan Stanley sale on top of the \$5m from EMC. It is therefore appropriate to recognise a \$5m cost of sales associated with this deal. The valid invoice and Morgan Stanley purchase order both specify consideration of \$6m; hence it is appropriate to recognise the debtor and revenue for this amount. This is the case because title had passed as at 30 June 2009. Satisfactory."

5.33 In addition to the above and subsequent to the date of the Deloitte memo, Deloitte sought a separate source of confirmation of the delivery of the hardware from EMC pre-quarter end, ultimately to Morgan Stanley.

5.34 In its report to the Audit Committee, Deloitte recorded that it had yet to have sight of the delivery of hardware by EMC pre quarter end and listed this as an "outstanding".²⁴¹

5.35 On 15 July 2009, Deloitte recorded that EMC were unable to supply any fully approved documentation regarding the delivery point. Deloitte recorded that Autonomy's point was that Morgan Stanley "have accepted the goods on 30 June as per email chains forwarded

²⁴¹ See {D003950267}, page 13.

[to Deloitte] *and then approved for payment the amount*". As a result, Deloitte finally considered that they needed to document the facts and then seek a "rep letter point" along the following lines:

*"We confirm that the despatch of hardware with a purchase price of \$5 million was made from EMC on the 30 June 2009."*²⁴²

- 5.36 This representation was included in the signed 15 July 2009 letter of representation provided by Autonomy to Deloitte as part of the Q2 2009 interim review undertaken by Deloitte.²⁴³

Deloitte's overall conclusion in respect of IAS 18.14

- 5.37 With regard to revenue recognition for this transaction, following the above events, Deloitte's overall conclusion was that US\$6 million hardware revenue was recognised.

My conclusion on the accounting treatment for the hardware

- 5.38 Based on the contemporaneous evidence set out above, I agree with Deloitte that it was appropriate to recognise a sale in respect of the hardware.
- 5.39 Accordingly, in my opinion Autonomy's accounting treatment in respect of the hardware set out at paragraph 5.5 was appropriate.

Claimants' allegations

- 5.40 The Claimants allege that the recognition of revenue in respect of this transaction was not compliant with IAS 18.14 as the hardware was not despatched until August and September 2009, therefore, the revenue should have been recognised in Q3 2009 and not in Q2 2009²⁴⁴.

Mr Holgate's instructed assumptions

- 5.41 Unlike the approach taken in Mr Holgate's instructions in respect of other impugned transactions (as discussed later in this report), in relation to the Morgan Stanley Hardware Transaction, Mr Holgate is not provided with any "*Factual summary*" on which he is requested to proceed.
- 5.42 Further, Mr Holgate is also not provided with any transaction specific contractual documentation in respect of this transaction, or series of transactions.²⁴⁵

²⁴² See {DEL00235854}.

²⁴³ {POS00132681}.

²⁴⁴ Re-Re-Amended Particulars of Claim, Paragraph 63J.

²⁴⁵ Mr Holgate's 'Instructions' and Annex 2 to those instructions at page 38, as appended to Mr Holgate's First Report at Appendix 2.

- 5.43 Instead, Mr Holgate is instructed to proceed only on assumptions provided by the Claimants.
- 5.44 Mr Holgate's opinions in respect of the Morgan Stanley Hardware Transaction are based exclusively therefore on two assumptions.
- 5.45 In respect of this transaction, Mr Holgate has been instructed to assume that:
- (a) *"In Q2 2009 Autonomy recognised US\$6 million of revenue in relation to a sale by Autonomy Inc of hardware to Morgan Stanley pursuant to an agreement dated 30 June 2009"*²⁴⁶; and
 - (b) *"The (Hitachi) hardware that was sold to Morgan Stanley pursuant to the 30 June 2009 agreement was, contrary to a representation given to Deloitte by Autonomy management, despatched to Morgan Stanley during August and September 2009, and thus in Q3 2009 rather than Q2 2009"*²⁴⁷.

Mr Holgate's analysis and conclusions in respect of the accounting treatment for the transaction

- 5.46 Mr Holgate's First Report states, based on the two instructed assumptions, that in respect of the Morgan Stanley Hardware Transaction:
- "It seems clear to me that only two of IAS 18's five criteria for revenue recognition were met as at 30 June 2009. Hence it was contrary to IFRS to recognise revenue on this transaction in Q2 2009."*²⁴⁸
- 5.47 According to Mr Holgate:
- "In a sale of goods transaction such as this one, the application of IAS 18's criteria for revenue recognition are quite straightforward. Unless there were any complications or unusual features - and I am not aware of any - the date of delivery of the goods to Morgan Stanley (MS) is a strong indicator of the date on which revenue should have been recognised".*²⁴⁹
- 5.48 More specifically, the transaction can be tested against the IAS 18.14 criteria, according to Mr Holgate, as follows.
- 5.49 Mr Holgate's view in relation to IAS 18.14(a) is that:

²⁴⁶ Mr Holgate's First Report, Appendix 2, page 5.

²⁴⁷ Mr Holgate's First Report, Appendix 2, page 5.

²⁴⁸ Mr Holgate's First Report, paragraph 4.54.

²⁴⁹ Mr Holgate's First Report, paragraph 4.53.

“In the absence of evidence to the contrary, risks and rewards of ownership of the hardware would be transferred to MS [Morgan Stanley] at the time of delivery, which I understand to be August/September 2009.

Hence, limb 14(a) is not met.”²⁵⁰

5.50 Mr Holgate’s view in relation to IAS 18.14(b) is that:

“Again, in the absence of evidence to the contrary, it appears that Autonomy would not have transferred continuing managerial involvement with the goods in question until the time of delivery, which I understand to be August/September 2009.

Hence, limb 14(b) is not met.”²⁵¹

5.51 Mr Holgate’s view in relation to IAS 18.14(c) is that IAS 18.14(c) was met.

5.52 Mr Holgate’s view in relation to IAS 18.14(d) is that:

“As there had been no delivery or transfer of control at 30 June 2009, it can be inferred that there was no reason, as at 30 June 2009, why MS [Morgan Stanley] would have been willing to pay for the goods.

Hence, limb 14(d) is not met.”²⁵²

5.53 Mr Holgate’s view in relation to IAS 18.14(e) is that IAS 18.14(e) was (likely) met, although he makes the point that the facts that he is asked to assume do not cover the point. However, he then goes further and asserts that, as it seems likely from the context that Autonomy would have known, at 30 June 2009, the cost of the goods in question that limb 14(e) was met.²⁵³

5.54 Based on the above, and particularly his observations, Mr Holgate concludes that as only two of IAS 18’s five criteria for revenue recognition were met as at 30 June 2009, it was contrary to IFRS to recognise revenue on the transaction in Q2 2009.²⁵⁴

My opinion on the accounting treatment adopting the Holgate-Morgan Stanley Assumptions

5.55 Below, I comment in turn on each of the two Holgate-Morgan Stanley Assumptions Mr Holgate is instructed apply to this transaction, without any consideration of the underlying facts.

²⁵⁰ Mr Holgate’s First Report, table at paragraph 4.53.

²⁵¹ Mr Holgate’s First Report, table at paragraph 4.53.

²⁵² Mr Holgate’s First Report, table at paragraph 4.53.

²⁵³ Mr Holgate’s First Report, table at paragraph 4.53.

²⁵⁴ Mr Holgate’s First Report, paragraph 4.54.

- 5.56 In respect of the first assumption that Mr Holgate has been instructed to make, there does not appear to be any dispute that US\$6 million of revenue was recognised by Autonomy in Q2 2009 in relation to the Morgan Stanley Hardware Transaction.
- 5.57 Accordingly, I do not add any further comment on this assumption.
- 5.58 In relation to the second Holgate-Morgan Stanley Assumption, in my opinion a sale can be genuine regardless of when inventory is physically despatched.
- 5.59 This is because it is more appropriately a matter of title to the goods passing, as well as the question of when the risks and rewards associated with the goods pass. The date of delivery of goods, even according to Mr Holgate, is only an indicator (albeit a strong one), even then in the absence of any complications or unusual features.²⁵⁵
- 5.60 In other words, substantive performance conditions under a contract (such as physical delivery) do not always have to be met in order for the IAS 18.14 criteria to be met and revenue recognised.
- 5.61 As noted, Mr Holgate implicitly confirms this by acknowledging that *“Unless there were any complications or unusual features ... the date of delivery of the goods to Morgan Stanley... is a strong indicator of the date on which revenue should have been recognised”*.²⁵⁶
- 5.62 In other words, in a straightforward sale and purchase of goods, the date of delivery could positively be a primary indicator for the appropriate date of revenue recognition.
- 5.63 However, this might not be the case where there might be complications or unusual features in the transaction.
- 5.64 Mr Holgate states that he is not aware of any such complications or unusual features.
- 5.65 Likewise, every comment Mr Holgate makes in respect of his analysis of the IAS 18.14 criteria (where he concludes that the relevant limb or condition is not met on the assumptions) is caveated by one or more of *“in the absence of evidence to the contrary”*, *“it appears ...”* or *“... it can be inferred that ...”*.²⁵⁷
- 5.66 Notwithstanding these qualifications across the board, Mr Holgate then proceeds however to state that it ‘seems clear’ that it was contrary to IFRS to recognise revenue on the transaction in Q2 2009, and does so in unequivocal terms.
- 5.67 That is, Mr Holgate proceeds and concludes on the only basis that he can, given the assumptions he is instructed to make. For example, if the only assumption he is given (in

²⁵⁵ Mr Holgate’s First Report, paragraph 4.53.

²⁵⁶ Mr Holgate’s First Report, paragraph 4.53.

²⁵⁷ Mr Holgate’s First Report, paragraph 4.53.

the absence of the facts), is that despatch of the hardware did not occur until after 30 June 2009, then he can only comment by regard to date of despatch or date of delivery of the referred to hardware.

- 5.68 Concluding on revenue recognition based only on an actual physical delivery of hardware to Morgan Stanley is, however, not conclusive in accounting treatment terms.
- 5.69 Although it is possible that the analysis in Mr Holgate's First Report at paragraphs 4.52 to 4.54 is appropriate, it is not necessarily the case. For this type of transaction it is necessary to understand more than the assumptions in Mr Holgate's paragraph 4.52.
- 5.70 In summary, therefore, in my opinion neither of the Holgate-Morgan Stanley Assumptions makes any difference to the accounting for this transaction, since the first assumption is not disputed, and the second assumption, Mr Holgate himself acknowledges, is useful only in the absence of evidence to the contrary that there were no complications or unusual features.
- 5.71 I now turn to that evidence.

My understanding of the facts applicable to the Holgate-Morgan Stanley Assumptions, and my conclusion on the accounting treatment

- 5.72 In this section I set out my understanding of the facts applicable to the Holgate-Morgan Stanley Assumptions in relation to this transaction.
- 5.73 For this transaction Mr Holgate's methodology is slightly different to other transactions and I explain what this means for my approach concerned.
- 5.74 In addition, I also set out why my approach to this transaction involves dealing with a much broader set of circumstances rather than restricting it only to facts touching on the assumptions given to Mr Holgate, and for a wider set of transactions in the summer of 2009 (see paragraph 5.17 above).
- 5.75 Next I deal with an aspect not covered by Mr Holgate (or Deloitte) - that is whether this transaction qualified as what is called a "bill and hold" sale - and the implications of that if it did.
- 5.76 I then set out my understanding of the relevant facts for the wider set of transactions needed to understand this impugned transaction i.e.:
- (a) the Autonomy - Morgan Stanley transactions in June - September 2009;
 - (b) the Autonomy - Hitachi/HDS transactions in June - August 2009; and
 - (c) the Autonomy - EMC transactions in June - September 2009.

5.77 I also include some relevant correspondence between Autonomy and Deloitte, and then summarise the factual position.

5.78 I then set out my conclusion on the accounting for the transaction.

My approach to this transaction so far as Mr Holgate's methodology is concerned

5.79 Elsewhere in my report, I adopt the approach of setting out my understanding under each of the accounting requirements opined upon by Mr Holgate in respect of the applicable transaction, which in this transaction would mean:

- (a) IAS 18.14(a);
- (b) IAS 18.14(b); and
- (c) IAS 18.14(d).

5.80 However, in his approach to commenting on the revenue recognition relating to this transaction, Mr Holgate uses the same reason (i.e. timing of delivery) to come to the conclusion that each of these three criteria of IAS 18.14 were not met as at 30 June 2009, being the original date of revenue recognition by Autonomy.

5.81 My understanding is, therefore, that Mr Holgate's position is that only physical delivery of the hardware (based on the assumptions given) should trigger revenue recognition in the context of this transaction.

5.82 Accordingly, I deal with my understanding of the facts applicable to this single issue rather than by consideration against each of the applicable criteria of IAS 18.14, although as I have alluded to, this appears to me to be an issue around a much broader set of circumstances.

5.83 Further, in respect of the applicable first assumption, that in Q2 2009 Autonomy recognised US\$6 million of revenue in relation to a sale by Autonomy of hardware to Morgan Stanley pursuant to an agreement dated 30 June 2009, this I understand is not in dispute. Accordingly, I do not comment further on this assumption.

5.84 Finally, Mr Holgate did not provide any opinion concerning the economic substance of this transaction, and therefore I do not address this as an issue. I assume, however, that Mr Holgate agrees that the transaction had substance, i.e. did not lack substance or economic substance, and proceed on this basis. Similarly, Mr Holgate is not instructed to consider the relevant cost of the hardware sold, and therefore I likewise do not address this.

5.85 The only issue, therefore, is the appropriate date for revenue recognition.

Why my approach to this transaction involves dealing with a much broader set of circumstances

- 5.86 I do not believe that this transaction can be understood on its own outside of a broader range of related transactions.
- 5.87 A review of the documentation provided by the Claimants in their Voluntary Particulars in relation to this transaction shows there are a number of other parties involved.
- 5.88 First, the provider or manufacturer of the hardware that was actually delivered to Morgan Stanley was Hitachi Data Systems (“HDS”, “Hitachi”), not Autonomy.²⁵⁸
- 5.89 Second, a comparison between the Hitachi hardware quote provided to Autonomy (HDS Quote ID 5251967.0001, dated 30 June 2009²⁵⁹), and the shipment notification of equipment shipped to Morgan Stanley pursuant to HDS Quote ID 5251967.0001²⁶⁰, shows that the documented ‘date shipped’ was recorded to be 19 August 2009, but also that the shipment made by Hitachi included different, additional items to that requested as at 30 June 2009 (by Autonomy purchase order to HDS) in any event.
- 5.90 Third, comparing Autonomy’s general ledger hardware revenue listing for Q3 2009, as relied upon by the Claimants in their Voluntary Particulars²⁶¹, to the Hitachi hardware delivery to Morgan Stanley similarly disclosed, shows that Autonomy recorded five other sales of hardware to Morgan Stanley in Q3 2009.
- 5.91 These Autonomy sales were recorded in August 2009 (one) and September 2009 (four), corresponding to the same period covered by the equipment shipment notes disclosed in MS 2009-07, which it therefore appears is the basis (and documentation) upon which the Claimants’ rely for the delivery dates in relation to the assumption for delivery made regarding this transaction.
- 5.92 In this transaction in particular, the subsequent physical delivery of hardware to Morgan Stanley is only a small element of the transaction. In my opinion, and more so in relation to this transaction, only once the entirety of the transaction has been properly laid out and understood can the question of when and how much revenue to recognise be addressed.²⁶²

²⁵⁸ My understanding is derived from a comparison of the Claimant’s voluntary particulars MS 2009-07, pages 14-16 but in particular MS 2009-07 page 16 with the ‘contract number FE677000’, compared to MS 2009-07, pages 19-22 and the associated detail including ‘Waybill Number FE 6770 F’ (as well as order status, reference number, contract number, date shipped and PO number). The hardware actually delivered to Morgan Stanley was physically delivered in the period 19-24 August 2009.

²⁵⁹ Voluntary Particulars, document “MS 2009-07”, page 7.

²⁶⁰ Voluntary Particulars, document “MS 2009-07”, pages 19-22.

²⁶¹ Voluntary Particulars, document “MS 2009-06”.

²⁶² As part of this, I also comment on the EMC hardware purchased.

5.93 As a result, in order to reach a conclusion, it is therefore necessary to understand more about the underlying transaction and what was agreed to be delivered, and if applicable why the delivery was delayed, and whether Morgan Stanley specifically requested this approach. Given the absence of any factual summary in relation to the Morgan Stanley Hardware Transaction as identified by the Claimants to Mr Holgate, I set out below a factual background to this transaction, as I can understand it, based on the sources of information available to me.

5.94 I note here that when looking at the wider set of transactions it becomes apparent that the second assumption given to Mr Holgate is factually incorrect.

5.95 The second assumption states as follows:

*“The (Hitachi) hardware that was sold to Morgan Stanley pursuant to the 30 June 2009 agreement was, contrary to a representation given to Deloitte by Autonomy management, despatched to Morgan Stanley during August and September 2009, and thus in Q3 2009 rather than Q2 2009.”*²⁶³

(my emphasis)

5.96 The actual applicable representation given to Deloitte by Autonomy management was as follows:

*“We are satisfied that the acquisition of \$9.0 million of hardware from EMC Corporation was an arms length commercial transaction. Additionally, we confirm that the despatch of hardware with a purchase price of \$5.0 million was made from EMC Corporation on the 30 June 2009.”*²⁶⁴

(my emphasis)

5.97 By reference to the emphasised phrases above, the despatch dates in the assumption relate also to purchases under the Morgan Stanley purchase commitment. Further, Autonomy management provided confirmation over the despatch of EMC hardware. No representation was made by Autonomy regarding Autonomy’s sale of hardware to Morgan Stanley or any aspect of it, contrary to the instruction provided to Mr Holgate.

Whether this transaction qualified as a “bill and hold” sale - and the implications of that

5.98 Before I address the circumstances of the transaction, however, it appears relevant to me to set out a material accounting consideration, unmentioned by Mr Holgate (or Deloitte).

²⁶³ Mr Holgate’s First Report, Appendix 2, Annex 1, page 5, paragraph 3.3.2.

²⁶⁴ {POS00132681}, page 2.

- 5.99 Assuming the final hardware despatch date is August 2009, the sale may have qualified as a 'bill and hold' sale. As noted elsewhere in this report and my First Report, revenue is recognised based on the specific circumstances of the transaction and there are many variations of underlying facts that can give rise to different accounting treatment.
- 5.100 The IAS 18 Appendix gives various illustrative examples showing that significant risks and rewards of ownership can pass at different times, depending on the circumstances. It directly confirms that it is possible that the risks and rewards of ownership can pass to a customer before any economic benefits pass to the customer via performance of contractual promises such as delivery. It is possible for the situation to arise, therefore, where the benefits to the customer of ownership of the goods in question attach not to the actual physical possession of the goods.
- 5.101 These forms of sale are highlighted in Illustrative Example 1 to IAS 18, where in the illustrative example it is presumed that delivery is delayed at the buyer's request but nevertheless the buyer accepts or takes title and accepts billing. This is referred to as a bill and hold sale.
- 5.102 IAS 18 Appendix IE1 notes in respect of its example of a bill and hold sale, that revenue is recognised²⁶⁵ when the buyer takes title, provided:
- (a) It is probable that delivery will be made;
 - (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;
 - (c) the buyer specifically acknowledges the deferred delivery instructions; and
 - (d) the usual payment terms apply.
- 5.103 Therefore, revenue can be recognised on a bill and hold sale meeting the above criteria where an entity bills a customer for goods but does not deliver those goods until a later date.
- 5.104 The appendix to IAS 18 acknowledges also as follows:
- "The law in different countries may mean the recognition criteria in the Standard are met at different times. In particular, the law may determine the point in time at which the entity transfers the significant risks and rewards of ownership. Therefore, the examples in this section need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place."*²⁶⁶

²⁶⁵ Revenue is not recognised when there is merely an intention to acquire or manufacture the goods in time for delivery.

²⁶⁶ IAS 18, Appendix A.

- 5.105 This does not mean that different revenue recognition criteria are applied in different countries but, rather, the recognition criteria are met at different times in different countries. The principle remains that the significant risks and rewards of ownership must have passed from the seller to the buyer.
- 5.106 Thus, under applicable law physical possession may not be a requirement for the economic benefits of the goods, or significant risks and rewards of ownership, to have passed to the customer. By way of example, this might be evidenced by a requirement for the customer to pay for the cost of storage, shipment and insurance on the goods even before taking physical possession. The criteria are also still relevant but may be broadly interpreted.
- 5.107 For example, where it might be expected that delivery has to be delayed at the buyer's request, in fact this is not explicitly stated, and is not a mandatory requirement. Hence, it is open to interpretation that IAS 18 accommodates recognising revenue in situations where the arrangement is prompted not by the customer but by the vendor (maybe because of hold-ups in the delivery process).
- 5.108 Similarly, IAS 18 could also allow a vendor to recognise revenue from a bill and hold arrangement as long as the vendor has enough of the item generally to be able to deliver it when requested, and meets all the other criteria. This is because the item has only to be on hand, identified and ready for delivery 'at the time the sale is recognised', albeit the seller must have had title to the goods, otherwise the seller could not validly have transferred title to the customer.²⁶⁷
- 5.109 As explained in my First Report, inter alia, "*Only once the transaction has been properly understood, can the questions of when and how much revenue to recognise be addressed*"²⁶⁸.
- 5.110 Similarly, based on various contemporaneous accounting guidance, I noted that while in most cases the transfer of the risks and rewards of ownership coincided with the transfer of the legal title or the passing of possession to the buyer, this may not always be the case²⁶⁹. I also noted that one of the considerations of revenue recognition was the shipment terms²⁷⁰; and another consideration was that it was important to establish the responsibilities of each party during the period between sale and delivery²⁷¹. In other words, a clear understanding of all the terms agreed between the parties is fundamental

²⁶⁷ In my view a comparison to US GAAP bill and hold requirements illustrates comfortably some of the IFRS bill and hold sales requirements in practice, which are much less specific than the US GAAP requirements. See Exhibit AAA - KPMG 2009 US GAAP - IFRS comparison.

²⁶⁸ My First Report, paragraph 4.26.

²⁶⁹ My First Report, paragraph 4.37.

²⁷⁰ My First Report, paragraph 4.42.

²⁷¹ My First Report, paragraph 4.39.

to the issue of revenue recognition, including if applicable the point in time when the buyer accepts billing.

- 5.111 As a result, simply saying as Mr Holgate does, for example, that “*In the absence of evidence to the contrary, risks and rewards of ownership of the hardware would be transferred ... at the time of delivery*” and that as a result of the post quarter end delivery IAS 18.14(a) was not met, is in my opinion incorrect.
- 5.112 As EY acknowledges in its relevant accounting guidance on bill and hold sales under IFRS, this is an area of revenue recognition in practice that “*might be open to inconsistent, controversial or varied accounting practices*”.²⁷²
- 5.113 The above takes on greater meaning in the context of the actual representation²⁷³ (as opposed to that included in the second assumption given to Mr Holgate) made by Autonomy management to Deloitte as at 30 June 2009.
- 5.114 However, if it did qualify as a bill and hold sale then revenue could be recognised despite no physical delivery at Autonomy’s point of revenue recognition.

The Facts: Autonomy - Morgan Stanley: June-September 2009

- 5.115 On 30 June 2009, Autonomy entered into a letter agreement with Morgan Stanley (pursuant to a Master Purchase Agreement of the same date²⁷⁴) titled “*RE: Purchase of Certain Hardware and Software from Autonomy, Inc.*”²⁷⁵ (the “Morgan Stanley Letter Agreement”).
- 5.116 In the Morgan Stanley Letter Agreement, Morgan Stanley agreed that on or before 30 June 2010, it would:
- “... purchase from Autonomy hardware and related software (collectively, the ‘Equipment’), manufactured and supplied by Autonomy’s third party supplier, Hitachi Data Systems Corporation (‘HDS’) or other third party suppliers agreed upon by the parties ... with an aggregate value of Twenty Million United States Dollars (US \$20,000,000.00) (the ‘Purchase Commitment’) ...”*²⁷⁶
- 5.117 The value of the purchases made towards satisfaction of the US\$20.0 million Purchase Commitment is stated to be determined by reference to the prices that Morgan Stanley

²⁷² Exhibit BBB - Ernst & Young 2008 International GAAP Volume 2, page 2053.

²⁷³ See paragraph 5.96: “... we confirm that the despatch of hardware with a purchase price of \$5.0 million was made from EMC Corporation on the 30 June 2009”.

²⁷⁴ {D008500518}.

²⁷⁵ {D003987275}.

²⁷⁶ {D003987275}, page 1.

could have purchased the Equipment at if the purchases were made directly from the suppliers.²⁷⁷ However, the agreement also stipulated that the:

“... aggregate purchase price to be paid to Autonomy by Morgan Stanley for the Equipment purchase pursuant to this Purchase Commitment shall be Thirteen Million Five Hundred Thousand United States Dollars (US \$13,500,000.00).”²⁷⁸

5.118 In other words, Autonomy and Morgan Stanley agreed that Autonomy would source for Morgan Stanley over the following 12 months US\$20 million of hardware and related software (‘Equipment’) for the agreed aggregate purchase price of US\$13.5 million.

5.119 The Morgan Stanley Letter Agreement further noted, however, that it (the letter agreement) and the parties’ performance under it was specifically:

“... made contingent on Morgan Stanley submitting a purchase order to Autonomy on or before June 30, 2009 for Equipment, with an aggregate purchase price to Autonomy of Six Million United States Dollars (US \$6,000,000.00) valued with reference to the price Morgan Stanley would have paid the applicable Supplier had it bought the equipment directly from the Supplier. Such purchase order shall be in addition to, and not in place of, the purchase orders otherwise required to satisfy the Purchase Commitment.”²⁷⁹

5.120 In respect of the transfer of title, risk of loss, delivery and acceptance of the Equipment (possibly pursuant it appears - although it is a matter of legal interpretation outside my expertise - only to the Purchase Commitment) and the transfer of risks and rewards of ownership, the Morgan Stanley Letter Agreement stated:

“Unless the parties agree otherwise in writing, title and risk of loss in and to the Equipment shall pass to Morgan Stanley F.O.B. [Free On Board] Autonomy’s warehouse, and acceptance shall be deemed to occur upon shipment in accordance with the Agreement. Autonomy shall accept delivery of all Equipment from [Equipment suppliers] at its warehouse facilities. Upon direction from Morgan Stanley, Autonomy shall, at its sole cost and expense, cause such Equipment to be delivered to each location specified by Morgan Stanley from time to time. Autonomy shall indemnify and hold harmless Morgan Stanley and its affiliates from and against any and all claims, liabilities, losses and damages to the Equipment until the Equipment is installed by Morgan Stanley or pursuant to Morgan Stanley’s instruction... Morgan Stanley may deploy any Equipment [including purchased under the US\$6 million purchase order] in any facility of Morgan Stanley or its affiliates, including any facility of a third party contractor, subcontractor, or service

²⁷⁷ {D003987275}, page 1.

²⁷⁸ {D003987275}, page 1.

²⁷⁹ {D003987275}, page 2.

provider engaged by Morgan Stanley or its affiliates to provide services for Morgan Stanley and/or its affiliates' benefit, which includes, without limitation, Autonomy and its affiliates."²⁸⁰

5.121 The 'Agreement' referred to above was the Master Purchase Agreement entered into between Autonomy and Morgan Stanley also on the same date i.e. 30 June 2009.

5.122 According to the Morgan Stanley Letter Agreement, the parties to the Morgan Stanley Letter Agreement agreed that (at least) the Purchase Commitment was made pursuant to the terms of the Agreement.

5.123 The Morgan Stanley Letter Agreement was agreed to be governed by, and construed in accordance with, the internal laws of the State of New York.²⁸¹

5.124 The Master Purchase Agreement with Morgan Stanley stated the following in respect of purchase orders²⁸²:

"If any of the terms or conditions of this Agreement conflict with any of the terms or conditions of any Purchase Order, unless otherwise provided herein, the terms or conditions of this Agreement will control. Subject to the terms and conditions hereof, [Autonomy] agrees to sell the products, and all associated documentation, identified in a Purchase Order (the "Products"), in the quantities, at the prices ("Product Prices") set forth in the applicable Purchase Order".

5.125 The Master Purchase Agreement further stated the following in respect of transfer of title, risk of loss, acceptance, payment, shipment, delivery, installation and warranties²⁸³:

*"The Products shall be deemed accepted upon delivery to the address(es) specified in an applicable Purchase Order, which may be Seller's [Autonomy's] warehouse."*²⁸⁴

*"All payments due to [Autonomy] by Morgan Stanley hereunder shall be payable forty-five (45) days following the date of receipt of an invoice from [Autonomy]."*²⁸⁵

*"[Autonomy] is fully responsible for all shipping, logistics and associated costs, and shall make the Products available to Morgan Stanley at the delivery site stipulated in the relevant Purchase Order."*²⁸⁶

"Title and risk of loss for the Product(s) shall transfer to Morgan Stanley upon shipment from the Product(s) manufacturer, provided, however, [Autonomy] shall indemnify and

²⁸⁰ {D003987275}, page 2.

²⁸¹ {D003987275}, page 3.

²⁸² {D008500518}, paragraph 1.

²⁸³ {D003996766}, pages 1 to 2.

²⁸⁴ {D003996766}, paragraph 2.

²⁸⁵ {D003996766}, paragraph 3.

²⁸⁶ {D003996766}, paragraph 5.

hold harmless Morgan Stanley and its affiliates from and against any and all claims, liabilities, losses and damages to the Products until the Products are installed by Morgan Stanley or pursuant to Morgan Stanley's instruction; provided further and notwithstanding the foregoing to the contrary, in no event shall Seller be liable for any damage or liability to the extent arising by reason of any act or omission of Morgan Stanley or any of its contractors (excluding [Autonomy] or its affiliates), as applicable.” [original emphasis]²⁸⁷

“The parties acknowledge and agree that, prior to installation, Morgan Stanley and its affiliates shall have the right to confirm the Products shipped hereunder, including, without limitation, confirming the manufacturer, product number and SKUs for each such Product so shipped, and shall notify Seller of any variance thereof, which variance shall be promptly remedied by Seller at its sole cost and expense.”²⁸⁸

“[Autonomy] shall pass through and make available to Morgan Stanley any manufacturer's warranties available from the Products manufacturer, to the extent the applicably supply contracts with such manufacturer(s) allow such warranties to be so passed to Morgan Stanley.”²⁸⁹

- 5.126 The Master Purchase Agreement was also agreed to be governed by, and construed in accordance with, the internal laws of the State of New York.²⁹⁰
- 5.127 A Morgan Stanley purchase order in respect of US\$6.0 million of ‘Bulk Premium MASS Storage Devices (3.278 Petabytes)’ was issued to Autonomy on 30 June 2009 with reference NADO361176^{291,292}. Shipment was noted to be to ‘Morgan Stanley, 1 New York Plaza, New York NY 10004’.
- 5.128 I have also seen an unsigned, unheaded purchase order dated 30 June 2009, stating that it was issued under and pursuant to the Master Purchase Agreement, with an as yet blank ‘TB’ requirement of mass storage, to be provided using certain of the hardware included in a detailed accompanying hardware matrix. The matrix listed hardware from Hitachi (HDS), EMC and Zantaz (ZTZ).²⁹³

²⁸⁷ {D003996766}, paragraph 5.

²⁸⁸ {D003996766}, paragraph 5.

²⁸⁹ {D003996766}, paragraph 6.

²⁹⁰ {D003996766} page 3, paragraph 10(b).

²⁹¹ {DEL1_003_1_00000110}, email dated “Wednesday, July 01, 2009 12.12 AM” which includes purchase order NADO361176.

²⁹² The purchase order is actually dated 1 July 2009, however, this is stated to be “EDT” (Eastern Daylight Time) and is included in an email dated 1 July 2009 12.12 AM. As Eastern Daylight Time is three hours ahead of Pacific Daylight Time (the time zone in San Francisco) the purchase order was in fact issued on 30 June 2009.

²⁹³ {D010800423}. See generally also {D010800421}-{D010800423}; and {D003998350}-{D003998350A}

- 5.129 Autonomy issued an invoice to Morgan Stanley, 5614-ANA dated 30 June 2009, for US\$6.0 million, referencing purchase order NADO361176.²⁹⁴ Payment terms were ‘net 45’.
- 5.130 On 2 July 2009, Kathleen Macedonio (Consultant at Morgan Stanley) emailed Cynthia Watkins (Autonomy) to confirm “*So this is payment only, correct*”.²⁹⁵
- 5.131 On the same day, Cynthia Watkins emailed confirmation back to Morgan Stanley that “*... I am confirming that we received the PO and that your order is assembled in our Pleasanton facility. So payment can be issued as we have fulfilled the order.*”²⁹⁶
- 5.132 Again on the same day, Morgan Stanley replied, emailing “*The order has been received in so payment can be released*”.²⁹⁷
- 5.133 As I have previously noted above²⁹⁸, physical delivery of the US\$6 million revenue associated hardware to Morgan Stanley occurred in the period in and around 19-24 August 2009. The hardware delivered in August 2009 to Morgan Stanley was HDS hardware.
- 5.134 Autonomy subsequently received the US\$6 million in payment from Morgan Stanley on 16 September 2009.²⁹⁹

The Facts - Autonomy - Hitachi/HDS: June-August 2009

- 5.135 Autonomy entered into a “*ONE-TIME RESELLER AUTHORIZATION AGREEMENT*” with HDS, effective 27 June 2009, to purchase hardware for onward sale to Morgan Stanley.³⁰⁰
- 5.136 Attached to the One-time Reseller Authorization Agreement was a list of equipment and services that HDS agreed Autonomy could resell to Morgan Stanley. I assume that the list set out the hardware included in quote ID 5251967.000 below.
- 5.137 Under the One-time Reseller Authorization Agreement, HDS agreed on behalf of Autonomy to provide Morgan Stanley with the services required to install and support the hardware, as well as warranties associated with the hardware. Title and risk of loss was to pass to Autonomy FOB HDS distribution centre, and the hardware deemed accepted upon shipment.³⁰¹

²⁹⁴ {DEL1_003_1_00000039}. I note that a copy of invoice 5614-ANA is also included in the Claimants’ Voluntary Particulars referenced MS 2009-05. This copy is dated 6 July 2009 rather than 30 June 2009. It appears that the invoice was reissued because the original did not include tax.

²⁹⁵ {DEL1_003_1_00000110}.

²⁹⁶ {DEL1_003_1_00000110}.

²⁹⁷ {DEL1_003_1_00000110}.

²⁹⁸ Footnote 258 of this report.

²⁹⁹ Voluntary Particulars, document “MS 2009-10”.

³⁰⁰ {D004002248}.

³⁰¹ In general terms, FOB is a shipping term that stands for ‘free on board’. If a shipment is designated FOB (the seller’s location), then as soon as the shipment of goods leaves the seller’s warehouse, the seller records the sale as complete. The buyer owns the products en route to its warehouse and must pay any delivery charges.

- 5.138 No right of return was granted under the One-time Reseller Authorization Agreement, with all hardware issues to be handled by HDS on behalf of Autonomy.
- 5.139 A quote for the hardware was issued by HDS pursuant to this agreement on 30 June 2009; it stated the quote ID as 5251967.0001 and the total purchase price as just under US\$6.0 million.³⁰²
- 5.140 The quote issued covered equipment of the nature that Morgan Stanley was seeking to acquire at this time i.e. storage equipment included in the undated purchase order that I refer to above.
- 5.141 Autonomy issued the relevant purchase order for the HDS hardware on the same day (30 June 2009) with the purchase order number PO09410-0.³⁰³
- 5.142 The purchase order referenced the quote ID 5251967.0001 and stated the total price to be US\$5,997,303.00.³⁰⁴ The hardware was listed to be shipped to Switch Communications, C/O Zantaz, Nevada. Shipping terms were 'FOB: ShipPt'. The product description was 'AMS Storage solutions per June 30, 2009'.
- 5.143 There is further background to the intended arrangement between Autonomy, Morgan Stanley and HDS in email correspondence from the time.³⁰⁵
- 5.144 HDS invoiced Autonomy for this hardware on 21 September 2009 (invoice number 7128700) referencing purchase order PO09410-0.³⁰⁶ As I have already noted, in fact it appears that the hardware was shipped from HDS on 19 August 2009 and was received by Morgan Stanley between 21-24 August 2009.³⁰⁷ The invoice separately confirms that the equipment was referenced as 'Install at - Morgan Stanley, 1 New York Plaza, New York NY 10004'.
- 5.145 I assume, therefore, that title to the HDS hardware did not pass to Autonomy any earlier than 19 August 2009 under the terms of the One-time Reseller Authorization Agreement.

The Facts - Autonomy - EMC: June-September 2009

- 5.146 Separately, and around the same time, Autonomy was negotiating with EMC to purchase hardware. It appears that each of HDS and EMS was seeking to make sales to Autonomy for their own quarter end revenue requirements, and was targeting Autonomy because of Autonomy's Digital Safe hardware storage requirements.³⁰⁸

³⁰² Voluntary Particulars, document "MS 2009-07", page 7: US\$5,997,303.00.

³⁰³ Voluntary Particulars, document "MS 2009-07", page 6.

³⁰⁴ Voluntary Particulars, document "MS 2009-07", page 6.

³⁰⁵ See, for example, {D004008195}.

³⁰⁶ Voluntary Particulars, document "MS 2009-07", page 5.

³⁰⁷ Voluntary Particulars, document "MS 2009-07", pages 16 and 19 to 22.

³⁰⁸ See, for example, {D004048982}, {D004044674}, {D004012248}. According to Mike Sullivan, EMC "... must really need the deal for the qtr."

- 5.147 For example, on or around 17 June 2009 EMC appeared to be offering to sell to Autonomy US\$4.5 million of equipment for US\$2.96 million, with EMC acknowledging that there was an opportunity of a larger deal with Autonomy for the sale of US\$5 million of equipment to Autonomy³⁰⁹. This was against a background of a similar offer from HDS for the sale and purchase of US\$5 million of HDS hardware in return for a commitment from HDS to purchase Autonomy software of US\$2.5 million in Q2 2009.³¹⁰ The context of the negotiations appears to be Digital Safe related, and Autonomy moving Digital Safe towards HDS drives.
- 5.148 Subsequently, on 29 June 2009, Autonomy entered into an arrangement to purchase US\$9.0 million of hardware from EMC.³¹¹ The context again appeared to be Digital Safe related.³¹² According to the same correspondence, it appears that Autonomy considered that it was successful in reaching a very good deal for Autonomy in terms of negotiated purchase price for the goods or products receivable.³¹³
- 5.149 The order for hardware ('Order Letter No.3'³¹⁴) was made by Zantaz to EMC, and was made subject to the terms and conditions of the Basic Ordering Agreement between the parties dated 22 September 2006.³¹⁵
- 5.150 The Basic Ordering Agreement between the parties dated 22 September 2006 consists of 'general terms and conditions', and, inter alia, an 'equipment exhibit' to the Basic Ordering Agreement. In general terms, following EMC's completion of an order or portion thereof, EMC "will issue an invoice for the Products with respect to which the order is complete".³¹⁶ The Basic Ordering Agreement was governed by the laws of the Commonwealth of Massachusetts.³¹⁷
- 5.151 Under the 'equipment exhibit', and the section titled 'Delivery and Acceptance', the agreement stated:
- "Title and risk of loss for Equipment shall transfer to Customer upon EMC's delivery to Customer location specified by Customer, except that for any shipment made during the last two weeks of any calendar quarter, title and risk of loss for Equipment shall pass to Customer FOB EMC's point of shipment. For shipments made during the last two weeks of any calendar quarter, EMC will provide and pay the cost of insurance, and in the event*

³⁰⁹ {D004044674}.

³¹⁰ {D004048982}.

³¹¹ {D003646889}.

³¹² {D004012248}. Introspect, or EDD, is also referred to.

³¹³ It is possible that the fair value of the US\$9 million EMC goods referred to at this time may have exceeded the purchase price, but I do not have any information to assess this further.

³¹⁴ {D003646889}.

³¹⁵ {D000707351}.

³¹⁶ {D000707351}, page 2, paragraph 2A.

³¹⁷ {D000707351}, page 4, paragraph 14.

*of damage to the Equipment during transit, EMC will assist in filing necessary claims with the appropriate parties and will make commercially reasonable efforts to make replacement Equipment available to Customer. Unless otherwise agreed in an order, EMC shall pay all shipment related charges and transit insurance.”*³¹⁸

5.152 Order Letter No.3 stated “EMC shall ship the Products on or about June 29, 2009, to the following location” and listed five locations, including Switch Communications and Zantaz, Pleasanton.

5.153 According to Order Letter No.3:

“Delivery of Equipment and Software shall be F.O.B. EMC’s shipping location. EMC shall be responsible for all costs of shipment including cost of insurance. In the event the Equipment is damaged or lost during shipment, EMC will assist in filing necessary claims with the appropriate parties.”

*“Payment terms are Net 30 days from date of invoice.”*³¹⁹

5.154 In fact, the order involved an upfront payment by Autonomy of US\$5 million to EMC,³²⁰ with subsequent financed instalment payments for the balance of US\$4 million. The payment of the US\$5 million was made by Autonomy on 30 June 2009, i.e. pre-quarter end.³²¹

5.155 I am unable to comment on any Basic Ordering Agreement meaning of the upfront US\$5 million payment from Autonomy to EMC made pre-quarter end, since the Basic Ordering Agreement in the ‘Ordering, Pricing and Payment’ general terms and conditions appears not to contemplate this scenario.³²² I assume, however, that EMC accepted payment in this way so that for its own financial reporting requirements³²³ it could recognise revenue in the same period.³²⁴

5.156 On invoice date 30 June 2009, EMC issued ‘proforma’ invoices to Autonomy totalling approximately US\$9 million. The proforma invoices included language stating ‘Invoices will be revised once order is shipped’.³²⁵

³¹⁸ {D000707351}, page 5.

³¹⁹ {D003646889}.

³²⁰ {D003646889}, page 3, and {D003950348}.

³²¹ Voluntary Particulars, document “MS 2009-04a”.

³²² {D000707351}, page 2, paragraph 2A.

³²³ EMC had a similar quarter end: <https://www.emc.com/about/news/press/2009/20090723-earnings.htm>.

³²⁴ Whether this was the case would necessarily be a matter of US GAAP at the time on which I do not comment in detail. However, I can make the general observation that unlike IFRS there was extensive guidance under US GAAP on revenue recognition specific to industries and types of contract.

³²⁵ {POS00121959}, pages 11 to 14.

- 5.157 On the one hand, it is stated that the proforma invoices were issued before the contract was signed³²⁶, and on the other hand that the proforma invoices provide confirmation that hardware had not been despatched as at 30 June 2009.³²⁷ The proforma invoices did not reference a 'Customer PO#' (Autonomy purchase order or order number), and therefore appear to support the former contention.³²⁸
- 5.158 It appears that EMC on or around 14 July 2009 agreed to re-issue the proforma sales invoices, with this language removed. Autonomy requested the reissued invoices on 13 July 2009³²⁹ in advance of the Q2 2009 Audit Committee meeting held on 14 July 2009³³⁰, noting that the equipment had already been paid for³³¹. In the event, EMC did provide revised invoices with the language removed, albeit with 'proforma' still on the top of the invoice and only then at the end of the US working day on 14 July 2009.³³²
- 5.159 Subsequently and almost immediately, it then appears that EMC began properly to re-issue the invoices, from 14 July 2009. Examples of the re-issued invoices show that they represented a series of invoices issued from 14 July 2009 onwards, nearly all referencing 'Order Letter #3'.³³³
- 5.160 Each of these fuller invoices referenced a 'document date' or 'invoice date', with dates between 14 July 2009 and 3 August 2009. The 'document date' or 'invoice date' matched the entry of 'date shipped'. The due date on each of the series of invoices was 30 days after the 'document date' or 'invoice date'. In other words, no account was taken on the face of any of the invoices (and it is not clear why) of the advance US\$5 million paid by Autonomy to EMC on 30 June 2009. The shipping terms noted on each of these fuller invoices were almost uniformly 'shipping point'.
- 5.161 It is unclear why Mike Sullivan was unable to obtain an email confirmation from EMC to confirm that 'all hardware ... was shipped to Autonomy on 30 June 2009'³³⁴, and I note that Mr Sullivan does not address this transaction at all, or his involvement in it, in his witness evidence. This is the case even though the Claimants' allege that Mr Sullivan "*did not*

³²⁶ {D003950370}.

³²⁷ Re-Re Amended Particulars of Claim, paragraph 63E.

³²⁸ {POS00121959}, pages 11 to 14.

³²⁹ {D003941703}.

³³⁰ {D003950370}.

³³¹ {D003941703}.

³³² {D003941703}. The email correspondence is timed after 5pm on 14 July 2009.

³³³ {D003555421}. There is a first page (annotated excel sheet) to these invoices, with no clear provenance. For the avoidance of doubt, I do not rely on this page. I do however note that it appears that, if applicable, any 'HULK' storage represented a small percentage of the overall order. See {D004001137} and {D004001138} and Exhibit LLL - Transcript of Proceedings, Volume 3, pages 344 to 345.

³³⁴ {D003950370}.

*request that EMC provide an email in the form suggested*³³⁵, thereby confirming his participation.

- 5.162 Nonetheless, on the face of the documents referred to above, it appears that EMC provide both confirmation that shipment of the equipment took place in Q2 2009, and separately that it was shipped in the weeks after 30 June 2009. The former is based in particular on the shipping terms referenced in the re-issued fuller invoices i.e. referencing ‘shipping point’, which of itself would require EMC sales hardware being shipped in the last two weeks of a calendar quarter according to the delivery and acceptance provisions of the Basic Ordering Agreement.³³⁶
- 5.163 If EMC therefore were confirming title to the EMC hardware did pass to Autonomy on 30 June 2009 in this way, then by virtue of this, Autonomy were in a probable position to have transferred title to Morgan Stanley under the Master Purchase Agreement. However, this appears in my view, to be a legal construction across different commercial agreements outside my area of expertise.
- 5.164 I note also that this does not explain the contradiction within the series of reissued EMC invoices, which had as a mirror entry on the invoice the same post quarter end shipping date as the ‘document date’ or ‘invoice date’, even though the shipping term was one applicable only to shipment in the last two weeks of a calendar quarter.
- 5.165 According to the Claimants, ultimately the EMC hardware was recorded as being accounted for by Zantaz as hardware for internal Autonomy use.³³⁷
- 5.166 Notwithstanding this, this does not create an accounting issue, particularly in a bill and hold transaction where title to goods passes before physical delivery or possession.
- 5.167 This is because in such a scenario, it was possible, under the Morgan Stanley Master Purchase Agreement, and prior to installation at Morgan Stanley, for Morgan Stanley:
- “... to confirm the Products shipped hereunder, including, without limitation, confirming the manufacturer, product number, and SKUs for each such Product so shipped, and shall notify Seller of any variance thereof, which variance shall be promptly remedied by Seller at its sole cost and expense.”*³³⁸
- 5.168 In other words, the agreement between Autonomy and Morgan Stanley allowed in any event confirmation of the Products to be installed at Morgan Stanley. That is, Morgan Stanley

³³⁵ Re-Re Amended Particulars of Claim, paragraph 63F.

³³⁶ See paragraph 5.151 of this report.

³³⁷ Re-Re Amended Particulars of Claim, paragraph 63I.2: see also Claimants’ voluntary particulars in relation to this transaction, including US\$7.179 million of hardware recognised by Zantaz (see MS 2009-11) as at 30 September 2009.

³³⁸ {D008500518}, page 2.

had the right to confirm that the products that were actually delivered were those they believed they had acquired under the bill and hold arrangement.³³⁹

5.169 This would be the case equally where Morgan Stanley was the customer and whether it was a bill and hold sale or otherwise.

Autonomy - Deloitte Correspondence: July 2009

5.170 I have identified previously much of the Deloitte review work in respect of this transaction, including the 12 July 2009 Deloitte working paper that specifically addressed the transaction, and therefore do not repeat it here. However, I also consider it relevant to set out some of the later exchanges between Deloitte and Autonomy management around this time. As the 12 July 2009 Deloitte working paper acknowledged, Deloitte needed “*assurance over when the hardware was shipped from EMC and received by Autonomy*”.³⁴⁰

5.171 On 13 July 2009, Autonomy indicated clearly that it was trying to get the invoices from EMC, showing delivery date.

5.172 Autonomy was also clear that the invoices then held by Autonomy were the pro-forma invoices issued in advance of the EMC contract signing to facilitate the payment of the US\$5 million upfront, and that Autonomy had already provided the contract, proof of payment of the US\$5 million, and “*Confirmation - albeit implied - that MS received the goods and are processing the payment*”.³⁴¹

5.173 On the same day, in the background, the Autonomy Finance department was still separately seeking written confirmation from EMC to say that EMC shipped all relevant hardware on 30 June 2009.³⁴²

5.174 On 15 July 2009, Deloitte noted from conversations between Autonomy and Deloitte that Autonomy confirmed to Deloitte that “*EMC are unable to supply any fully approved documentation*”.³⁴³

5.175 Following this came Deloitte’s suggestion for the specific wording of the management representation to be provided by Autonomy. The wording, therefore, was Deloitte’s suggested wording, and was very specific: “*We confirm that the despatch of hardware with a purchase price of \$5 million was made from EMC on the 30 June 2009.*”³⁴⁴

³³⁹ For any avoidance of doubt, this is not the same as a right of return, which could again effect the date of revenue recognition.

³⁴⁰ {DEL1_003_1_00000036}, page 3.

³⁴¹ {D003950348}.

³⁴² See {D003950370}.

³⁴³ {POS00132300}.

³⁴⁴ {POS00132300}.

5.176 I interpret the word ‘despatch’ to mean ‘shipped’ in this context. Accordingly, it appears to me that the Deloitte requirement was solely in relation to confirmation that EMC had shipped the hardware on 30 June 2009. What Deloitte may have meant by this is not explained, but what this means, in my view, in practice was a matter of legal agreement and transfer of title, rather than necessarily physical shipment.

Summary of the Factual Position

5.177 Therefore, and as I understand the relevant facts, the following is a brief summary of the various conditions and/or events needed for Autonomy to recognise the US\$6 million revenue.

- (a) the US\$6 million purchase order received from Morgan Stanley on 30 June 2009 was agreed to be governed by the terms of the Master Purchase Agreement of the same date;
- (b) title to hardware purchased under the Master Purchase Agreement passed to Morgan Stanley upon shipment from the hardware manufacturer;
- (c) the US\$6 million purchase order received from Morgan Stanley related to the purchase of ‘bulk premium MASS storage devices’, which were capable of being acquired from multiple sources;
- (d) Morgan Stanley conceded taking title to the hardware by confirming payment instruction shortly after 30 June 2009, i.e. on 2 July 2009, Morgan Stanley provided written confirmation that they were happy to release payment for the hardware sold to Morgan Stanley by Autonomy³⁴⁵;
- (e) the Master Purchase Agreement allowed Morgan Stanley to subsequently confirm the hardware shipped by reference to manufacturer, product number and SKU;
- (f) Autonomy agreed to purchase US\$9 million of EMC hardware and related goods also on or around 29-30 June 2009;
- (g) title to this hardware passed from EMC to Autonomy ‘FOB EMC’s point of shipment’;
- (h) EMC shipped Autonomy’s US\$9 million order (or substantially all of it) on 30 June 2009 (meaning that EMC implicitly confirmed the EMC hardware was identified and on hand at EMC’s ‘point of shipment’). The re-issued invoices provided by EMC confirmed that the hardware was ‘shipped’ (within the terms of the Basic Ordering Agreement between EMC and Autonomy dated 22 September 2006);

³⁴⁵ {DEL1_003_1_00000110}.

- (i) Autonomy separately purchased hardware from HDS, and subsequently physically delivered this hardware to Morgan Stanley in place of EMC hardware to which Morgan Stanley had taken title but not installation;
- (j) Deloitte's Q2 2009 review requirement was for Autonomy management to provide a written representation to Deloitte that the despatch of (relevant) hardware with a purchase price of US\$5 million was made from EMC on 30 June 2009;
- (k) there was US\$1 million of relevant hardware on hand at Autonomy's facility at Pleasanton to make up the Morgan Stanley order to US\$6 million; and
- (l) transfer of title in the above arrangements meant that the risks and rewards of ownership passed to the relevant customer when expected, and prior to actual physical possession being taken of the goods.

5.178 I note, however, that confirmation of when legal title to the EMC hardware passed from EMC to Autonomy, (and onward to Morgan Stanley under separate agreement) is a legal issue outside of my expertise. I would, again however, note that assuming that this was the arrangement for the transfer of title to the hardware between EMC, Autonomy and Morgan Stanley, then I would further assume that these parties understood this to be the arrangement.

Conclusion

5.179 The arrangements entered into between Morgan Stanley and Autonomy on or around 30 June 2009 essentially appear to be back to back with that between EMC and Autonomy.

5.180 Under IFRS bill and hold sales, subject to certain judgemental criteria, physical shipment or delivery of goods to the customers' own premises would not necessarily be required to recognise revenue from the arrangement.

5.181 So long as Autonomy held legal title to the hardware that it was selling to Morgan Stanley as at 30 June 2009, then from an accounting perspective it was possible for Autonomy to recognise revenue. This appears consistent with Deloitte's view.

5.182 The written representation provided by Autonomy to Deloitte (as drafted by Deloitte), i.e. *"We are satisfied that the acquisition of \$9.0 million of hardware from EMC Corporation was an arms length commercial transaction. Additionally, we confirm that the despatch of hardware with a purchase price of \$5.0 million was made from EMC Corporation on the 30 June 2009."*³⁴⁶

³⁴⁶ {POS00132681}, page 2.

does not, in my view, contradict this situation; to the contrary, in my opinion, it adds weight to the form of the arrangement.

- 5.183 This was the case where Deloitte was asking only for confirmation that EMC ‘despatched’ the hardware, i.e. that EMC acted to transfer legal title of the US\$5 million of hardware to Autonomy.
- 5.184 From an accounting perspective, each of the Morgan Stanley Letter Agreement, Morgan Stanley Master Purchase Agreement and EMC Basic Ordering Agreement provides details of the transfer of legal title and the details of responsibility for the goods under different scenarios. As I have noted above, in a bill and hold sale, the legal circumstances are highly relevant.
- 5.185 From Deloitte’s perspective, they also appear to acknowledge that the legal provisions around responsibility for the goods under different scenarios reflected standard commercial arrangements, rather than issues of the risks and rewards of ownership transferring, and what they were primarily concerned with was transfer of (legal) title.
- 5.186 Subject to a legal determination of transfer of title to hardware from EMC to Autonomy³⁴⁷, the US\$6 million of revenue recognised by Autonomy as at 30 June 2009 was appropriate.
- 5.187 In my view, Mr Holgate’s analysis in proceeding from the factually incorrect second Holgate-Morgan Stanley Assumption leads to the wrong accounting conclusion.
- 5.188 Further, I also do not agree with the Claimants’ voluntary particulars in respect of this transaction.

³⁴⁷ I assume that Autonomy was able to separately identify the US\$1 million balance of the sale from its own inventory, as claimed at the time.

6 RESELLERS - GENERAL ASSUMPTIONS MADE BY MR HOLGATE

Introduction

- 6.1 In section 5 of Mr Holgate's First Report he sets out the 13 general assumptions that he has been instructed to adopt by his instructing solicitors ("Holgate Assumptions"³⁴⁸ 1 to 13"). Mr Holgate has then been instructed to consider, in the light of these instructed assumptions (and against the background of certain assumed (but in many cases disputed) facts), the accounting treatment and, more specifically, the accounting for revenue, for the reseller transactions³⁴⁹ impugned by the Claimants.³⁵⁰
- 6.2 In this section of my report I make some general observations on Mr Holgate's approach in respect of the reseller transactions impugned in this case (see paragraphs 6.7 to 6.47).
- 6.3 I then consider in general each of the 13 assumptions that Mr Holgate has been instructed to adopt in respect of the impugned reseller transactions and provide my comments at paragraphs 6.49 to 6.170 below.
- 6.4 In general, Mr Holgate concludes that the recognition of revenue for each reseller transaction within the impugned transactions was not in accordance with IAS 18.14 (in particular, IAS 18.14(a) and/or IAS 18.14 (b) and IAS 18.14(d), as a result of certain of the Holgate Assumptions in each case) and was therefore invalid³⁵¹.
- 6.5 In respect of Transaction 5 in Schedule 3 to the Re-Re-Amended Particulars of Claim Mr Holgate asserts that IAS 18.14, IFRS 3.51 and IFRS 3.52 were not met.³⁵² In respect of Transaction 29 in Schedule 3 to the Re-Re-Amended Particulars of Claim Mr Holgate asserts that IAS 18.20(b) was not met.³⁵³
- 6.6 I consider Mr Holgate's assertions in respect of non-compliance with these accounting standards, and the Holgate Assumptions that he has been instructed apply, for each of the individual reseller transactions at **Appendix 3.1 to 3.37** of this report.

³⁴⁸ I use the term "Holgate Assumptions" for expediency. For the avoidance of doubt, I recognise that the assumptions on which Mr Holgate comments are those given to him by his instructing solicitors. I do not mean to convey that they are Mr Holgate's assumptions in any way; rather they are the basis on which Mr Holgate has been instructed to proceed.

³⁴⁹ With the exception of Transaction 5: MicroTech (end-user DiscoverTech) where Mr Holgate has been provided with a "*Factual summary*" but not Holgate Assumptions to adopt.

³⁵⁰ As set out in Mr Holgate's letter of instruction, attached as Appendix 2 to Mr Holgate's First Report.

³⁵¹ Mr Holgate's First Report, Appendix 3.

³⁵² Mr Holgate's First Report, Appendix 3, page 112.

³⁵³ Mr Holgate's First Report, Appendix 3, page 150.

Mr Holgate's approach to analysis of reseller transactions

- 6.7 I first of all set out some features of Mr Holgate's analysis of the reseller transactions before looking at each of the 13 assumptions he has been instructed to adopt.
- 6.8 The features are as follows:
- (a) Mr Holgate's analysis is not fact specific;
 - (b) the relative importance of facts, substance and assumptions in Mr Holgate's analysis;
 - (c) overall format of Mr Holgate's analysis;
 - (d) the use of hindsight by Mr Holgate; and
 - (e) reference to "*patterns*" to justify the use of hindsight.

Mr Holgate's analysis is not fact specific

- 6.9 As noted at paragraph 6.1 above, Mr Holgate has assessed the accounting treatment of the reseller transactions on the basis of the assumptions that he has been instructed to adopt. The Holgate Assumptions are, by their nature, general; Mr Holgate has not been provided with any transaction-specific assumptions in respect of the impugned reseller transactions.
- 6.10 Mr Holgate makes much of the summary at Appendix 4 and throughout section 5 of his First Report as to the common "*features*" of certain of the transactions³⁵⁴. These "*features*" are the assumptions provided to Mr Holgate by his instructing solicitors (including, for each transaction, a statement of the assumptions that purportedly apply) and are based on the Claimants' allegations.
- 6.11 It is unclear exactly what supporting documents Mr Holgate has reviewed as he does not provide such detail in his report; Annex 2 to his instruction letter³⁵⁵ states that he has been provided with "*Contractual documentation in respect of the VAR transactions*" and a "*VAR agreement between Autonomy, Inc and Iron Mountain Information Management, Inc with an effective date of 3 June 2011*".
- 6.12 This means that Mr Holgate may have reviewed some documents and determined them to be supportive of his position, or determined them to be unsupportive - it is impossible to know. Equally it is unclear what documents he has not reviewed, or only briefly reviewed and dismissed as not relevant. Furthermore, it is not clear that Mr Holgate has considered

³⁵⁴ See, for example, Mr Holgate's First Report, paragraph 5.4 and Appendix 4.

³⁵⁵ Attached as Appendix 2 to Mr Holgate's First Report.

if the available evidence - whether provided by the Claimants or the Defendants - is consistent with the assumptions that he has been instructed to adopt.

- 6.13 In undertaking his “*IFRS analysis*” of each transaction in Appendix 3 to his First Report, Mr Holgate has not seen or been provided with, and hence has not taken account of, much of the witness evidence (either the Claimants’ or Defendants’)³⁵⁶ and the contemporaneous documentation, including the working papers of Deloitte, all of which is available in the documents submitted and disclosed in these proceedings. Instead, his analysis appears to have been based almost exclusively upon the assumptions that he has been instructed to make (together with a “*Factual summary*” for each transaction provided to him by his instructing solicitors, to which I refer further below). In light of the highly judgemental nature of many of the accounting issues in this case I consider these all to be important sources of information, as set out in sections 4 and 6 of my First Report.
- 6.14 As a general matter, when considering the accounting treatment of transactions, one has to have regard to the facts. This is particularly the case in my view when dealing with IAS 18 because the eventual treatment is so fact dependent.
- 6.15 The actual facts become even more important where they are disputed and in my opinion regard must be had to all of the relevant facts - including the disputed facts - of each individual transaction in considering the appropriate accounting treatment. Indeed, Mr Holgate and I agreed in our Joint Statement that the individual commercial facts relating to each transaction or item are highly relevant to its accounting treatment and that regard has to be had to the individual facts of each transaction.³⁵⁷
- 6.16 It is very common to have large numbers of transactions that have essentially the same basic facts that drive the accounting treatment - for example the treatment of the sale of a product is unlikely to be dependent on whether 10 or 20 items are sold. The quantity sold is not a relevant fact for the accounting treatment. One would not therefore need to look at every single sale of that product to ascertain the accounting treatment.
- 6.17 However, that is not the case here - and indeed it is often not the case with large transactions and negotiated transactions. Mr Holgate and I both noted that each of the 37 reseller transactions is different (albeit Mr Holgate also makes the point that the impugned reseller transactions “*share many similarities*”)³⁵⁸.

³⁵⁶ Annex 2 to Mr Holgate’s letter of instruction lists the documents provided to him, which includes only four witness statements - see Mr Holgate’s First Report, Appendix 2.

³⁵⁷ Joint Statement, page 12, sections 3(a) and (b).

³⁵⁸ Joint Statement, page 19, section 5(a).

The relative importance of facts, substance and assumptions in Mr Holgate's analysis

- 6.18 Clearly the facts are important in these matters, and Mr Holgate does not disregard them altogether. Indeed, he has a “*Factual summary*” for each transaction that he has been provided with setting out the basic elements of each transaction - customer, amount, date etc. - but also other matters that are assumed. The basic elements are not the facts that drive the accounting. The facts that drive Mr Holgate's conclusions on the accounting are mainly assumed facts. Each of Mr Holgate's assumptions is an assumed fact or a number of separate assumed facts.
- 6.19 Mr Holgate does analyse many of the assumptions he has been given; much of Mr Holgate's analysis concerns the matter of ‘substance’, and he asserts that substantially all of the assumptions that he has been instructed to adopt go to the substance of the transactions³⁵⁹ (except Holgate Assumptions 6 and 7³⁶⁰). Essentially the point Mr Holgate is making is that all of the assumed facts mean that, when applied to any individual transaction, that transaction had no economic substance.
- 6.20 However, when setting out his comments as to which Holgate Assumptions are relevant to the economic substance of individual transactions in Appendix 3 to his First Report, Mr Holgate only refers to some or all of Holgate Assumptions 1 to 4 and 9 to 10. It is not clear why Mr Holgate does not refer to the other Holgate Assumptions where he is instructed that they apply to a particular transaction. Therefore it appears that Mr Holgate's analysis in the main body of his report is inconsistent with his Appendix 3 in this regard.
- 6.21 Mr Holgate also uses some of the assumptions to bolster the conclusions that he has drawn from other assumptions³⁶¹.
- 6.22 In this way, he treats the assumptions as fact, without acknowledging that they are based on matters that are, for the most part, disputed between the parties, and without setting out the underlying evidence.
- 6.23 In addition, Mr Holgate has not considered whether the assumptions that he has been asked to make apply to any, or all, of the other (non-impugned) transactions that Autonomy entered into in the Relevant Period. As a result, he has not considered whether the assumptions are common features of Autonomy's business.

³⁵⁹ Mr Holgate's First Report, paragraphs 5.5, 5.9, 5.17.1(2), 5.21.1(2), 5.21.4(2), 5.21.5(2) and 5.21.6(2).

³⁶⁰ Mr Holgate's First Report, paragraphs 5.21.2 and 5.21.3.

³⁶¹ See, for example, Mr Holgate's First Report, paragraphs 5.9.3, 5.11 to 5.13, 5.18 and 5.22.

Overall format of Mr Holgate's analysis

- 6.24 In Appendix 3 to his First Report Mr Holgate sets out his analysis of each of the reseller transactions.
- 6.25 Mr Holgate's analysis of each transaction follows a brief "*Factual summary*" that he is again instructed to adopt and a statement of the assumptions that purportedly apply to that particular transaction, both of which collectively have been provided to him by his instructing solicitors.³⁶² In some cases the "*Factual summary*" contains information that is disputed between the parties and, as such, amounts to further assumptions based on assertions made by the Claimants' witnesses.³⁶³
- 6.26 Further Mr Holgate does not appear to have attempted to link any of the assumptions that he has been instructed to adopt back to the available evidence relating to each individual transaction³⁶⁴.
- 6.27 In some cases Mr Holgate comments additionally on condition (b) of IAS 18.14, which is not pleaded for certain transactions³⁶⁵.

The use of hindsight by Mr Holgate

- 6.28 In many cases the "*Factual summary*" contains information that would only have been available after the consideration of the recognition of revenue by Autonomy and which therefore involves the use of hindsight. In some cases the later events took place many months, and even over a year, after Autonomy's sale of a licence to the reseller.³⁶⁶ Also, in some cases the information relates to a decision taken by HP, after its acquisition of Autonomy³⁶⁷.

³⁶² As set out in Mr Holgate's letter of instruction, attached as Appendix 2 to his First Report.

³⁶³ See, for example, in Appendix 3 to Mr Holgate's First Report, Transaction 6, MicroTech (end-user Honeywell) and Transaction 13, MicroTech (end-user Vatican Library), paragraph 1.2: "*Autonomy did not need [the ATIC] facility*"; Transaction 10, Capax Discovery (end-user FSA), paragraph 1.3: "*The 'significant up-front costs and expenses' referred to in the 29 June 2011 agreement were not required*"; Transaction 18, FileTek (end-user USDVA), paragraph 1.3: "*The Autonomy group company did not need any of the Storhouse licences that it purchased*"; Transaction 30, DiscoverTech (end-user PRISA), paragraph 1.4: "*The DiscoverPoint Engine software purchased was not needed or used and was of no discernible value to the Autonomy group*".

³⁶⁴ See, for example, paragraphs 6.56, 6.65, 6.66 and 6.87 of this section of my report. Also see paragraphs 6.11 to 6.13 above.

³⁶⁵ In Appendix 3 to his First Report Mr Holgate comments on IAS 18.14(b) in respect of Transactions 5, 9, 17, 19 and 22 where he says "*Unclear whether criterion met or not*"; this condition is not referred to for these transactions in Schedule 3 to the Re-Re-Amended Particulars of Claim.

³⁶⁶ See, for example, in Appendix 3 to Mr Holgate's First Report, Transaction 6, MicroTech (end-user Honeywell), paragraphs 1.2 to 1.4; Transaction 10, Capax Discovery (end-user FSA), paragraphs 1.2 to 1.5; Transaction 13 MicroTech (end-user Vatican Library), paragraph 1.2; Transaction 18, FileTek (end-user USDVA), paragraph 1.2.

³⁶⁷ See, for example, "*Factual summary*" for Transaction 15, Realise (end-user Credit Suisse), paragraph 1.2 of Appendix 3 of Mr Holgate's First Report: "*On 21 September 2012, the full invoice value remaining was written off.*"

6.29 In accounting terms such events would not therefore impact on revenue recognition, which should be based only on contemporaneous information available at the point of considering the accounting for the revenue.

6.30 As set out in the Joint Statement, Mr Holgate and I agreed the following with regard to the relevance of hindsight to an accountant:

“Financial statements are necessarily prepared, approved and audited after the relevant reporting date. For example, Autonomy’s year end (annual reporting date) was 31 December and it generally approved and published its accounts towards the end of the following February (the signing date). Financial statements are based on transactions and events up to the reporting date and conditions as at the reporting date. Information coming to light between the reporting date and the signing date is taken into account only insofar as it sheds light on circumstances prevailing at the reporting date. Information coming to light in that period is disregarded insofar as it describes transactions and other events that arise after the reporting date. Information that comes to light after the signing date can be taken into account only at the next reporting date.”³⁶⁸

6.31 In summary, then, to the extent that there was subsequent evidence that provided more information about conditions that existed at a particular reporting date, this can be taken into account up to the point that the quarterly / interim reviews / financial statements are authorised for issue. Thereafter, one would not ordinarily reopen or revisit the accounting for transactions in prior periods (unless there was a change of accounting policy or error)³⁶⁹. Accordingly, when considering the individual reseller transactions in **Appendix 3.1 to 3.37** of this report I only consider information up to the date that the relevant quarterly / interim reviews / financial statements were authorised for issue.

Reference to “patterns” to justify the use of hindsight

6.32 Mr Holgate justifies the use of hindsight by reference to patterns that he sees developing in the impugned transactions. He is effectively saying that certain matters that happened after a transaction should have been foreseen based on prior events.

³⁶⁸ Joint Statement, pages 6 to 7.

³⁶⁹ See section 3 of this report - “Events after the reporting period”.

6.33 Mr Holgate refers to this issue in his First Report (in the context of Holgate Assumptions 11³⁷⁰, 12³⁷¹ and 13³⁷², which I consider separately in this section):

“A different point also needs to be made about assumptions 11, 12 and 13. They all relate to events that occurred after the date of what was held out as a sale by Autonomy to the VAR. However, they are all different ways of implementing the agreement/understanding referred to at assumption 10, which existed at the time of the transaction. It might be argued that, ignoring assumption 10 and viewing assumptions 11-13 in isolation, these factors could not reasonably have been taken into account in considering the accounting for the transaction at the time it was effected. This would have been a fair point as regards the first, or perhaps the first few such transactions, but it would soon have become clear that a pattern of frequent cancellations, in one form or another, was emerging. That pattern should have signalled that something unusual was occurring and have led to a reconsideration of the appropriate accounting treatment of subsequent transactions - namely that the sales had no substance and that no revenue should be recognised in respect of them.”³⁷³

6.34 Also in relation to this point Mr Holgate states, in respect of Holgate Assumption 11:

“Most businesses of any size have had experiences in customer relationships in which they have had to cancel a sales agreement or issue a credit note or write off a debt in full. However, generally these are rare and unfortunate events, not routine ways of conducting business and are not based on a prior agreement or understanding that the counterparty to a transaction will be protected from risk (i.e. assumption 10). Where one, or a combination, of these features was adopted as a routine or even occasional way of dealing with situations that occur from time to time, they constitute strong evidence that the sale to the VAR was not genuinely made and that there was no transfer of the risks and rewards of ownership.”³⁷⁴

6.35 Mr Holgate elaborates on his First Report in the Joint Statement as follows:

³⁷⁰ Holgate Assumption 11: *“The VAR was relieved of its ostensible liability to pay the price for the Autonomy software licence it had purchased by one or more of the following means: (a) the purported sales agreement between Autonomy and the VAR being cancelled, (b) a credit note being issued to the VAR discharging its ostensible liability to pay the price, or (c) the VAR’s debt being written off”* - Mr Holgate’s First Report, paragraph 5.2.11.

³⁷¹ Holgate Assumption 12: *“Where the Autonomy group company subsequently achieved a direct sale to the end-user, the Autonomy group company arranged for the end-user to pay the VAR so that the VAR could then pay the relevant Autonomy group company”* - Mr Holgate’s First Report, paragraph 5.2.12.

³⁷² Holgate Assumption 13: *“An Autonomy group company was caused to make a payment to the VAR to purchase rights, goods or services that the Autonomy group company did not need (and which had no discernible value to it), but which had the purpose and effect of putting the VAR in funds which it then used to pay for the Autonomy software licence”* - Mr Holgate’s First Report, paragraph 5.2.13.

³⁷³ Mr Holgate’s First Report, paragraph 5.23.

³⁷⁴ Mr Holgate’s First Report, paragraph 5.21.4.

“A related point is that accounting for transactions should take into account information about earlier, similar transactions. For example, if it emerges prior to a signing date that a significant proportion of sales to a particular category of customer result in non-payment, it is necessary to take that information into account in deciding how to account for a current transaction, even though it might be too early to draw a conclusion (for example, that there is a bad debt) about that current transaction in isolation.”³⁷⁵

6.36 Also in the Joint Statement, in response to the question of “Whether, in accounting for the sale to a VAR, Autonomy should have taken into account the outcome of earlier, similar transactions with VARs”, Mr Holgate states:

“Yes, Autonomy should have done so. This can be regarded simply as ‘learning from experience’. I note that in no case did the VAR effect a sale to the end-user; rather Autonomy’s sale to the VAR was concluded by Autonomy putting the VAR in funds or was cancelled by reversing the sale or issuing a credit note or the debt being written off. This should have been taken into account in Autonomy’s accounting.”³⁷⁶

6.37 A critical point here is that Mr Holgate disregards the fact that the impugned transactions do not constitute all of the transactions entered into by Autonomy during the Relevant Period. If one proceeds on the basis that one can draw a pattern from a group of earlier impugned transactions then applying that to later transactions of the same type is going to mean that all those later transactions are similarly impugned.

6.38 In fact Mr Holgate goes further than this when he says, in respect of Holgate Assumption 11:

“... Where one, or a combination, of these features was adopted as a routine or even occasional way of dealing with situations that occur from time to time, they constitute strong evidence that the sale to the VAR was not genuinely made and that there was no transfer of the risks and rewards of ownership.”³⁷⁷

6.39 So, according to Mr Holgate, there is a relevant pattern to consider here even if something happens only occasionally and therefore I presume is the justification for Mr Holgate not considering all of the transactions. This overall approach is self-fulfilling and is not the way that any relevant accounting, for example provisioning, proceeds.

6.40 However, this approach means that Mr Holgate does not provide any indication of when or how a pattern could be said to be established in the context of all the transactions Autonomy entered into with different end-users and/or resellers over time, or even in the context only of the impugned transactions (including, for example, whether regard should

³⁷⁵ Joint Statement, page 6.

³⁷⁶ Joint Statement, pages 21 and 22.

³⁷⁷ Mr Holgate’s First Report, paragraph 5.21.4.

be had to one or more particular resellers in seeking to identify a “*pattern*”, in which accounting period(s) or at what point the number and/or value of transactions would constitute a “*pattern*”).

- 6.41 Instead Mr Holgate refers back to his instructed assumptions as support for the proposition. This results in a circular situation whereby, even before any pattern emerges (or has had time to emerge and be considered on its facts), Mr Holgate adopts the position in the Voluntary Particulars that already pre-emptively seeks to assert that the revenue in question was not recognisable at the point of the transaction with the reseller from the outset.
- 6.42 To take an example with regard to Holgate Assumption 11(c) (write off of the reseller’s debt) and his comments in the Joint Statement with regard to bad debts set out above, Mr Holgate has given no consideration to what a “*usual*” level of bad debts might be for Autonomy or even for software companies in general.
- 6.43 Instead it seems that Mr Holgate proceeds on the basis that a bad debt by its nature is very rare and if one sees more than a few, that is indicative of something suspicious. He writes as follows:
- “Most businesses of any size have had experiences in customer relationships in which they have had to cancel a sales agreement or issue a credit note or write off a debt in full. However, generally these are rare and unfortunate events...”*³⁷⁸.
- 6.44 My own experience as an accountant is that while bad debts or the issue of credit notes are “*unfortunate*” they are far from rare. Indeed I would say that they are common in business. However, I do see how, if one is used to seeing bad debts only rarely, one would take the view that a number is indicative of some different circumstance, or as Mr Holgate says, “*That pattern should have signalled that something unusual was occurring*”³⁷⁹.
- 6.45 But if that is the case it underlines the need to look at the facts.
- 6.46 It is apparent from Deloitte’s contemporaneous audit and review working papers that Deloitte considered during its audit and review work whether a pattern was emerging of reseller deals being replaced by direct deals between Autonomy and end-users³⁸⁰. Deloitte brought the matter to the attention of Autonomy’s Audit Committee³⁸¹ and ultimately concluded that Autonomy’s revenue recognition was still reasonable overall, with the

³⁷⁸ Mr Holgate’s First Report, paragraph 5.21.4.

³⁷⁹ Mr Holgate’s First Report, paragraph 5.23.

³⁸⁰ See, for example, section 10 (Capax Discovery (end-user Eli Lilly); section 19 (MicroTech (end-user Vatican Library); section 27 (Capax Discovery (end-user Merrill Lynch) and section 29 (DiscoverTech (end-user Bank of America)) in this report.

³⁸¹ See, for example, Deloitte’s Q1 2010 Audit Committee Report, page 2 and Q2 2010 Audit Committee Report, page 5 ({DEL1_003_1_00000245} and {DEL1_003_1_00000143} respectively.

knowledge of instances of sales being resold directly, including across different accounting periods. Mr Holgate has not seen Deloitte's working papers so makes no comment in this regard.

- 6.47 In overall terms Mr Holgate's identification of a pattern seems to me to be based on a limited number of assumed facts and the basic overall assumption that the impugned transactions should be impugned. In those circumstances Mr Holgate's conclusions seem somewhat inevitable.
- 6.48 I now consider in general each of the 13 assumptions that Mr Holgate has been instructed to adopt in respect of the impugned reseller transactions.

Holgate Assumption 1: Communication between Autonomy and reseller

- 6.49 Mr Holgate has been instructed to assume that, "*There had been no communication between Autonomy and the VAR relating to a transaction involving the identified end-user until immediately prior to the end of the relevant quarter*".³⁸²

Mr Holgate's analysis

- 6.50 Mr Holgate does not identify what is meant by the timeframe in this assumption, and what constitutes "*immediately prior to the end of the relevant quarter*".
- 6.51 Notwithstanding this, Mr Holgate asserts that this assumption goes to the substance of a transaction rather than the criteria for recognition of revenue under IAS 18.14.³⁸³
- 6.52 Indeed, Mr Holgate questions:

*"For a significant sale to occur, as it were, suddenly, with no prior communication is highly unusual. It raises questions about the substance of the transaction. What were the circumstances surrounding the goods that Autonomy suddenly decided to sell to a VAR, and the VAR, equally quickly, with little or no opportunity for investigation, decided to buy?"*³⁸⁴

My comments

- 6.53 As a general point, a sale is (and can be) genuine regardless of when in an entity's reporting period it takes place and how quickly (or not) it appears to take place.
- 6.54 It is irrelevant to the recognition of revenue whether communication between Autonomy and a reseller relating to the impugned reseller transactions took place well in advance of

³⁸² Mr Holgate's First Report, paragraph 5.2.1.

³⁸³ Mr Holgate's First Report, paragraph 5.9.

³⁸⁴ Mr Holgate's First Report, paragraph 5.9.1.

the quarter end or immediately before, however those time periods might be defined (as noted at paragraph 6.50, Mr Holgate does not specify). This would not, in my view, invalidate a sale that took place under a written sales contract.

- 6.55 In carrying out my analysis of the transactions with resellers impugned in this case I have seen multiple purchase orders relating to sales to resellers of Autonomy's software which state that they are entered into pursuant to a master reseller agreement that was in place prior to the date of the purchase order. In some cases the master reseller agreement was in place substantially before the date of the impugned transaction, and substantially before the Relevant Period.³⁸⁵
- 6.56 Therefore, the general terms and conditions of sales to Autonomy's resellers appear, at least in these cases, to have been agreed upon by both parties earlier than "*immediately prior to the end of the relevant quarter*" in which a transaction was carried out; rather it was the transaction-specific terms on an individual basis which were agreed close to the end of the quarter. Indeed, the purchase order states that it was under and pursuant to an already negotiated master agreement. Such agreements are common in business. One of the reasons of course is to govern the very common situations where matters may have had to be expedited quickly, or without having to go through various administrative procedures again and again. It appears, then, that Holgate Assumption 1 presupposes that there were no master reseller agreements in place. Indeed, Mr Holgate does not appear to have been aware of their existence.
- 6.57 The Defendants state that it was common (both for Autonomy and in the software industry generally) for sales (including reseller sales) to be concluded close to quarter end, as customers were aware of the bargaining power this gave them³⁸⁶.
- 6.58 Similarly, the nature of Autonomy's product (software that had already been developed and did not require material customisation prior to sale³⁸⁷), together with a delivery by online download meant that delivery (and sales) could take place very quickly,³⁸⁸

³⁸⁵ See master reseller agreements for MicroTech dated 29 June 2006 ({D000001951}), Tikit dated 27 October 2005 ({D001166033}) and Microlink dated 21 November 2003 ({D002882308}). Purchase orders between Capax Discovery and Autonomy refer to a Value Added Reseller Agreement dated 30 June 2009 (see, for example, {D003986835}) although the agreement itself refers to the "*Effective Date*" as "*May __, 2009*" ({POS00131269}). The Second Defendant's Amended Defence also refers to May 2009 as the effective date of the agreement - Schedule 3, page 8, paragraph 25. Of the impugned reseller transactions, nine relate to MicroTech (Transactions 5, 6, 7, 8, 13, 25, 32, 33 and 37), ten to Capax Discovery (Transactions 2, 3, 4, 10, 16, 20, 21, 27, 28 and 34) and one to Tikit (Transaction 26). Transaction 1 in respect of Microlink relates to 11 individual transactions (although the purchase orders for these transactions do not specify that they are issued under a master reseller agreement - see section 7, paragraph 7.5 of this report).

³⁸⁶ Dr Lynch's First Witness Statement, paragraphs 93 and 257; Mr Hussain's Witness Statement, paragraph 118(A).

³⁸⁷ See paragraph 4.34 of my First Report.

³⁸⁸ As also noted, for example, in Dr Lynch's First Witness Statement, paragraph 257.

particularly when also taking into account the existence of master reseller agreements as referred to above.

- 6.59 Moreover, many of the resellers were repeat customers of Autonomy that had done deals with Autonomy in the past.³⁸⁹ As Mr Holgate observes, a reseller was unlikely to be “*a naïve and inexperienced party*”.³⁹⁰ However, Mr Holgate does not consider the wider commercial context, or investigate what was (or was not) usual practice between Autonomy and the resellers, or indeed in the software industry generally.

Holgate Assumption 2: Price negotiation between Autonomy and reseller

- 6.60 Mr Holgate has similarly been instructed to assume that, “*There was no price negotiation between the VAR and Autonomy*”.³⁹¹

Mr Holgate’s analysis

- 6.61 Although he states, with regard to the circumstances assumed under Holgate Assumption 2, that “*this is highly unusual*”, Mr Holgate then accepts that this may happen in practice and provides three examples. Again Mr Holgate questions why a reseller would agree to a price proposed by Autonomy without any negotiations, noting that it “*seems unlikely*” that the reseller was a naïve or inexperienced party and that a “*more obvious answer is that the VAR was not truly taking on the risk of the goods in question*”.³⁹²
- 6.62 Again, Mr Holgate asserts that this assumption goes to the substance of a transaction rather than the criteria for recognition of revenue under IAS 18.14.³⁹³

My comments

- 6.63 Again, as a general point, there is nothing to say that a sale price must always be negotiated between parties, nor what such “*negotiation*” should involve.
- 6.64 The First Defendant’s Amended Defence refers to the allegation that there was no price negotiation between Autonomy and the reseller and explains:

“... *the resellers were often repeat customers that had done numerous deals with Autonomy in the past, and typically received a standard 10% discount on the purchase price of the software.*”³⁹⁴

³⁸⁹ First Defendant’s Amended Defence, paragraph 99.4.2 - also see paragraph 6.64 of this section.

³⁹⁰ Mr Holgate’s First Report, paragraph 5.9.2.

³⁹¹ Mr Holgate’s First Report, paragraph 5.2.2.

³⁹² Mr Holgate’s First Report, paragraph 5.9.2.

³⁹³ Mr Holgate’s First Report, paragraph 5.9.

³⁹⁴ First Defendant’s Amended Defence, paragraph 99.4.2.

- 6.65 Mr Holgate makes no acknowledgement of these comments (although he was provided with the First Defendant's Amended Defence³⁹⁵); instead Mr Holgate's "*more obvious answer*" as set out at paragraph 6.61 merely reiterates the Claimants' allegations.
- 6.66 Furthermore, as set out at paragraph 6.55, in respect of many of the transactions there was a master reseller agreement in place between Autonomy and the reseller, in some cases going back a number of years. One of the three examples put forward by Mr Holgate of where there might not be price negotiations in practice is "*if there was an established pattern of trade between the two parties and the price was predetermined under a supply agreement*"³⁹⁶. However, he then asserts that "*none of these circumstances applied in this case*".
- 6.67 In so doing, Mr Holgate fails to acknowledge the fact that some of the resellers were repeat customers as noted above, as well as the existence of the master agreements between Autonomy and resellers that were already in place (albeit, other than discounts agreed such as those referred to by Dr Lynch³⁹⁷, purchase prices were not agreed in those master agreements).

Holgate Assumption 3: Reseller prior sales efforts and relationship with end-user

- 6.68 Mr Holgate has been instructed to assume that, "*The VAR had made no prior efforts to sell such a licence to, and had no prior relationship or contact with, the identified end-user*".³⁹⁸

Mr Holgate's analysis

- 6.69 Again, Mr Holgate asserts that this assumption goes to the substance of a transaction rather than the criteria for recognition of revenue under IAS 18.14.³⁹⁹
- 6.70 Mr Holgate states:

"Where the end-user was an existing Autonomy customer (for example, Kraft and Eli Lilly), then one would have thought that both Autonomy and the customer/end-user would have wanted to maintain its existing relationship. If the end-user were a new customer to Autonomy, then Autonomy would surely not wish to confuse a new customer

³⁹⁵ Annex 2 to Mr Holgate's instruction letter.

³⁹⁶ Mr Holgate's First Report, paragraph 5.9.2.

³⁹⁷ See, for example, paragraph 6.64 of this section of my report.

³⁹⁸ Mr Holgate's First Report, paragraph 5.2.3.

³⁹⁹ Mr Holgate's First Report, paragraph 5.9.

by suddenly selling the goods under discussion to a third party who was unknown to the new customer.”⁴⁰⁰

My comments

6.71 Mr Holgate states:

“... one might think that, from Autonomy’s point of view, the relationship and interaction between the VAR and the end-user does not greatly matter. If Autonomy were selling to the VAR in a genuine, straightforward manner, it would matter little what the VAR then did with the goods.”⁴⁰¹

6.72 This is an important point. As set out in my First Report, 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.⁴⁰² What subsequently happened between the reseller and the end-user was irrelevant for the purposes of Autonomy’s revenue recognition. This was also the basis on which Deloitte undertook its audit and review work in respect of Autonomy; Mr Welham explains:

“Our audit testing, through confirmations obtained from the VARs, addressed whether ownership and risk passed to the VAR. We did not therefore seek to interrogate either Autonomy or third parties as to the subsequent negotiations of the VAR’s sale to the proposed end-users - the transaction being audited was the sale to the VAR, not the end-user.”⁴⁰³

6.73 However, Mr Holgate goes on to state that the other assumptions he has been instructed to adopt regarding the reseller transactions impugned by the Claimants suggest that the “sale by Autonomy to the VAR was far from genuine and straightforward”.⁴⁰⁴ In this way Mr Holgate treats the assumptions that he has been asked to make as if they were fact, without acknowledging the areas of dispute in this case.

6.74 It further appears from Mr Holgate’s comments at paragraph 6.70 above that he is suggesting that, under the only two possible scenarios in a reseller transaction with regard to Autonomy’s relationship with the customer (i.e. the customer was either a new, or existing, customer of Autonomy), there is not a good reason to enter into such a transaction

⁴⁰⁰ Mr Holgate’s First Report, paragraph 5.9.3.

⁴⁰¹ Mr Holgate’s First Report, paragraph 5.9.3.

⁴⁰² First Report, paragraph 8.6.

⁴⁰³ Mr Welham’s Witness Statement, paragraph 224.

⁴⁰⁴ Mr Holgate’s First Report, paragraph 5.9.3.

or arrangement. However, a number of individuals acknowledge in their witness statements that resellers were, and are, commonly used in the software industry.⁴⁰⁵

- 6.75 In some cases the master reseller agreements between Autonomy and the resellers provided for the reseller to deliver “Services” to the end-user that might include, among other things, demonstration, pre-sales support, installation, customisation, training, maintenance and support services and other consulting or integration of Autonomy products⁴⁰⁶.
- 6.76 I understand that the motivation for the reseller in entering into these transactions with Autonomy was, at least in part, the opportunity to build a relationship with the end-users identified in the contracts in order to subsequently sell its own services to such end-users⁴⁰⁷. Therefore, it does not appear unduly unusual that a reseller may not have had any relationship or contact with the identified end-user prior to the sale by Autonomy to the reseller.
- 6.77 Furthermore, if a reseller could typically earn a 10% margin on multi-million dollar transactions such as these, in addition to the possibility of entering into a professional relationship of its own with the end-user (as happened, for example, between Capax Discovery and both TXU and the FSA⁴⁰⁸), it would appear to be incentivised to do such deals even where there had been no prior relationship or contact with the identified end-user.

Holgate Assumption 4: Reseller provision of added value or service

- 6.78 Mr Holgate has been instructed to assume that, “*The VAR did not undertake or propose to provide any added value, or any service, to the end-user*”.⁴⁰⁹

Mr Holgate’s analysis

- 6.79 Again, Mr Holgate asserts that this assumption goes to the substance of a transaction rather than the criteria for recognition of revenue under IAS 18.14.⁴¹⁰

⁴⁰⁵ See, for example, Dr Lynch’s First Witness Statement, paragraph 248; Mr Egan’s Witness Statement, paragraph 22; Mr Welham’s Witness Statement, paragraph 72.

⁴⁰⁶ See, for example, MicroTech Autonomy Government Reseller Agreement {D000001951}, paragraph 1.1 (22) and 3.1(1); Capax Discovery Value Added Reseller Agreement {POS00131269}, paragraphs 1.1(i) and 3.1(a); Tikit Worksite Master Reseller Agreement {D001414332}, paragraph 5.3 and Schedule 2, paragraph 3.3.

⁴⁰⁷ For example, Mr Baiocco, in his US testimony, agreed that “*being a VAR*” was “*a way to potentially create direct and valuable relationships with new clients in order to sell them additional products and services*” - see Exhibit Y to my First Report - Mr Baiocco, Transcript of Proceedings, Volume 4, page 640 (lines 6 to 11). Also see for example, Mr S Truitt, Hearsay Notice of the Transcript of Proceedings, page 3340 (lines 5 to 13).

⁴⁰⁸ I discuss this further at paragraph 6.85 of this report.

⁴⁰⁹ Mr Holgate’s First Report, paragraph 5.2.4.

⁴¹⁰ Mr Holgate’s First Report, paragraph 5.9.

6.80 Mr Holgate states:

*“Normally in a multi-party commercial relationship, each party provides a service or adds value in some way, so as to justify its role and its economic return. A VAR would, therefore, be expected to add value either by assisting in securing the sale or in offering further services to the end-user (or both).”*⁴¹¹

6.81 At the same time, Mr Holgate acknowledges, *“There is no rule in either commercial practice or in IAS 18 that precludes a party from being involved in a transaction without adding any value.”*⁴¹²

6.82 Mr Holgate questions why Autonomy would allow a reseller a margin or a Marketing Assistance Fee (“MAF”) in a transaction without the reseller adding any value or apparently being involved in the sale process. He states:

*“A possible answer is that Autonomy gave a margin or MAF to the VAR as the price of trying (but failing, in my view) to justify revenue recognition that could not otherwise occur or earlier revenue recognition than would have arisen from a sale direct to the end-user.”*⁴¹³

My comments

6.83 There was, and is, no requirement (whether in commercial practice or in accounting terms) for a reseller to provide “added value”. Indeed, as set out above, Mr Holgate acknowledges this point himself.⁴¹⁴

6.84 Notwithstanding this, as set out at paragraph 6.75, in some cases the master reseller agreements between Autonomy and the resellers provided for the reseller to deliver “Services” to the end-user.

6.85 I note that in the example of the Capax Discovery transaction relating to TXU as end-user, Capax Global (the parent company of Capax Discovery) subsequently provided installation services to TXU⁴¹⁵, and for the Capax Discovery transaction relating to the FSA as end-user,

⁴¹¹ Mr Holgate’s First Report, paragraph 5.9.4.

⁴¹² Mr Holgate’s First Report, paragraph 5.9.4.

⁴¹³ Mr Holgate’s First Report, paragraph 5.9.4.

⁴¹⁴ Mr Holgate’s First Report, paragraph 5.9.4. Also see, for example, Dr Lynch’s Witness Statement, paragraph 248. More particularly, Mr Egan states that a reseller might send software to its customer “with or without modifications made by the VAR” (Mr Egan’s Witness Statement, paragraph 24) and that, “In many instances, VARs provide additional value to a software company’s products by modifying or adding features to the software itself or by providing a service to an end-user associated with the software (for example, integrating new software with the customers’ existing computer systems). VARs of this type make money by charging the end-user for the value they have added to, or provided with, the software. Some VARs merely purchase and resell software to their own customers. They act as sales organizations and make a profit by purchasing a software license at one price and reselling the same license to an end-user at a higher price” (Mr Egan’s Witness Statement, paragraph 22).

⁴¹⁵ Mr Baiocco’s Witness Statement, paragraph 35.

Mr Baiocco states, “More than a year later we did provide professional services to the FSA relating to the software that Autonomy licensed to the FSA.”⁴¹⁶

- 6.86 With regard to MAFs, Dr Lynch states that, “payment of MAFs was an industry standard mechanism for incentivising and rewarding resellers” and sets out a number of reasons why Autonomy would pay a MAF to a reseller, including such a situation as where the goods were not in the event sold on by the reseller.⁴¹⁷ Further, Mr Hussain’s evidence sets out specifically that:

“[a] decision to pay a MAF was not necessarily predicated on the VAR having provided specific “actual marketing assistance” in relation to a particular transaction, but could be paid to ensure that a VAR was incentivised to market Autonomy products in the future”.⁴¹⁸

- 6.87 Mr Holgate makes no acknowledgement of Dr Lynch’s comments when he questions why Autonomy would allow a reseller a margin or MAF (although he was provided with Dr Lynch’s First Witness Statement⁴¹⁹); instead Mr Holgate’s “possible answer” as set out at paragraph 6.82 again merely reiterates the Claimants’ allegations.

Holgate Assumption 5: Digital Safe operation

- 6.88 Mr Holgate has been instructed to assume that:

“For VAR transactions involving the sale of a licence to use Digital Safe software (and software to be used with Digital Safe), the Digital Safe software could only be implemented and thereafter operated by Autonomy (and not by the VAR)”.⁴²⁰

Mr Holgate’s analysis

- 6.89 Mr Holgate asserts that this assumption goes again to the substance of a transaction, as well as to IAS 18.14(a) and (b).⁴²¹

- 6.90 Mr Holgate states:

“... a typical contract between Autonomy and the end-user for a licence to use Digital Safe software (and software to be used with Digital Safe) involved the supply of the software, implementation, monitoring and support of the same, together with hosting over a period of time. It is that combination that is of value to an end-user. The Digital Safe software

⁴¹⁶ Mr Baiocco’s Witness Statement, paragraph 48.

⁴¹⁷ Dr Lynch’s First Witness Statement, paragraph 253.

⁴¹⁸ Second Defendant’s Amended Defence, paragraph 295(b).

⁴¹⁹ Annex 2 to Mr Holgate’s instruction letter.

⁴²⁰ Mr Holgate’s First Report, paragraph 5.2.5.

⁴²¹ Mr Holgate’s First Report, paragraph 5.21.1.

*was of no value to the end-user absent Autonomy's implementation and operational services. It follows that the supply of only the Digital Safe software (and software to be used with Digital Safe) to a VAR had no economic significance: (a) from Autonomy's point of view, it did not supply anything of independent value to the VAR, and so no revenue should have been recognised; (b) from the VAR's point of view, it did not acquire anything that it could either use itself or on-sell to an end-user in the absence of the 'related services' (implementation and monitoring and support); and the VAR was not in a position to provide those related services to an end-user."*⁴²²

My comments

- 6.91 Holgate Assumption 5 does not of itself invalidate the sale as a reseller could sell the Digital Safe software to an end-user and arrange for Autonomy to provide the related services. Indeed, Mr Holgate notes this himself in a footnote to his report; at the same time, Mr Holgate states that he has been further instructed to assume that this did not happen and would only occur when the end-user was ready to contract. However, even if, subsequently, this did not happen, it does not mean that the sale was invalid in circumstances where Autonomy could provide such services.
- 6.92 Further, as set out in my First Report⁴²³, it appears that some of Autonomy's customers who did have a Digital Safe licence for use on their own premises were able to archive their own data independently from Autonomy's storage capability, and paid additionally for the related services as required.⁴²⁴
- 6.93 I deal with Digital Safe and the facts applicable to Holgate Assumption 5 separately as part of my consideration of hosting.

Holgate Assumption 6: Reseller ability to pay Autonomy

- 6.94 Mr Holgate has been further instructed to assume that, "*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*".⁴²⁵

Mr Holgate's analysis

- 6.95 Mr Holgate asserts that this assumption goes to IAS 18.14(d).⁴²⁶

⁴²² Mr Holgate's First Report, paragraph 5.21.1.

⁴²³ My First Report, paragraph 15.32.

⁴²⁴ For example, it appears that Manufacturer's Life ({D000161474}) and the Serious Fraud Office ({D001420337}) operated Digital Safe on their premises and paid Autonomy for related services such as monitoring.

⁴²⁵ Mr Holgate's First Report, paragraph 5.2.6.

⁴²⁶ Mr Holgate's First Report, paragraph 5.21.2.

6.96 Mr Holgate states:

“If a customer does not have the means to settle the purchase price of the goods it is buying, that invalidates the recognition of a sale by the seller. IAS 18, paragraph 14(d) requires, among other things, that “it is probable that the economic benefits associated with the transaction will flow to the entity”. It follows clearly from this that, if the customer does not have the means to pay, recognition of revenue is invalid. The question then is whether the additional words “in the absence of an onward sale of the relevant licence to the identified end-user” affects that conclusion. They mean that the VAR could not pay Autonomy unless and until the VAR made a sale to the end-user. But there were no cases in which the VAR made a sale to the end-user, so these additional words are of no relevance. This sixth assumption (VAR’s inability to pay), therefore results in the recognition of revenue by Autonomy being invalid at the time of the ‘sale’ to the VAR.”⁴²⁷

My comments

6.97 Of course, revenue should not be recognised if it was known at the time of the sale that a reseller was unable (and would never be able) to pay for the goods being sold. In such a situation, in my opinion the transaction would fail to meet IAS18.14(d) and the revenue could not be recognised until such time as it became probable that the goods would be paid for. However, this is not the same as Holgate Assumption 6 which states that the reseller did not have the ability to pay in the absence of an onward sale, not that it would never be able to pay. Similarly, Mr Holgate states in his First Report that, *“If a customer does not have the means to settle the purchase price of the goods it is buying, that invalidates the recognition of a sale by the seller.”⁴²⁸* Given Mr Holgate states *“does not”*, in my view, this can only be a reference to the position at the time of the sale. Again, this is not the same as an assumption that the reseller would never be able to pay. I do not know whether the Claimants and Mr Holgate meant to say that the reseller would never be able to pay, but it is not what either has said (as referred to above in this paragraph), and I am not in a position to re-write the Holgate Assumptions. A sale shall still be recognised if, at the time of the sale, it was probable that the reseller would be able to pay within a reasonable time, even if at the time of the sale it did not have money in the bank to make payment immediately.

6.98 The “collectability” test⁴²⁹ was, and is, an important consideration when recognising revenue. It is a judgement formed at the time of the sale, and needs to be considered based on what was understood at the time. Deloitte considered collectability as part of

⁴²⁷ Mr Holgate’s First Report, paragraph 5.21.2.

⁴²⁸ Mr Holgate’s First Report, paragraph 5.21.2.

⁴²⁹ As to which, see my First Report, paragraph 4.52.

its audit and review work when testing individual transactions, and when reviewing the individual reseller transactions I have considered whether this was sufficient to conclude that IAS 18.14(d) (Probable that economic benefits will flow to the entity) was met (see **Appendix 3.1 to 3.37** of this report). Mr Holgate has not seen Deloitte's working papers so makes no comment in this regard.

- 6.99 I would add here that a subsequent bad debt does not invalidate a sale. In line with IAS 18.18, in the event that an uncertainty over the collectability of a debt associated with a sale arises subsequent to recognising that sale, the appropriate treatment is to recognise this as an expense i.e. a bad debt, or bad debt provision. It does not suggest that the revenue should not have been recognised at the time of the transaction.

Holgate Assumption 7: Capax Discovery financial history

- 6.100 Mr Holgate has been instructed to assume that:

“For sales to Capax Discovery as VAR: Capax Discovery was a newly incorporated company in March 2009 and therefore had no financial history at that time. Capax Discovery wrote to Autonomy in March 2009, providing financial information for Capax Global “on the express understanding that Capax Global is a separate and distinct entity from Capax Discovery. All contractual obligations will be between Capax Discovery and Autonomy only”.”⁴³⁰

Mr Holgate's analysis

- 6.101 Mr Holgate notes:

“The effect of this letter seems clear, namely that Capax Global's financial strength was not relevant. Therefore, any assessment of creditworthiness should have focused on Capax Discovery, which was the entity with which Autonomy was contracting. If, in the event of any difficulty, Capax Global were to step in and give support, that would be entirely voluntary on its part and therefore not something that could be relied on by Autonomy. As Capax Discovery was a new company with no trading history, there was no available evidence of its ability to pay and therefore no basis for concluding that it could or would do so.”

- 6.102 Mr Holgate asserts that this assumption goes to IAS 18.14(d).⁴³¹

⁴³⁰ Mr Holgate's First Report, paragraph 5.2.7.

⁴³¹ Mr Holgate's First Report, paragraph 5.21.3.

My comments

- 6.103 The logical extension of Mr Holgate's analysis is that seemingly Autonomy entered into an arrangement in which it knew it could never recognise revenue, as it did not have a reasonable expectation that it was probable that it would be paid. In particular, Mr Holgate states, "*As Capax Discovery was a new company with no trading history, there was no available evidence of its ability to pay and therefore no basis for concluding that it could or would do so*". This would seem to suggest that, for every sales transaction to a new company with no trading history, the seller would be prohibited from recognising revenue. This does not appear to me to be particularly commercial.
- 6.104 In addition, even if there was no legal obligation for Capax Global to support Capax Discovery, this would not preclude Capax Global from choosing to do so (as Mr Holgate acknowledges). In circumstances where a group of companies has common ownership and management, in my opinion it would be usual to assume that a group would stand behind the financial obligations of one of its subsidiaries if required.
- 6.105 Mr Holgate has been instructed that this assumption relates to Capax Discovery transactions with end-users TXU (Q2 and Q3 2009), Kraft (Q3 2009), Eli Lilly (Q4 2009) and the FSA (Q1 2010)⁴³². It is not clear why this assumption has been applied to these transactions and not to the other Capax transactions within the impugned transactions, nor what the Claimants consider changed after Q1 2010 such that this assumption no longer applies. Clearly, by the time of the transaction with end-user FSA in Q1 2010, approximately a year had passed and Capax had undertaken a number of transactions with Autonomy, thus building up a trading and payment history over that time.
- 6.106 As far as I am aware, Deloitte never concluded that revenue could not be recognised because Capax Discovery was unable to meet its obligations to Autonomy. Deloitte was aware that Capax Discovery was a relatively new company and considered collectability in detail as part of its audit work and review work⁴³³.
- 6.107 Mr Holgate has not seen Deloitte's working papers and so makes no comment in this regard.
- 6.108 Further, as set out in my First Report, Mr Baiocco, in the Transcript of Proceedings, refers to a line of credit that may have been used to pay for 'VAR licences'.⁴³⁴

⁴³² Appendix 4 to Mr Holgate's First Report. These are Transactions 2, 3, 4, and 10 in Schedule 3 to the Re-Re-Amended Particulars of Claim.

⁴³³ See, for example, section 8, paragraphs 8.23 to 8.26.

⁴³⁴ See paragraph 9.38 of my First Report.

Holgate Assumption 8: Subsequent sales effort to end-user

6.109 Mr Holgate has been instructed to assume that:

*“The VAR did not, after the agreement between Autonomy and the VAR had been entered into, make any effort to sell a licence for the relevant software to the end-user. Instead, the Autonomy group company continued its own efforts to achieve a sale of the licence directly with the end-user (and without consultation with the VAR)”.*⁴³⁵

Mr Holgate’s analysis

6.110 Mr Holgate asserts that this assumption goes to the substance of a transaction, as well as IAS 18.14(a) and (b).⁴³⁶

6.111 Mr Holgate states:

*“... if the reseller had genuinely bought the item, the reseller would have everything to gain or lose by succeeding or failing to make the sale to the end-user that is, the reseller would have the risks and rewards relating to the item it had bought. If, as posited here, it is Autonomy who continued that sales effort, that is strong evidence that it had not transferred to the reseller the risks and rewards with respect to licences that the reseller purported to purchase. This is particularly so where key commercial terms with the identified end-user such as the nature of the goods or services sold and their prices have not been agreed at the time of the purchase order (as I can see was the case for some of the 37 transactions discussed at Appendix 3). Likewise, a vendor who continued the sales effort would clearly have retained managerial involvement in and control over the goods in question.”*⁴³⁷

My comments

6.112 As noted in my First Report and at paragraph 6.72, 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.⁴³⁸

6.113 Accordingly, on its own, whether or not a reseller subsequently sold, or even attempted to sell, a licence for the relevant software to an end-user was of no consequence to Autonomy’s revenue recognition considerations as the relevant transaction from Autonomy’s perspective was its own sale to the reseller. Where Autonomy continued its

⁴³⁵ Mr Holgate’s First Report, paragraph 5.2.8.

⁴³⁶ Mr Holgate’s First Report, paragraph 5.17.1.

⁴³⁷ Mr Holgate’s First Report, paragraph 5.17.1.

⁴³⁸ My First Report, paragraph 8.6.

own efforts to achieve a sale of the licence directly to the end-user, in my opinion this would not necessarily have invalidated the sale, and could simply have been for genuine commercial reasons.

6.114 Dr Lynch also states:

“where Autonomy staff continued in discussion with the proposed end user, the reseller retained control of the product and it was the reseller’s decision as to whether to transact”.⁴³⁹

6.115 However, if at the time of the sale to the reseller, Autonomy intended to continue to attempt to sell direct to the end-user, and if it intended to cancel the sale to the reseller (or otherwise relieve the reseller of the debt) on a subsequent successful direct sale (or no sale) then no revenue should be recognised in the income statement until such time as, for example, a sale to the end-user made probable the flow of economic benefits to Autonomy.

6.116 Therefore, Holgate Assumption 8 is only relevant to the accounting treatment in these particular circumstance described above.

6.117 If, as appears to have happened in certain cases, an identified end-user in a reseller transaction subsequently elected to contract directly with Autonomy, the timing of this would need to be considered. Where the deal went direct after the point that the quarterly / interim reviews / financial statements were authorised for issue, this would be irrelevant for the purposes of Autonomy’s revenue recognition at the time⁴⁴⁰. Where the deal went direct before the point that the quarterly / interim reviews / financial statements were authorised for issue, this would need to be considered further based on the individual facts of the transaction to ascertain whether that (direct) sale indicated that a condition existed in relation to the sale to the reseller at the balance sheet date and which could impact upon the appropriate accounting treatment.

Holgate Assumption 9: Specified end-user

6.118 Mr Holgate has been instructed further to assume that, *“The purchase orders or sales agreements for the transactions between Autonomy and the VAR specified that the software was for onward licensing to the particular end-user”*.⁴⁴¹

⁴³⁹ First Defendant’s Amended Defence and Counterclaim, paragraph 109.2.

⁴⁴⁰ See paragraphs 6.28 to 6.31 of this report.

⁴⁴¹ Mr Holgate’s First Report, paragraph 5.2.9.

6.119 Mr Holgate again asserts that this assumption goes to the substance of a transaction rather than any criteria for recognition of revenue under IAS 18.14.⁴⁴²

Mr Holgate's analysis

6.120 Mr Holgate states:

*"... this strongly suggests that the 'sale' from Autonomy to the VAR lacked substance and was artificial. I cannot imagine that a VAR would purchase a defined set of software licences having no knowledge of the likelihood that the sale would complete and no means of selling the goods it was purchasing to anyone else. ... Assumption 9 tells us that the sale to the VAR was not the end of the story as far as Autonomy was concerned; indeed it suggests that the sale to the VAR is not an important part of the story at all."*⁴⁴³

My comments

6.121 In my view, such suggestions as made by Mr Holgate do not appear commercial, or based in commercial reality, for example without consideration of the master reseller agreements entered into.

6.122 While I am not a lawyer, in the context of, for example, proprietary intellectual property, in isolation, I cannot see how specifying an end-user for onward licensing would invalidate a sale to a reseller; it merely demonstrates a way of working.

6.123 Mr Holgate's comment that "*Assumption 9 tells us that the sale to the VAR was not the end of the story as far as Autonomy was concerned*" raises an important point regarding Autonomy's accounting treatment in respect of reseller transactions. In the very nature of a reseller transaction, it is unlikely that it would be "*the end of the story*", since Autonomy would still have an interest in ensuring that its reputation was not eroded in any way.

6.124 As noted at paragraph 4.45 of my First Report, PwC's Guidance includes the seller having control over the resale of the item (for example, being able to control the price or counterparty) as one of five potential indicators of continuing managerial involvement. However, as also explained in my First Report, in my experience, a feature of the sale of intangible assets is the manufacturer's desire to control any potential exploitation of its intellectual property⁴⁴⁴. In my opinion, in the case of intellectual property, features such as the above are just protective rights attempting to prevent Autonomy's intellectual

⁴⁴² Mr Holgate's First Report, paragraph 5.12.

⁴⁴³ Mr Holgate's First Report, paragraph 5.11.

⁴⁴⁴ My First Report, paragraph 4.46.

property being devalued in the market, and would not amount to managerial involvement to the degree normally associated with ownership.

- 6.125 In any case, as noted in my First Report and at paragraph 6.72 above, 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 sold the product on to an identified end-user was irrelevant for Autonomy's revenue recognition.⁴⁴⁵
- 6.126 This approach, by reference to IFRS (in particular IAS 18.14), differs to HP's accounting for sales to resellers as, under US GAAP, sales to resellers are viewed on a "*sell-through basis*"; in other words, revenue is recognisable by the product manufacturer only when the reseller sells the product to the end-user.⁴⁴⁶ Mr Holgate introduces and acknowledges the concept of such "*sell-through arrangements*" in his report⁴⁴⁷ and uses this as an example of circumstances in which risks and rewards are not transferred (in the context of Holgate Assumption 10)⁴⁴⁸.
- 6.127 Mr Holgate's comments therefore appear to suggest that, in his opinion, any transaction entered into by Autonomy with a reseller where an end-user is named in the contractual documents lacks substance. A review of other purchase orders and sales agreements relating to transactions with resellers which are not impugned in this case shows that the end-user is, in practice, also identified in these documents.⁴⁴⁹
- 6.128 Mr Holgate also refers to the "*combined effect*" of Holgate Assumptions 1 to 4, plus Holgate Assumption 9, as indicative of a lack of substance⁴⁵⁰. In my opinion, these five assumptions do not necessarily mean that there was no economic substance to a transaction. This is because a transaction can still have economic substance if the five assumptions described above apply either individually or collectively to a transaction: that is, a sale will still be a sale even if, subject to the facts:
- (a) it is only first envisaged at a quarter-end;
 - (b) the price is agreed without negotiation;
 - (c) the reseller had no prior relationship or contact with the proposed end-user;
 - (d) the reseller did not undertake or propose to provide any added value, or any service, to the end-user; and

⁴⁴⁵ My First Report, paragraph 8.6.

⁴⁴⁶ This distinction is referred to in Dr Lynch's First Witness Statement, paragraph 239.

⁴⁴⁷ Mr Holgate's First Report, paragraph 3.39.2.

⁴⁴⁸ Mr Holgate's First Report, paragraph 5.8.1.

⁴⁴⁹ See, for example, {D010066947} and {D001693156}.

⁴⁵⁰ Mr Holgate's First Report, paragraphs 5.10 to 5.11.

(e) the sales contract specified that the software was for onward licensing to a particular end-user.

6.129 To be clear, even with these five assumptions present, if there is a written sales contract and all of the criteria for revenue recognition set out in IAS 18.14 have been met, the sale has economic substance and revenue should be recognised.

Holgate Assumption 10: Side agreement - reseller liability to pay Autonomy

6.130 Mr Holgate has been instructed to assume that:

*“There was an agreement or understanding (whether or not legally enforceable) between the Autonomy group company and the VAR, which was not apparent on the face of the written contractual documentation between the Autonomy group company and the VAR, to the effect that the VAR would not be required to satisfy any liability to Autonomy from its own resources”.*⁴⁵¹

Mr Holgate’s analysis

6.131 Mr Holgate asserts that this assumption goes to the substance of a transaction, as well as IAS 18.14(a), (b) and (d).⁴⁵²

6.132 Mr Holgate notes:

*“The presence of a side agreement or understanding contradicts the formal provisions of the contract regarding payment; it evidences that the intention of the parties is that a conventional sale is not taking place at all. It tells us that there might be some kind of conditional sale, but that is quite different; a conditional sale does not merit accounting recognition until the conditions are satisfied.”*⁴⁵³

6.133 Mr Holgate also states:

*“Payment for goods or services supplied is so fundamental a feature of a commercial contract that an agreement or understanding indicating that payment out of the VAR’s own resources is not necessary fundamentally changes the substance of the transaction: a transaction with this feature is artificial and lacks substance. This would be the case even if the understanding were unenforceable in a Court of law. It remains the case that, because the parties intended the side agreement or understanding to apply, the transaction lacked substance.”*⁴⁵⁴

⁴⁵¹ Mr Holgate’s First Report, paragraph 5.2.10.

⁴⁵² Mr Holgate’s First Report, paragraph 5.8.

⁴⁵³ Mr Holgate’s First Report, paragraph 5.5.

⁴⁵⁴ Mr Holgate’s First Report, paragraph 5.6.

My comments

6.134 Mr Holgate's analysis appears to be inconsistent where he states that:

*"In circumstances where the VAR does not have to pay for the software from its own resources, it is clear that Autonomy would not have transferred to the VAR the risks and rewards of ownership of the goods (para 14(a)). Indeed, IAS 18 gives this situation as a specific example of where risks and rewards are not transferred"*⁴⁵⁵.

6.135 However, the "specific example" that Mr Holgate refers to, IAS 18.16(b), is an example of a situation in which an entity may retain the significant risks and rewards of ownership⁴⁵⁶.

6.136 In respect of Holgate Assumption 10, the key part is the assumption that the reseller would not be required to satisfy any liability to Autonomy from its own resources. In such a situation, in my opinion the transaction would lack economic substance and would fail to meet at least IAS 18.14(a) and (d) (and likely (b)). In these circumstances, no revenue associated with Autonomy's transaction with the reseller should be recognised in the accounting records, until such time as, for example, a sale to an end-user made probable the flow of economic benefits to Autonomy.

6.137 The existence, or otherwise, of a side agreement such that the reseller was not liable to settle its debts to Autonomy from its own resources is a matter of disputed fact. The existence of a side agreement would not necessarily have prevented the recognition of revenue on the transaction. If such an arrangement did exist, the judgement made around whether or not it was appropriate to recognise revenue at the relevant date would depend upon the actual terms of the side agreement. If the side agreement was clear in terms that the reseller would not be bound, or otherwise required, to satisfy a liability to Autonomy from its own resources, then it would not be appropriate for Autonomy to recognise the revenue associated with the transaction with the reseller, until such time, for example, as a sale to an end-user made probable the flow of economic benefits to Autonomy.

6.138 From the documentation I have reviewed, it appears that representatives of the resellers understood, in fact and contrary to Holgate Assumption 10, that such an agreement did not relieve the resellers of their recognised obligations to pay Autonomy in respect of the transactions.⁴⁵⁷

6.139 In response to the allegations raised in witness evidence concerning alleged side agreements, Dr Lynch states:

⁴⁵⁵ Mr Holgate's First Report, paragraph 5.8.1.

⁴⁵⁶ Mr Holgate's First Report, paragraph 5.8.1.

⁴⁵⁷ See for example, my First Report, paragraphs 9.33 to 9.36 and 10.35 to 10.36.

*“At no point did [Mr Egan] suggest to me that he was assuring the resellers that they would not be on risk for the full contract price or that he was otherwise entering into oral side agreements. I was not aware of any side agreements and my understanding was that the contractual terms of our arrangements with resellers precluded any such agreements.”*⁴⁵⁸

6.140 Dr Lynch also states:

*“The contractual paperwork made it plain that resellers were on risk and I never thought otherwise. My understanding was that the contractual paperwork was designed to render invalid any oral side agreements, assurances, handshakes, words of comfort, understandings or mixed messages that a salesperson or managers in Autonomy’s offices around the world might have given any reseller. It overruled any hope a reseller might harbour that Autonomy would provide assistance in the event an end-user deal did not close or forgive a late payment. There was nothing to prevent Autonomy from enforcing its rights against any reseller to my knowledge, then and now. If Autonomy did not do so, for whatever commercial reason, that was entirely Autonomy’s business decision. It is a commercial reality that suppliers have some reluctance to sue their resellers and may view this as a last resort, but that is a very different thing to an agreement or understanding of the type that HP claims existed on the sales it has challenged. Further, Autonomy had clear policies forbidding the sales department from entering into any such “inferable” agreements or understandings. HP overlooks the hundreds of reseller deals that were performed in accordance with their terms. Resellers were legally on risk and they knew this.”*⁴⁵⁹

6.141 Finally I understand, although again it is a legal matter, that the reseller agreements contained an entire agreement clause that provided that these agreements could not be varied other than in writing⁴⁶⁰, which is contrary to Holgate Assumption 10. While a legal matter, even if there was an oral side agreement in place (which is disputed), such a clause suggests there would be no validity to any agreement which was not contained in the contractual documentation itself.

6.142 As noted in my First Report, as is clear from PwC’s 2009 Guidance, 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.⁴⁶¹

⁴⁵⁸ Dr Lynch’s Second Witness Statement, paragraph 44.

⁴⁵⁹ Dr Lynch’s First Witness Statement, paragraph 245.

⁴⁶⁰ First Defendant’s Amended Defence, paragraph 99A. See, for example, MicroTech {D000001951}, clause 14.4.

⁴⁶¹ My First Report, paragraphs 4.25 to 4.29.

Holgate Assumption 11: Reseller relieved of liability to pay

6.143 Mr Holgate has been instructed to assume that:

*“The VAR was relieved of its ostensible liability to pay the price for the Autonomy software licence it had purchased by one or more of the following means: (a) the purported sales agreement between Autonomy and the VAR being cancelled, (b) a credit note being issued to the VAR discharging its ostensible liability to pay the price, or (c) the VAR’s debt being written off”.*⁴⁶²

Mr Holgate’s analysis

6.144 Mr Holgate asserts that this assumption goes again to the substance of the transaction, as well as IAS 18.14(a) and (d).⁴⁶³

6.145 Mr Holgate states:

*“Most businesses of any size have had experiences in customer relationships in which they have had to cancel a sales agreement or issue a credit note or write off a debt in full. However, generally these are rare and unfortunate events, not routine ways of conducting business and are not based on a prior agreement or understanding that the counterparty to a transaction will be protected from risk (i.e. assumption 10). Where one, or a combination, of these features was adopted as a routine or even occasional way of dealing with situations that occur from time to time, they constitute strong evidence that the sale to the VAR was not genuinely made and that there was no transfer of the risks and rewards of ownership.”*⁴⁶⁴

My comments

6.146 In making the assertions set out at paragraph 6.145, Mr Holgate provides no indication of what he would consider to be “occasional”, “routine” or “from time to time”, whether in the context of the impugned transactions or taking into account all of the transactions entered into by Autonomy in the Relevant Period (as noted at paragraph 6.23 Mr Holgate has not considered the latter at all). For example, encountering events such as those described under Holgate Assumption 11 on an “occasional” basis may not be cause for concern, whereas their being “adopted as a routine” might. Obviously “rare” speaks for itself - and I would disagree based on my experience that this is a relevant test, but I do understand how Mr Holgate based on his experience may have taken a contrary view.

⁴⁶² Mr Holgate’s First Report, paragraph 5.2.11.

⁴⁶³ Mr Holgate’s First Report, paragraph 5.21.4.

⁴⁶⁴ Mr Holgate’s First Report, paragraph 5.21.4.

- 6.147 Dr Lynch sets out that, in some instances, Autonomy could take a commercial decision to supply directly to the end-user and reverse its deal with the reseller or designate the reseller as Autonomy's payee⁴⁶⁵.
- 6.148 Dr Lynch and Mr Hussain both describe how Autonomy (like all companies, in my view) would sometimes take commercial decisions at Autonomy's discretion.⁴⁶⁶ Such, or similar, decisions can be made for any number of reasons, including, but not limited to, safeguarding a company's route to market and its sales channels and/or protecting its reputation. The presence of such subsequent actions is not in or of itself cause for concern.
- 6.149 Further, as already noted, relying on events that occurred subsequent to the date at which quarterly / interim reviews / financial statements were authorised for issue involves hindsight. Such events would not therefore directly impact on revenue recognition, which should be based only on contemporaneous information available at the time of consideration of the recognition of revenue by Autonomy.⁴⁶⁷
- 6.150 Mr Holgate does not even distinguish between decisions taken by Autonomy and those taken by HP. For example, in the case of Transaction 15, Realise (end-user Credit Suisse), the actual write off by Autonomy took place under HP's ownership. It is difficult to reconcile Mr Holgate's assertion that Holgate Assumption 11(c) was a method of implementing a side agreement (i.e. Holgate Assumption 10)⁴⁶⁸ with HP having taken the decision to make the write off.

⁴⁶⁵ Dr Lynch states: "I had a general understanding that, on occasion, reseller deals departed from the conventional pattern of "Autonomy sells to reseller/reseller sells to end user", for example, where an end user decided to purchase from Autonomy directly. HP has cherry picked 37 transactions to try to identify deals of this nature. In those circumstances, Autonomy had a couple of options. We could say to the end user that we would not supply them and direct them to the reseller, but we would avoid doing this if it was likely to cause problems in our relationship with the end user, particularly if the end user was a repeat customer. I had a general awareness that Autonomy could take the commercial decision to supply to the end user and unwind the reseller deal or designate the reseller as Autonomy's payee, although I would not have been the person at Autonomy to make that decision. In those circumstances, Autonomy would generally pay the reseller a MAF for their lost margin on the end-user deal. I now know that this happened in a handful of cases, a very small percentage of the overall total of sales to resellers." Dr Lynch's First Witness Statement, paragraph 258.

⁴⁶⁶ Dr Lynch's First Witness Statement, paragraphs 245, 258, 266 and 267 and Mr Hussain's Witness Statement, paragraphs 118E and 122.

⁴⁶⁷ See paragraphs 6.28 to 6.31 of this report.

⁴⁶⁸ Mr Holgate's First Report, paragraphs 5.22 and 5.23.

Holgate Assumption 12: Autonomy asks end-user to pay reseller after direct sale

6.151 Mr Holgate has been instructed to assume that:

“Where the Autonomy group company subsequently achieved a direct sale to the end-user, the Autonomy group company arranged for the end-user to pay the VAR so that the VAR could then pay the relevant Autonomy group company.”⁴⁶⁹

Mr Holgate’s analysis

6.152 Mr Holgate asserts that this assumption goes to the substance of a transaction, as well as IAS 18.14(a), (b) and (d).⁴⁷⁰

6.153 Mr Holgate states:

“The key question that arises here is why the Autonomy group company would seek to achieve a direct sale with the end-user. The situation evidences very strongly that the ‘sale’ to the VAR was artificial. The Autonomy group company might assist the VAR with the VAR’s sales effort but that is a different arrangement to what is described. It is equally artificial for the Autonomy group company to ask the end-user to pay the VAR - a party with which the end-user had had little or no contact.”⁴⁷¹

My comments

6.154 In my opinion, my comments in respect of Holgate Assumption 11 are also relevant here.

6.155 Mr Holgate asserts that a direct sale to an end-user “*evidences very strongly*” that the sale to a reseller was artificial, when all this does is replicate an assumption without consideration or investigation as to the chain of events leading up to why the sale may subsequently have been made directly with a previously identified end-user.

6.156 Mr Holgate does not appear to have considered Dr Lynch’s explanation (as also referred to at paragraph 6.147 in the context of Holgate Assumption 11) that, in some instances, Autonomy could take a commercial decision to supply directly to the end-user and reverse its deal with the reseller or designate the reseller as Autonomy’s payee⁴⁷².

6.157 Further, as already noted, relying on events that occurred subsequent to the date at which quarterly / interim reviews / financial statements were authorised for issue involves hindsight. Such events would not therefore directly impact on revenue recognition, which

⁴⁶⁹ Mr Holgate’s First Report, paragraph 5.2.12.

⁴⁷⁰ Mr Holgate’s First Report, paragraph 5.21.5.

⁴⁷¹ Mr Holgate’s First Report, paragraph 5.21.5.

⁴⁷² Dr Lynch’s First Witness Statement, paragraph 258.

should be based only on contemporaneous information available at the time of consideration of the recognition of revenue by Autonomy.⁴⁷³

Holgate Assumption 13: Autonomy makes purchase from reseller

6.158 Mr Holgate has been instructed to assume that:

*“An Autonomy group company was caused to make a payment to the VAR to purchase rights, goods or services that the Autonomy group company did not need (and which had no discernible value to it), but which had the purpose and effect of putting the VAR in funds which it then used to pay for the Autonomy software licence”.*⁴⁷⁴

Mr Holgate’s analysis

6.159 Mr Holgate asserts that this assumption goes to the substance of a transaction, as well as IAS 18.14(a) and (d).⁴⁷⁵

6.160 Mr Holgate states:

*“It is clearly not normal commercial practice for an entity to purchase goods from any party that it does not need. These types of arrangement are generally artificial. To buy goods that are not needed is in effect a disguised gift; it is a transfer of value with little or nothing of value being received in exchange. For Autonomy to have made a disguised gift to a VAR in order that the VAR could settle the amount outstanding invalidates Autonomy’s original sale, as, taking the two transactions together, Autonomy has not gained from the transactions.”*⁴⁷⁶

My comments

6.161 Mr Holgate appears to have considered little, if any, of the underlying evidence and he does not appear to have questioned in any way the assumption put to him that Autonomy was simply purchasing goods that it did not need.

6.162 As a general point, I note that there is nothing wrong with a company buying goods or services from its own customers. This is common practice in many industries, as is also noted by Dr Lynch, who also notes that this is commonplace in the software industry⁴⁷⁷.

6.163 Nor is there anything wrong with a customer waiting for payment from the other party before making payment to that same party. If a reseller used the money paid by Autonomy

⁴⁷³ See paragraphs 6.28 to 6.31 of this report.

⁴⁷⁴ Mr Holgate’s First Report, paragraph 5.2.13.

⁴⁷⁵ Mr Holgate’s First Report, paragraph 5.21.6.

⁴⁷⁶ Mr Holgate’s First Report, paragraph 5.21.6.

⁴⁷⁷ Dr Lynch’s Amended Defence and Counterclaim, paragraph 111.

for the purchase of a certain product from the reseller to pay down some of the reseller's outstanding debts to Autonomy, it does not necessarily follow that Autonomy must have purchased that product for that sole reason.

- 6.164 The matter of whether various goods purchased were of value to Autonomy is in dispute and, in my view, needs to be considered for each individual transaction.
- 6.165 Further, as already noted, relying on events that occurred subsequent to the date at which quarterly / interim reviews / financial statements were authorised for issue involves hindsight. Such events would not therefore directly impact on revenue recognition, which should be based only on contemporaneous information available at the time of consideration of the recognition of revenue by Autonomy.⁴⁷⁸
- 6.166 Mr Holgate states that buying goods that are not needed are in effect a disguised gift. Further, Mr Holgate states *“For Autonomy to have made a disguised gift to a VAR in order that the VAR could settle the amount outstanding invalidates Autonomy’s original sale, as, taking the two transactions together, Autonomy has not gained from the transactions.”*⁴⁷⁹
- 6.167 However, in order for this to be the case, when considering collectability at the time of the original sale, Autonomy must have anticipated that it was not probable that the economic benefits would flow to it as it intended to put the reseller in funds by purchasing unnecessary goods or services from it. This appears to require Holgate Assumption 10 to be present also.
- 6.168 In my opinion, if it was not anticipated at the time of an original sale to the reseller that Autonomy would purchase goods or services it did not need as a way to relieve the reseller of its obligation to pay (such that the reseller was not required to settle its liability to Autonomy from its own resources), then such a purchase could not have been taken into account when considering if Autonomy would gain from the transaction (i.e. whether it was probable that economic benefits would flow to Autonomy).
- 6.169 As I have explained above, in line with IAS 18.18, in the event that an uncertainty over the collectability of a debt associated with a sale arises subsequent to recognising that sale, the appropriate treatment is to recognise this as an expense i.e. a bad debt, or bad debt provision. It does not suggest that the revenue should not have been recognised at the time of the transaction. So, if the purchase was a way of relieving the reseller of its obligation to pay because it was no longer probable that the reseller would be able to make payment, then the effect of the purchase would be to avoid recognising a bad debt.

⁴⁷⁸ See paragraphs 6.28 to 6.31 of this report.

⁴⁷⁹ Mr Holgate's First Report, paragraph 5.21.6.

6.170 In summary, in the absence of Holgate Assumption 10, if Holgate Assumption 13 alone applies, this would mean that Autonomy had avoided recognising a bad debt, but would not impact upon the initial recognition of Autonomy's sale to the reseller.

Conclusion on Holgate Assumptions in respect of resellers

6.171 In summary, in my opinion none of the Holgate Assumptions makes any difference to the initial accounting for the impugned reseller transactions save for:

- (a) Holgate Assumption 8, specifically, if Autonomy continued efforts to make a direct sale to the end-user with the intention of relieving the reseller of the debt; and
- (b) potentially, Holgate Assumption 10, the responsibility for payment.

6.172 In respect of Holgate Assumption 8, if at the time of the sale to the reseller, Autonomy intended to continue to attempt to sell direct to the end-user, and if it intended to cancel the sale to the reseller (or otherwise relieve the reseller of the debt) on a subsequent successful direct sale (or no sale) then no revenue should be recognised in the income statement until such time as, for example, a sale to the end-user made probable the flow of economic benefits to Autonomy.

6.173 However, Holgate Assumption 8 is only relevant to the accounting treatment in these particular circumstances described above.

6.174 In respect of Holgate Assumption 10, the key part is the assumption that the reseller would not be required to satisfy any liability to Autonomy from its own resources. If it were found that there was a side agreement to this effect, in my opinion the transaction would lack economic substance and would fail to meet at least IAS 18.14(a) and (d) (and likely (b)). In these circumstances, no entries at all in respect of revenue associated with Autonomy's transaction with the reseller should have been recognised in the accounting records, until such time, for example, as a sale to an end-user made probable the flow of economic benefits to Autonomy.

6.175 In respect of Holgate Assumption 6 revenue should not have been recognised if it was known at the time of the sale that a reseller was unable (and would never be able) to pay for the goods being sold. In such a situation, in my opinion the transaction would fail to meet IAS18.14(d) and the revenue could not be recognised until such time as it became probable that the goods would be paid for. However, this is not the same as Holgate Assumption 6 which states that the reseller did not have the ability to pay in the absence of an onward sale, not that it would never be able to pay.

6.176 With regard to the reseller's ability to pay Autonomy in respect of its debts, I have reviewed Deloitte's contemporaneous audit and review working papers for each

transaction (where available), in particular Deloitte's comments as to collectability. I set out my comments in this regard, as part of my consideration of whether IAS 18.14(d) was met for each of the reseller transactions impugned by the Claimants, in **Appendix 3.1 to 3.37** to this report that follow.

7 ALLEGED RECIPROCAL TRANSACTIONS

Introduction

7.1 In section 6 of Mr Holgate's First Report he sets out his views on the accounting for six alleged reciprocal transactions entered into by Autonomy in the Relevant Period. Mr Holgate states:

*"These transactions (which some may describe as barter transactions) typically involve Autonomy selling goods or services to third parties and, at or around the same time, buying goods or services from the same third party."*⁴⁸⁰

7.2 For the avoidance of doubt, the fact that sales and purchase transactions are carried out with the same counterparty, at around the same time, does not necessarily mean that those transactions are barter transactions. As set out in my First Report⁴⁸¹, KPMG's 2008/9 Guidance sets out that these features are only an indicator that transactions could be linked, or barter transactions. In assessing the accounting treatment of the transactions regard has to be had to the individual facts of each transaction.

7.3 I set out in my First Report what is meant by a reciprocal transaction and the paragraphs of IAS 18 which are applicable in order to identify and measure revenue resulting from such transactions.⁴⁸² I also set out the Claimants' allegations in respect of the alleged reciprocal transactions.⁴⁸³

7.4 In the Joint Statement Mr Holgate and I agreed that "[e]ven if the alleged reciprocal transactions are determined to be linked, this does not necessarily preclude separate recognition of each limb of any such transaction i.e. the recognition of the gross fair value of the sale and purchase."⁴⁸⁴

7.5 In this section I provide:

- (a) my comments on Mr Holgate's approach to considering the alleged reciprocal transactions; and
- (b) my approach to determining if a sale and purchase are linked and, if so, how such transactions should be accounted for.

⁴⁸⁰ Mr Holgate's First Report, paragraph 6.1.

⁴⁸¹ Exhibit H to my First Report - KPMG'S 2008/9 Guidance, page 801, paragraph 4.2.100.20.

⁴⁸² My First Report, paragraphs 12.5 to 12.12.

⁴⁸³ My First Report, paragraphs 12.14 to 12.18.

⁴⁸⁴ Joint Statement, page 25, "Agreed view" on "Agenda Item" 6(a).

Mr Holgate's approach to analysis of the alleged reciprocal transactions

Mr Holgate's sources of information

- 7.6 Mr Holgate has assessed the accounting treatment of the reciprocal transactions on the basis of the assumptions he has been instructed to adopt. It is unclear exactly what supporting documents Mr Holgate has reviewed in carrying out his analysis of the alleged reciprocal transactions as he does not provide such detail in his report.
- 7.7 In undertaking his analysis of each transaction in section 6 to his First Report, Mr Holgate does not appear to have seen or been provided with, and hence has not taken account of, much of the witness evidence (either the Claimants' or Defendants')⁴⁸⁵ and the contemporaneous documentation, including the working papers of Deloitte, all of which is available in the documents submitted and disclosed in these proceedings. Instead, his analysis appears to have been based almost exclusively upon the assumptions that he has been instructed to make (together with a "Factual summary" for each transaction provided to him by his instructing solicitors). In the light of the highly judgemental nature of many of the accounting issues in this case I consider these all to be important sources of information, as set out in sections 4 and 6 of my First Report.
- 7.8 Further, he appears to have taken no account of substantial amounts of information - including accounting information - which is presumably in the hands of the Claimants, for example Autonomy's underlying accounting records. Such information unless disclosed is not available to me.
- 7.9 As set out in section 2 of this report, when considering the accounting treatment of transactions, one has to have regard to the facts. This is particularly the case when considering 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 as this is fact specific, and the actual accounting will typically require the application of judgement in the context of the existence (or not) and applicability (or not) of relevant indicators of linkage.
- 7.10 The actual facts become even more important where they are disputed and in my opinion regard must be had to all of the relevant facts - including the disputed facts - of each individual transaction in considering the appropriate accounting treatment. Indeed, Mr Holgate and I agreed in our Joint Statement that the individual commercial facts

⁴⁸⁵ Annex 2 to Mr Holgate's letter of instruction lists the documents provided to him, which includes only four witness statements - see Mr Holgate's First Report, Appendix 2.

relating to each transaction or item are highly relevant to its accounting treatment and that regard has to be had to the individual facts of each transaction.⁴⁸⁶

Mr Holgate's consideration of the overall relationship between Autonomy and the counterparties in the alleged reciprocal transactions

- 7.11 As I understand it, the identification of the existence of reciprocity and the transactions asserted to be relevant in consideration of this reciprocity as analysed by Mr Holgate, is an exercise undertaken by the Claimants. This was not something considered by Autonomy at the relevant time. Nor is it the product of any analysis by Mr Holgate himself.
- 7.12 The Claimants have provided no methodology which enables me to understand the basis on which any two or more transactions are asserted to be reciprocal.
- 7.13 This means that if, for example, there are transactions between Autonomy and a counterparty, some of which are asserted to be reciprocal and some which are not, there is no reasoning either by the Claimants or Mr Holgate as to why that is the case.
- 7.14 Before determining that reciprocal arrangements existed between Autonomy and its counterparties and what the appropriate accounting treatment for transactions carried out under these arrangements should be, it is necessary for all of the relevant transactions between the parties to be considered together in order to understand the overall commercial relationship at the time and the effect of the series of transactions as a whole.
- 7.15 Mr Holgate has considered only the transactions suggested to him by the Claimants to be relevant for the purposes of considering the substance of the transactions between Autonomy and its counterparties. He has not considered other transactions or the wider relationship between the parties.
- 7.16 In my opinion, failing to consider other potentially relevant transactions in a commercial relationship under these circumstances means that IAS 18.13 has not been appropriately considered. This is because IAS 18.13 requires that the “[revenue] *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*”, not just two transactions in isolation. That is, it is difficult to see how the commercial effect can be properly understood if all relevant transactions have not been appropriately considered. [emphasis added]

⁴⁸⁶ Joint Statement, page 12, sections 3(a) and (b).

Mr Holgate's approach to determining the accounting treatment for linked transactions

7.17 Mr Holgate sets out two approaches to determining the accounting treatment of a given transaction or set of related transactions at paragraphs 6.7(a) and (b) of his First Report and states that either approach leads to the same answer. However, Mr Holgate only describes the accounting treatment, or lack thereof, for transactions with no substance. I set out below the approach that I consider is appropriate to apply to all transactions which are, or may be, linked and which have, or may have, no substance.

Accounting considerations for linked transactions

7.18 I set out below the series of considerations under IAS 18 when determining the accounting treatment for sales and purchase transactions which are, or may be, linked, whether they have substance or not.

7.19 The necessary analysis is as follows:

- (a) consider if a sale and purchase are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole as set out in IAS 18.13.
 - (i) if not, i.e. if there is a commercial rationale for each transaction separately, these transactions shall be accounted for as a separate sale and a separate purchase;
 - (ii) if, as set out in Mr Holgate's analysis, the transactions are considered to have no substance then nothing is accounted for;
 - (iii) if however, the substance of the transactions is that they are linked in the way anticipated by IAS 18.13, then;
- (b) IAS 18.13 requires that the revenue recognition criteria are applied to the linked transactions together. Therefore it is necessary to consider whether the transactions taken as a whole meet the recognition criteria of IAS 18.14. The criteria most relevant to the transactions described as reciprocal transactions are IAS 18.14(c) and (d);
- (c) in order to reliably measure revenue (IAS 18.14(c)), the measurement criteria in IAS 18.9 to IAS 18.12, in particular IAS 18.12, should be applied to determine the amount of revenue which is generated in a scenario where goods or services are exchanged between parties. The requirements of IAS 18.12 are, in summary:

- (i) if the goods or services exchanged are similar, no revenue is generated (and consequently IAS 18.14(d) is not met);
- (ii) if the goods or services are dissimilar then 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;
- (iii) where the fair value of the goods or services received cannot be reliably measured, 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; and
- (d) similarly, in considering whether it is probable that the economic benefits associated with the transaction will flow to the entity (IAS 18.14(d)) it is necessary to consider if the benefit of the goods or services being received in exchange for the sale will flow. If the value has been determined in IAS 18.14(c) to be nil, then effectively IAS 18.14(d) is not met as no economic benefits will flow to the entity making the sale. In fact, if the fair value of the goods or services being received is nil, then the transaction will fail to give rise to revenue as defined in IAS 18.7 because there is no gross inflow of economic benefits that gives rise to an increase in the seller's equity.

7.20 Mr Holgate, in omitting his consideration of the second approach set out in paragraph 6.7(b) of his first report, suggests his overriding assumption is that the two or more transactions have no substance. Given this assumption it seems to me that Mr Holgate does not need to proceed any further. That is, if the relevant transactions have no substance then, so far as the revenue element in Autonomy's books is concerned, it should not be accounted for.

7.21 However, Mr Holgate does go further in describing the transactions, but it is always against the backdrop that these transactions were artificial.

7.22 For five of the six alleged reciprocal transactions⁴⁸⁷, Mr Holgate has been instructed to assume that Autonomy did not need and / or use products and / or services purchased from the counterparties to the transactions. In my opinion this is insufficient reason not to regard a transaction as a sale. Part of the overall assessment is whether the transaction had commercial rationale, and part of that assessment may include a consideration of whether there was an intention to utilise the products and / or services at the relevant time. What actually happened with the use of the products / services as a result of

⁴⁸⁷ All except Transaction 6: MicroTech.

circumstances that may have arisen after the purchase has no effect on the assessment of the commercial rationale at the time of the transaction.

- 7.23 My approach is somewhat different to Mr Holgate's. I have looked at each of the transactions and identified the accounting treatment based on the available evidence including identifying elements of disputed factual evidence which, if so determined (i.e. if the Claimants' allegations are confirmed), would mean the transactions did not have substance.
- 7.24 In **Appendix 5.1 to 5.6** I set out my detailed analysis of the six alleged reciprocal transactions in this matter.

8 HOSTING TRANSACTIONS

Introduction

- 8.1 The Claimants assert that Dr Lynch and Mr Hussain “*caused Autonomy group companies to engage in improper transactions and accounting practices*”⁴⁸⁸ including “*Improper revenue recognition*”.⁴⁸⁹
- 8.2 The assertions extend to the alleged “*Acceleration of hosting revenue*”⁴⁹⁰, being the subject matter which I consider in this section of my report.
- 8.3 First, I summarise my observations, comments and opinions as set out in my First Report (paragraphs 8.7 to 8.55), based on the documentation and evidence available to me at that time. This is organised as follows:
- (a) background to the hosting transactions;
 - (b) how Autonomy accounted for revenue from the hosting transactions;
 - (c) the Claimants’ allegations regarding the purpose of the hosting transactions;
 - (d) the relevant parts of IAS18 for recognising revenue from the sale of goods; the rendering of services; linked transactions and transactions involving multiple elements;
 - (e) the principle issue in dispute;
 - (f) the substance of the Digital Safe transactions according to the witness evidence reviewed by me; and
 - (g) my preliminary conclusions.
- 8.4 I next set out a summary of Mr Holgate’s analysis, including the assumptions he is instructed to make, and his conclusions (paragraphs 8.56 to 8.87), and then provide comment on Mr Holgate’s analysis ((paragraphs 8.88 to 8.96).
- 8.5 I then set out the sources of further evidence reviewed by me subsequent to my previous report, which include applicable Deloitte audit and review transaction working papers (paragraphs 8.97 to 8.174). This includes also setting out my understanding, based on this further review and assessment, of the following issues:
- (a) commerciality of the re-structuring arrangements;

⁴⁸⁸ Re-Re-Amended Particulars of Claim, paragraph 26.

⁴⁸⁹ Re-Re-Amended Particulars of Claim, paragraph 30.2.

⁴⁹⁰ Re-Re-Amended Particulars of Claim, paragraph 30.2.3.

- (b) independent value of the licences as separate components; and
- (c) fair value.

8.6 Lastly, I then set out my overall conclusions on the accounting treatment (paragraphs 8.175 to 8.216).

My First Report: summary findings

8.7 I refer to section 15 of my First Report (“Hosting Transactions”).

Background

8.8 In 2007, Autonomy purchased Zantaz Inc (“Zantaz”), a global market leader in content archiving and electronic discovery products (e-Discovery software). Zantaz offered customers data hosting services, utilising data hosting software known as “Digital Safe”. Data stored at Zantaz’s data centres could be accessed, searched and retrieved remotely by customers.⁴⁹¹

8.9 The e-Discovery software was used for the purposes of the review and disclosure of material in litigation.⁴⁹²

8.10 Following its acquisition of Zantaz, Autonomy continued to offer customers hosted services.⁴⁹³

8.11 Revenue arising from hosting transactions was originally accounted for as a stream of revenue over the period of the hosting contract and recognised rateably over this period.⁴⁹⁴ This was due to the functionality of the software at the time being mainly focused on the storage of information, not its analysis.⁴⁹⁵

8.12 From around summer 2008⁴⁹⁶ Autonomy restructured the Zantaz hosted offering to develop a “hybrid” model which included a licence for customers to own Autonomy’s software which Autonomy would host.⁴⁹⁷

8.13 Under the restructured model, the customer had the option to relocate its data elsewhere (including the software under licence) without the loss of its archive and without the loss of the software functionality.⁴⁹⁸

⁴⁹¹ First Defendant’s Amended Defence, paragraph 29.15 to 29.15.2.

⁴⁹² Mr Yealland’s Witness Statement, dated 14 September 2018, paragraph 54.

⁴⁹³ Re-Re-Amended Particulars of Claim, paragraph 30.2.3.1.

⁴⁹⁴ Re-Re-Amended Particulars of Claim, paragraph 30.2.3.1.

⁴⁹⁵ First Defendant’s Amended Defence, paragraph 137.1.

⁴⁹⁶ Mr Sullivan’s Witness Statement, paragraph 24.

⁴⁹⁷ First Defendant’s Amended Defence, paragraph 29.15.2.

⁴⁹⁸ First Defendant’s Amended Defence, paragraph 48.4.0.

Accounting for revenue

- 8.14 In broad terms, 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;⁴⁹⁹ and
 - (b) the data hosting (storage) component (and any other services) was recognised rateably over the period of provision.⁵⁰⁰

Claimants’ allegations

- 8.15 The Claimants allege that the hosting arrangements were restructured by Autonomy for the purposes 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.⁵⁰¹
- 8.16 The Claimants assert that both the Digital Safe and e-Discovery hosting arrangements were, in substance, transactions for the provision of services and should be accounted for as such (under the provisions of IAS 18), with all revenue recognised over the period during which Autonomy hosted the customer’s data.⁵⁰²
- 8.17 The Claimants assert that the Digital Safe software licence had no independent value to the hosting arrangement in the absence of additional support from Autonomy. Customers were incentivised into entering such arrangements by the overall reduction in fees over the term of the arrangement.⁵⁰³
- 8.18 According to the Claimants, because 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.⁵⁰⁴
- 8.19 As regards e-Discovery software, the Claimants acknowledge that it was capable of operating independently of the hosting services. However, it is asserted that the fair value of the revenue on a sale of a licence for e-Discovery software could not be reliably measured and therefore the requirements of IAS 18.14 were not met.⁵⁰⁵

⁴⁹⁹ First Defendant’s Amended Defence, paragraphs 141 to 141.2.

⁵⁰⁰ First Defendant’s Amended Defence, paragraph 141.

⁵⁰¹ Re-Re-Amended Particulars of Claim, paragraph 30.2.3.2.

⁵⁰² Re-Re-Amended Particulars of Claim, paragraphs 30.2.3.3 and 109.

⁵⁰³ Re-Re-Amended Particulars of Claim, paragraphs 30.2.3.3 and 110.1.

⁵⁰⁴ Re-Re-Amended Particulars of Claim, paragraphs 30.2.3.3 and 110.1.

⁵⁰⁵ Re-Re-Amended Particulars of Claim, paragraph 110.2

Recognition of revenue - relevant accounting standards

- 8.20 In Section 4 of my First Report, I reviewed the relevant sections of International Accounting Standard 18 'Revenue' ("IAS 18") and related industry guidance relevant to the Claimants' allegations.
- 8.21 To summarise:
- (a) International Reporting Standards (and in particular within this framework IAS 18) are principles-based and as such application thereof requires professional judgement given the particular facts and circumstances;
 - (b) owing, in part, to limited guidance on important topics (such as revenue recognition for multiple-element arrangements), IAS 18 has subsequently been replaced by International Financial Reporting Standard 15 ("IFRS 15 - Revenue from Contracts with Customers"). IFRS 15 was developed in order to remove inconsistencies between accounting for revenue under IFRS and US GAAP;
 - (c) IAS 18 prescribes the accounting treatment of revenue arising from:
 - (i) the sale of goods;
 - (ii) the rendering of services; and
 - (iii) interest, royalties and dividends.
 - (d) the guidance requires consideration of the substance of transactions and not just their legal form; and
 - (e) revenue generation from the sale of software licences was not specifically addressed under IAS 18, giving rise for the need for judgement in its application.

Recognition of revenue from the sale of goods

- 8.22 IAS 18.14 states that revenue from the sale of goods shall be recognised when the following five conditions are met:
- (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;
 - (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.

8.23 As regards the measurement of revenue, IAS 18 provides that:

“Revenue shall be measured at the fair value of the consideration received or receivable.”

“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.”

Recognition of revenue from the rendering of services

8.24 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. 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.

8.25 Conditions (a), (b) and (d) are identical to conditions (c), (d) and (e) under IAS 18.14 required to recognise revenue on the sale of goods.

8.26 Revenue is recognised in the accounting periods in which the services are rendered (IAS 18.21).

8.27 When the outcome cannot be estimated reliably, revenue shall be recognised only to the extent of the expenses recognised that are recoverable (IAS 18.26).

Linked transactions and exchange of goods for sale

8.28 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.

8.29 Two or more transactions may be linked so that the individual transactions have no commercial effect on their own. In such cases, it is the combined effect of the two transactions together that is accounted for.

Transactions involving multiple elements

8.30 Revenue recognition criteria 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.

The principal issue in dispute

8.31 The principal issue in dispute between the parties in relation to 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.

8.32 The answer to this question then determines whether the revenues in respect of these 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 provision of services by reference to IAS 18.20 (and IAS 18.25 in respect of storage and other services). This being the accounting treatment adopted by Autonomy; or
- (b) as a sale from the rendering of services over time, by reference to IAS 18.20 and IAS 18.25. This being the accounting treatment asserted by the Claimants.

Substance of Digital Safe transactions

8.33 The Claimants’ fundamental assertion is that the Digital Safe software licences could not be separated from the data storage services and as such the licences had no independent value to the customer.

8.34 It is asserted by the Claimants that the revenue recognition criteria could not therefore be applied separately to a Digital Safe licence sale (as a separately identifiable component of a data archiving transaction).

8.35 It is my understanding that under the “hybrid” hosting arrangements, customers considered they had acquired the right to a Digital Safe licence and therefore had the option (and right) to take the storage system in-house to archive data itself at any time during the licence term.

8.36 According to Dr Lynch’s witness evidence:

*“Customers owned the licences and could choose where to host their data, whether with Autonomy, onsite or with third-party providers.”*⁵⁰⁶

⁵⁰⁶ Dr Lynch’s First Witness Statement, paragraph 443(b).

*“Digital Safe licences had value to customers and could be used by customers without significant Autonomy support.”*⁵⁰⁷

*“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.”*⁵⁰⁸

*“... Digital Safe was written in industry-standard language and protocol ...”*⁵⁰⁹

*“... Autonomy offered training courses and manuals to customers on how to operate the software.”*⁵¹⁰

8.37 Dr Lynch’s witness evidence is consistent with that of Mr Hussain, who notes:

“... 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.”*⁵¹¹

8.38 By contrast, Mr Goodfellow, Autonomy’s Director of Global Accounts and Chief Technology Officer of Infrastructure, expresses difficulties which would be faced by customers should they choose to set up and make use of Digital Safe without the support of Autonomy’s managed services.⁵¹²

8.39 Mr Goodfellow lists a number of Autonomy customers who utilised Digital Safe on-premises (including American Express, AXA, BNP Paribas, Citibank, Manufacturers Life, Merck, the Serious Fraud Office, UBS and VA Vaco). However, he notes that “*managed services*” would need to have been provided by Autonomy in order for customers to use the software on-premise.⁵¹³

8.40 Notwithstanding any practical difficulties which customers may have faced in taking Digital Safe software on-premise, it would appear that a number of Autonomy customers chose to, and were able to, archive their own data independent of Autonomy.

⁵⁰⁷ Dr Lynch’s First Witness Statement, paragraph 448(a).

⁵⁰⁸ Dr Lynch’s First Witness Statement, paragraph 448(a).

⁵⁰⁹ Dr Lynch’s First Witness Statement, paragraph 448(a).

⁵¹⁰ Dr Lynch’s First Witness Statement, paragraph 448(a).

⁵¹¹ Mr Hussain’s Witness Statement, paragraphs 215 to 216.

⁵¹² Mr Goodfellow’s Witness Statement, paragraph 18.

⁵¹³ Mr Goodfellow’s Witness Statement, paragraph 25 (a) to 25(l).

- 8.41 There also appear to be instances of hosted customers moving Digital Safe in-house during the term of the contract. Mr Wang, Autonomy's Vice President of Product Development for Digital Safe, refers in his first witness statement to the transition of Citigroup data from Autonomy data centres to Citigroup's own site.⁵¹⁴
- 8.42 Furthermore, from a customer's perspective, there would appear to have been independent value to the customer owning a Digital Safe (see, for example, witness statement of Mr Sullivan).⁵¹⁵ Mr Sullivan appears to support, from a customer's perspective, an independent value to owning a Digital Safe licence separate to the value of the data storage service provided by Autonomy.
- 8.43 It will be a question of fact to be determined, but on the basis that Autonomy customers themselves ascribed a value to the licence rights then prima face, from an accounting perspective, the Digital Safe licence was separable from the underlying archiving of customer data.
- 8.44 By way of illustration, in Q1 2011 Morgan Stanley chose to cancel the services associated with its Digital Safe licence but did not want to cancel the licence itself, suggesting that Morgan Stanley, as a customer, considered the licence and hosting services to be separate components of the transaction.⁵¹⁶

Reliable measurement of revenue - e-Discovery licences

- 8.45 Whilst the Claimants accept that e-Discovery software licences could be operated by customers independently of the hosting services provided by Autonomy, it is asserted that no reliable fair value could be measured and attributed to a hosted licence.
- 8.46 The Claimants therefore consider that the requirements of IAS 18.14 could not be satisfied and accordingly revenue from the hosted licences could not be recognised as a sale at the time of the agreement.
- 8.47 It is my understanding that revenue recognised on Autonomy's e-Discovery licence sales was based on the price agreed in the contract between Autonomy and the customer, on an arms-length basis.

⁵¹⁴ Mr Wang's First Witness Statement, paragraph 34.

⁵¹⁵ See, for example, Mr Sullivan's Witness Statement, paragraph 32: "... 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"

⁵¹⁶ {DEL1_004_1_00002242}.

8.48 Dr Lynch sets out in his first witness statement:

*“Autonomy often priced EDD services using rate cards. [D001457677, D004178874, D002345263] 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.”*⁵¹⁷

8.49 This is consistent with Mr Hussain’s witness evidence:

*“... 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 for services; and (iii) a maintenance charge of 5 per cent. of the licence fee.”*⁵¹⁸

*“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.”*⁵¹⁹

8.50 An example contract (with Phillip Morris International) provided by Dr Lynch contains a rate card setting out fees for the components and possible services as described by Mr Hussain.⁵²⁰

8.51 As part of the 2010 year-end audit, Deloitte reviewed and concluded that the separate e-Discovery licence sale satisfied the requirements of IAS 18.14 and therefore could be recognised at the time of the agreement.⁵²¹

Revenue recognised on rendering of services

8.52 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.⁵²²

My preliminary conclusions

8.53 Based on the evidence which I had reviewed and considered in preparing my First Report, it appeared to me that the Digital Safe licences were capable of being separated from the hosting services provided by Autonomy.

8.54 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 from Digital

⁵¹⁷ Dr Lynch’s First Witness Statement, paragraph 472.

⁵¹⁸ Mr Hussain’s Witness Statement, paragraph 219.

⁵¹⁹ Mr Hussain’s Witness Statement, paragraph 219.

⁵²⁰ {D001457677}, page 21.

⁵²¹ {POS00176529}, tab “2”.

⁵²² In accordance with IAS 18.20 and IAS 18.25.

Safe licence sales at the date of the sale agreement, with the separate storage services revenue recognised over the term of the underlying agreement.

- 8.55 The evidence also suggests that information was available to assist in arriving at a fair value for e-Discovery services, which could then be used to determine a residual fair value of an e-Discovery licence. In these circumstances (subject to the other four criteria of IAS 18.14 being met) Autonomy was entitled, and arguably required, to recognise the revenue generated on e-Discovery licence sales at the date of the agreement, with the separate data storage revenue recognised over the term of the underlying agreement.

Mr Holgate's Assumptions and conclusions: Digital Safe transactions

- 8.56 At section 7 of his First Report, Mr Holgate considers the accounting treatment of Digital Safe and e-Discovery transactions under separate headings and under the separate assumptions he is instructed to make. Mr Holgate is not provided in this section of his instructions with a "Factual Summary" in relation to either Digital Safe transactions or e-Discovery transactions.⁵²³
- 8.57 The assumptions that Mr Holgate has been instructed to make, and Mr Holgate's concluding opinions as to the appropriate accounting treatment of revenue in each of the circumstances, are as detailed below.

Digital Safe Transactions

- 8.58 The underlying assumptions that Mr Holgate has been instructed to make are as follows⁵²⁴:
- (a) *"After Autonomy sold customers licences to the Digital Safe software, new customers received substantially the same service as they would have done if they had contracted on a Software-as-a-Service ("SaaS") basis, and existing customers received substantively the same service as they had previously received under their prior SaaS arrangements, albeit under a different legal / payment structure";*⁵²⁵
 - (b) *"The Digital Safe system (comprising the Digital Safe software - which performed the capture and index function - and the hardware) was at all times installed only at Autonomy's data centres";*⁵²⁶
 - (c) *"A Digital Safe licence was of no independent value to a hosted customer. A customer could not customise, configure or implement the Digital Safe system*

⁵²³ Mr Holgate's First Report, Appendix 2, Annex 1, pages 28 to 31.

⁵²⁴ Where it appears applicable, I have split out individual assumptions where it appears to me that the instruction includes more than one assumption Mr Holgate is asked to make.

⁵²⁵ Mr Holgate's First Report, Appendix 2, page 29, paragraph 57.1.

⁵²⁶ Mr Holgate's First Report, Appendix 2, page 29, paragraph 57.1.

*(including the software) for use on its own premises. This could only be performed by Autonomy, using Autonomy's proprietary knowledge and resources. The implementation process for use on a customer's premises was complex and took several weeks (at a minimum) to complete. Unless and until that process had been undertaken, the Digital Safe system was incapable of operation. Provision of the necessary Autonomy customisation, configuration and implementation services for the use of Digital Safe on a customer's premises did not generally form part of the contracts with hosted customers";*⁵²⁷

- (d) *"The Digital Safe system (including the software) required ongoing managed services (without which it would malfunction and ultimately stop working altogether). In practice, only Autonomy could provide these services and provision for them for use of Digital Safe on a customer's premises did not form part of the contracts with hosted customers";*⁵²⁸
- (e) *"There were no user-manuals regarding either the implementation or ongoing support and management of Digital Safe, and no third parties (let alone customers) who could provide such services";*⁵²⁹
- (f) *"Where hosted Digital Safe deals involved sale of software other than Digital Safe software, such software could only be used, or was sold for use, with Digital Safe";*⁵³⁰
- (g) *"The negotiations between Autonomy and existing hosted customers preceding the restructured hosting transactions were largely instigated by Autonomy (not the customer). In the case of both new and existing customers the licence model proposed by Autonomy and the negotiations largely centred on price (i.e. the amount that the customer would save over the lifetime of the contract). Autonomy's primary purpose in structuring the deals to include a licence was the upfront recognition of revenue";*⁵³¹
- (h) *"The intention and understanding of both Autonomy and the customers was that, after the sale of the licence, the Digital Safe system and the customers' data would be hosted, and all associated services would be performed, by Autonomy at its data centres";*⁵³² and

⁵²⁷ Mr Holgate's First Report, Appendix 2, page 29, paragraph 57.2.

⁵²⁸ Mr Holgate's First Report, Appendix 2, page 29, paragraph 57.3.

⁵²⁹ Mr Holgate's First Report, Appendix 2, page 29, paragraph 57.4.

⁵³⁰ Mr Holgate's First Report, Appendix 2, page 29, paragraph 57.5.

⁵³¹ Mr Holgate's First Report, Appendix 2, page 29, paragraph 57.6.

⁵³² Mr Holgate's First Report, Appendix 2, page 29, paragraph 57.7.

(i) *“None of the hosted customers brought the Digital Safe system (comprising the Digital Safe software and accompanying hardware) in house”.*⁵³³

8.59 Based on the above instructed assumptions, Mr Holgate proceeds to consider his views as to the relevant and appropriate accounting treatment of revenue recognition for the sale of a Digital Safe licence in conjunction with Autonomy’s provision of hosting services, as follows.

8.60 First of all, Mr Holgate notes his understanding that:

*“... the Claimants do not take issue for the purpose of these proceedings with the accounting treatment for “on premise” deals, i.e. where Digital Safe was implemented at the customer’s own site.”*⁵³⁴

8.61 Mr Holgate’s considerations are therefore limited to the “hosted” Digital Safe arrangements as set out in Schedule 6 to the Re-Re Amended Particulars of Claim.

8.62 Amongst others, Mr Holgate makes the following commercial observations:

*“[Despite a new customer being] granted a licence to use the Digital Safe software, the software in fact remained in Autonomy’s data centres and was used by Autonomy to provide the services to the customer.”*⁵³⁵

“Even if a hosted customer wanted to take the Digital Safe system (including the software) on premise at some stage within the term of the software licence, the customer would not have had the technical knowledge and understanding to be able to make use of it.”

⁵³⁶

8.63 Mr Holgate states, with reference to both existing and new customers:

*“... to speak of granting to the customer a licence to use the Digital Safe software had no real meaning for practical purposes”.*⁵³⁷

8.64 In considering the accounting treatment for hosted transactions involving the sale of a Digital Safe licence, Mr Holgate observes⁵³⁸:

(a) economic substance / substance over form is an important underlying concept in accounting;

⁵³³ Mr Holgate’s First Report, Appendix 2, page 29, paragraph 57.8.

⁵³⁴ Mr Holgate’s First Report, paragraph 7.1

⁵³⁵ Mr Holgate’s First Report, paragraph 7.4.3.

⁵³⁶ Mr Holgate’s First Report, paragraph 7.4.3.

⁵³⁷ Mr Holgate’s First Report, paragraph 7.4.3.

⁵³⁸ Mr Holgate’s First Report, paragraph 7.6.

- (b) the substance of a transaction is represented by its commercial effect (or economic reality) in practice;
- (c) identifying substance is to some extent a matter of professional judgement;
- (d) where the substance differs from the strict legal form, it is the substance (over strict legal form) which determines the accounting treatment;
- (e) where a transaction has no substance it should have no accounting effect;
- (f) the sale of a licence had no commercial effect in practice and therefore had no substance (in the sense that the service provided was unaffected by the contractual changes that have been made)⁵³⁹; and
- (g) the substance of the arrangement was the capturing, indexing and archiving of data throughout the contract period. These services were unaffected by the sale of the licence.

8.65 Based on the above premises, Mr Holgate concludes the appropriate accounting treatment for fees payable for such services is:

- (a) *“For existing customers: continuation of recognition of revenue over the period that the services were rendered”*; ⁵⁴⁰
- (b) *“For new customers: recognition of revenue over the period that the services were rendered”*; ⁵⁴¹ and
- (c) there should be, “[n]o upfront recognition of revenue in respect of the grant to the customer of the right to use the Digital Safe software” (on the basis of there being no commercial meaning or significance to such a grant).⁵⁴²

8.66 Mr Holgate then proceeds to consider whether transactions should be considered together or separately. As regards hosted Digital Safe transactions, Mr Holgate notes there were two different components:

- (a) the grant of a licence; and
- (b) the provision of ongoing services,

but notes that the licence was not a separate component which could be provided on a standalone basis (i.e. could not be used by a customer independently from the hosting and

⁵³⁹ Mr Holgate identifies as being particularly important, in identifying substance, the instructed assumptions as paragraphs 7.3.1, 7.3.6, 7.3.8 and 7.3.8 of his First Report. (See Mr Holgate’s First Report, paragraph 7.6)

⁵⁴⁰ Mr Holgate’s First Report, paragraph 7.6.1.

⁵⁴¹ Mr Holgate’s First Report, paragraph 7.6.2.

⁵⁴² Mr Holgate’s First Report, paragraph 7.6.3.

related services component), adding that it was “*not feasible, from a commercial or technical perspective, for the licence to be sold as a separable good*”.⁵⁴³

8.67 Accordingly, the revenue recognition criteria should be applied to each Digital Safe transaction as a whole in accordance with the overall substance, namely the provision of data hosting services over a period of time with no part of the revenue recognised upfront.⁵⁴⁴ Mr Holgate proceeds then to conclude that recognising revenue using the straight line method in relation to the upfront license is preferable⁵⁴⁵, and that the pattern of recognition of the revenue over time should not be affected by the pattern of cash flows.⁵⁴⁶

8.68 As regards the sale of software that was not itself Digital Safe, Mr Holgate notes that he was:

“asked to assume that such software “could only be used, or was sold for use, with Digital Safe””.⁵⁴⁷

8.69 On this basis, Mr Holgate concludes that the same criteria would apply as for licence fees, as there would be no transfer of independent value to the customer other than the value of the Digital Safe services provision. However, Mr Holgate accepts that if the software could be used by the customer separately from Digital Safe, then the licence sale may qualify for immediate revenue recognition.⁵⁴⁸

8.70 Finally, Mr Holgate accepts that if he were wrong about the Digital Safe services, and if the Digital Safe licence was a separately identifiable component of the hosting arrangements such that the provisions of IAS 18 relating to the sale of goods applies. He continues to say that he does not believe that those criteria for the sale of goods would be met in any event.⁵⁴⁹

8.71 In particular, Mr Holgate states that two of the five IAS 18.14 criteria are not, and would not, be met at any time during the hosting arrangement. These two criteria (which sales of Digital Safe Licences would fail on) are:

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

⁵⁴³ Mr Holgate’s First Report, paragraph 7.8.

⁵⁴⁴ Mr Holgate’s First Report, paragraph 7.8. In reaching this conclusion, Mr Holgate has relied, in particular, on the instructed assumptions set out in his First Report at paragraphs 7.3.2, 7.3.3 and 7.3.4.

⁵⁴⁵ Mr Holgate’s First Report, paragraph 7.16

⁵⁴⁶ Mr Holgate’s First Report, paragraph 7.17

⁵⁴⁷ Mr Holgate’s First Report, paragraph 7.18.

⁵⁴⁸ Mr Holgate’s First Report, paragraph 7.18.

⁵⁴⁹ Mr Holgate’s First Report, paragraph 7.19.

- (b) Autonomy retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods.⁵⁵⁰

8.72 The principal justifications given are that the Digital Safe Licence remains used by Autonomy, sits on Autonomy hardware in Autonomy data centres not accessible by customers, and is maintained by Autonomy employees (and in any event on premise customer implementations are not possible without Autonomy).⁵⁵¹

Mr Holgate's Assumptions and conclusions: E-Discovery transactions

8.73 The underlying assumptions that Mr Holgate has been instructed to make are as follows:

- (a) *“Autonomy performed a variety of services as part of its hosted e-Discovery offering, many of which (e.g. performance quality control checks, resolution of data imaging / processing issues, e.g. from password protected, encrypted or corrupted documents, data culling, batching, report production, format conversion and load file creation) were not performed automatically by the software, but rather required action or intervention by Autonomy personnel. The process was akin to a production line requiring a significant level of involvement from Autonomy’s staff at each stage of the e-Discovery process”*;⁵⁵²
- (b) *“With the exception of the deals with BP, the term of each of the hosted e-Discovery licences was relatively short (two to three years) and Autonomy was contracted to provide services for the duration of the term. BP had a perpetual licence with a limited capacity and Autonomy was contracted to provide services for an initial term of three years. During the initial three year period, BP was to pay a monthly Application Service fee of US\$4/GB/month, following which the Application Service Fee increased to US\$10/GB/month”*;⁵⁵³
- (c) *“Each hosted e-Discovery customer received substantially the same service regardless of whether it had acquired a licence, i.e. the same service as a customer who contracted on a SaaS basis: only the legal / payment structure varied. Existing hosted customers who had originally contracted on a SaaS basis received substantially the same service as they had previously”*;⁵⁵⁴
- (d) *“Unlike the Digital Safe software, the e-Discovery software was capable of being used independently of an Autonomy hosted arrangement, but was either sold as*

⁵⁵⁰ Mr Holgate's First Report, paragraphs 7.20 and 7.21.

⁵⁵¹ Mr Holgate's First Report, paragraph 7.20

⁵⁵² Mr Holgate's First Report, Appendix 2, page 30, paragraph 58.1.

⁵⁵³ Mr Holgate's First Report, Appendix 2, page 30, paragraph 58.2.

⁵⁵⁴ Mr Holgate's First Report, Appendix 2, page 30, paragraph 58.3.

*standalone software (which the customer would use itself, without Autonomy providing e-Discovery services) or as part of a hosted arrangement. If a hosted customer decided to take the e-Discovery software on premise during the term of the licence, Autonomy would not have provided the services that the customer expected to receive and for which it had effectively prepaid through payment of the upfront licence fee. Generally, it would not have been practicable for the hosted customers to take the software and the data in-house to perform the services themselves”;*⁵⁵⁵

- (e) *“The intention and understanding of both Autonomy and its customers was that the software and data would be hosted and maintained by Autonomy in its data centres, and the associated e-Discovery services would be performed by Autonomy, for at least the contractually agreed period. This is what happened in practice”;*⁵⁵⁶
- (f) *“The negotiations between Autonomy and the customers were focused on price. Autonomy typically introduced the option of an upfront licence fee and highlighted the significant discounts it offered the customer as compared to the price on a SaaS basis. From the perspective of the customers, the transactions involved the purchase of hosted e-Discovery services with an upfront prepayment in the form of a licence fee. Autonomy’s primary purpose in structuring the deals to include a licence was the upfront recognition of revenue”;*⁵⁵⁷
- (g) *“Autonomy management did not have an established fair value for each of the individual components of hosted e-Discovery deals”;*⁵⁵⁸
- (h) *“There was only a small number of hosted e-Discovery deals including an upfront licence fee and they differed materially in terms of authorised users, capacity/ limitations, structure of pricing, contract term and the prices charged”;*⁵⁵⁹
- (i) *“Autonomy did not apply standard prices for e-Discovery software licences sold for use independently of an Autonomy hosting arrangement. Software was sold to different customers by Autonomy at different prices depending on the individual customer’s perception of the value of the software to that particular customer in that particular customer’s environment”;*⁵⁶⁰

⁵⁵⁵ Mr Holgate’s First Report, Appendix 2, page 30, paragraph 58.4.

⁵⁵⁶ Mr Holgate’s First Report, Appendix 2, page 30, paragraph 58.5.

⁵⁵⁷ Mr Holgate’s First Report, Appendix 2, page 31, paragraph 58.6.

⁵⁵⁸ Mr Holgate’s First Report, Appendix 2, page 31, paragraph 58.7.

⁵⁵⁹ Mr Holgate’s First Report, Appendix 2, page 31, paragraph 58.8.

⁵⁶⁰ Mr Holgate’s First Report, Appendix 2, page 31, paragraph 58.9.

- (j) *“There was no standard or quoted price list for the different services provided in hosted e-Discovery deals involving the purchase of a licence. There was a price list for these services when provided as part of a SaaS deal, but this did not take into account the price paid for a licence. Similarly, the price lists attached to the hosting contracts were for services to be provided beyond the licence term and/or capacity, and therefore did not take into account the price paid for a licence. In any event, price was often heavily negotiated such that there was no ‘typical charge’ for the individual components of a hosted e-Discovery deal”;*⁵⁶¹
- (k) *“There was no disaggregated management information relating to the cost of providing the individual components of hosted e-Discovery deals. In particular, Autonomy did not record costs by business area (e.g. for e-Discovery or components thereof) nor did it prepare management accounts containing a profit and loss/ contribution statement by business area”;*⁵⁶² and
- (l) *“The infrastructure and costs involved in delivering a hosted e-Discovery service are different to a hosted Digital Safe service. The two types of deal are not comparable in terms of cost or fair value”.*⁵⁶³

8.74 Based on the above assumptions, Mr Holgate considers the relevant and appropriate accounting treatment of revenue as follows.

8.75 First of all, Mr Holgate again notes his understanding that:

*“... the claimants do not take issue for the purposes of these proceedings with the accounting treatment for “on premise” deals, i.e. where e-Discovery software was implemented at the customer’s own site.”*⁵⁶⁴

8.76 Mr Holgate then proceeds to make the following commercial observations, amongst others, of the hosted e-Discovery arrangements:

- (a) although new customers were granted a licence to use the e-Discovery software, the software in fact remained in Autonomy’s data centres and was used by Autonomy to provide the e-Discovery services to the customer;⁵⁶⁵
- (b) the same applied to existing e-Discovery customers to whom a new licence was granted;⁵⁶⁶

⁵⁶¹ Mr Holgate’s First Report, Appendix 2, page 31, paragraph 58.10.

⁵⁶² Mr Holgate’s First Report, Appendix 2, page 31, paragraph 58.11.

⁵⁶³ Mr Holgate’s First Report, Appendix 2, page 31, paragraph 58.12.

⁵⁶⁴ Mr Holgate’s First Report, paragraph 7.23.

⁵⁶⁵ Mr Holgate’s First Report, paragraph 7.26.3.

⁵⁶⁶ Mr Holgate’s First Report, paragraph 7.26.4.

- (c) “... to speak of granting to the customer a licence to use the e-Discovery software had no real meaning for practical purposes.”⁵⁶⁷; and
- (d) the value was in the service to be received by the customer over the duration of the contract, not in the licence.⁵⁶⁸

8.77 Based on the above premises, Mr Holgate concludes the appropriate accounting treatment for fees payable for such services as follows (Mr Holgate excludes two BP deals which he considers separately). He notes that:

- (a) the same considerations of substance as relevant in the Digital Safe context are also relevant in the e-Discovery context;⁵⁶⁹
- (b) the sale of an e-Discovery licence as part of a hosted arrangement had no commercial effect in practice and therefore no substance;⁵⁷⁰
- (c) the substance of the transaction was the provision of e-Discovery services including data capture, processing, indexing, archiving and production. These services were unaffected by the sale of a licence;⁵⁷¹ and
- (d) the licence fee was, when properly considered, an advance payment for the provision of these services.⁵⁷²

8.78 Taking the above into account, Mr Holgate concludes that the appropriate accounting treatment for fees payable for such services (including the upfront licence fee) is:

- (a) “For existing customers: continuation of recognition of revenue over the period that the e-Discovery services were rendered”;⁵⁷³
- (b) “For new customers: recognition of revenue over the period that the e-Discovery services were rendered”;⁵⁷⁴ and
- (c) “No upfront recognition of revenue in respect of the grant to the customer of the right to use the e-Discovery software” (as there is no commercial meaning or significance to such a grant).⁵⁷⁵

⁵⁶⁷ Mr Holgate’s First Report, paragraphs 7.26.3 and 7.26.4.

⁵⁶⁸ Mr Holgate’s First Report, paragraph 7.26.4.

⁵⁶⁹ Mr Holgate’s First Report, paragraph 7.28.

⁵⁷⁰ Mr Holgate’s First Report, paragraph 7.28.

⁵⁷¹ Mr Holgate’s First Report, paragraph 7.28.

⁵⁷² Mr Holgate’s First Report, paragraph 7.28.

⁵⁷³ Mr Holgate’s First Report, paragraph 7.28.1.

⁵⁷⁴ Mr Holgate’s First Report, paragraph 7.28.2.

⁵⁷⁵ Mr Holgate’s First Report, paragraph 7.28.3.

- 8.79 Mr Holgate then notes there is also a need to consider whether transactions should be considered together or separately.⁵⁷⁶
- 8.80 He notes there are two different components:
- (a) the grant of a licence; and
 - (b) the provision of on-going services.⁵⁷⁷
- 8.81 He acknowledges that e-Discovery software was capable of being sold, and operated, independently, but states that he is instructed to assume that this would not have been practicable and that it did not happen in practice.⁵⁷⁸
- 8.82 Mr Holgate notes:
- “... the on premise arrangements in which e-Discovery software was sold and operated independently of an Autonomy hosted arrangement are different from the hosted transactions...*
- ... the fact that, in those independent transactions, the software licence was considered to be a separately identifiable component of the overall arrangement, says nothing about how the licence is to be regarded in the hosted e-Discovery arrangements.”*⁵⁷⁹
- 8.83 Mr Holgate concludes:
- (a) there was no substance to the granting of a licence;⁵⁸⁰ and
 - (b) the revenue recognition criteria should be applied to the transaction as a whole in order to reflect the combined substance of the two elements of the transaction, being the provision of e-Discovery services over a period of time.⁵⁸¹
- 8.84 As regards the BP contracts, Mr Holgate considers these in substance to be similar to the other e-Discovery contracts.⁵⁸²
- 8.85 Mr Holgate accepts that if he were wrong about the substance of the e-Discovery transactions (such that the revenue recognition criteria for the sale of goods apply to the grant of the licence), he does not believe that those particular criteria were met.⁵⁸³
- 8.86 He states that three of the five criteria would not be met, in other words:

⁵⁷⁶ Mr Holgate's First Report, paragraph 7.29.

⁵⁷⁷ Mr Holgate's First Report, paragraph 7.30.

⁵⁷⁸ Mr Holgate's First Report, paragraph 7.30.

⁵⁷⁹ Mr Holgate's First Report, paragraph 7.30.

⁵⁸⁰ Mr Holgate's First Report, paragraph 7.30.

⁵⁸¹ Mr Holgate's First Report, paragraph 7.30.

⁵⁸² Mr Holgate's First Report, paragraph 7.31.

⁵⁸³ Mr Holgate's First Report, paragraph 7.36.

- (a) Autonomy has not transferred to the buyer the significant risks and rewards of ownership of the goods;
- (b) Autonomy retains continuing managerial involvement to the degree usually associated with ownership or effective control over the goods; and
- (c) the amount of revenue cannot be measured reliably.⁵⁸⁴

8.87 As regards (c), Mr Holgate states that whilst it might be possible to establish a fair value of the individual components based on either:

- (a) price; or
- (b) cost plus margin,

he refers to the assumptions which he has been instructed to make which he says means it would not have been possible to reliably measure the revenue attributable to the software licence.⁵⁸⁵

My conclusions on Mr Holgate's report and opinion

8.88 It is Mr Holgate's opinion that based on the assumptions he is instructed to make, there should be no upfront recognition of revenue in respect of the software licence sale as part of a hybrid hosting arrangement.

8.89 Mr Holgate was instructed to assume that a Digital Safe licence was of no independent value to a customer, that the software could not work on a customer's premises without Autonomy's (and no one else's) ongoing support, there were no user manuals, the intention and understanding was the customer data would be hosted by Autonomy and all associated services would be performed by Autonomy at Autonomy's own data centres.

8.90 In the above circumstances, Mr Holgate states:

*"... to speak of granting to the customer a licence to use the Digital Safe software had no real meaning for practical purposes."*⁵⁸⁶

*"The sale of a licence to Digital Safe had no commercial effect in practice and therefore no substance."*⁵⁸⁷

8.91 Based on these assumptions that Mr Holgate has been instructed to make, in my opinion, there is not another credible way to analyse the Schedule 6 Digital Safe transactions. In other words, the assumptions that Mr Holgate has been instructed to adopt do not lead to

⁵⁸⁴ Mr Holgate's First Report, paragraph 7.37.

⁵⁸⁵ Mr Holgate's First Report, paragraph 7.37.

⁵⁸⁶ Mr Holgate's First Report, paragraph 7.4.3.

⁵⁸⁷ Mr Holgate's First Report, paragraph 7.6.

any other accounting treatment outcome or conclusion other than that reached by Mr Holgate.

- 8.92 Likewise, as regards e-Discovery transactions, Mr Holgate reaches the same conclusion that there should be no upfront recognition of revenue in respect of the software licence sale as part of a hybrid hosting arrangement.
- 8.93 Again, Mr Holgate was instructed to assume, amongst others, that:
- (a) it would have been impractical for hosted customers to take the e-Discovery software and data in-house to perform the services themselves;
 - (b) the understanding was that the software and data would be hosted by Autonomy at its data centres and all associated e-Discovery services would be performed by Autonomy;
 - (c) the transaction essentially involved an upfront prepayment in the form of a licence fee;
 - (d) Autonomy management did not have an established fair value for each of the individual components of hosted e-Discovery deals;
 - (e) Autonomy did not apply standard prices for e-Discovery software licences sold for independent use; and
 - (f) that there was no standard or quoted pricelist for the different services provided in hosted e-Discovery arrangements involving the purchase of a licence.
- 8.94 In the above circumstances, Mr Holgate states:
- “... to speak of granting to the customer a licence to use the e-Discovery software had no real meaning for practical purposes.”*⁵⁸⁸
- “... the value was in the service to be received over the duration of the contract, not in the licence...”*⁵⁸⁹
- 8.95 Again, based on the specific assumptions that Mr Holgate was instructed to make, in my opinion, there is again not another credible way to analyse the Schedule 6 transactions for the sale of E-Discovery licences.
- 8.96 However, if for example, it was possible for customers to perform the services themselves, contrary to just the single assumption that it was not practicable for a customer to perform the service itself, then I would not agree in the same way.

⁵⁸⁸ Mr Holgate’s First Report, paragraph 7.26.3.

⁵⁸⁹ Mr Holgate’s First Report, paragraph 7.26.4.

My summary of the evidence presented (as I understand it)

- 8.97 In preparing this Supplemental Report I have had the opportunity to review and consider the following additional witness evidence:
- (a) Second Witness Statement of Dr Michael Lynch, dated 16 November 2018;
 - (b) Witness Statement of Alastair Martin (“Mr Martin”), dated 16 November 2018;
 - (c) Supplemental Witness Statement of Roger Wang (“Mr Wang”), dated 15 November 2018;
 - (d) Supplemental Witness Statement of Samuel Yan (“Mr Yan”), dated 14 November 2018;
 - (e) Witness Statement of Poppy Gustafsson (“Ms Gustafsson”), dated 15 November 2018;
 - (f) Supplemental Witness Statement of James Krakoski (“Mr Krakoski”), dated 5 November 2018;
 - (g) Witness Statement of Eloy Avila (“Mr Avila”), dated 15 November 2018;
 - (h) Witness Statement of Donald Avant (“Mr Avant”), dated 9 November 2018;
 - (i) Supplemental Witness Statement of Christopher Goodfellow (“Mr Goodfellow”), *undated*;
 - (j) Witness Statement of Andrew Gersh (“Mr Gersh”), dated 14 November 2018; and
 - (k) Mr Holgate’s First Report

8.98 I have also provided further comment of relevance arising from the witness statements and evidence disclosed for the purposes of my First Report, including the witness statement of Mr Welham, and below also identify examples of Deloitte’s audit and review findings in regard to examples of hosting transactions.

Brief summary of Deloitte’s relevant and audit review work

8.99 I have reviewed the Deloitte working papers which support Deloitte’s revenue recognition conclusions for a sample of hosting transactions listed at Schedule 6 Re-Re Amended Particulars of Claim. My review comprised consideration of the following sample of Schedule 6 high value transactions (in terms of licence revenues recognised upfront):

- (a) Bank of America Q1 2009;⁵⁹⁰

⁵⁹⁰ {POS00148758}, tab “(3) BOA”.

- (b) Morgan Stanley Technology Q4 2009;⁵⁹¹
- (c) Bank of America Q1 2010;⁵⁹²
- (d) BP Q2 2010;⁵⁹³
- (e) JP Morgan Chase & Co Q2 2010;⁵⁹⁴
- (f) Metropolitan Life Q2 2010;⁵⁹⁵
- (g) Deutsche Bank / EMARS Group Q1 2011;⁵⁹⁶
- (h) Metropolitan Life Q2 2011;⁵⁹⁷
- (i) US Postal Service Q2 2011;⁵⁹⁸ and
- (j) Iron Mountain Q2 2011;⁵⁹⁹

8.100 The above sample covers a total of US\$84m of software licence fees recognised upfront in Autonomy’s accounts throughout the period from Q1 2009 to Q2 2011 (Schedule 6 of the Re-Re Amended Particulars of Claim comprises transactions with licence revenues recognised upfront totalling US\$187m).

8.101 Deloitte’s conclusion in respect of each of the above transactions is broadly the same:

“Revenue recognition

(a) The risks and rewards of ownership passed to the customer when the items were delivered [In the case of the Q2 2011 Iron Mountain transaction: “when the deal was signed”⁶⁰⁰]. As all of Autonomy’s obligations have been fulfilled the risks and rewards have been transferred.

(b) Autonomy has not retained any managerial control.

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

(d) It is probable that economic benefits will flow to Autonomy

⁵⁹¹ {POS00148762}, tab “(2) Morgan Stanley”.

⁵⁹² {POS00176888}, tab “(4) BOA”.

⁵⁹³ {POS00176879}, tab “(2) BP (large)”.

⁵⁹⁴ {POS00176879}, tab “(4) JP Morgan Chase”.

⁵⁹⁵ {POS00176868}, tab “8”.

⁵⁹⁶ {POS00169466}, tab “4”.

⁵⁹⁷ {POS00179295}, tab “5”.

⁵⁹⁸ {POS00179295}, tab “6”.

⁵⁹⁹ {POS00170784} tab “8” - I note that this is the Q2 2011 Iron Mountain transaction considered by Mr Holgate at paragraphs 7.40 to 7.58 of his first report. I have not considered this transaction further than a review of Deloitte’s conclusions.

⁶⁰⁰ {POS00170784} tab “8”

(e) There are no costs incurred in this transaction.

SATISFACTORY

Conclusion

SATISFACTORY”

8.102 In addition to the above conclusion, the working papers for the following transactions include an additional comment, as follows:

(a) BP Q2 2010: *“Note that we have confirmed with Pete Menell (CTO) that Autonomy retains no managerial involvement in this sale. With the exception of providing the services outlined under the contract, there is no further involvement from Autonomy.”*⁶⁰¹ ; and

(b) JP Morgan Chase & Co: *“Note that we have confirmed with Chris Goodfellow that Autonomy retains no managerial involvement in this sale. With the exception of providing the services outlined under the contract, there is no further involvement from Autonomy.”*⁶⁰²

8.103 As is apparent, Deloitte therefore considered hosting transactions at the time to be capable of being separated into separate components, and a fair value calculated for the licence element.

Commerciality of the re-structuring arrangements

8.104 The Claimants assert that hosting arrangements were restructured primarily for the purposes of revenue acceleration.⁶⁰³

8.105 This assertion is disputed by the Defendants who maintain that the restructured “hybrid” arrangements were adopted for commercial reasons.⁶⁰⁴

8.106 Dr Lynch states:

*“Autonomy offered a hybrid hosting model to ensure it remained competitive in the hosting business in light of market changes and commercial realities. Data storage rates were rapidly falling, making the existing rates under Autonomy’s contracts uncompetitive.”*⁶⁰⁵

8.107 Dr Lynch expands on this, confirming that the hybrid arrangements had the commercial effect of binding customers over a longer term, providing Autonomy with a greater

⁶⁰¹ {POS00176879}.

⁶⁰² {POS00176879}.

⁶⁰³ Re-Re-Amended Particulars of Claim, paragraph 30.2.3.2.

⁶⁰⁴ First Defendant’s Amended Defence, paragraph 48.4.2.

⁶⁰⁵ Dr Lynch’s First Witness Statement, paragraph 446.

predictability in the future size of its hosting business thereby affording a better understanding for future investment requirements.⁶⁰⁶

8.108 In his second witness statement, Dr Lynch further outlines the significant changes in the software industry leading up to 2010. He describes a *“significant and sudden shift towards hosted solutions, otherwise known as the cloud.”*⁶⁰⁷

8.109 Dr Lynch adds that whereas previously most of Autonomy’s customers purchased licences, *“... by 2010, the vast majority of Autonomy’s archiving customers opted for hosted solutions.”*⁶⁰⁸

8.110 During this period, Dr Lynch also refers to data storage rates *“falling by orders of magnitude”*⁶⁰⁹ and the importance of Autonomy offering customers corresponding cost savings. Dr Lynch cites as an example customer USPS who was offered a variety of different delivery mechanisms (including SaaS) but opted for a licence model.⁶¹⁰ Dr Lynch later adds that:

“I now know that USPS specifically requested a licence model, as USPS was interested in bringing its system in-house”.^{611 612}

8.111 Mr Hussain also highlights the commercial advantages of the hybrid arrangements, stating that they were *“... commercially advantageous to Autonomy because (amongst other things) they allowed Autonomy to lock customers into fixed-term contracts, gain commercial certainty about receipt of minimum amounts of revenue from those customers, and up-sell other products.”*⁶¹³.

8.112 Mr Wang (Autonomy vice president of product development for Digital Safe) accepts that one of the benefits of the licence model was that it locked in the customer since the customer had already prepaid upfront for the service for several years. However, he takes the view that:

*“... it was the upfront payment for the licence, as opposed to the licence itself, which locked in the customer.”*⁶¹⁴

8.113 Mr Goodfellow (Autonomy chief technical officer of infrastructure) supports the Claimants’ assertions:

⁶⁰⁶ Dr Lynch’s First Witness Statement, paragraph 460.

⁶⁰⁷ Dr Lynch’s Second Witness Statement, paragraph 66.

⁶⁰⁸ Dr Lynch’s Second Witness Statement, paragraph 66.

⁶⁰⁹ Dr Lynch’s Second Witness Statement, paragraph 68.

⁶¹⁰ Dr Lynch’s Second Witness Statement, paragraph 69.

⁶¹¹ Dr Lynch’s Second Witness Statement, paragraph 74.

⁶¹² {D001098669} / {D000974754}.

⁶¹³ Mr Hussain’s Witness Statement, paragraph 30.

⁶¹⁴ Mr Wang’s First Witness Statement, paragraph 47.

“My understanding was that the reason why Autonomy moved to the licence model was so that it could accelerate the recognition of revenue. The trade-off for the earlier recognition of revenue was a reduction in overall revenue to Autonomy from what was, in actual practice, the same business and service relationship.”

“I viewed the move towards the new licence structure as being driven by accounting rather than business or technical issues”.⁶¹⁵

- 8.114 Mr Krakoski (Digital Safe sales executive) notes that there were no real changes in the services provided, but he accepts that the licence model afforded Autonomy a commercial benefit by locking in customers:

“Although the licence gave the customer the right to use the Digital Safe software, nothing actually changed compared with the pre-existing SaaS arrangement.”⁶¹⁶

“The licence model did enhance customer lock-in due to the fact that customers had paid a significant sum upfront.”⁶¹⁷

- 8.115 Mr Krakoski further describes the position from a sales viewpoint, explaining that sales representatives were highly incentivised to seek out licence opportunities and that significantly more commission could be earned from structuring new / restructuring existing hosting contracts to include upfront licence revenue.

- 8.116 He explains that customers were willing to enter into restructured contracts and purchase licenses to Digital Safe because of aggregate cost savings over the term of the contract compared with pre-existing arrangements.

- 8.117 However, as regards the licence, Mr Krakoski notes:

“... although a customer bought a licence to use the software, in practice, the customer was not able to do anything with it. It was common knowledge within Autonomy that Digital Safe was not easy to manage - it was a proprietary system and it was impractical for a customer or a third party to set it up or manage it; only Autonomy could do that.”⁶¹⁸

- 8.118 Mr Krakoski also states that customers:

“... wanted the arrangement to continue as before (just with the financial savings).”⁶¹⁹

⁶¹⁵ Mr Goodfellow’s First Witness Statement, paragraph 14.

⁶¹⁶ Mr Krakoski’s First Witness Statement, paragraph 13.

⁶¹⁷ Mr Krakoski’s First Witness Statement, paragraph 16.

⁶¹⁸ Mr Krakoski’s First Witness Statement, paragraph 24.

⁶¹⁹ Mr Krakoski’s First Witness Statement, paragraph 25.

8.119 In contrast, and in support of the Defendants' assertions, Ms Gustafsson (Autonomy's former European financial controller and a past member of Deloitte's audit team responsible for the audit of Autonomy) expresses surprise in the suggestion that Autonomy's only motivation to restructure existing hosted deals was to get accelerated revenues⁶²⁰. Ms Gustafsson highlights the commercial benefits afforded to Autonomy by the restructured arrangements:

*"For hosting, we offered discounts on long-term storage accounts to encourage customers to have the most amount of data with us so that they were "locked in" and it would be too much of an effort to move."*⁶²¹

*"Locking in customers by renegotiating their existing hosted contracts was normal, prudent business practice given rapid changes to the hosted market."*⁶²²

*"The most important thing for companies, such as Autonomy, to do was to ensure its hosted customers were more likely to stay on a long-term basis ..."*⁶²³

*"When storage rates were falling due to advances in technology, securing an upfront financial commitment from a customer was valuable, and there was an absolute commercial benefit in doing so."*⁶²⁴

"By bringing a customer's commitment upfront, Autonomy effectively de-risked the contract, reducing the chance the customer walking away years in the future, if cheaper storage rates were on offer elsewhere".⁶²⁵

8.120 Ms Gustafsson continues:

*"Customers were willing to make large upfront payments under a restructured deal if they saw they were getting: (i) optionality; and (ii) reduced storage rates over the life of the arrangement. Optionality came in the form of the customer gaining a licence, which meant they could take their data in-house if they wanted, or move the data to a third party storage provider..."*⁶²⁶

⁶²⁰ Ms Gustafsson's Witness Statement, paragraph 128, referring to the statement of Mr Egan.

⁶²¹ Ms Gustafsson's Witness Statement, paragraph 126.

⁶²² Ms Gustafsson's Witness Statement, paragraph 127.

⁶²³ Ms Gustafsson's Witness Statement, paragraph 127.

⁶²⁴ Ms Gustafsson's Witness Statement, paragraph 127.

⁶²⁵ Ms Gustafsson's Witness Statement, paragraph 128.

⁶²⁶ Ms Gustafsson's Witness Statement, paragraph 134.

Independent value of licences as separate components

8.121 Autonomy accounted for the revenue arising from “hybrid” transactions in two separate parts:

- (a) the value of the licence component was recognised upfront; and
- (b) the data hosting (storage) component (and any other services) was recognised rateably over the period of provision of the arrangements.

8.122 The Claimants assert that the Digital Safe software licences were not separately identifiable components of hosting arrangements and therefore had no independent value. As such, revenue from the sale of licences could not be recognised upfront, at the point of sale.

8.123 This assertion is disputed by the Defendants.

8.124 Mr Hussain emphasises the two separately identifiable components of the hybrid arrangements, commenting:

*“These arrangements reflected the fact that Autonomy was selling the customer both a licence to use Autonomy software (which could be used with or without Autonomy hosting services) and separate hosting services. It was appropriate to charge for those products separately.”*⁶²⁷

*“The arrangements ... recognised the fact that, in providing hybrid arrangements, Autonomy was selling customers two discrete elements: (a) first, a licence to use Autonomy’s Digital Safe and/or eDiscovery software and/or other software, which could be used regardless of whether the customer took advantage of Autonomy’s hosting services or not; (b) second, Autonomy’s hosting services.”*⁶²⁸

*“The hosting services were separate from the software provided pursuant to the licence. The payments received in relation to the sale of the licences were not, and should not have been, treated as pre-payments for hosting and related services...”*⁶²⁹

8.125 In addition, Mr Hussain continues:

*“... a number of customers for Autonomy’s data-hosting services chose to install the licensed software on-premises (either their own, or on a third-party provider’s).”*⁶³⁰

⁶²⁷ Mr Hussain’s Witness Statement, paragraph 31.

⁶²⁸ Mr Hussain’s Witness Statement, paragraph 182.

⁶²⁹ Mr Hussain’s Witness Statement, paragraph 210.

⁶³⁰ Mr Hussain’s Witness Statement, paragraph 214.

8.126 Mr Wang, in his first witness statement, identifies a number of issues regarding customers own on-site hosting of Digital Safe software, in particular the levels of ongoing support required of Autonomy:

- (a) onsite deployment of Digital Safe Autonomy required customers to purchase managed services. Mr Wang states that if any customer insisted on Digital Safe, “... we [Autonomy] *provided substantial ongoing support.*”;⁶³¹
- (b) difficulties caused by the absence / limited level of remote monitoring and lack of customer facing documentation, and because of this Mr Wang says that “... *Autonomy was trying to move these customers [Air Liquide, BNP Paribas and Rand] onto a solution designed for on-premise use (i.e. EAS or CAMM).*”;⁶³²
- (c) Apple: wanted to run the software entirely by itself but Autonomy were providing “*a lot of support*”;⁶³³
- (d) AXA: was sold Digital Safe without managed services. AXA refused remote access for security reasons but Mr Wang advised AXA that remote access was required to ensure Digital Safe worked and operated properly;⁶³⁴
- (e) Citi: was one of the few customers that removed its data from Autonomy’s data centres and took on-premise. Because of its size, Mr Wang describes this as having been a “*very complex implementation process*”;⁶³⁵
- (f) Manufacturers Life expressed concerns about Digital Safe being on-premise, as it would need “*unrestricted VPN access*” from Autonomy;⁶³⁶ and
- (g) Rand: Mr Wang notes issues with the delivery, performance and implementation of Digital Safe and a lack of provision of training and guides.⁶³⁷

8.127 Mr Wang takes the view:

*“Digital Safe was a sticky product in any event given the difficulties and expense of switching providers. Particularly for longer term customers who stored a lot of data with Autonomy, it would have been such a painful process to move.”*⁶³⁸

8.128 Whilst Mr Wang points out a number of operational issues concerning the implementation and hosting of Digital Safe by customers on-premise, there appears to be nothing within

⁶³¹ Mr Wang’s First Witness Statement, paragraph 25.

⁶³² Mr Wang’s First Witness Statement, paragraph 28.

⁶³³ Mr Wang’s First Witness Statement, paragraph 30.

⁶³⁴ Mr Wang’s First Witness Statement, paragraph 31.

⁶³⁵ Mr Wang’s First Witness Statement, paragraph 34.

⁶³⁶ Mr Wang’s First Witness Statement, paragraph 35.

⁶³⁷ Mr Wang’s First Witness Statement, paragraphs 37 to 41.

⁶³⁸ Mr Wang’s Witness Statement, paragraph 47.

Mr Wang's evidence that Digital Safe could not (albeit not without some difficulties) be hosted by customers themselves.

- 8.129 Furthermore, Mr Avila disagrees with Mr Wang's apparent suggestion that there is something untoward about Autonomy having access to check on customers' safes from time to time. Mr Avila states:

"This is not my understanding. Vendors that service these large enterprise organizations often are given the ability to "dial in" via VPN or otherwise to check in to make sure everything is fine or otherwise to monitor the product." ⁶³⁹

- 8.130 As regards the requirement for Autonomy to assist customers implement and provide ongoing support services, Dr Lynch comments:

"This was not an unusual feature of Digital Safe. Virtually all enterprise software requires a technically skilled person to implement or manage its use..." ⁶⁴⁰

- 8.131 In his supplemental witness statement, Mr Wang states that Digital Safe required considerable ongoing support from Autonomy as well as Autonomy's involvement in its initial implementation. Without this support, Mr Wang says *"Digital Safe would fail."* ⁶⁴¹

- 8.132 Mr Wang accepts Dr Lynch's assertion that Digital Safe was written in industry standard programming language, but maintains that owing to its complexities, qualified engineers would need significant training to be able to build or operate it. ⁶⁴²

- 8.133 Mr Goodfellow is of the same view as Mr Wang:

"... only people who are extremely familiar with Digital Safe (i.e. people who work or have worked at Autonomy) can readily understand it and... although a customer might buy a licence to use Digital Safe software, in practice, the customer would not be able to do anything with it without significant Autonomy support ..." ⁶⁴³

- 8.134 In his first witness statement, Mr Yan (senior member of the Digital Safe product development team) states:

"Digital Safe was designed to be a hosted solution - it was designed to be located at an Autonomy data center and managed by Autonomy personnel." ⁶⁴⁴

⁶³⁹ Mr Avila's Witness Statement, paragraph 31.

⁶⁴⁰ Dr Lynch's Second Witness Statement, paragraph 75(a).

⁶⁴¹ Mr Wang's Supplemental Witness Statement, paragraph 6.

⁶⁴² Mr Wang's Supplemental Witness Statement, paragraph 6(a).

⁶⁴³ Mr Goodfellow's Supplemental Witness Statement, paragraph 4.

⁶⁴⁴ Mr Yan's First Witness Statement, paragraph 26.

8.135 Mr Yan continues:

*“We [the product development team] did not build it [Digital Safe] with a view to offering it as an on-premise solution ... which customers could run themselves.”*⁶⁴⁵

8.136 However, Mr Yan continues to say that following Autonomy’s acquisition of Zantaz, the product development team was:

*“... encouraged, and at times pressurized, into trying to package Digital Safe into a self-contained appliance for sale to on-premise customers. This led to the development of what was known amongst the software developers as “Safe in a Box” (subsequently marketed as “Arcpliance”), which was essentially a computer box with the capacity to archive a limited amount of data. This solution was provided to the relatively small number of customers who insisted, despite our discouragement, on taking their Digital Safes on-premise.”*⁶⁴⁶

8.137 Mr Yan explains that the process of setting up Digital Safe on a customer’s premises involved customisation, configuration and implementation of the software. He states that:

*“In practice, a Digital Safe could only be customized, configured and implemented on a customer’s premises by Autonomy.”*⁶⁴⁷

8.138 Further, Mr Yan disputes Dr Lynch’s claim that Digital Safe could be and was configured and implemented on the customer’s premises for customer use otherwise than by Autonomy, on multiple occasions, stating:

*“I am not aware of a single customer who has ever successfully implemented, or even attempted to implement, Digital Safe itself (i.e. without Autonomy).”*⁶⁴⁸

8.139 Mr Yan continues to say that Digital Safe:

*“... is a very complex and alive solution, which requires ongoing support services from Autonomy far beyond standard support and maintenance in order to maintain it.”*⁶⁴⁹

*“All Digital Safe systems required this level of support from Autonomy, regardless of whether they were hosted or on-premise ...”*⁶⁵⁰

⁶⁴⁵ Mr Yan’s First Witness Statement, paragraph 26.

⁶⁴⁶ Mr Yan’s First Witness Statement, paragraph 28.

⁶⁴⁷ Mr Yan’s First Witness Statement, paragraph 36.

⁶⁴⁸ Mr Yan’s First Witness Statement, paragraph 39.

⁶⁴⁹ Mr Yan’s First Witness Statement, paragraph 41.

⁶⁵⁰ Mr Yan’s First Witness Statement, paragraph 42.

*“Whilst it was in theory technically possible for a customer or third party to have managed or operated Digital Safe themselves, in practice they could not do so without support from Autonomy.”*⁶⁵¹

8.140 Dr Lynch accepts that Autonomy would assist and support customers with the implementation of purchased software, but notes that such services were not constant⁶⁵², and that customers would be charged for services they received⁶⁵³.

8.141 In his Amended Defence, Dr Lynch notes:

*“Many companies themselves installed and operated Digital Safe, and thus there is no basis to argue the licences lacked independent value.”*⁶⁵⁴

8.142 Dr Lynch expands:

*“Customers could, and many did, choose to host their data in-house or with a third party provider, using the licence portion of the Autonomy contract. Even for customers that continued to use Autonomy’s hosting services, the licence component was a valuable asset. The Claimants have now admitted that both relevant hosting products (Digital Safe and e-discovery) were in fact sold independently.”*⁶⁵⁵

8.143 Mr Martin (Autonomy group head of technical and customer operations) adds support to Dr Lynch’s position, stating:

*“... the claim that the Digital Safe software could not be used by customers on-premise does not make sense to me.”*⁶⁵⁶

8.144 Mr Martin refers to on-premise delivery to customers including Bank of America, Deutsche Bank, SFO, AXA and Merck.⁶⁵⁷

*“To the best of my knowledge and understanding, there was no technical reason why Autonomy would not have been able to train its partners. While Digital Safe was by no means a “simple” or “easy” piece of software, the implementation and operation of Digital Safe was not a closely-guarded trade secret and it was in our interest for customers or partners to be able to run the software themselves.”*⁶⁵⁸

⁶⁵¹ Mr Yan’s First Witness Statement, paragraph 47.

⁶⁵² Dr Lynch’s Second Witness Statement, paragraph 75(c).

⁶⁵³ Dr Lynch’s Second Witness Statement, paragraph 75(d).

⁶⁵⁴ First Defendant’s Amended Defence, paragraph 48.4.3.

⁶⁵⁵ First Defendant’s Amended Defence, paragraph 48.4.3.1.

⁶⁵⁶ Mr Martin’s Witness Statement, paragraph 31.

⁶⁵⁷ Mr Martin’s Witness Statement, paragraphs 31 to 33.

⁶⁵⁸ Mr Martin’s Witness Statement, paragraph 37.

8.145 Mr Martin continues:

*“... I do not understand why a license would have no value to a customer if the customer does not implement and run it itself. During my time at Autonomy, I encountered numerous reasons why customers wanted the Digital Safe license as opposed to the hosted offering. For example, some customers wanted full and complete control over their data [Apple]; some needed to comply with statutory requirements regarding their data leaving a certain jurisdiction [ManuLife ... and UBS Switzerland ...]; some had a policy disfavoring third parties from being able to access their data [SFO ...]; some wanted to resell Digital Safe as a service themselves [Rand ...]; and some may have wanted to ensure that Autonomy’s Digital Safe source code is in escrow in case something were to happen to Autonomy [Morgan Stanley ... and AXA ...].”*⁶⁵⁹

8.146 Mr Martin’s position is corroborated by the witness evidence of Mr Avila (Autonomy chief technical officer), who agrees with the reasons stated by Mr Martin (above) as to why customers wanted the Digital Safe licence.⁶⁶⁰

8.147 As regards the provision of support to those customers choosing to take Digital Safe on-premise, Dr Lynch states:

*“Autonomy offered customers training courses on the software, which the big banks took advantage of... There were also a multitude of written manuals available to customers working with Digital Safe... Digital Safe ... was sold as a standalone solution.”*⁶⁶¹

8.148 Mr Wang disputes Dr Lynch’s claim, stating:

*“... there were no customer facing training manuals to explain to customers how to operate or manage the solution...”*⁶⁶²

8.149 Mr Wang continues:

*“Release notes [provided to customers by Autonomy and which Mr Wang says Dr Lynch is referring to] ... would never cover the implementation or operation of Digital Safe itself.”*⁶⁶³

8.150 As regards training and user manuals, Mr Yan agrees with Mr Wang:

“The only customer facing guides were the Digital Safe User Guides...”

⁶⁵⁹ Mr Martin’s Witness Statement, paragraph 39.

⁶⁶⁰ Mr Avila’s Witness Statement, paragraph 30.

⁶⁶¹ Dr Lynch’s First Witness Statement, paragraph 470.

⁶⁶² Mr Wang’s Supplemental Witness Statement, paragraph 6(d).

⁶⁶³ Mr Wang’s Supplemental Witness Statement, paragraph 6(d).

“... These ... provided only very cursory explanations about how to perform various functions within Digital Safe ...” ⁶⁶⁴

8.151 Mr Yan continues:

“There were a few ad hoc (unsuccessful) attempts at training, in the course of which we may have shared what limited materials we had ... but we never created customer facing user manuals regarding implementation / management of Digital Safe because there was never any expectation that even with such a manual the customer would be able to implement or manage the Digital Safe themselves.” ⁶⁶⁵

8.152 Mr Krakoski (Digital Safe sales executive) notes:

“Digital Safe training did not cover the implementation or ongoing operation of the Digital Safe software. Such matters went to the mechanics of Digital Safe itself and were therefore far more complex than simple front-end functionality. The implementation and ongoing operation of Digital Safe were not subjects on which we provided customers with training and were in any event not matters for the customer given that Autonomy provided these services.” ⁶⁶⁶

8.153 Regarding Dr Lynch’s suggestions that some customers were given the opportunity to purchase Digital Safe software alone, Mr Yan states:

“... a customer would not have been able to do anything with a Digital Safe licence if the customer had bought such a licence and nothing else...” [referring to the need for Autonomy’s services in respect of installation, implementation, operation and management of Digital Safe].⁶⁶⁷

8.154 Mr Yan continues:

“... In reality, the customer did not gain any flexibility from purchasing the licence ... because it could not do anything with the Digital Safe software without substantial further assistance from Autonomy.” ⁶⁶⁸

⁶⁶⁴ Mr Yan’s First Witness Statement, paragraph 47.

⁶⁶⁵ Mr Yan’s First Witness Statement, paragraph 49.

⁶⁶⁶ Mr Krakoski’s Supplemental Witness Statement, paragraph 4.

⁶⁶⁷ Mr Yan’s First Witness Statement, paragraph 52.

⁶⁶⁸ Mr Yan’s First Witness Statement, paragraph 53.

8.155 Mr Yan responds to the examples of on-premise deals provided by Dr Lynch⁶⁶⁹, highlighting the ongoing level of involvement required of Autonomy in each of these circumstances, including:⁶⁷⁰

- (a) American Express: Autonomy was responsible for installation, monitoring and maintaining the Digital Safe software;
- (b) BNP Paribas: Autonomy carried out the implementation process which involved customisation. Autonomy continued to monitor the software through VPN access;
- (c) Citibank: Engaged the services of an Autonomy employee on an almost permanent basis. Autonomy continued to monitor the software via VPN access;
- (d) Manufacturers Life: Autonomy provided ongoing services until acquiring a presence in Canada, when Manufacturers Life then became a hosted customer;
- (e) Merck: Implemented by Autonomy with continued provision of Autonomy's remote management services;
- (f) Serious Fraud Office: an Autonomy operations engineer was assigned to the SFO. Autonomy was given remote access on request; and
- (g) UBS: Autonomy provided remote managed services.

8.156 As regards the separability of the individual licence and hosting components, Ms Gustafsson expresses the view (from an accounting perspective) that the key point in determining the separability of the licence component element (for revenue recognition purposes) was not whether customers had actually chosen to host their data on-premise, but rather the fact that customers "*had the option of doing so*" under the terms of the arrangement, should they choose to. ⁶⁷¹ In other words, provided that the customer had the option to, and was able to, take the Digital Safe software on-premise, the software licence could be considered a separate component of the overall arrangement.

8.157 Ms Gustafsson describes the hosted arrangements as being an example of what she refers to as a "bundled" contract, which meant there were a number of different components making up the total package. Ms Gustafsson refers to these individual components as being:

- (a) licence;
- (b) support and maintenance;
- (c) professional services fees;

⁶⁶⁹ First Defendant's Amended Defence and Counterclaim, paragraph 154.1.

⁶⁷⁰ Mr Yan's First Witness Statement, paragraph 57.

⁶⁷¹ Ms Gustafsson's Witness Statement, paragraph 135.

- (d) monitoring and administration fees; and
- (e) the hosting fees.⁶⁷²

8.158 In other words, in summary, it is very clear from the above range of opinions that there is a large factual divide between the parties as to whether, even where in fact a customer did take Digital Safe ‘on premise’, the Digital Safe licence could be run independently without Autonomy support; and / or whether it required Autonomy authorisation, installation, implementation and management, even if it could be provided ‘on premise’. This is said to be relevant to the question of the value of the licence as a standalone product. As I stated in my First Report, 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 customers⁶⁷³. For the avoidance of doubt, my opinion on this remains unchanged. Similarly, I repeat my opinion expressed at paragraph 15.24 of my First Report, that in order to assess the substance of a transaction with multiple elements, the transaction should be viewed from the perspective of the customer.

Fair value

8.159 The Claimants assert that the fair value of the revenue on a sale of a software licence in conjunction with the provision of hosted services could not be readily measured. Accordingly, the requirements of IAS 18 for the upfront recognition of revenue from such licence sales could not be met.

8.160 Dr Lynch explains the process of establishing fair value of licences. In his response, he clarifies:

*“The fair value of the licence was correctly measured using the residual method, and revenue from the licence sale was recognised in accordance with IAS 18. For each deal, a cost analysis was performed to capture the costs of the hosting portion (often using the standard rate for data storage), with the fair value of the licence calculated based on the residual value of the complete contract. This treatment was discussed with, reviewed by, and concurred in by Deloitte.”*⁶⁷⁴

8.161 Dr Lynch also states:

“... the Finance Department worked closely with Deloitte to test revenue recognition of these deals, which involved testing the fair value of the licence component”.

⁶⁷² Ms Gustafsson’s Witness Statement, paragraph 136.

⁶⁷³ My First Report, paragraph 15.33.

⁶⁷⁴ First Defendant’s Amended Defence, paragraph 141.2.

“... I ... understood that Deloitte were totally comfortable with the approach we took. I further understood that the Audit Committee considered these transactions as well”. ⁶⁷⁵

8.162 Ms Gustafsson explains:

“The accountant is required to work out the “fair value” of each of the separate components. You must calculate the fair value of the licence using the residual value, i.e. you know the total value of the bundled deal, you deduct the fair value of each of the service-related components, and the value you are left with is the fair value of the licence.” ⁶⁷⁶

8.163 Ms Gustafsson notes that she supported the sales teams when negotiating with customers by preparing models illustrating how each individual component of the bundled deal could be priced.⁶⁷⁷

8.164 Ms Gustafsson adds:

“From an IFRS perspective, once you have deducted the fair value of all of the separately identifiable components of the deal, you are left with the fair value of the licence. This is the value attributable to the archiving licence, whether hosted by Autonomy or the customer.”

“Once that licence has been delivered and you can reasonably assume the fees are collectable, then you recognise the revenue on that licence.” ⁶⁷⁸

8.165 Ms Gustafsson further notes:

“Assessing the fair value of these deals was not something that sales personnel would have been involved in, given it was the role of Autonomy’s finance function. For every restructured hosted deal, Deloitte, as Autonomy’s auditors prepared a revenue testing sheet, and the audit team had access to all relevant documents and other information necessary to perform their independent fair value assessment.” ⁶⁷⁹

8.166 I also refer to Dr Lynch’s explanation as to how Autonomy priced e-Discovery services using rate cards, which enabled the fair value of the services to be established separate from the value of the licence (paragraphs 8.48 and 8.50 of this section).

8.167 I also further refer to Mr Hussain’s corresponding explanation (paragraph 8.49 of this section) as to how Autonomy was able to establish a reliable fair value attributable to the

⁶⁷⁵ Dr Lynch’s First Witness Statement, paragraph 449.

⁶⁷⁶ Ms Gustafsson’s Witness Statement, paragraph 136.

⁶⁷⁷ Ms Gustafsson’s Witness Statement, paragraph 137.

⁶⁷⁸ Ms Gustafsson’s Witness Statement, paragraph 142.

⁶⁷⁹ Ms Gustafsson’s Witness Statement, paragraph 143.

services based on (i) per-data unit prices for hosting services; (ii) man hour rates for services; and (iii) maintenance charge percentages.

- 8.168 Based on the evidence of Ms Gustafsson (a qualified chartered accountant, former member of the Deloitte audit team responsible for Autonomy's audit and former Autonomy European financial controller), contrary to the Claimants' assertions, there would appear to have been clear procedures in place and relevant financial information available for the purposes of establishing "fair value" of the individual components of the hosting arrangements.
- 8.169 It would also appear from Ms Gustafsson's evidence that Deloitte, Autonomy's auditors, had a close involvement in the process and ultimately concurred with the revenue recognition treatment adopted as regards licence sales revenue as a separate component of the hosting arrangements.
- 8.170 In particular, Mr Welham of Deloitte refers to the restructuring of hosted services from:
- (a) the provision of those services on a SaaS (Software as a Service) basis, the revenue of which was recognised over the period in which the hosting services were performed; to
 - (b) the purchase of a licence for Digital Safe and e-Discovery software (for which customers paid an up-front, one-off licence fee) and significantly reduced ongoing charges for data storage and other services.⁶⁸⁰
- 8.171 Mr Welham then refers to the restructured arrangements as being "*bundled arrangements*" (being transactions which comprise multiple components of licence, storage, support and maintenance), referring to IAS 18 paragraph 13 which provides 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."*⁶⁸¹
- 8.172 Mr Welham notes also that in such circumstances:
- "... the revenue recognition criteria set out in IAS 18, paragraph 14 (in the case of the sale of a good) and IAS 18, paragraph 20 (in the case of the rendering of a service) can be applied to each of the components of the arrangement separately, according to its substance."*⁶⁸²
- 8.173 He further notes:

⁶⁸⁰ Mr Welham's Witness Statement, paragraph 87.

⁶⁸¹ Mr Welham's Witness Statement, paragraph 88, quoting from IAS 18 paragraph 13.

⁶⁸² Mr Welham's Witness Statement, paragraph 89.

*“If the conclusion is that there are not separately identifiable components of the transaction, or that there are multiple, separately identifiable components but that, given the substance of the transaction, the recognition criteria should not be applied separately to each component, then the revenue recognition criteria (in either paragraph 14 or 20) must be applied to the transaction as a whole...”*⁶⁸³

8.174 In summary, therefore, whilst the Claimants’ allege that the fair value of a software license cannot be measured in a hosted services scenario, the Defendants point to the residual value method, meaning that if all other components of a transaction can be measured at fair value, the remaining fair value balance must be the fair value of the licence.

My overall conclusions on the accounting treatment

8.175 In my opinion, the assumptions put to Mr Holgate can generally only provide for one way to account for the impugned transactions.

8.176 These assumptions, however, are in contrast to the position portrayed in the Defendants’ witness evidence. The assumptions are also in contrast to Deloitte’s, Autonomy’s own auditors, understanding of the facts and circumstances at the time.

8.177 The result appears to be a very broad factual dispute between the parties, based on the witness evidence provided. The only other evidence that I am aware of is the Deloitte audit and review working papers, which I briefly commented on as assessing, for example, the Digital Safe upfront licence purchases as sale of goods revenue.

8.178 The Defendants’ assertions, combined with the witness evidence in support thereof, would suggest a different proposition to the assumptions put to Mr Holgate, in that:

- (a) licences did have independent value and were perceived by customers as having such;
- (b) the software could operate as a standalone product and could be used with or without Autonomy hosting services;
- (c) the software could be transferred, installed and configured to the customer’s own systems; and⁶⁸⁴
- (d) on many occasions, Digital Safe was used by customers independently of Autonomy’s hosting arrangements.

⁶⁸³ Mr Welham’s Witness Statement, paragraph 90.

⁶⁸⁴ As a corollary of (a) to (c).

- 8.179 The Defendants' witness evidence would also suggest that the licence component of the hybrid arrangements could justifiably be considered a separately identifiable component to the overall hosting services transaction.
- 8.180 It is on the above basis that both Autonomy, and Deloitte, concluded on the revenue recognition accounting treatment adopted, and as I have said earlier, I consider both Autonomy and its auditors justified in reaching their conclusions in respect of that accounting treatment, if indeed the facts claimed are so determined.
- 8.181 In my opinion, one appropriate test in order to understand the substance of the transaction is having regard to what the customer considered it was purchasing. If, as appears possible, the customer agreed it was purchasing a separate licence (i.e. it appears possible from consideration of the specific contractual terms agreed with the customer, including how the customer protected its own interests), then it is quite possible that the rights accruing to an 'on-premise' customer could be the same rights protected by a hosted customer. This would be the case if any issues as to installation or monitoring costs of on-site customers were taken care of by separate payment for those services.
- 8.182 As I have commented on throughout this section of my report, many of the facts, issues and/or circumstances relating to the transactions in dispute are themselves subject to considerable dispute as evidenced by the competing evidence provided by the parties' witness statements. Significantly, there are substantial differences in the witness evidence which are fundamental to a full and proper consideration of the appropriate revenue recognition principles applicable for both Digital Safe and e-Discovery transactions. The opposing positions appear to me to be, in summary:

Digital Safe hosted transactions

- 8.183 Claimants' assertions:
- (a) hosting arrangements were restructured primarily for the purposes of accelerating revenue recognition;
 - (b) Digital Safe and e-Discovery hosting arrangements were, in substance, transactions for the provision of services;
 - (c) Digital Safe software licences were not capable of being separated from the data storage services under hybrid hosting arrangements;
 - (d) customers choosing to transfer the software on-premise would face considerable difficulties without the support of Autonomy's ongoing managed services;

- (e) in practice, although customers purchased licences, they were not able to do anything with them without Autonomy's support;
- (f) as such, licences had no independent value; and
- (g) revenue recognition criteria could not therefore be applied to a Digital Safe licence sale as a separately identifiable component of the hybrid hosting transactions.

8.184 Defendants' assertions:

- (a) hosting arrangements were restructured for commercial reasons. The hybrid model ensured that Autonomy remained market competitive, bound in customers over a longer term, offered aggregate cost savings and offered customers optionality of taking the licence elsewhere;
- (b) customers owned the software licence which gave the customer the option to choose where to host their data, whether in house or with a third-party provider, at any time during the licence period. Many customers chose to do so;
- (c) the software could operate as a standalone product and could be used with or without Autonomy hosting services;
- (d) the software could be transferred, installed and configured to the customer's own systems;
- (e) on many occasions, Digital Safe was used by customers independently of Autonomy's hosting arrangements; and
- (f) accordingly, the licences had independent value to the customer.

E-Discovery hosted transactions

8.185 The key determinant here is the premise that these were again hosted transactions.

8.186 The Claimants assert that no reliable fair value could be measured and attributed to a hosted licence.

8.187 The Defendants assert that the fair value of services could be distinguished from the value of the licence.

Accounting treatment: revenue recognition

8.188 Autonomy accounted for revenue arising from the hybrid arrangements in two separate parts:

- (a) recognising revenue from the sale of the licence component upfront; and

- (b) recognising revenue from data hosting (and other services) rateably over the period of provision.
- 8.189 Based on the position asserted by the Defendants (which appears to be consistent with the position as was generally understood to be the case by Deloitte at the time), it would appear to me that Autonomy, and Deloitte, concluded that the above adopted accounting treatment under the provisions of IAS18 was appropriate.
- 8.190 The Claimants, however, assert that the facts and circumstances are somewhat different to those as asserted by the Defendants and as were understood by Deloitte.
- 8.191 I understand from the witness evidence of Mr Welham, that Deloitte accepts that the Claimants' assertions would have been entirely relevant to the overall conclusion reached on revenue recognition of the Digital Safe licence sale.
- 8.192 I would concur with that position, and therefore do not explore the necessary accounting judgement further.
- 8.193 By contrast, as regards e-Discovery transactions, the Claimants accept that e-Discovery software was capable of operating independently on the hosted services, but assert that because the Claimants consider that the fair value of revenue arising from the sale of an e-Discovery licence could not be reliably measured, the licence component of the transaction could not be separately accounted for as a sale under the provisions of IAS 18.14.
- 8.194 The Defendants' assert the contrary, that a reliable fair value could be attributed to the separable e-Discovery licence.
- 8.195 On this basis, Autonomy considered it appropriate to recognise revenue from the sale of an e-Discovery licence upfront, with the remaining separable hosting services revenue recognised rateably over the period of provision. Again, Deloitte concurred with Autonomy's treatment.
- 8.196 Mr Holgate's conclusion was that, based on his instructed assumptions, recognising revenue upfront in respect of sales of licences in hosted e-Discovery transactions was non-compliant with IFRS in part because IAS 18.14(c) - the requirement that the amount of revenue can be reliably measured - was not met.
- 8.197 I reiterate here that Mr Holgate bases this conclusion on the following assumptions he has been instructed apply to e-Discovery transactions:

- (a) *“Autonomy management did not have an established fair value for each of the individual components of hosted e-Discovery deals”⁶⁸⁵;*
- (b) *“There was only a small number of hosted e-Discovery deals including an upfront licence fee and they differed materially in terms of authorised users, capacity/limitations, structure of pricing, contract terms and the prices charged”⁶⁸⁶;*
- (c) *“Autonomy did not apply standard prices for e-Discovery software licences sold for use independently of an Autonomy hosting arrangement”⁶⁸⁷;*
- (d) *“There was no standard or quoted price list for the different services provided in hosted e-Discovery deals involving the purchase of a licence. There was a price list for these services when provided as part of a SaaS deal, but this did not take into account the price paid for a licence. Similarly, the price lists attached to the hosting contracts were for services to be provided beyond the licence term and/or capacity, and therefore did not take into account the price paid for a licence. In any event, price was often heavily negotiated such that there was no “typical charge” for the individual components of a hosted e-Discovery deal”⁶⁸⁸;*
- (e) *“There was no disaggregated management information relating to the cost of providing the individual components of hosted e-Discovery deals. In particular, Autonomy did not record costs by business area (e.g. for e-Discovery or components thereof) nor did it prepare management accounts containing a profit and loss/ contribution statement by business area”⁶⁸⁹; and*
- (f) *“The infrastructure and costs involved in delivering a hosted e-Discovery service are different to a hosted Digital Safe service. The two types of deal are not comparable in terms of cost or fair value”⁶⁹⁰.*

8.198 Mr Holgate then goes on to state that these assumptions indicate that there was:

- (a) *“a high degree of variability in the prices charged for the e-Discovery software and related services in a hosting arrangement”;* and
- (b) *“a lack of sufficiently disaggregated and relevant management information relating to costs”⁶⁹¹.*

⁶⁸⁵ Mr Holgate’s First Report, paragraph 7.25.7.

⁶⁸⁶ Mr Holgate’s First Report, paragraph 7.25.8.

⁶⁸⁷ Mr Holgate’s First Report, paragraph 7.25.9.

⁶⁸⁸ Mr Holgate’s First Report, paragraph 7.25.10.

⁶⁸⁹ Mr Holgate’s First Report, paragraph 7.25.11.

⁶⁹⁰ Mr Holgate’s First Report, paragraph 7.25.12.

⁶⁹¹ Mr Holgate’s First Report, paragraph 7.37.

8.199 Following this, Mr Holgate concludes:

“This means that it would not have been possible to reliably measure the revenue attributable to the software licence, either using the residual method (i.e. where fair value is capable of being established in respect of all other components of the transaction and therefore a fair value is attributed to, in this case, the licence, by reference to the residual amount of the revenue for the transaction) or otherwise.”⁶⁹²

8.200 However, IAS 18 does not provide any specific guidance on estimating the fair value of the components of a transaction.

8.201 Therefore, in my opinion, this issue is capable of being considered by reference to other standards in IFRS under the hierarchy in IAS 8:

“[i]n the absence of an IFRS that specifically applies to a transaction...management shall refer to, and consider the applicability of, the following sources in descending order:

the requirements in IFRSs dealing with similar and related issues; and

the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.”⁶⁹³

8.202 I note that this is not an issue specific to IAS 18.

8.203 For example, it is commonly seen in estimating fair value in the context of investments. In IAS 39⁶⁹⁴, particularly in relation to estimating the fair value of investments in equity instruments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument.

8.204 Application guidance in relation to this particular topic is as follows:

“The fair value...is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that instrument or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

There are many situations in which the variability in the range of reasonable fair value estimates of investments in equity instruments that do not have a quoted market price and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument...is likely not to be significant. However, if the range of reasonable fair

⁶⁹² Mr Holgate’s First Report, paragraph 7.37.

⁶⁹³ Exhibit N to my First Report - IAS 8.10 to IAS 8.11.

⁶⁹⁴ I should note for completeness that IAS39 is being replaced by IFRS 9 - but this makes no difference to the point I make about fair values. That is because fair value considerations in IAS39 have been rolled forward into IFRS 9.

value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the instrument at fair value.”⁶⁹⁵

- 8.205 This guidance makes it clear that where there might be a range of potential fair values, unless that range of fair values is significant, or the probabilities of the various estimates within the range cannot be reasonably assessed, then the investment is required to be measured at its fair value. Only in the alternative is a measurement at fair value precluded, i.e. a significant range within which it is not possible to reasonably assess the probabilities of the various estimates of the fair value, is a fair value not capable of being assessed. In practice (at least for entities that reported in the UK), this requirement was and has been interpreted narrowly, in that it was therefore very rare for such an unlisted equity investment not to be measured at a calculated fair value.
- 8.206 Applying this guidance to the process of estimating the fair value of components of an e-Discovery transaction involving the sale of a licence and e-Discovery services suggests that provided Autonomy could reasonably estimate the level of services required on a typical e-Discovery contract, and could also measure the costs of providing such services reliably (on a cost plus basis), then Autonomy was reasonably able to estimate the revenue attributable to the services provided under an e-Discovery contract.
- 8.207 Therefore, Autonomy could reliably measure the revenue attributable to the licence element of the transaction using the residual method.
- 8.208 Mr Holgate states that the assumptions he has been instructed apply to e-Discovery transactions indicate that there was a high degree of variability in the prices charged for the e-Discovery software and related service and a lack of disaggregated management information relating to the cost of providing the individual components of hosted e-Discovery deals.
- 8.209 However, I find it difficult to believe that the range of possible costs for these services was so wide that a reasonable estimate of the cost, and therefore the value (on a cost plus margin basis), could not be determined or that Autonomy had no idea of the costs associated with the various parts of its business.
- 8.210 In my experience, in practice, companies such as Autonomy will find a reasonable basis for estimating the costs of such services if required, such that the estimate is sufficiently reliable and is not likely to result in a material error. Paragraph 8.206 sets out that, a company may do so as follows:

⁶⁹⁵ Exhibit NNN - IAS39.AG80 to IAS39.AG81.

- (a) estimating the level of services required on a typical e-Discovery contract by reference to its previous experience of such contracts, adjusted for any obvious difference in the arrangement being assessed. This estimate will necessarily be an average, any actual variation in which would be expected to smooth out over time;
- (b) applying its knowledge of staff costs and overheads for that area of the business responsible for providing e-Discovery services (by reference to the costs actually measured in the income statement); and
- (c) monitoring these estimates over time in comparison to the actual costs incurred on e-Discovery projects to assess whether the estimates are in fact reasonable.

8.211 In contrast to this view, it appears to me that Mr Holgate is of the opinion that assessing the fair value of the e-Discovery services is an exact science.

8.212 In my experience the assessment of fair value does not require precision and IFRS confirms this. IFRS accepts it is possible in some circumstances to place reliance upon an estimate for fair value without that reliance resulting in a material error.

8.213 I do not think Mr Holgate's approach has any support in the standards or the literature and accordingly, I do not believe that the degree of accuracy that Mr Holgate appears to suggest is required needs to be, or should be, applied to an estimate of the fair value of such applicable services.

8.214 In my opinion, therefore, in respect of being able to account for the fair value of a separable e-Discovery licence, I would strongly agree that both Autonomy and Deloitte were justified in reaching that conclusion.

8.215 I would also reiterate the comments I made in my First Report in that the application of certain accounting standards, and in particular the use of 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.

8.216 I would also further emphasise, however, that in my opinion, while it will be a question of fact to be determined, on the basis that Autonomy customers themselves ascribed a value to the licence rights, then prima face, from an accounting perspective, for example the Digital Safe licence was separable from the underlying archiving of customer data.

9 “OTHER” TRANSACTIONS

Introduction

- 9.1 In my First Report I set out that 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;
 - (b) PRISA Digital S.L. (“PRISA”) in Q4 2010;
 - (c) Amgen Inc. (“Amgen”) in Q4 2010; and
 - (d) Iron Mountain Information Management Inc. (“Iron Mountain”) in Q2 2011.
- 9.2 As set out in my First Report, with the exception of the transaction with Iron Mountain, I consider that the main area of disagreement between the parties is essentially the same in respect of the “*other*” transactions. This is because the Claimants consider that the economic substance of the transactions with Spurs, PRISA and Amgen was that of the provision of a “*solution*”, to which the provision of services was integral, and that either no revenue, or revenue only to the extent that costs were recoverable, should have been recognised, on the basis that no working solution had been provided to the customer by the end of the reporting period.⁶⁹⁶
- 9.3 This also appears to be the basis on which Mr Holgate forms his conclusions in respect of the transactions with Spurs, PRISA and Amgen.
- 9.4 The disagreement between the parties regarding the Iron Mountain transaction is in respect of a fair value adjustment made to revenue on a sale to Iron Mountain on the same day as Autonomy acquired the Iron Mountain Digital Business. The parties disagree on whether such a fair value adjustment was appropriate.
- 9.5 In order to form an opinion on the appropriate accounting treatment for each of the “*other*” transactions, it is necessary to consider the underlying facts applicable to each transaction, including the contractual terms. As set out in the Joint Statement, both I and Mr Holgate agree that the facts relating to each transaction must be considered on an individual basis as they are highly relevant to its accounting treatment.⁶⁹⁷
- 9.6 As a result, I consider each of the “*other*” transactions to be standalone transactions and therefore I do not make any overarching comments about them in this section. Rather, I

⁶⁹⁶ Re-Re-Amended Particulars of Claim, paragraphs 115.2 to 115.2.2.

⁶⁹⁷ Joint Statement, page 12, “*Agreed view*” on “*Agenda Item*” 3(a) and (b).

consider individually the four “other” transactions impugned in this matter in Appendix 7.1 to 7.4 to this report.

10 VOLUNTARY PARTICULARS

Introduction

- 10.1 Voluntary particulars were served by the Claimants on 26 September, 2 October, 10 October, 16 October, 24 October and 7 November 2018, corresponding to Schedule 4 and Schedule 6 to the Re-Re-Amended Particulars of Claim (collectively the “**Voluntary Particulars**”, individually “voluntary particulars” or a “set of voluntary particulars”).⁶⁹⁸ Schedule 4 and Schedule 6 to the Re-Re-Amended Particulars of Claim set out the Claimants’ pleaded adjustments to Autonomy’s reported revenue and profits⁶⁹⁹ due to the impugned transactions on a quarterly basis⁷⁰⁰, whereas the Voluntary Particulars set out the Claimants’ accounting treatment that it is claimed Autonomy should have applied to each individual impugned transaction and the Claimants’ proposed adjustments to Autonomy’s accounting records in respect of each such impugned transaction.
- 10.2 As part of my review of each impugned transaction, I have also undertaken a review of the relevant transaction voluntary particulars.
- 10.3 It appears to me, however, that because many of the same issues arise, it is more appropriate to address issues generally rather than across each impugned transaction. Therefore, my comments in this section proceed principally on that basis.⁷⁰¹
- 10.4 In this section I consequently set out, in respect of the Voluntary Particulars as a whole and/or individual transaction voluntary particulars:
- (a) an overview of the Voluntary Particulars served by the Claimants (paragraphs 10.5 to 10.11);
 - (b) details of my review of each individual transaction set of voluntary particulars (paragraphs 10.12 to 10.14);
 - (c) details of the assumptions I make during my review of the individual transaction voluntary particulars (paragraphs 10.15 to 10.22);

⁶⁹⁸ Statement of truth on Voluntary Particulars to Schedule 4 and 6. The revenue and profit adjustments listed in Schedule 4 to the Re-Re-Amended Particulars of Claim agree to the Claimants’ proposed adjustments to revenue and profit contained in the Voluntary Particulars. An additional set of Voluntary Particulars has been provided in replacement for Transaction 15: Realise (end-user Credit Suisse). Schedule 4 to the Re-Re-Amended Particulars of Claim agrees to the replacement set of Voluntary Particulars for Transaction 15: Realise (end-user Credit Suisse) served on 24 October 2018.

⁶⁹⁹ Profit from operations which is prior to adjustments for interest and tax.

⁷⁰⁰ Re-Re-Amended Particulars of Claim, page 41, paragraph 57C and page 116, paragraphs 113 to 114.

⁷⁰¹ Where I may not have commented on a particular category of voluntary particulars, or a particular individual transaction, in this section, my comments are included elsewhere in this report.

- (d) the findings from my review of the voluntary particulars for the reseller transactions (paragraphs 10.23 to 10.89);
- (e) the findings from my review of the voluntary particulars for the alleged reciprocal transactions (paragraphs 10.90 to 10.114);
- (f) the findings from my review of the voluntary particulars in relation to hardware (paragraphs 10.115 to 10.118);
- (g) the findings from my review of the voluntary particulars in relation to hosting (paragraphs 10.119 to 10.126);
- (h) The findings from my review of the voluntary particulars for the “other” transactions (paragraphs 10.127 to 10.128);
- (i) An overview of Mr Holgate’s conclusions regarding the Voluntary Particulars (paragraphs 10.129 to 10.150); and
- (j) My conclusions (paragraph 10.151 to 10.154).

Overview of the Voluntary Particulars

- 10.5 As noted above, the Voluntary Particulars actually refer to 54 separate sets of voluntary particulars, each related to individual impugned transactions or categories of impugned transactions.
- 10.6 Each individual set of voluntary particulars then consists of;
- (a) a spreadsheet, titled “Further Particulars”, which sets out the calculations for the Claimants’ proposed adjustments to Autonomy’s accounting records and provides the Claimants’ narrative in support of its proposed adjustments;⁷⁰² and
 - (b) documents served in support of the respective “Further Particulars”⁷⁰³.
- 10.7 In this report, I refer mostly to the respective spreadsheets when providing transaction specific comment and as a result specify when I am otherwise referring to the supporting documentation.
- 10.8 The Claimants set out the calculations in each voluntary particulars’ spreadsheet across three columns for each relevant quarter between Q1 2009 and Q2 2011, as set out below;

⁷⁰² The “Further Particulars” generally have two worksheets within each workbook (which for ease I refer to as a spreadsheet); the first worksheet containing the calculations for the Claimants’ proposed adjustments to Autonomy’s accounting records and the second worksheet which details the general notes applicable to the calculations in the voluntary particulars, referred to in the first worksheet.

⁷⁰³ This includes invoices, purchase orders and ledger extracts, amongst other documentation, for the impugned transactions.

- Column A: Titled 'Booked': these represent Autonomy's accounting treatment (as presented by the Claimants), with reference to the documents served in support of the individual transaction voluntary particulars, set out against general ledger codes for both income statement and balance sheet items.
- Column B: Titled 'Should have been': these represent the Claimants' accounting treatment, on the basis that the allegations made by the Claimants (disputed by the Defendants) are determined to be founded.
- Column C: Titled 'Adjustment required': these represent the adjustments to Autonomy's accounting records, proposed by the Claimants, calculated by deducting the figures recorded as "Should have been" from the "Booked" figures (i.e. Column B less Column A).
- 10.9 The Claimants also provide in support of their proposed adjustments a narrative, for each quarter affected by their changes in accounting treatment, titled "Explanation of adjustments".
- 10.10 An extract of the voluntary particulars for Transaction 2: Capax Discovery (end-user TXU) in Q2 2009 is shown in Figure 1 below by way of example of how the voluntary particulars for this impugned transaction are presented by the Claimants generally, and across all the Voluntary Particulars.

Details of my review of the Voluntary Particulars

- 10.12 As stated above, for the purposes of this report, I have reviewed the accounting treatment applied in the Voluntary Particulars for the impugned transactions⁷⁰⁵ as referred to in the Re-Re-Amended Particulars of Claim and Schedules 3, 5 and 7 to the Re-Re-Amended Particulars of Claim. In doing so, I have considered whether the Claimants' accounting treatment is:
- (a) in accordance with IFRS and the conceptual framework based on the "Explanation of adjustments" as provided in the individual transaction details / voluntary particulars and the accounting standards referred to in the Re-Re-Amended Particulars of Claim and in Schedules 3, 5 and 7 to the Re-Re-Amended Particulars of Claim; and
 - (b) in accordance with the individual impugned transaction details provided in the Re-Re-Amended Particulars of Claim and in Schedules 3, 5 and 7 to the Re-Re-Amended Particulars of Claim.
- 10.13 From this review, I have further considered Mr Holgate's opinions, provided in his First Report, which relate to the Claimants' proposed accounting adjustments in relation to each of the impugned transactions.
- 10.14 I note, here, that the Claimants have not provided any details of the whole population of reseller transactions entered into by Autonomy in any given quarter, either by value or number, and therefore the Voluntary Particulars in relation to the impugned reseller transactions should only be considered to be a partial subset of Autonomy's transactions in any given quarter.

Details of my assumptions that apply to my review of the Voluntary Particulars

- 10.15 Before I discuss the results of my review, I set out the assumptions I make during my review of the Voluntary Particulars. In some cases the assumptions are themselves the product of accounting treatment issues that I identified in the Voluntary Particulars.
- 10.16 The Voluntary Particulars do not show the complete accounting entries posted by Autonomy in relation to each transaction and explain in the general notes to the voluntary particulars that "*The adjustment summaries do not show the full double entry for each transaction, instead showing the entries affected by the adjustments.*"⁷⁰⁶

⁷⁰⁵ 54 sets of voluntary particulars have been provided in total in relation to the impugned transactions.

⁷⁰⁶ An example may be seen in the Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - TXU 2009", tab "General notes", note GN2. The term "*adjustment summaries*" is not defined in the voluntary particulars. The adjustment summaries are assumed to be the calculations for the Claimants' proposed adjustments to Autonomy's accounting records as set out in the voluntary particulars.

- 10.17 Transactions are recorded in an entity's accounts on the basis of "double-entry accounting".⁷⁰⁷ However, the voluntary particulars generally do not reflect the increases in Autonomy's financial assets arising from the recording of revenue from its sales (or from the recording of deferred revenue relating to the future recognition of a sale), which are typically recorded as either accounts receivable or cash, as the voluntary particulars do not show this double-entry accounting.⁷⁰⁸
- 10.18 Moreover, the voluntary particulars do not, for all the transactions, comment on the accounting treatment that would apply outside of the Relevant Period. For example, in the voluntary particulars for Transaction 34: Capax Discovery (end-user UBS), the Claimants' accounting entries reverse the recognition of US\$7.664 million of revenue in respect of licences, and transfers the amount from Autonomy's consolidated income statement to deferred revenue in respect of licences on Autonomy's consolidated balance sheet in Q2 2011.⁷⁰⁹ The voluntary particulars in relation to this transaction do not then provide details of the subsequent accounting treatment required to remove the deferred revenue amount of US\$7.664 million from Autonomy's consolidated balance sheet in a later quarter.
- 10.19 Mr Holgate, the Claimants' accounting expert, states that "*If a transaction has no substance then it should have no accounting effect*".⁷¹⁰ Overall the use of deferred revenue by the Claimants in the voluntary particulars is in nearly every case in direct contradiction to the opinion of the Claimants' accounting expert on each impugned reseller transaction. I explain this inconsistency between the Claimants' Voluntary Particulars and the Claimants' accounting experts' position in greater detail below.
- 10.20 As a result of the accounting treatment issues noted above, i.e. due to the approach taken in the Voluntary Particulars, during my review I made a number of assumptions:
- (a) under Autonomy's accounting treatment, in cases where I have not seen Autonomy's related underlying accounting entries, the accounting entry that would apply under double-entry accounting is that which appears to be the most likely, based on details concerning the individual transaction provided in the Re-

⁷⁰⁷ In my experience, a transaction undertaken by an entity would have an equal effect on at least two of the entity's accounts. For example, for the sale of goods, revenue may be recognised in the selling entity's accounts (if the conditions of IAS 18.14 is met), with an equal accounting entry to recognise the financial asset received by the selling entity in exchange for the goods sold. The accounting entry may be in either accounts receivable (for amounts owed by the customer) or cash (for amounts received from the customer).

⁷⁰⁸ The voluntary particulars show Autonomy recognised income (such as revenue for licences), therefore, I would expect there to be, under Autonomy's accounting treatment, a corresponding accounting entry within either the accounts receivable or cash accounts as appropriate.

⁷⁰⁹ Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - UBS 2 2011".

⁷¹⁰ Mr Holgate's First Report, page 72, paragraph 7.6. The same point is made in different language at paragraph 6.7(a), where Mr Holgate states that "*One accounting approach is simply to say that there is no substance, therefore there is no accounting recognition.*"

Re-Amended Particulars of Claim and in the Schedules to the Re-Re-Amended Particulars of Claim;⁷¹¹

- (b) in cases in which the Claimants have not proposed an adjustment in the voluntary particulars for a transaction detailed in the Re-Re-Amended Particulars of Claim and in the Schedules to the Re-Re-Amended Particulars of Claim,⁷¹² the Claimants agree with Autonomy's accounting entry;⁷¹³ and,
- (c) under the Claimants' accounting treatment, the Claimants would apply the accounting treatment they have applied in the voluntary particulars during the Relevant Period to Autonomy's accounting records after Q2 2011.⁷¹⁴

10.21 The construction of the Voluntary Particulars in general as detailed above, in my view, causes difficulty in both providing an opinion concerning whether Autonomy's accounting treatment (as presented by the Claimants) in each set of voluntary particulars is fairly represented, and secondly in deciphering and understanding the adjustments proposed by the Claimants in each set of individual transaction voluntary particulars.

10.22 In the following section I set out my findings from my review of the Voluntary Particulars relating to the impugned reseller transactions.

My review of the Voluntary Particulars of the impugned reseller transactions

10.23 The Claimants have provided 38 sets of voluntary particulars in relation to 37 reseller transactions detailed on Schedule 3 to the Re-Re-Amended Particulars of Claim.⁷¹⁵

10.24 The individual transaction voluntary particulars set out Autonomy's accounting (as presented by the Claimants) for the impugned reseller transactions as being the

⁷¹¹ For example, in relation to entries against accounts receivable and cash, which are generally not shown in the voluntary particulars. In the Schedules to the Re-Re-Amended Particulars of Claim, the Claimants provided assertions concerning the amounts and period in which Autonomy was paid by the resellers. It is possible however that there are also further accounting entries, posted by Autonomy, that may affect my understanding of Autonomy's accounting treatment, not presented by the Claimants in the voluntary particulars. I have not been provided with access to Autonomy's accounting system.

⁷¹² For example, the Re-Re-Amended Particulars of Claim, Schedule 3, page 19, for Transaction 10: Capax Discovery (end-user FSA) asserts that on 25 August 2010, Autonomy entered a direct agreement with the FSA for hosting and archiving services amounting to US\$6.676 million. Autonomy's accounting treatment of this transaction is not explained either in Schedule 3 to the Re-Re-Amended Particulars of Claim or the Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - FSA 2010".

⁷¹³ This is based on the general notes in the voluntary particulars that "*The adjustment summaries do not show the full double entry for each transaction, instead showing the entries affected by the adjustments.*" An example may be seen in the Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - TXU 2009", tab "General notes", note GN2.

⁷¹⁴ In some instances there is insufficient detail to comment on the accounting treatment applied by the Claimants outside the Relevant Period.

⁷¹⁵ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**. The total of 38 includes the additional set of voluntary particulars which has been provided in replacement for Transaction 15: Realise (end-user Credit Suisse).

recognition of revenue on sale to the reseller.⁷¹⁶ Under Autonomy's accounting there would also be an accounting entry in either 'accounts receivable' or 'cash'.⁷¹⁷

- 10.25 The Claimants allege that the identified sales to resellers could not be recognised as revenue as the sales did not meet all the revenue recognition sub-conditions⁷¹⁸ set out in:
- (a) IAS 18.14 for sale of goods (all impugned transactions other than Transaction 29: Computer Trading (end-user Poste Italiane)); or
 - (b) IAS 18.20 for rendering of services for Transaction 29.⁷¹⁹
- 10.26 The Claimants' alleged restated accounting treatment in the individual transaction voluntary particulars reverses the revenue recognised by Autonomy in Autonomy's consolidated income statement on the sale to the reseller and instead carries forward the amount as deferred revenue on Autonomy's consolidated balance sheet for each of the individually impugned reseller transactions.⁷²⁰ In nearly two-thirds (24 of the 37) of these impugned reseller transactions, the individual transaction voluntary particulars include a balance for transaction revenue in deferred revenue at the end of the Relevant Period under the Claimants' proposed accounting treatment (which under Autonomy's accounting treatment - as presented by the Claimants - was recognised as revenue on sale to the reseller).⁷²¹
- 10.27 The Claimants also make further adjustments in the individual transaction voluntary particulars based on events (some circumstances of which are also separately disputed as between the Parties) that arose following the original transaction (often in subsequent reporting periods).
- 10.28 As a result, and in light of the above, and other factors, I discuss the Claimants' proposed adjustments considering whether they are in accordance with IFRS and the Framework or Conceptual Framework and are in accordance with the transaction details provided in the Re-Re-Amended Particulars of Claim, as I set out in paragraph 10.12, in relation to the following:⁷²²
- (a) sales to resellers and credit notes (discussed at paragraphs 10.30 to 10.49);

⁷¹⁶ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**, My Comment 1.

⁷¹⁷ This is generally not reflected in the voluntary particulars, as discussed at paragraph 10.17.

⁷¹⁸ See My First Report, Exhibit F, paragraph 14, for the revenue recognition conditions for sales of goods and paragraph 20 for the revenue recognition conditions for rendering of services.

⁷¹⁹ Re-Re-Amended Particulars of Claim, Schedule 3. See under False Accounting for Transactions 1 to 37.

⁷²⁰ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**, My Comment 1.

⁷²¹ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**, My Comment 4.

⁷²² I have not discussed all of the Claimants' proposed adjustments detailed in the voluntary particulars.

- (b) bad debts (discussed at paragraphs 10.50 to 10.59);
- (c) sales made to end-users (discussed at paragraphs 10.60 to 10.72); and
- (d) payments made to the reseller for the purchase of rights, goods and services, and included in this I have addressed the acquisition of Microlink (discussed at paragraphs 10.73 to 10.89).

10.29 I discuss each in turn below.

Accounting treatment for sales to resellers: subsequent credit notes

10.30 The individual transaction voluntary particulars set out Autonomy's accounting (as presented by the Claimants) as being the recognition of revenue on sale to the reseller for each of the impugned reseller transactions. Schedule 3 to the Re-Re-Amended Particulars of Claim notes that there are instances in which Autonomy subsequently issued a credit note to cancel the sales invoice to the reseller.

10.31 In my experience, the accounting effect of issuing a subsequent period credit note on an entity's financial statements would be that the amount of invoiced revenue, or an amount less than the invoiced revenue amount, is removed based on the amounts recorded on the credit note, removing revenue from the income statement⁷²³ and also removing (practically) any associated accounts receivable balance as the customer would no longer be under an obligation to pay the amounts owing to the entity once the credit note is issued. In practice a credit note could be issued at any time including in an accounting period subsequent to the initial recognition of the revenue from the original sale transaction. If subsequent facts arose supporting the raising of a credit note, it follows that the accounting adjustment for the credit note would be included in the subsequent accounting period (i.e. the amount pertaining to the original sale is removed, but at the time of the credit note being issued because, for example, in my experience future credit notes would not be back dated as it would cause issues with accounting periods).

10.32 By comparison, the Claimants' proposed entries in the individual transaction voluntary particulars, under the Claimants' accounting treatment, adjusts for Autonomy's recognition of these future credit notes by reversing the revenue originally recognised by Autonomy on the sale to the reseller (i.e. using a backdating approach), before then carrying forward an equal amount as deferred revenue on Autonomy's consolidated

⁷²³ There are exceptions, for example, as can be seen in relation to Transaction 24: DiscoverTech (end-user Bank of America) in which a discount for early payment to DiscoverTech was recorded as a cost on Autonomy's consolidated income statement, under "collection fees", as oppose to a removal of revenue, but in any event a credit memo was raised against DiscoverTech's account to remove the balance associated with the early payment discount. Voluntary Particulars, documents "BoA 1 2010-06" and "BoA 1 2010-07".

balance sheet (as described at paragraph 10.26). Then in a subsequent quarter, only when the credit note was in fact raised, do the Claimants reverse the credit note entry, and instead recognise the credit note against the deferred revenue which they propose should have been recognised.⁷²⁴

10.33 Consequently, the Claimants remove their own deferred revenue amounts carried forward, and I assume accounts receivable,⁷²⁵ in the amounts and in the period the credit note was originally issued by Autonomy.⁷²⁶

10.34 However, the Claimants further allege that, concerning the reseller transactions, *“From at least Q2 2009 Lynch and Hussain caused Autonomy group companies to engage in the practice of entering into transactions with VARs that lacked economic substance and were not genuinely in the furtherance of Autonomy’s business, but were, rather, for the improper purpose of providing a pretext for the inappropriate or premature recognition of revenue.”*⁷²⁷ [emphasis added] Prima facie if a transaction lacked economic substance, as alleged, then no accounting entries would be appropriate in any event, again raising issues with the voluntary particulars.

10.35 In accounting standards, there is no specific guidance within IFRS on accounting for deferred revenue. Deferred revenue would be recognised if a seller had received payment in advance (which is a question of fact), or an unconditional contractual right to receive payment existed (for example pre-invoicing against an unconditional agreement for post period subsequent payment), in respect of the sale of a good that did not yet meet the conditions in IAS 18.14. In other words, in the context of this second example, this equates to the recognition of a valid accounts receivable balance associated with the sale.⁷²⁸

⁷²⁴ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**, My Comment 5. There is also an instance in which a consolidation level adjustment was posted by Autonomy in Q2 2010 to reverse the licence revenue previously recognised which had a credit note issued to cancel the sale in Q3 2010. Transaction 12: DiscoverTech (end-user PMI). The Claimants treat this adjustment in the same way as the credit note by reversing the consolidation adjustment and releasing the deferred revenue. Voluntary Particulars, spreadsheet “00_Further particulars - DiscoverTech - PMI 2010”.

⁷²⁵ The voluntary particulars, as I discussed in paragraph 10.17, do not generally set out adjustments to accounts receivable therefore this has to be assumed.

⁷²⁶ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**, My Comment 5.

⁷²⁷ Re-Re-Amended Particulars of Claim, page 62, paragraph 73.

⁷²⁸ Further explanation concerning accounting guidance for deferred revenue may be seen at **Appendix 8**.

- 10.36 By contrast if a transaction lacked economic substance it should not be recorded in the financial statements at all.⁷²⁹ This is consistent with Mr Holgate's opinion, as he states that "*If a transaction has no substance then it should have no accounting effect*".⁷³⁰
- 10.37 However in this case the Claimants have removed revenue from Autonomy's consolidated income statement, and simply included it as a deferred balance in Autonomy's consolidated balance sheet as deferred revenue to be released to Autonomy's consolidated income statement as revenue at a later date, presumably when the Claimants assert under subsequent circumstances that each of the conditions of IAS 18.14 have subsequently been met.
- 10.38 Autonomy's original accounting was to recognise a sale (a credit to Autonomy's consolidated income statement) with the other side of the accounting double entry being the recognition of a debtor balance (i.e. a debit, and therefore an asset) in Autonomy's consolidated balance sheet. Again the Claimants appear to make no adjustment to Autonomy's consolidated balance sheet asset that was recorded as the other side of the accounting double entry i.e. the debit, or debt, in respect of the sale.
- 10.39 From this it follows that the Claimants acknowledge that the transaction has economic substance. This contradicts the claim that the impugned reseller transactions lacked economic substance. This is the case for all 37 impugned reseller transactions in which the impugned reseller transaction is recognised under the Claimants' accounting treatment as deferred revenue on Autonomy's consolidated balance sheet.
- 10.40 In my view, if a transaction lacked economic substance as alleged by the Claimants,⁷³¹ under the Claimants' accounting treatment, there would be no accounting entries recognised in relation to the transaction, including there being no recognition of deferred revenue or accounts receivable. The accounting is further explained in detail at **Appendix 8**.

⁷²⁹ For fullness, there do exist a very small number of exceptions clearly set out in specific IFRS accounting standards which allow for the recognition of items in financial statements that otherwise would not meet the definition of an 'asset' within the meaning of IFRS and the Framework/ Conceptual Framework. In other words, by way of exception only, there are a small number of IFRS accounting standards that require (or permit) recognition of items not meeting the definition of an asset under the Framework and the replacement Conceptual Framework but these are exceptions only. For instance, goodwill on acquisition under International Accounting Standard 22 'Business Combinations' ("IAS 22") may be recognised as an asset within an entity's consolidated financial statements despite not meeting the definition of an asset as set out under the Framework. Similarly, International Financial Reporting Standard 6 ("IFRS 6") "*permits an entity to develop an accounting policy for exploration and evaluation assets without specifically considering the requirements of paragraphs 11 and 12 of IAS 8*", where in turn IAS 8 refers back to a requirement to consider the requirements of the Framework.

⁷³⁰ Mr Holgate's First Report, page 72, paragraph 7.6.

⁷³¹ Re-Re-Amended Particulars of Claim, page 62, paragraph 73.

10.41 The example below illustrates this inherent contradiction in the Claimants' (and Mr Holgate's which I deal with later on in this section) accounting opinion and/or treatments.

Example 1: Transaction 7: MicroTech (end-user Manufacturers Life)

10.42 Autonomy received a purchase order from MicroTech as reseller in relation to end-user Manufacturers Life in Q4 2009 for US\$1.08 million in respect of software licences plus US\$104,000⁷³² for support and maintenance.⁷³³

10.43 On 31 March 2010 (Q1 2010), Autonomy issued a credit note to MicroTech against the Q4 2009 purchase order, adjusting for a revenue amount associated with the licences and support and maintenance.⁷³⁴

10.44 I discuss the individual transaction voluntary particulars in relation to the purchase order for Q4 2009 and Q1 2010, which is presented in Figure 2 below. In my discussion:

- (a) Column A refers to the voluntary particulars columns titled "Booked" and shows Autonomy's accounting entries (as presented by the Claimants);
- (b) Column B refers to the columns titled "Should have been" and shows the Claimants' accounting entries; and
- (c) Column C refers to the columns titled "Adjustment required" and shows the Claimants' difference between Column B and Column A, as described at paragraph 10.8.

⁷³² Calculated as 5% of licence fees of US\$1,080,000 plus US\$50,000.

⁷³³ Voluntary Particulars, document "MT-MNL 2009-02".

⁷³⁴ Voluntary Particulars, document "MT-MNL 2009-05".

Figure 2 - Voluntary particulars extract for Transaction 7: MicroTech (end-user Manufacturers Life) in Q4 2009 and Q1 2010. ⁷³⁵

		Q4 2009						Q1 2010					
General ledger code GN1	Description GN2	Booked (A)		Should have been (B)		Adjustment required (C = B - A)		Booked (A)		Should have been (B)		Adjustment required (C = B - A)	
		DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)
		\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Income statement													
400000	Revenue - licence		(1,080,000)			1,080,000		1,080,000					(1,080,000)
545000	Finder / GSA fees									220,308		220,308	
Balance sheet													
202000	Accrued payables										(220,308)		(220,308)
231000	Deferred revenue - licence			(1,080,000)		(1,080,000)							
232000	Deferred revenue - support		(104,000)		(104,000)								
392300	Retained earnings							(1,080,000)				1,080,000	

⁷³⁵ Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - Manufacturers Life 2009".

10.45 The individual transaction voluntary particulars entries for Q4 2009 are described below:⁷³⁶

- (a) Column A shows that Autonomy's accounting entries (as presented by the Claimants) in regard to the purchase order were to recognise revenue of US\$1.08 million in respect of the sale of software licences to MicroTech on Autonomy's consolidated income statement in Q4 2009. The advance US\$104,000 of support and maintenance in respect of the purchase order was accounted for in deferred revenue on Autonomy's consolidated balance sheet, by Autonomy.⁷³⁷
- (b) Column B shows the Claimants' position i.e. that Autonomy should not have accounted for the balance of revenue of US\$1.08 million in respect of licences under the Q4 2009 purchase order. Therefore, the Claimants remove Autonomy's recorded revenue under Column A and adjust the amounts to be recognised in deferred revenue in Q4 2009. This results in the amounts of US\$1.08 million in respect of the sale of software licences and US\$104,000 in respect of support and maintenance both being accounted for as deferred revenue on Autonomy's consolidated balance sheet.
- (c) Column C shows the difference between Column B and Column A.

10.46 The voluntary particulars entries for Q1 2010 are described below:⁷³⁸

- (a) Column A shows that Autonomy removed an amount of revenue equal to the value of the software licences in the amount of US\$1.08 million in Autonomy's consolidated income statement and by its absence removed US\$104,000 from deferred revenue for the associated transaction support and maintenance from Autonomy's consolidated balance sheet in Q1 2010, i.e. the quarter the credit note was issued to MicroTech.
- (b) Column B shows the Claimants' position that the amounts of US\$1.08 million in respect of the software licences and US\$104,000 in respect of support and maintenance should have been omitted from Autonomy's consolidated balance sheet by the absence of these balances in Column B, consistent with Autonomy's booked position recorded in Column A (Q1 2010). This is illustrated by the red graphics in Figure 2, which shows that according to the Claimants deferred revenue should be carried forward from Q4 2009 to Q1 2010 and then the Claimants own adjustment is implicitly subsequently reversed, leaving no amount for either

⁷³⁶ Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - Manufacturers Life 2009".

⁷³⁷ Support and maintenance was pro-rated over the term of the service provided.

⁷³⁸ Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - Manufacturers Life 2009".

licence deferred revenue or support and maintenance deferred revenue on Autonomy's consolidated balance sheet.

- (c) Column C shows the difference between Column B and Column A. The Claimants reverse Autonomy's accounting for the credit note issued to MicroTech in Q1 2010 by increasing revenue by US\$1.08 million.⁷³⁹

10.47 The individual transaction voluntary particulars do not show an asset balance in relation to this sale in Q4 2009, but implicitly there must be one (as a result of double-entry accounting). Therefore, one must assume Autonomy recorded an amount of US\$1.184 million⁷⁴⁰ in accounts receivable on Autonomy's consolidated balance sheet in Q4 2009, being the amount invoiced by Autonomy to MicroTech in relation to this transaction (as the Claimants assert no cash payments were received from MicroTech in relation to the amounts owed).⁷⁴¹

10.48 Therefore, what the above must also implicitly demonstrate, contrary to the Claimants' position asserted in the Re-Re-Amended Particulars of Claim,⁷⁴² is that the Claimants acknowledge that an accountable transaction occurred in the earlier period by virtue of there being a definitive deferred revenue balance according to the Claimants.

10.49 In my view, the Claimants' accounting treatment infers that the Q4 2009 transaction has economic substance because it results in the recognition of a balance sheet deferred revenue balance. If the transaction lacked economic substance, as alleged by the Claimants,⁷⁴³ no 'substantive' accounting entries would be recognised in relation to the transaction including there being no recognition and subsequent removal of deferred revenue (and initial recognition of a related asset, which I would expect to have been accounts receivable and which in this instance in Q4 2009 could only have been an amount recoverable from MicroTech).⁷⁴⁴

⁷³⁹ Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - Manufacturers Life 2009", under "Explanation of adjustments" in Q1 2010.

⁷⁴⁰ Licence fees of US\$1.08 million plus support and maintenance of US\$104,000.

⁷⁴¹ Re-Re-Amended Particulars of Claim, Schedule 3, page 16.

⁷⁴² Re-Re-Amended Particulars of Claim, page 62, paragraph 73.

⁷⁴³ Re-Re-Amended Particulars of Claim, page 62, paragraph 73.

⁷⁴⁴ The Claimants' accounting treatment, which recognises a liability (deferred revenue) and a financial asset (either accounts receivable or cash) on Autonomy's consolidated balance sheet is applied in relation to all 37 impugned reseller transactions. The Claimants' accounting treatment in relation to credit notes can be seen in six of the 16 impugned reseller transactions in which a credit note was raised during the Relevant Period. This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**, My Comments 1 and 5. Where I refer to no 'substantive' accounting entries, I consider in my approach only the net transaction balances and do not address any indirect issues relating to sales taxes or VAT, etc. accounted for that could then be reclaimed.

Accounting for bad debts in the voluntary Particulars

- 10.50 Schedule 3 to the Re-Re-Amended Particulars of Claim notes that there are instances in which Autonomy recorded bad debt provisions against some of the impugned reseller transactions. When recognising a bad debt, the effect on an entity's accounts would be a charge is recognised on the income statement for the bad debt expense, resulting in a reduction in profit before tax in that period. At the same time, a provision would reduce the associated accounts receivable amount on the balance sheet (sometimes, but not all the time down to nil), due to a reduction in the amount management prospectively expected to recover from the customer.
- 10.51 Sometimes such a provision is based on the age of the outstanding debt alone. An entity can also record a bad debt provision in instances where management subsequently became aware of information. That is, they were not aware of it or it had not arisen at the time the accounts receivable and corresponding revenue was recognised, which would then result in the amounts owed by the customer being subsequently adjudged to no longer be collectable, in full or in part. The recognition of a bad debt provision does not however, and would not by itself either, suggest that the original transaction to which it relates lacked economic substance.
- 10.52 The individual transaction voluntary particulars, under the Claimants' accounting treatment, adjust for Autonomy's subsequent recognition of a bad debt charge by reversing the bad debt expense, both removing the bad debt expense on Autonomy's consolidated income statement and the bad debt provision on Autonomy's consolidated balance sheet.⁷⁴⁵ This treatment is applied by the Claimants in five of the transactions.⁷⁴⁶
- 10.53 This results then in the anomalous situation where, under the Claimants' accounting treatment, an implied accounts receivable balance⁷⁴⁷ would then be left overstated. This being the case, it would result in an indication to users of the accounts that the recoverable amount of financial assets was higher than was, in fact, the case. Similarly, profit would be overstated on Autonomy's consolidated income statement as the accounting entry, being an expense in Autonomy's consolidated income statement, has been removed from the income statement. In my view, this is yet a further example of

⁷⁴⁵ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**, My Comment 2.

⁷⁴⁶ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**, My Comment 2. Transaction numbers 9, 14, 17, 19 and 22.

⁷⁴⁷ As I have already discussed in detail, accounts receivable is not reflected in the voluntary particulars, therefore the effect on the accounts receivable balance may not be seen in the voluntary particulars. However, deferred revenue is not released by the Claimants under this treatment, therefore, the corresponding amount in accounts receivable would generally remain in Autonomy's consolidated financial statements.

how the Claimants' proposed adjustments across the Voluntary Particulars are inconsistent with the pleaded case.

Example 2: Transaction 17: Comercializadora (end-user TV Azteca)

- 10.54 Autonomy entered into a reseller agreement with Comercializadora for end-user TV Azteca in Q3 2010 for US\$1.5 million in respect of licences plus US\$150,000 for support and maintenance.⁷⁴⁸
- 10.55 Autonomy subsequently recorded a bad debt provision of US\$549,945 in Q2 2011 in respect of this sale.⁷⁴⁹
- 10.56 I discuss the voluntary particulars in relation to the transaction for Q3 2010 to Q2 2011, which is presented in Figure 3 below. In my discussion:
- (a) Column A refers to the voluntary particulars columns titled "Booked" and shows Autonomy's accounting entries (as presented by the Claimants);
 - (b) Column B refers to the columns titled "Should have been" and shows the Claimants' accounting entries; and
 - (c) Column C refers to the columns titled "Adjustment required" and shows the Claimants' difference between Column B and Column A, as described at paragraph 10.8.

⁷⁴⁸ Voluntary Particulars, document "CC-TV 2010-02".

⁷⁴⁹ Voluntary Particulars, document "CC-TV 2010-07", tab "Data", cell V1111. This document is a spreadsheet which sets out the calculations for the bad debt provision. Voluntary Particulars, document "CC-TV 2010-10", tab "Current Quarter", rows 16 and 17 and tab "Bal Sheet", cell B18 shows the total bad debt provision for Q2 2011.

Figure 3 - Voluntary particulars extract for Transaction 17: Comercializadora (end-user TV Azteca) in Q3 2010 to Q2 2011.⁷⁵⁰

		Q3 2010						Q4 2010					
General ledger code GN1	Description GN2	Booked (A)		Should have been (B)		Adjustment required (C = B - A)		Booked (A)		Should have been (B)		Adjustment required (C = B - A)	
		DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)
		\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Income statement													
400000	Revenue - licence		(1,500,000)			1,500,000							
410000	Revenue - support		(411)			411		(37,808)				37,808	
676000	Bad debt												
Balance sheet													
122000	Bad debt (balance sheet)												
231000	Deferred revenue - licence				(1,500,000)	(1,500,000)				(1,500,000)		(1,500,000)	
232000	Deferred revenue - support		(149,589)		(150,000)	(411)		(111,781)		(150,000)		(38,219)	
392300	Retained earnings							(1,500,411)				1,500,411	

		Q1 2011						Q2 2011					
General ledger code GN1	Description GN2	Booked (A)		Should have been (B)		Adjustment required (C = B - A)		Booked (A)		Should have been (B)		Adjustment required (C = B - A)	
		DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)
		\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Income statement													
400000	Revenue - licence												
410000	Revenue - support		(36,986)			36,986		(37,397)				37,397	
676000	Bad debt							549,945				(549,945)	
Balance sheet													
122000	Bad debt (balance sheet)							(549,945)				549,945	
231000	Deferred revenue - licence				(1,500,000)	(1,500,000)				(1,500,000)		(1,500,000)	
232000	Deferred revenue - support		(74,795)		(150,000)	(75,205)		(37,398)		(150,000)		(112,602)	
392300	Retained earnings		(1,538,219)			1,538,219		(1,575,205)				1,575,205	

⁷⁵⁰ Voluntary Particulars, spreadsheet "00_Further particulars Comercializadora - TV Azteca SA de CV 2010".

10.57 The individual transaction voluntary particulars entries for Q3 2010 are described below:⁷⁵¹

- (a) Column A shows that Autonomy's accounting entries (as presented by the Claimants) in regard to the reseller agreement were to account for revenue of US\$1.5 million in respect of software licences and revenue of US\$411 in respect of support and maintenance⁷⁵² on Autonomy's consolidated income statement in Q3 2010. The remaining US\$149,589 relates to support and maintenance that was recognised in deferred revenue on Autonomy's consolidated balance sheet at the period end.
- (b) Column B shows the Claimants' position which is that Autonomy should not have recognised revenue of US\$1.5 million in respect of software licences or revenue of US\$411 in respect of support and maintenance in regard to the Q3 2010 reseller sale. Therefore, the Claimants remove the amounts recorded as revenue under Column A and transfer the amounts to deferred revenue (in Q3 2010). This results in the amounts of US\$1.5 million in respect of licences and US\$150,000 in respect of support and maintenance being accounted for as deferred revenue on Autonomy's consolidated balance sheet at the end of Q3 2010. This is illustrated by the red graphics in Figure 3.
- (c) Column C shows the difference between Column B and Column A.

10.58 The voluntary particulars entries for Q4 2010 to Q2 2011 are described below:⁷⁵³

- (a) Column A shows that Autonomy released further revenue in respect of support and maintenance to Autonomy's consolidated income statement from deferred revenue in Q4 2010 to Q2 2011. In Q4 2010, deferred revenue of US\$149,589 carried forward from Q3 2010 was reduced by US\$37,808, which was released to Autonomy's consolidated income statement, leaving US\$111,781 in deferred revenue for support and maintenance on Autonomy's consolidated balance sheet in Q4 2010. Autonomy then continued to release further support and maintenance revenue to Autonomy's consolidated income statement, reducing the deferred revenue balance, in Q1 2011 to Q2 2011.

⁷⁵¹ Voluntary Particulars, spreadsheet "00_Further particulars Comercializadora - TV Azteca SA de CV 2010".

⁷⁵² Support and maintenance was pro-rated over the term of the service provided. Autonomy's initial accounting entry recognised US\$150,000 of deferred revenue in respect of support and maintenance on 30 September 2010. See ledger extract in Voluntary Particulars, document "CC-TV 2010-04", page 19. Subsequently, Autonomy accounted for one day of support and maintenance revenue in Q3 2010 for the service provided on 30 September 2010. The remaining amounts in respect of support and maintenance from the Q3 2010 reseller agreement was released to Autonomy's consolidated income statement in quarterly instalments over a year.

⁷⁵³ Voluntary Particulars, spreadsheet "00_Further particulars Comercializadora - TV Azteca SA de CV 2010".

In Q2 2011, Autonomy recorded a bad debt charge in Autonomy's consolidated income statement of US\$549,945 and recorded a bad debt provision of US\$549,945 on Autonomy's consolidated balance sheet.

(b) Column B shows that the Claimants' position is that the US\$1.5 million in respect of the sale of software licences and US\$150,000 in respect of related support and maintenance should not have been accounted for as revenue on Autonomy's consolidated income statement at any time between Q3 2010 and Q2 2011. Instead, from Q4 2010 to Q2 2011, the US\$1.5 million of deferred revenue in respect of the licences and US\$150,000 of deferred revenue in respect of the support and maintenance is carried forward on Autonomy's consolidated balance sheet in each quarter from Q3 2010. This is illustrated by the red graphics in Figure 3. In Q2 2011, the bad debt charge to Autonomy's consolidated income statement of US\$549,945 and the bad debt provision of US\$549,945 on Autonomy's consolidated balance sheet is then removed by the Claimants and no amounts are recorded in relation to the bad debt.

(c) Column C shows the difference between Column B and Column A.

10.59 The overall outcome of the Claimants' treatment, is that on Autonomy's consolidated balance sheet there must remain an accounts receivable balance (which according to the Claimants, but disputed by the Defendants, was an obligation that the reseller did not have the means to pay Autonomy in the absence of an onward sale to the end-user⁷⁵⁴) and a deferred revenue balance in Q2 2011. And separately in Q2 2011 by virtue of the reversal of the bad debt expense the profit for the quarter is grossed up by the amount of US\$549,945. As a result, in my opinion this accounting treatment, which the Claimants allege should have been followed, is again inherently contradictory in its premise. Recognising an asset and liability during Q3 2010 to Q2 2011 undermines any lack of economic substance contention, as does similarly reversing a bad debt charge (in these circumstances).⁷⁵⁵

Accounting treatment of sales made to the end-user

10.60 Similar inherent contradictions arise in the Claimants' accounting treatment for instances where sales of software were made direct to the end-user in place of the reseller.

10.61 As previously explained, the Claimants, in the voluntary particulars, have reversed the revenue previously recognised by Autonomy for all 37 reseller transactions in the quarter

⁷⁵⁴ Re-Re-Amended Particulars of Claim, page 64, paragraph 74.3.4 and Schedule 3, page 33.

⁷⁵⁵ Appendix 9, My Comment 2, set out the voluntary particulars in which this accounting treatment may be seen.

in which it was recognised by Autonomy by instead recognising a similar amount in deferred revenue.⁷⁵⁶ Then subsequently, where relevant, the Claimants have recognised revenue in the alternative circumstances when a direct agreement was entered into between Autonomy and the end-user.⁷⁵⁷ I note there are 19 such transactions.⁷⁵⁸

10.62 In my view, as discussed above,⁷⁵⁹ the Claimants' accounting treatment infers that the transaction originally recognised by Autonomy has economic substance because even according to the Claimants it must still result in the recognition of an asset and associated deferred revenue liability. If the transaction lacked economic substance, as alleged by the Claimants, no accounting in the consolidated financial statements would be required in relation to the transaction including there being no recognition and subsequent reversal of deferred revenue (and initial recognition of related assets, which I would expect to have been accounts receivable, and their subsequent reversal).

10.63 Hence, the Claimants' accounting treatment infers that any adjustments to Autonomy's accounting treatment is based on a timing issue for revenue recognition, as opposed to the sale to the reseller lacking substance as alleged by the Claimants.⁷⁶⁰ The example below further illustrates this.

Example 3: Transaction 2: Capax Discovery (end-user TXU)

10.64 Autonomy received two purchase orders from Capax Discovery in relation to a reseller agreement for end-user TXU:

- (a) the first in Q2 2009 for US\$783,086 in respect of software licences plus US\$78,309 for support and maintenance;⁷⁶¹ and
- (b) the second in Q3 2009 for US\$67,817 in respect of software licences and US\$395,023 for hardware.⁷⁶²

⁷⁵⁶ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**, My Comment 1.

⁷⁵⁷ **Appendix 10**. Transaction 1: Microlink (various end-users) and Transaction 20: Capax Discovery (end-user DKO), in which the sales involved a second reseller, have been included in **Appendix 10**. In relation to Transaction 20: Capax Discovery (end-user DKO), the Claimants recognised revenue on an asserted agreement made between DKO and MicroTech with Capax Discovery reselling the software and support to MicroTech and MicroTech acting as second reseller. Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - DKO 2010". In relation to Transaction 1: Microlink (various end-users), the Claimants recognised revenue on an asserted agreement made between Microlink and a second reseller Computer Security Solutions. Voluntary Particulars, spreadsheet "00_Further particulars - MicroLink 2009".

⁷⁵⁸ **Appendix 10**.

⁷⁵⁹ At paragraphs 10.30 to 10.49 of this section.

⁷⁶⁰ Re-Re-Amended Particulars of Claim, page 62, paragraph 73.

⁷⁶¹ Voluntary Particulars, document "CPX-TXU 2009-02".

⁷⁶² {D007935802}. The Claimants assert that Autonomy's accounting treatment was "Licence revenue of \$61,652 was recognised as revenue immediately on 30 September 2009. Support and maintenance of \$6,165 was deferred, to be recognised over the following year. Hardware revenue of \$395,023 was also recognised immediately on 30 September 2009." Schedule 3 to the Re-Re-Amended Particulars of Claim, page 6.

10.65 However, Autonomy entered into a direct agreement with TXU on 18 September 2009 for licensed software, purchased equipment and services amounting to US\$1.693 million.⁷⁶³

10.66 I discuss the individual transaction voluntary particulars in relation to the purchase orders for Q2 2009 and Q3 2009, which is presented in Figure 4 below. In my discussion:

- (a) Column A refers to the voluntary particulars columns titled “Booked” and shows Autonomy’s accounting entries (as presented by the Claimants);
- (b) Column B refers to the columns titled “Should have been” and shows the Claimants’ accounting entries; and
- (c) Column C refers to the columns titled “Adjustment required” and shows the Claimants’ difference between Column B and Column A, as described at paragraph 10.8.

⁷⁶³ {D002695552}.

Figure 4 - Voluntary particulars extract for Transaction 2: Capax Discovery (end-user TXU) in Q2 2009 and Q3 2009.⁷⁶⁴

		Q2 2009						Q3 2009					
		Booked (A)		Should have been (B)		Adjustment required (C = B - A)		Booked (A)		Should have been (B)		Adjustment required (C = B - A)	
General ledger code ^{GN1}	Description ^{GN2}	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)
		\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Income statement													
400000	Revenue - licence		(783,086)			783,086					(783,086)		(783,086)
410000	Revenue - support		(215)			215		(19,738)		(215)	19,523		
Balance sheet													
231000	Deferred revenue - licence				(783,086)		(783,086)						
232000	Deferred revenue - support		(78,094)		(78,309)		(215)		(58,356)		(78,094)		(19,738)
392300	Retained earnings								(783,301)			783,301	

⁷⁶⁴ Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - TXU 2009".

10.67 The individual transaction voluntary particulars entries for Q2 2009 are described below:⁷⁶⁵

- (a) Column A shows Autonomy's accounting entries (as presented by the Claimants) in regard to the first purchase order. This showed recognised revenue of US\$783,086 in respect of licences and revenue of US\$215 in respect of support and maintenance⁷⁶⁶ on Autonomy's consolidated income statement in Q2 2009. The remaining US\$78,094 of support and maintenance in respect of the first purchase order remained in deferred revenue on Autonomy's consolidated balance sheet.
- (b) Column B shows the Claimants' position, i.e. that Autonomy should not have accounted for revenue of US\$783,086 in respect of the licences or revenue of US\$215 in respect of support and maintenance in regards to the Q2 2009 purchase order in Q2 2009. Therefore, the Claimants adjust the amounts recorded as revenue under Column A by transferring the amounts to deferred revenue in Q2 2009. This results in the amounts of US\$783,086 in respect of licences and US\$78,309 in respect of support and maintenance being accounted for as deferred revenue in Autonomy's consolidated balance sheet at the end of Q2 2009, according to the Claimants.
- (c) Column C shows the difference between Column B and Column A.

10.68 The voluntary particulars entries for Q3 2009 are described below:⁷⁶⁷

- (a) Column A shows that Autonomy continued to release revenue in respect of support and maintenance to Autonomy's consolidated income statement from deferred revenue in Q3 2009. Deferred revenue of US\$78,094 carried forward from Q2 2009 was reduced by US\$19,738, which was released to Autonomy's consolidated income statement as support and maintenance revenue, leaving US\$58,356 in deferred revenue for support and maintenance on Autonomy's consolidated balance sheet in Q3 2009.⁷⁶⁸
- (b) Column B shows the Claimants' position that the US\$783,086 of revenue in respect of the software licences should have been accounted for i.e. recognised in Q3 2009. The Claimants state that "*The transaction in Q2 2009 with Capax Discovery*

⁷⁶⁵ Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - TXU 2009".

⁷⁶⁶ Support and maintenance was pro-rated over the term of the service provided. Autonomy's initial accounting entry recognised US\$78,309 of deferred revenue in respect of support and maintenance on 30 June 2009. See ledger extract in Voluntary Particulars, document "CPX-TXU 2009-04", page 14. Subsequently, Autonomy accounted for one day of support and maintenance revenue in Q2 2009 for the service provided on 30 June 2009. The remaining amounts in respect of support and maintenance from the Q2 2009 purchase order was released to Autonomy's consolidated income statement in quarterly instalments over a year.

⁷⁶⁷ Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - TXU 2009".

⁷⁶⁸ Autonomy continued to release support and maintenance revenue to Autonomy's consolidated income statement, reducing the deferred revenue balance, in Q4 2009 to Q2 2010. This is not shown in Figure 4 but can be seen in the Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - TXU 2009".

*for end-user TXU was replaced by a direct agreement with TXU in Q3 2009.*⁷⁶⁹

The US\$783,086 of deferred revenue in respect of licences carried forward from Q2 2009 is thus removed by the Claimants from Autonomy's consolidated balance sheet and released to Autonomy's consolidated income statement as revenue.

Also, the Claimants indicate that the same US\$215 of revenue in respect of support and maintenance should only have been accounted for in the later quarter,⁷⁷⁰ with the remaining amount of US\$78,094 remaining in deferred revenue.⁷⁷¹

(c) Column C shows the difference between Column B and Column A.

10.69 The above indicates that the Claimants' adjustment to Autonomy's accounting treatment is based solely on a timing issue for revenue recognition. This timing issue is illustrated by the red graphics in Figure 4 which shows the Claimants account for an equivalent amount of revenue in Q3 2009 to the amount Autonomy accounted for in Q2 2009. However, again by virtue of the deferred revenue balance accounted for by the Claimants in Q2 2009, this again indicates the Claimants' believe the original transaction to have had substance. For the avoidance of doubt, individually this transaction would also not have been considered material.⁷⁷²

10.70 The voluntary particulars in relation to Transaction 2: Capax Discovery (end-user TXU) do not refer at all to the accounting treatment of the second purchase order received by Autonomy in Q3 2009⁷⁷³. I have assumed that no adjustments are reflected in the voluntary particulars in respect of the Q3 2009 purchase order as this purchase order was received in the same quarter that Autonomy ultimately entered into the direct agreement with TXU. Under the Claimants' assertion that revenue should have been accounted for only in the quarter in which ultimately a direct agreement was entered into between Autonomy and

⁷⁶⁹ Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - TXU 2009", under "Explanation of adjustments" in Q3 2009.

⁷⁷⁰ The Claimants state that "*The direct agreement included the provision of support and maintenance services from 30 September 2009. Therefore, one day of support revenue should have been recognised in Q3 2009, with the balance remaining deferred as at 30 September 2009.*" Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - TXU 2009", under "Explanation of adjustments" in Q3 2009.

⁷⁷¹ The Claimants continue to release support and maintenance revenue to Autonomy's consolidated income statement, reducing the deferred revenue balance, in each quarter between Q4 2009 and Q3 2010, stating that "*support revenue should have been recognised on a straight line daily basis over a period of one year as from 30 September 2009*". This is not shown in Figure 4 but can be seen in the Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery - TXU 2009", "Explanation of adjustments" in Q4 2009 to Q3 2010.

⁷⁷² The Claimants' proposed adjustment in Q2 2009 reduces revenue and consequently profit before tax by US\$783,301, as shown in Figure 4 under Column C in Q2 2009 (US\$783,086 plus US\$215). Deloitte's materiality for the Q2 2009 Deloitte Audit Committee Report was US\$5.4 million based on profit before tax, which is above the amount of the Claimants' proposed adjustment. {DEL1_003_1_00000200} (Q2 2009 Deloitte Audit Committee Report), page 1.

⁷⁷³ See paragraph 10.64(b) of this report.

TXU, an adjustment to revenue in respect of the Q3 2009 purchase order would have a net effect of nil.

- 10.71 Nonetheless, the above Claimants' accounting treatment raises a number of fundamental issues, not least of which is that if, as the Claimants allege, an impugned reseller transaction lacked economic substance,⁷⁷⁴ the agreement direct with the ultimate customer would be a separate and distinct transaction and should not be associated with any deferred revenue associated with the reseller transaction. Yet, the Claimants' accounting treatment can only infer that the reseller arrangement with Capax Discovery has its own economic substance separable from the economic substance of the Autonomy transaction with TXU.
- 10.72 In other words, in my opinion, the Claimants' position is inherently contradictory again and by its accounting it accepts that each of the transactions, firstly with Capax Discovery, and secondly with TXU, are transactions of substance, since both according to the Claimants result in assets to Autonomy.

Accounting treatment in relation to the alleged payments made to resellers, and the acquisition of Microlink

- 10.73 Over and above the impugned reseller transactions that the Claimants refer to, the Claimants additionally allege that *"An Autonomy group company was caused to make a payment to the VAR to purchase rights, goods or services that the Autonomy group company did not need (and which had no discernible value to it), but which had the purpose and effect of putting the VAR in funds which it then used to pay for the Autonomy software licence ("reciprocal VAR transactions")"*.⁷⁷⁵ These allegations are different to those associated with non-reciprocal reseller transactions.
- 10.74 Where the Claimants have identified an impugned reseller transaction as being a *"reciprocal VAR transaction"*, the Claimants' accounting treatment in the voluntary particulars removes the revenue on the sale to the reseller recognised in Autonomy's consolidated income statement but again carries forward these amounts as deferred revenue. However, this deferred revenue balance is then netted off by the Claimants against Autonomy's costs arising on purchases from the same reseller in a future quarter.⁷⁷⁶
- 10.75 This Claimants' accounting treatment has the general effect therefore in Autonomy's consolidated financial statements of removing revenue from Autonomy's consolidated

⁷⁷⁴ Re-Re-Amended Particulars of Claim, page 62, paragraph 73.

⁷⁷⁵ Re-Re-Amended Particulars of Claim, page 66, paragraph 74.4.3.3.

⁷⁷⁶ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in Appendix 9, My Comment 6.

income statement from the sales to the reseller and either removing the purchase costs or the asset on Autonomy's consolidated balance sheet. Any excess in the cost of purchase(s) from the reseller (compared to the amounts received from/ recoverable on sales to the reseller) is then recognised by the Claimants as a cost, reducing profit, on Autonomy's consolidated income statement.

- 10.76 Though not classified as a reciprocal VAR transaction, the Claimants also assert that, under Transaction 5: MicroTech (end-user DiscoverTech), "*The \$10,000,000 sale of Control Point software to MicroTech is considered a transaction that is linked to the acquisition of Microlink.*"⁷⁷⁷
- 10.77 Similar to the Claimants' accounting treatment for "*reciprocal VAR transactions*",⁷⁷⁸ the Claimants' proposed adjustments in the voluntary particulars removes the revenue (on the sale to MicroTech previously recognised by Autonomy) from Autonomy's consolidated income statement and carries forward these amounts as deferred revenue on Autonomy's consolidated balance sheet. The deferred revenue is then netted off by the Claimants against the goodwill balance recognised on consolidation as a result of the acquisition of Microlink in Q1 2010.⁷⁷⁹ This is set out in further detail in the example below, and again is inconsistent with the Claimants' pleaded case.

Example 4: Transaction 5: MicroTech (end-user DiscoverTech)

- 10.78 Autonomy received a purchase order from MicroTech in relation to a sale for end-user DiscoverTech on 29 December 2009 for US\$10 million in respect of software licences.⁷⁸⁰ Autonomy recognised US\$476,190 of the purchase order amount as deferred revenue for support and maintenance, resulting in US\$9.524 million being recognised as licence revenue.⁷⁸¹
- 10.79 In a separate transaction, a Unit Purchase Agreement dated 4 January 2010 was entered into by Autonomy for the acquisition of 100% of the equity shares of Microlink from Microlink's shareholders, David Truitt (Microlink's majority owner and CEO ("Mr D Truitt")) and Timothy Wharton, for a purchase price of US\$55 million.⁷⁸² I note that the Claimants assert that the total consideration was US\$56.9 million and that Autonomy accounted for

⁷⁷⁷ Re-Re-Amended Particulars of Claim, Schedule 3, page 14.

⁷⁷⁸ As referred to in paragraph 10.73.

⁷⁷⁹ Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - DiscoverTech 2009".

⁷⁸⁰ {D003229743}.

⁷⁸¹ Voluntary Particulars, document "MT-DT 2009-03", page 32 and "MT-DT 2009-02", pages 4 and 5.

⁷⁸² Voluntary Particulars, document "MT-DT 2009-07", page 1, page 11 (Section 2.1) and page A-1 (Schedule A). Page 9 to the Unit Purchase Agreement defines the Purchase Price as US\$55 million, as adjusted after the Closing pursuant to Section 2.5 and/or as a result of any payment made pursuant to Section 2.3(c) and/or any indemnification payment in accordance with Section 9.10.

the payment of US\$55 million as an investment in Microlink.⁷⁸³ I do not comment here on how Autonomy may have accounted for this acquisition.

- 10.80 The Claimants assert that on “5 January 2010, David Truitt and Timothy Wharton remitted \$8,000,000 and \$2,000,000, respectively, to DiscoverTech to fund its purchase of Autonomy’s Control Point software through MicroTech, a company in which David Truitt held a large interest.”⁷⁸⁴ The Claimants further assert that on 5 January 2010, DiscoverTech made a payment of \$10,000,000 to MicroTech. On 6 January 2010, payment in full was received by Autonomy Inc from MicroTech in relation to the 29 December 2009 transaction for end-user DiscoverTech.⁷⁸⁵
- 10.81 The Claimants assert that the “\$10,000,000 sale of Control Point software to MicroTech is considered a transaction that is linked to the acquisition of Microlink”,⁷⁸⁶ and subsequently claim that “In terms of the application of IAS 18, \$10 million of the supposed consideration offsets the \$10 million of revenue, such that no revenue ought to have been recognised.”⁷⁸⁷ It is disputed by the Parties whether the transactions should be accounted for separately.
- 10.82 The Claimants also refer to an email sent by David Truitt on 18 November 2009 in which David Truitt stated:
- “You might think I’m crazy to pay 5 million for an unproven product, but I think I would like to give that a shot. What I was thinking was that we would include the purchase of DiscoverPoint in with the Control Point OEM, so Autonomy would show revenue on both products in the 10 million dollar order. So total at closing for the Microlink purchase would be 55 million with an immediate purchase of DP and Control Point OEM for 10 million from the New Company.”⁷⁸⁸*
- 10.83 The Claimants allege that “In the event, on 29 December 2009, Autonomy prepared a draft purchase order for Control Point (without DiscoverPoint). Autonomy was not in a position to offer a licence of DiscoverPoint, because, in December 2009, Microlink had assigned ownership of DiscoverPoint to DiscoverTech. Despite the fact that the proposed purchase order was now for a licence of only one of the pieces of software rather than two, the proposed purchase price remained the same at US\$10 million. This fact provides further

⁷⁸³ Re-Re-Amended Particulars of Claim, Schedule 3, page 12. I have not seen the underlying supporting documentation for these matters.

⁷⁸⁴ Re-Re-Amended Particulars of Claim, Schedule 3, page 12.

⁷⁸⁵ Re-Re-Amended Particulars of Claim, Schedule 3, page 12.

⁷⁸⁶ Re-Re-Amended Particulars of Claim, Schedule 3, page 14.

⁷⁸⁷ Re-Re-Amended Particulars of Claim, Schedule 3, page 14.

⁷⁸⁸ Re-Re-Amended Particulars of Claim, Schedule 3, page 13.

support for the inference pleaded above that Autonomy's offer to purchase Microlink for US\$55 million was inflated by US\$10 million.”⁷⁸⁹

- 10.84 I discuss the individual transaction voluntary particulars in relation to the purchase order for Q4 2009 and matters in Q1 2010, which is presented in Figure 5 below. In my discussion:
- (a) Column A refers to the voluntary particulars columns titled “Booked” and shows Autonomy’s accounting entries (as presented by the Claimants);
 - (b) Column B refers to the columns titled “Should have been” and shows the Claimants’ accounting entries; and
 - (c) Column C refers to the columns titled “Adjustment required” and shows the Claimants’ difference between Column B and Column A, as described at paragraph 10.8.

⁷⁸⁹ Re-Re-Amended Particulars of Claim, Schedule 3, page 13.

Figure 5 - Voluntary particulars extract for Transaction 5: MicroTech (end-user DiscoverTech) in Q4 2009 and Q1 2010.⁷⁹⁰

		Q4 2009						Q1 2010					
		Booked (A)		Should have been (B)		Adjustment required (C = B - A)		Booked (A)		Should have been (B)		Adjustment required (C = B - A)	
General ledger code ^{GN1}	Description ^{GN2}	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)
		\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Income statement													
400000	Revenue - licence		(9,523,810)			9,523,810							
410000	Revenue - support		(2,609)			2,609			(117,417)			117,417	
Balance sheet													
173000	Goodwill on acquisition							10,000,000					(10,000,000)
231000	Deferred revenue - licence				(9,523,810)		(9,523,810)						
232000	Deferred revenue - support		(473,581)		(476,190)		(2,609)		(356,164)			356,164	
392300	Retained earnings							(9,526,419)				9,526,419	

⁷⁹⁰ Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - DiscoverTech 2009".

10.85 The individual transaction voluntary particulars entries for Q4 2009 are described below:⁷⁹¹

- (a) Column A shows that Autonomy's accounting entries (as presented by the Claimants) in regard to the purchase order were to account for revenue of US\$9.524 million in respect of licences and revenue of US\$2,609 in respect of support and maintenance⁷⁹² on Autonomy's consolidated income statement in Q4 2009. The remaining US\$473,581 of support and maintenance in respect of the purchase order remained in deferred revenue on Autonomy's consolidated balance sheet.
- (b) Column B shows the Claimants' position which is that Autonomy should not have accounted for revenue of US\$9.524 million in respect of software licences or revenue of US\$2,609 in respect of support and maintenance relating to the Q4 2009 purchase order. Therefore, the Claimants remove the amounts recorded as revenue under Column A and transfer the amounts to deferred revenue in Q4 2009. This results in the amounts of US\$9.524 million in respect of licences and US\$476,190 in respect of support and maintenance being accounted for by the Claimants as deferred revenue on Autonomy's consolidated balance sheet. This is illustrated by the red graphics in Figure 5.
- (c) Column C shows the difference between Column B and Column A.

10.86 The voluntary particulars entries for Q1 2010 are described below:⁷⁹³

- (a) Column A shows that Autonomy continued to release revenue in respect of support and maintenance to Autonomy's consolidated income statement from deferred revenue in Q1 2010. Deferred revenue of US\$473,581 carried forward from Q4 2009 was reduced by US\$117,417, which was released to Autonomy's consolidated income statement as support and maintenance revenue, leaving US\$356,164 in deferred revenue for support and maintenance on Autonomy's consolidated

⁷⁹¹ Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - DiscoverTech 2009".

⁷⁹² Support and maintenance was pro-rated over the term of the service provided. Autonomy's initial accounting entry recognised US\$476,190 of deferred revenue in respect of support and maintenance on 31 December 2009. See ledger extract in Voluntary Particulars, "MT-DT 2009-03", page 32. Subsequently, Autonomy accounted for two days of support and maintenance revenue in Q4 2009 for the service provided in December 2009. The remaining amounts in respect of support and maintenance from the Q4 2009 purchase order was released to Autonomy's consolidated income statement in quarterly instalments over a year.

⁷⁹³ Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - DiscoverTech 2009".

balance sheet in Q1 2010.⁷⁹⁴ In Q1 2010, Autonomy recorded an asset of US\$10 million for goodwill on acquisition on Autonomy's consolidated balance sheet.⁷⁹⁵

- (b) Column B shows the Claimants' position that US\$9.524 million in respect of licences and US\$476,190 in respect of support and maintenance should not have been accounted for as revenue in Autonomy's consolidated income statement in either Q4 2009 or Q1 2010. According to the Claimants, the credit amount of US\$10 million (US\$9.524 million in respect of licences plus US\$476,190 in respect of support and maintenance) in deferred revenue carried forward from Q4 2009 is eliminated from Autonomy's consolidated balance sheet in Q1 2010 by offsetting the amount against the asset of US\$10 million for goodwill on acquisition.⁷⁹⁶ This is illustrated by the red graphics in Figure 5 which highlights the absence of amounts being recorded, according to the Claimants, under deferred revenue and goodwill on acquisition as a result of the amounts being offset.
- (c) Column C shows the difference between Column B and Column A.

10.87 As previously discussed, if a transaction lacked economic substance as alleged by the Claimants, under the Claimants' accounting treatment, there would be no accounting entries recognised in relation to the transaction, including there being no recognition of deferred revenue or accounts receivable in Q4 2009⁷⁹⁷. Subsequently, in my view, under the Claimants' assertions, in Q1 2010 the US\$10 million cash receipt by Autonomy from MicroTech in relation to the Q4 2009 purchase order would be recognised within Autonomy's accounts as a financial asset (in cash) with a corresponding accounting entry in a liability account^{798,799}. If the sale by Autonomy to MicroTech and the acquisition of MicroLink by Autonomy are linked transactions⁸⁰⁰ in the context of IAS 18.13, then the liability would be netted against goodwill on acquisition in Q1 2010.

⁷⁹⁴ Autonomy continued to release support and maintenance revenue to Autonomy's consolidated income statement, reducing the deferred revenue balance, in Q2 2010 to Q4 2010. This is not shown in Figure 5 but can be seen in the Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - DiscoverTech 2009".

⁷⁹⁵ Autonomy continued to carry forward the asset balance of US\$10 million for goodwill on acquisition from Q1 2010. This is not shown in Figure 5 but can be seen in the Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - DiscoverTech 2009".

⁷⁹⁶ The Claimants' narrative in the voluntary particulars states "*For the reasons set out in Schedule 3 (transaction 5), the deferred revenue balances brought forward in Q1 2010 have been eliminated by offsetting against the goodwill balance recognised on consolidation as a result of the acquisition of MicroLink in Q1 2010.*" Voluntary Particulars, spreadsheet "00_Further particulars - MicroTech - DiscoverTech 2009".

⁷⁹⁷ Re-Re-Amended Particulars of Claim, Schedule 3, page 12. The Claimants assert that "*On 6 January 2010, payment in full was received by Autonomy Inc from MicroTech in relation to the 29 December 2009 transaction for end-user DiscoverTech.*" Therefore, the initial accounting entry in Q4 2009 posted by Autonomy would be against accounts receivable.

⁷⁹⁸ This would not be in the deferred revenue liability balance.

⁷⁹⁹ Re-Re-Amended Particulars of Claim, Schedule 3, page 12.

⁸⁰⁰ As alleged by the Claimants, Re-Re-Amended Particulars of Claim, Schedule 3, page 13.

- 10.88 An additional factor which will affect the accounting treatment is the fair value of the Control Point software in relation to the Q4 2009 purchase order which will ascertain the amount which should be recognised as revenue in Autonomy's consolidated income statement (subsequent to the sale transaction being determined to have economic substance and at the point at which the conditions of IAS 18.14 were met), and whether, and the amount by which, any remaining liability balance, not recognised as revenue, might potentially be netted against goodwill on acquisition.
- 10.89 As discussed at **Appendix 3.5**, whether the US\$10 million sale to MicroTech was at fair value is a matter of disputed fact.

My review of the Voluntary Particulars of the Schedule 5 transactions, the alleged reciprocal transactions

- 10.90 The Claimants have provided nine sets of voluntary particulars in relation to the alleged reciprocal transactions which relate to six counterparties detailed on Schedule 5 to the Re-Re-Amended Particulars of Claim.⁸⁰¹
- 10.91 The individual transaction voluntary particulars, in relation to the alleged reciprocal transactions, set out Autonomy's accounting (as presented by the Claimants) as being the recognition of revenue on sale to the counterparty.⁸⁰² Further, Autonomy accounts for the purchase(s) from the same counterparty as a separate transaction to the sale, as either a cost on Autonomy's consolidated income statement or an asset on Autonomy's consolidated balance sheet.⁸⁰³
- 10.92 Under the Claimants' accounting treatment, the Claimants do not recognise revenue against any of the alleged reciprocal transaction software license sales made by Autonomy.
- 10.93 Instead, the Claimants' accounting treatment adjusts the revenue recognised by Autonomy in the consolidated income statement on the software sale to the counterparty and either:
- (a) carries forward the amounts as deferred revenue in respect of licences and support and maintenance on Autonomy's consolidated balance sheet and subsequently nets off this deferred revenue balance against any costs of purchases made by Autonomy from the same counterparty in a subsequent period; or

⁸⁰¹ Additional sets of voluntary particulars have been provided in relation to the same counterparty for alleged reciprocal transactions that occurred in different periods. **Appendix 11**.

⁸⁰² This is set out in each of the voluntary particulars for the alleged reciprocal transactions as can be seen in **Appendix 11**, My Comment 1. Revenue recognised by Autonomy in relation to the alleged reciprocal transactions is in respect of licences, support and maintenance and hardware.

⁸⁰³ This is set out in each of the voluntary particulars for the alleged reciprocal transactions as can be seen in **Appendix 11**, My Comment 2.

- (b) where both the sale to the counterparty and the purchase(s) made by Autonomy from the same counterparty occurred within the same period, the Claimants, as in the example above, reverse the revenue recognised by Autonomy and instead offset the amounts against the purchases in the same period (without amounts being moved to deferred revenue).⁸⁰⁴

10.94 This results, according to the Claimants, in a net expense being recognised in relation to over two-thirds of the alleged reciprocal transactions (seven out of nine)⁸⁰⁵ in Autonomy's consolidated income statement and a reduction in the asset value in relation to Transaction 5: EMC, in Autonomy's consolidated balance sheet, with the revenue originally recognised by Autonomy being removed in full from Autonomy's consolidated income statement for all the reciprocal transactions.⁸⁰⁶

10.95 This accounting treatment mirrors the Claimants' accounting treatment for reciprocal reseller transactions, as discussed at paragraphs 10.73 to 10.77. The adjustments to include generally a deferred revenue balance against each initial sale transaction are, however, inconsistent and fundamentally wrong where the Claimants' again similarly claim that each such transaction lacks economic substance.

10.96 In this category, the Claimants allege that *"an Autonomy group company (i) granted a software licence to a counterparty at one price and (ii) purchased products (including software), rights and/or services from that counterparty at a greater price. In these cases, the purchase(s) and the sale(s) were linked in such a way that their commercial effect could not be understood without reference to the series of transactions as a whole. The products, rights and/or services purchased were of no discernible value to the Autonomy group, or the goods or services were purchased at sums in excess of their fair value. These transactions lacked economic substance. 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. These contrived transactions meant that the Autonomy group was funding*

⁸⁰⁴ This is set out in each of the voluntary particulars for the alleged reciprocal transactions as can be seen in **Appendix 11**, My Comment 1. In relation to Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 2: VMS (Q4 2010), the Claimants reverse the revenue recognised by Autonomy and offset these amounts against both the purchase of data licences from VMS and also the purchase costs of hardware for resale to VMS (purchased by Autonomy from Insight) in Q4 2010. Voluntary Particulars, spreadsheet "00_Further particulars - Video Monitoring Services 2010 A&B".

⁸⁰⁵ Transaction 1 to 4 of Schedule 5 to the Re-Re-Amended Particulars of Claim. This is set out in each of the voluntary particulars for the alleged reciprocal transactions as can be seen in **Appendix 11**, My Comment 3a.

⁸⁰⁶ In relation to Schedule 5 to the Re-Re-Amended Particulars of Claim, Transaction 6: MicroTech, a balance remains in deferred revenue under the Claimants' accounting treatment in the voluntary particulars. Schedule 5 to the Re-Re-Amended Particulars of Claim, page 16, asserts that on 8 September 2011 (outside the Relevant Period) a credit note was raised to MicroTech to cancel the outstanding balance owed to Autonomy.

the purchase by counterparties of its own software in order to allow Autonomy inappropriately to report revenue and profits.”⁸⁰⁷

- 10.97 As discussed under my review of the reseller transactions, in my view, if a transaction lacked economic substance as alleged by the Claimants, under the accounting treatment, there would be no accounting entries recognised in relation to the transaction. I regard this view as also supported by Mr Holgate: see for example Mr Holgate’s First Report paragraphs 6.4 and 6.7.
- 10.98 The Claimants’ accounting treatment carries forward the Autonomy sales related amounts as deferred revenue on Autonomy’s consolidated balance sheet in relation to two-thirds (six out of nine) of the alleged reciprocal transactions.⁸⁰⁸
- 10.99 Further, the Claimants’ adjustments in relation to all nine transactions do not adjust any accounts receivable balance Autonomy would have recognised on the sale to the counterparty.⁸⁰⁹ Each of the above approaches individually, and collectively, again highlights the fundamental dichotomy between the Claimants’ allegations concerning the impugned transactions in the Re-Re-Amended Particulars of Claim and the contrary adjustments to Autonomy’s accounting treatment as proposed by the Claimants in the voluntary particulars. This is similarly mirrored in Mr Holgate’s own contradictions when he comments on the reciprocal transactions voluntary particulars, which I deal with below.
- 10.100 Further, if the reciprocal purchase also lacked economic substance, as alleged by the Claimants,⁸¹⁰ under the Claimants’ accounting treatment there would again be no accounting entries recognised in relation to in that case the purchase transaction, being the recognition of the purchase expense or asset and the corresponding accounts payable (Autonomy’s obligation to pay the seller for debt owed in relation to the purchase).
- 10.101 If, as alleged by the Claimants, first, the sale and the purchase are determined to be linked, and second the linked sale and purchase transaction lacked economic substance, then both the sale and purchase transaction(s) would be removed in whole from the accounts and only any net cash movement would be recognised within Autonomy’s accounts, with any excess cash payments made by Autonomy being recognised as a miscellaneous expense in Autonomy’s consolidated income statement.⁸¹¹

⁸⁰⁷ Re-Re-Amended Particulars of Claim, page 16, paragraph 30.2.2.1. See also the Re-Re-Amended Particulars of Claim, paragraphs 94C and 94D.

⁸⁰⁸ This is set out in each of the voluntary particulars for the alleged reciprocal transactions as can be seen in **Appendix 11**, My Comment 1a.

⁸⁰⁹ This is set out in each of the voluntary particulars for the alleged reciprocal transactions as can be seen in **Appendix 11**.

⁸¹⁰ In relation to Transactions 1, 2, 3, 4 and 6 of Schedule 5 to the Re-Re-Amended Particulars of Claim, page 4, 8, 10, 12 and 17.

⁸¹¹ For completeness, a net receipt in this scenario would be recognised by Autonomy as ‘other income’.

10.102 However, the Claimants' accounting treatment does not reverse the sale and purchase transactions recognised by Autonomy and only recognise the net cash movement. Instead, the Claimants adjust Autonomy's consolidated financial statements based on the purchase invoice recognised by Autonomy, as opposed to adjustments that would result in the recognition of only the net cash movement.

10.103 The example below illustrates this inherent contradiction in the Claimants' (and Mr Holgate's which I deal with later on in this section) accounting opinion and/or treatments. In relation to the example, Schedule 5, Transaction 1: Capax Discovery, the voluntary particulars cover three purchase orders from Capax Discovery during the period from Q1 2009 to Q2 2011 in relation to this transaction. For simplicity, I only discuss the first purchase order in the voluntary particulars for the period Q1 2009 to Q2 2009.

*Example 5: Transaction 1: Capax Discovery (Q1 2009 to Q2 2009)*⁸¹²

10.104 Autonomy received a purchase order from Capax Discovery in Q1 2009 for US\$7.5 million in respect of software licences plus US\$750,000⁸¹³ for support and maintenance.⁸¹⁴

10.105 In the next quarter, Q2 2009, Autonomy received two invoices from Capax Discovery for a total of US\$520,000 for Electronic Data Discovery services ("EDD services").⁸¹⁵

10.106 I discuss the voluntary particulars in relation to the Q1 2009 purchase order for Q1 2009 to Q2 2009, which is presented in Figure 6 below. In my discussion:

- (a) Column A refers to the voluntary particulars columns titled "Booked" and shows Autonomy's accounting entries (as presented by the Claimants);
- (b) Column B refers to the columns titled "Should have been" and shows the Claimants' accounting entries; and
- (c) Column C refers to the columns titled "Adjustment required" and shows the Claimants' difference between Column B and Column A, as described at paragraph 10.8.

⁸¹² The full details of this transaction are addressed in more detail in **Appendix 5.1**.

⁸¹³ Calculated as 5% of licence fees of US\$7.5 million per year, across two years i.e. 10% in total.

⁸¹⁴ Voluntary Particulars, document "CPX 2009-02", pages 1 and 11.

⁸¹⁵ Voluntary Particulars, documents "CPX 2009-07" and "CPX 2009-08". US\$520,000 calculated as US\$250,000 plus US\$270,000.

Figure 6 - Voluntary particulars extract for Transaction 1: Capax Discovery in Q1 2009 to Q2 2009.⁸¹⁶

		Q1 2009					Q2 2009						
General ledger code	Description ^{GN2}	Booked (A)		Should have been (B)		Adjustment required (C = B - A)		Booked (A)		Should have been (B)		Adjustment required (C = B - A)	
		DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)	DR	(CR)
		\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Income statement													
400000	Revenue - licence		(7,500,000)			7,500,000							
410000	Revenue - support		(1,027)			1,027		(93,493)				93,493	
542000	User manuals												
542500	Manufacturing product costs												
661011	Billable 3rd party engagements							520,000					(520,000)
Balance sheet													
135000	Prepayment												
202000	Accrued accounts payable												
231000	Deferred revenue - licence				(7,500,000)		(7,500,000)				(6,980,000)		(6,980,000)
232000	Deferred revenue - support		(748,973)		(750,000)		(1,027)		(655,480)		(750,000)		(94,520)
392300	Retained earnings							(7,501,027)					7,501,027

⁸¹⁶ Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery 2009 and 2011".

10.107 The voluntary particulars entries for Q1 2009 are described below:⁸¹⁷

- (a) Column A shows that Autonomy's accounting entries (as presented by the Claimants) in regard to the purchase order were to recognise revenue of US\$7.5 million in respect of the sale of software licences and revenue of US\$1,027 in respect of support and maintenance⁸¹⁸ on Autonomy's consolidated income statement in Q1 2009. The remaining US\$748,973 relates to support and maintenance that was recognised as deferred revenue on Autonomy's consolidated balance sheet at the period end.
- (b) Column B shows the Claimants' position that the US\$7.5 million in respect of licences and the US\$750,000 in respect of related support and maintenance (or any part thereof) should not have been accounted for as revenue on Autonomy's consolidated income statement in Q1 2009. Therefore, the Claimants remove Autonomy's recorded revenue and adjust the amounts to be recognised in deferred revenue in Q1 2009. This results in the amounts of US\$7.5 million in respect of the sale of the software licences and US\$750,000 in respect of support and maintenance being both accounted for as deferred revenue on Autonomy's consolidated balance sheet.
- (c) Column C shows the difference between Column B and Column A.

10.108 The voluntary particulars entries for Q2 2009 are described below:⁸¹⁹

- (a) Column A shows that Autonomy released further revenue in respect of support and maintenance to Autonomy's consolidated income statement from deferred revenue in Q2 2009. In Q2 2009, deferred revenue of US\$748,973 carried forward from Q1 2009 was reduced by US\$93,493, which was released to Autonomy's consolidated income statement, leaving US\$655,480 in deferred revenue for support and maintenance on Autonomy's consolidated balance sheet in Q2 2009. Column A also shows that Autonomy recognised US\$520,000 of expenses on Autonomy's consolidated income statement, referred to as "Billable 3rd party engagements".
- (b) Column B shows the Claimants' position that the US\$520,000 of purchase expenses should have been netted off against the Claimants' carried forward software

⁸¹⁷ Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery 2009 and 2011".

⁸¹⁸ Support and maintenance was pro-rated over the term of the service provided. Autonomy's initial accounting entry recognised US\$750,000 of deferred revenue in respect of support and maintenance on 31 March 2009. See ledger extract in Voluntary Particulars, document "CPX 2009-04", page 6. Subsequently, Autonomy accounted for one day of support and maintenance revenue in Q1 2009 for the service provided on 31 March 2009. The remaining amounts in respect of support and maintenance from the Q1 2009 purchase order was released to Autonomy's consolidated income statement in quarterly instalments over two years.

⁸¹⁹ Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery 2009 and 2011".

licence related deferred revenue.⁸²⁰ This is reflected in Figure 6 as the amounts allocated to Billable 3rd party engagements is reduced by US\$520,000 to nil and deferred revenue in respect of licences is also reduced by US\$520,000⁸²¹.

(c) Column C shows the difference between Column B and Column A.

- 10.109 The individual transaction voluntary particulars do not show an asset balance (i.e. accounts receivable) in relation to this sale in Q1 2009, but implicitly there must be one, as a result of double-entry accounting.
- 10.110 I assume Autonomy recorded an amount of US\$8.25 million⁸²² in accounts receivable on Autonomy's consolidated balance sheet in Q1 2009, in respect of the Q1 2009 purchase order, as the Claimants assert that the first payment from Capax Discovery was US\$500,000 in Q2 2009.⁸²³
- 10.111 As previously discussed, the above clearly demonstrates, contrary to the Claimants' position asserted in the Re-Re-Amended Particulars of Claim,⁸²⁴ that the Claimants acknowledge that an accountable transaction occurred in Q1 2009 by virtue of there being a deferred revenue balance according to the Claimants.
- 10.112 The voluntary particulars also do not show the cash movement in relation to Autonomy's purchase. According to the Claimants, Autonomy paid Capax Discovery US\$520,000 on 22 June 2009.⁸²⁵ As discussed above, if, as alleged by the Claimants, both the sale and linked purchase lacked substance, then each of them, alternatively, both together, should be reversed from the financial statements and Autonomy's accounting records and only the cash movement would be recognised within Autonomy's accounts, with net cash payment made by Autonomy being recognised as an expense in Autonomy's consolidated income statement.
- 10.113 Schedule 5 to the Re-Re-Amended Particulars of Claim asserts that US\$500,000 was received by Autonomy and a payment of US\$520,000 was made by Autonomy in Q2 2009. Therefore, according to the Claimants' pleaded position where there was no economic substance, this should logically result in a net payment by Autonomy to Capax Discovery of US\$20,000⁸²⁶ in Q2 2009 which, based on the Claimants' allegations, should have been

⁸²⁰ The Claimants' narrative in the voluntary particulars states "For the reasons set out in Schedule 5 (transaction 1), the amounts originally recognised as revenue have been reversed and instead carried forward as deferred revenue in order to be netted against the EDD services and supplemental EAS support costs invoiced by Capax Discovery between Q2 2009 and Q2 2011." Voluntary Particulars, spreadsheet "00_Further particulars - Capax Discovery 2009 and 2011".

⁸²¹ US\$7.5 million less US\$520,000 equals US\$6.98 million.

⁸²² US\$7.5 million in respect of licences plus US\$750,000 in respect of support and maintenance.

⁸²³ Schedule 5 to the Re-Re-Amended Particulars of Claim, page 1.

⁸²⁴ Schedule 5 to the Re-Re-Amended Particulars of Claim, page 4.

⁸²⁵ Schedule 5 to the Re-Re-Amended Particulars of Claim, page 1.

⁸²⁶ US\$500,000 minus US\$520,000.

recognised as an expense in Autonomy's consolidated income statement under the Claimants' proposed adjustments in the voluntary particulars.

10.114 This is not the accounting treatment reflected in the voluntary particulars as shown in Figure 6 which shows a net expense of nil in Q2 2009. In my view, it is absolutely clear that the Claimants' accounting treatment is inconsistent with their allegation that the sale and purchase lacked economic substance which should have reflected a miscellaneous expense of US\$20,000 in Q2 2009.

My review of the Voluntary Particulars in relation to hardware

10.115 The Claimants have provided individual transaction voluntary particulars⁸²⁷ and corresponding supporting documentation in relation to the hardware sale amounting to US\$6 million to Morgan Stanley in Q2 2009.

10.116 The voluntary particulars set out Autonomy's accounting (as presented by the Claimants) as being the recognition of hardware revenue relating to the sale to Morgan Stanley in Q2 2009 and the recognition of COGS in relation to hardware in the same period.⁸²⁸

10.117 The Claimants' accounting treatment reverses the revenue and COGS recognised by Autonomy in relation to hardware in Q2 2009 and instead recognises hardware revenue, and COGS, in the following quarter, Q3 2009.⁸²⁹

10.118 I have reviewed the voluntary particulars in relation to the Claimants' proposed adjustments. Due to the nature of the impugned issue, other than in relation to revenue I do not comment on the Claimants' accounting treatments in the voluntary particulars in relation to this transaction. For ease, my comments are made in section 5 above. The single (material) issue in my view in relation to this transaction is whether the US\$6 million was appropriately recognised in Q2 2009.

My review of the Voluntary Particulars in relation to hosting

10.119 Schedule 6 to the Re-Re-Amended Particulars of Claim sets out the Claimants' pleaded adjustments to Autonomy's reported revenue and profits⁸³⁰ due to the impugned hosting arrangements and corresponds to the Voluntary Particulars in relation to hosting.⁸³¹

⁸²⁷ Voluntary Particulars, spreadsheet "00_Further particulars - Morgan Stanley Q2 2009".

⁸²⁸ Voluntary Particulars, spreadsheet "00_Further particulars - Morgan Stanley Q2 2009".

⁸²⁹ Voluntary Particulars, spreadsheet "00_Further particulars - Morgan Stanley Q2 2009".

⁸³⁰ Profit from operations which is prior to adjustments for interest and tax.

⁸³¹ Voluntary Particulars, spreadsheet "00_Further Particulars - Hosting arrangements_Schedule 6_26.10.18", tab "Hosting Sched 6 -Summary".

- 10.120 The Claimants' proposed adjustments in relation to the hosting transactions are totalled per quarter and set out in Schedule 4 to the Re-Re-Amended Particulars of Claim as "*hosting arrangements*".
- 10.121 The related Voluntary Particulars set out Autonomy's accounting treatment (as presented by the Claimants) in relation to the hosting arrangements as being the recognition of licence revenue. The Claimants' narrative of the adjustments states that "*The revenue that was attributed to the sale of Digital Safe and eDiscovery software licences as part of hosting arrangements was recognised at the commencement of those arrangements*".⁸³²
- 10.122 However, the Claimants assert that "*Each of the hosting arrangements listed in Schedule 6 involving Digital Safe (and/ or software to be used with Digital Safe) or eDiscovery was, in substance, a transaction for the provision of services over the period during which the Autonomy group company hosted the customer's data.*"⁸³³
- 10.123 The Claimants further assert that "*Under IAS 8, paragraph 10, and IAS 18, paragraphs 13, 20 and 25, the hosting arrangements should therefore have been accounted for as services, with revenue recognised over the periods in which the services were provided.*"⁸³⁴
- 10.124 The Claimants' accounting treatment in relation to these transactions in the Voluntary Particulars is that "*For the reasons set out at paragraphs 109 and 110 of the draft Re-Re-Amended Particulars of Claim, the revenue that was attributed to the sale of Digital Safe and eDiscovery software licences as part of hosting arrangements should have been recognised rateably over the term of the licence.*"⁸³⁵
- 10.125 Therefore, the Claimants' proposed adjustments for individual hosting transactions reverse the revenue originally recognised on Autonomy's consolidated income statement in relation to the hosting arrangements and instead carry forward the amounts as deferred revenue on Autonomy's consolidated balance sheet. The revenue is then recognised over the term of the hosting arrangement under IAS 18.20 (rendering of a service).
- 10.126 I have reviewed the individual transaction voluntary particulars in relation to these Claimants' adjustments for the hosting arrangements and make the single comment that each hosted customer arrangement should be considered on its own facts. As I note in section 8, it remains in dispute as to whether 'hosting' can be accounted for as the sale of a software licence, with associated services, or, according to the Claimants, should have been accounted for as solely the provision of a service, irrespective of the IDOL software

⁸³² Voluntary Particulars, spreadsheet "00_Further Particulars - Hosting arrangements_Schedule 6_26.10.18", tab "Hosting Sched 6 -Summary".

⁸³³ Re-Re-Amended Particulars of Claim, page 112, paragraph 109.

⁸³⁴ Re-Re-Amended Particulars of Claim, page 112, paragraph 109.

⁸³⁵ Voluntary Particulars, spreadsheet "00_Further Particulars - Hosting arrangements_Schedule 6_26.10.18", tab "Hosting Sched 6 -Summary".

license. As a consequence, I do not comment on the Claimants' hosting Voluntary Particulars at this time, either transaction by transaction or collectively, in advance of the determination of the disputed facts. I reiterate, however, that each individual transaction should be looked at on its own facts, once any determination of the hosting accounting issues is arrived at, since there are likely to be specific circumstances surrounding individual transactions that could also affect the accounting issues.

My review of the Voluntary Particulars relating to the 'Other' transactions

10.127 The Claimants have provided five sets of individual transaction voluntary particulars in relation to the 'other' transactions which relate to four counterparties detailed on Schedule 7 to the Re-Re-Amended Particulars of Claim.⁸³⁶

10.128 I have reviewed the Voluntary Particulars in relation to the Claimants' adjustments for 'other transactions'. In my view, the Claimants' proposed adjustments in the individual transaction voluntary particulars in relation to the 'other' transactions are consistent with the pleadings as provided in Schedule 7 to the Re-Re-Amended Particulars of Claim. My views on the appropriate accounting for the 'other' transactions are set out in the relevant 'other transactions' sections of my report.

Overview of Mr Holgate's conclusions regarding the Voluntary Particulars

10.129 As a general point, Mr Holgate states that "*If a transaction has no substance then it should have no accounting effect*".⁸³⁷ I agree with this.

10.130 Mr Holgate was instructed by Travers Smith on behalf of the Claimants to "*Please review the 53 sets of Voluntary Particulars that have been served by the Claimants in these proceedings in relation to their case as set out in Schedules 4 and 6 on the draft Re-Re-Amended Particulars of Claim. Please explain whether, on the assumption that the Claimants' criticisms of Autonomy's accounting treatment are established, you agree or disagree with the adjustments to Autonomy's accounting treatment set out in each of the Voluntary Particulars. Insofar as you consider that adjustments should be made which are different from those set out in the Voluntary Particulars, please set out your proposed adjustments in your report.*"⁸³⁸

⁸³⁶ Two sets of voluntary particulars have been provided in relation to Schedule 7, Transaction 1: Tottenham Hotspur for each of the sales transactions that occurred in Q2 2010 and Q1 2011. The folder names of the five sets of voluntary particulars in relation to "other" transactions are: Tottenham Hotspur 2010; Tottenham Hotspur 2011; Prisa 2010; Amgen Inc 2010; and Iron Mountain 2011.

⁸³⁷ Mr Holgate's First Report, page 72, paragraph 7.6.

⁸³⁸ Mr Holgate's First Report, Appendix 2, page 37, paragraph 70.

10.131 In his First Report, Mr Holgate states, “*I have carefully reviewed all 54⁸³⁹ of the Voluntary Particulars in order to determine whether I agree or disagree with the Claimants’ case as set out in columns B and C and whether there are any adjustments that I would propose to the way in which the Claimants have addressed them, on the assumption that the Claimants’ criticisms of Autonomy’s accounting treatment are established...*”⁸⁴⁰

10.132 Mr Holgate then concludes, “*The outcome of my review is that I agree with the adjustments identified in columns B and C, which do not in my view require adjustment.*”⁸⁴¹

10.133 As a result, Mr Holgate agrees with the Claimants’ proposed adjustments in the Voluntary Particulars without revision or amendment or adjustment, despite:

- (a) the fundamental inconsistencies between the Claimants’ allegations concerning the impugned transactions in the Re-Re-Amended Particulars of Claim, and the contradictory accounting treatment and accounting entry consequences proposed by the Claimants in the Voluntary Particulars, (which I have highlighted above); and
- (b) the similar inconsistencies between Mr Holgate’s individual opinions expressed on each impugned transaction and his overall conclusion that “*the adjustments identified in columns B and C [of the Voluntary Particulars], which do not in my [his] view require adjustment*”⁸⁴², which I set out below.

10.134 Such persistent contradictory positions arising from the Claimants’ proposed adjustments in the Voluntary Particulars occur with:

- (a) the Claimants’ entries of deferred revenue which are ubiquitous and undermine the Claimants’ adjustments almost universally across all impugned reseller transactions and generally across the alleged reciprocal transactions (paragraphs 10.135 to 10.142);
- (b) the Claimants’ adjustments to the bad debt charges (paragraphs 10.143 to 10.145); and
- (c) the Claimants’ adjustments in relation to Transaction 5: MicroTech (end-user DiscoverTech) (paragraphs 10.146 to 10.150).

⁸³⁹ This refers to the Voluntary Particulars provided for all the impugned transactions. I assume the total of 54 includes the 53 sets of voluntary particulars plus an additional set of voluntary particulars which was provided by the Claimants in replacement for Transaction 15: Realise (end-user Credit Suisse).

⁸⁴⁰ Mr Holgate’s First Report, page 100, paragraph 9.

⁸⁴¹ Mr Holgate’s First Report, page 100, paragraph 9.

⁸⁴² Mr Holgate’s First Report, page 100, paragraph 9.

The Claimants' recognition of deferred revenue in the voluntary particulars

- 10.135 Firstly, Mr Holgate agrees with the Claimants' allegations generally, where he opines that 34⁸⁴³ of the 37 impugned transactions lacked economic substance.⁸⁴⁴
- 10.136 However, the Claimants' recognition of deferred revenue, which Mr Holgate concludes, "...do[es] not in my view require adjustment",⁸⁴⁵ inherently requires the Claimants to confirm that the transactions have economic substance. Put another way, a recognition of deferred revenue means that there is an expectation at the date of the recording of the transaction that the transaction entered into will result in the transfer to Autonomy of economic benefits associated with the transaction.
- 10.137 This is contradictory to each assertion made by both the Claimants and Mr Holgate⁸⁴⁶ that the impugned reseller transactions lacked economic substance. In my opinion, the Claimants' and Mr Holgate's assertions would result in the accounting situation where no transaction occurred from an accounting perspective, leading to no amounts relating to the transaction being recorded or being capable of being recorded in Autonomy's consolidated financial statements. This is set out in more detail in **Appendix 8**.
- 10.138 Mr Holgate, in his First Report, does not comment on the Claimants' movement of revenue to deferred revenue or any necessary corresponding accounts receivable (or cash) amounts under the Claimants' accounting treatment, and hence omits to address the manifest inconsistency between any allegation that a transaction lacked substance and the proposed adjustments reflected in the Voluntary Particulars in general.
- 10.139 I note that Mr Holgate may subsequently be trying to amend his position in the Joint Statement dated 28 January 2019, where he states in response to an agenda item, "*Yes, the Claimants' Voluntary Particulars correctly reflect that the revenue should not have been recognised on the sale to the VAR but should instead have been recognised on Autonomy's direct sale (if any) to the end-user.*"⁸⁴⁷ However, even this does not address the contradiction in the Claimants' position, and Mr Holgate's support of that position. This is the contradiction where the Claimants' proposed adjustments (presented in Column C to the Voluntary Particulars), as agreed by Mr Holgate, record against the initial

⁸⁴³ In regards to the three remaining reseller transactions, Mr Holgate suggests that for Transaction 5: MicroTech (end-user DiscoverTech), "*the substance appears to be that the \$10 million is, wholly or mostly, a reduction in the acquisition price, rather than revenue*", that for Transaction 17: Comercializadora (end-user TV Azteca) "*The transaction may lack economic substance...*" and that "*...it is hard to see that this transaction had any substance*", and that for Transaction 29: Computer Trading (end-user Poste Italiane) "*It is difficult to determine the substance of this transaction based on the information available to me.*" Mr Holgate's First Report, Appendix 3, page 112, paragraph 2.1, page 132, paragraph 2.1 and page 150, paragraph 2.1.

⁸⁴⁴ Mr Holgate's First Report, Appendix 3. See paragraph 2.1 for each of the remaining 34 impugned reseller transactions excluding Transaction 5, Transaction 17 and Transaction 29.

⁸⁴⁵ Mr Holgate's First Report, page 100, paragraph 9.

⁸⁴⁶ For 34 of the 37 impugned reseller transactions.

⁸⁴⁷ Joint Statement of Peter Alan Holgate and Gervase MacGregor dated 28 January 2019, page 23, paragraph 5(c).

impugned reseller sales transactions an adjusted deferred revenue balance, which then must by association have a compensating asset (in double entry accounting terms).

10.140 Further, in his First Report, Mr Holgate, in relation to the alleged reciprocal transactions in Schedule 5 of the Re-Re-amended Particulars of Claim, concludes that *“For the reasons set out in Chapter 6, I conclude, on the basis of the assumptions I have been instructed to make and other factual information provided to me, that Autonomy should not have recognised revenue on any of the 6 reciprocal transactions and, where the price payable by Autonomy under the linked transaction exceeded the amount to be received by Autonomy, Autonomy should have recognised the net cost as an expense.”*⁸⁴⁸

10.141 In relation to each individual alleged reciprocal transaction, Mr Holgate opines that the Autonomy sale to the six counterparties lacked or had no substance.⁸⁴⁹ However, the Claimants’ recognition of deferred revenue and presumably accounts receivable, which Mr Holgate concludes, *“...do[es] not in my view require adjustment”*,⁸⁵⁰ inherently again requires the Claimants to confirm that each such initial sale had economic substance.

10.142 Mr Holgate further opines that four of the six alleged reciprocal transactions had corresponding purchases that also lacked substance.⁸⁵¹ However, Mr Holgate again does not address the inconsistency between his claim that the purchase lacked substance, which is also alleged by the Claimants, and the Claimants’ proposed adjustments in the individual transaction voluntary particulars, which I refer to above. As a result, as I have already highlighted, Mr Holgate’s confirmation of these voluntary particulars contradicts his own accounting opinions expressed in the relevant section of his report.

The Claimants’ proposed adjustments to the bad debt charges

10.143 Similarly, Mr Holgate agrees with the Claimants’ proposed adjustments to any bad debt charges, as discussed above, stating, *“No sale that meets the criteria in IAS 18, paragraph 14 has occurred; therefore it is incorrect to record a sale and a bad debt expense. A bad debt expense should be recorded when there has been a valid sale but the customer has*

⁸⁴⁸ Mr Holgate’s First Report, page 5, paragraph 2.4.

⁸⁴⁹ Mr Holgate’s First Report, page 60, paragraph 6.21; page 62, paragraph 6.38; page 64, paragraph 6.56; page 66, paragraph 6.73; page 67, paragraph 6.85; and page 69, paragraph 6.96.

⁸⁵⁰ Mr Holgate’s First Report, page 100, paragraph 9.

⁸⁵¹ Mr Holgate’s First Report, page 62, paragraph 6.38; page 64, paragraph 6.56 and page 66, paragraph 6.73. In regards to Transaction 1: Capax Discovery, Mr Holgate opines that *“It is clear from assumptions 5 and 7 above that the linked transaction was artificial and lacked substance.”* I assume this refers to both the sale and purchase transactions. Mr Holgate’s First Report, page 60, paragraph 6.21. In relation to Schedule 5, Transaction 5: EMC, Mr Holgate opines that *“It appears that the net amount paid by Autonomy is attributable to the purchase of some or all of EMC’s products, rights and/or services; and this amount should be capitalised by Autonomy, to the extent that it represents the fair value of the acquired hardware and software.”* Mr Holgate’s First Report, page 67, paragraph 6.86. In relation to Schedule 5, Transaction 6: MicroTech, Mr Holgate opines that *“The structure that Autonomy put in place, and the alternative of paying its own funds to MicroTech, demonstrate that the sale of a software licence to MicroTech had no substance, as there was clearly no intention that Autonomy would expect MicroTech to pay out of its own funds, and that IAS 18.14(d) was not met”*. Mr Holgate’s First Report, page 69, paragraph 6.96.

*defaulted on payment.*⁸⁵² The suggested adjustments are then included in the Voluntary Particulars.⁸⁵³

10.144 Mr Holgate further states that *“If a sale is genuinely made yet results in non-payment, it is correct to retain the sale as part of revenue and to record a bad debt expense. However, where, as here, the sale had no substance and the write off of the debt was simply the mechanism for cancelling the sale, the appropriate accounting treatment is to record nil as revenue and nil as bad debt expense.”*⁸⁵⁴

10.145 In other words, the removal of the bad debt expense is adopted as a corollary of no economic substance but in reality is fundamentally inconsistent with a deferred revenue adjustment that maintains the full balance of the associated transaction in the financial statements, albeit in deferred revenue.

The Claimants’ adjustments in relation to Transaction 5: MicroTech (end-user DiscoverTech)

10.146 Mr Holgate’s First Report comments that, *“if the fair value of the Control Point software that DiscoverTech bought is say \$1 million, then the \$1 million is a valid sale by Autonomy and the remaining \$9 million should properly be regarded by Autonomy as a reduction in the purchase price of Microlink (which would manifest itself as a reduction in the goodwill on acquisition). If the fair value of the Control Point software was nil, then the whole \$10 million should properly be regarded by Autonomy as a reduction in the purchase price of Microlink. I note that the Voluntary Particulars for Schedule 3, Transaction 5 assumes that the whole \$10 million should be adjusted to goodwill, reflecting a fair value of the Control Point software of nil. In the circumstances described above, this seems a reasonable assumption.”*⁸⁵⁵

10.147 I agree with Mr Holgate in the respect that if the US\$10 million sale of the software to MicroTech was at fair value, no adjustment would be needed to Autonomy’s accounting for such a US\$10 million sale to MicroTech (or the acquisition of Microlink by Autonomy). Whether the US\$10 million was at fair value is a matter of disputed fact.

10.148 Mr Holgate agrees that the Claimants’ assumption that the fair value of nil for the Control Point software is reasonable. This is consistent with Mr Holgate’s conclusion that the Claimants’ proposed adjustments, *“...do not in my view require adjustment.”*⁸⁵⁶

⁸⁵² Mr Holgate’s First Report, Appendix 3, page 106, paragraph 3.2; page 118, paragraph 3.2; page 125, paragraph 3.2; pages 126 to 127, paragraph 3.2; page 129, paragraph 3.2; page 133, paragraph 3.2; page 137, paragraph 3.2; pages 140 to 141, paragraph 3.2; page 150, paragraph 3.3; and page 154, paragraph 3.2.

⁸⁵³ This is set out in each of the voluntary particulars for the reseller transactions as can be seen in **Appendix 9**, My Comment 2.

⁸⁵⁴ Mr Holgate’s First Report, page 52, paragraph 5.21.4.

⁸⁵⁵ Mr Holgate’s First Report, Appendix 3, pages 111 to 112, paragraph 2.1.

⁸⁵⁶ Mr Holgate’s First Report, page 100, paragraph 9.

- 10.149 Mr Holgate states that, “...all or most of the \$10m should have been treated as a reduction in the cost of acquisition...”⁸⁵⁷ indicating, in my view, that there is uncertainty concerning the appropriate amount to adjust for under the Claimants’ accounting treatment. Yet, Mr Holgate has concurred that a US\$10 million adjustment is appropriate.
- 10.150 Mr Holgate makes a number of assertions relating to this transaction which I have discussed in detail at **Appendix 3.5**.

My conclusions

- 10.151 In my opinion, the Claimants’ accounting treatment set out in each of the individual reseller transaction voluntary particulars and generally across the Voluntary Particulars as a whole means that the Claimants acknowledge and confirm that each impugned reseller transaction had economic substance. This is inherent in the Claimants’ recognition of a deferred revenue balance (and implicitly an associated asset balance) in relation to each of the impugned reseller transactions (where applicable).
- 10.152 As a result, there is a fundamental inconsistency in the Claimants’ approach to the assessment of each reseller transaction, and its proposed accounting for the same transaction. This is then adopted and corroborated by Mr Holgate.
- 10.153 The same is also the case for the Claimants’ accounting treatment set out in the Voluntary Particulars in relation to alleged reciprocal transactions. Again, the Claimants’ proposed accounting treatment generally reflects yet further fundamental inconsistencies between the Claimants’ allegations in the Re-Re-Amended Particulars of Claim and the Claimants’ accounting treatment adopted in the Voluntary Particulars. Again, for the alleged reciprocal transactions, the Claimants’ accounting treatment requires at least the sale transactions to have economic substance.
- 10.154 Finally, for the other categories of transactions within the Voluntary Particulars, unless otherwise stated in my report, I do not agree with the Claimants’ Voluntary Particulars, or any of the adjustments proposed for the individually impugned transactions or categories of impugned transactions.
- 10.155 With regard to “Column A” in the Claimants’ voluntary particulars, unless otherwise stated in this report, and subject to subsequent determination of the facts and matters that are in dispute in this case, I agree with Autonomy’s accounting treatment with regard to the recognition of revenue in respect of software licences (and, to the extent included in certain of the alleged reciprocal transactions, hardware).

⁸⁵⁷ Mr Holgate’s First Report, Appendix 3, page 112, paragraph 3.2.

11 SUMMARY OF CONCLUSIONS

11.1 In this section of my report I summarise my conclusions in respect of each category of the alleged “*improper transactions and accounting practices*” according to the Claimants:

- (a) hardware sales and disclosures, including the Morgan Stanley hardware transaction (paragraphs 11.3 to 11.18);
- (b) reseller transactions (paragraphs 11.19 to 11.36);
- (c) alleged reciprocal transactions (paragraphs 11.37 to 11.44);
- (d) hosting transactions (paragraphs 11.45 to 11.52); and
- (e) “other” transactions (paragraphs 11.53 to 11.60).

11.2 I also summarise my comments in respect of the Claimants’ Voluntary Particulars (paragraphs 11.61 to 11.66).

Reporting of hardware sales

11.3 In my First Report, I concluded that sales of hardware did not need to be separately or individually disclosed, either under IAS 18.35 or IFRS 8.32. I remain of that opinion after considering Mr Holgate’s First Report.

11.4 I note Mr Holgate refers also to IAS 1. In my opinion, the references to IAS 1 do not take the issue any further.

11.5 In my opinion, I consider that based on the same facts, different judgements could be reached by different accountants in relation to IAS 1 presentational matters within financial statements. In this same context, I consider Mr Holgate’s reference to the need for disclosure of hardware sales under IAS 1.29 by virtue of their nature to be flawed.

11.6 This is all the more the case where Deloitte specifically considered Autonomy’s presentation in its financial statements of these matters as part of its audit and review work, and was satisfied that no additional disclosure was required.

11.7 Overall, I consider that Mr Holgate is seeking to use IAS 1 as a disclosure standard rather than its true purpose as a presentation standard; this being so, his reliance on IAS 1.29 is inappropriate (as also shown by the subsequent amendment of IAS 1.30A).

Disclosure of hardware cost related accounting

11.8 Where Autonomy presented its financial statements, and in particular classified its expenses, on a functional basis rather than by their nature, it was open to Autonomy management judgement as to how to allocate costs to functions.

- 11.9 Whereas Mr Holgate considers that the rationale for the hardware sales has no impact on the appropriate accounting treatment of the costs of the hardware, it is my view that given that it is clear that management's accounting judgement is required when determining how the costs should be presented, it is in fact necessary to consider the rationale behind the sales.
- 11.10 This separately also goes to the heart of the different presentations and the understanding of them by users of financial statements. Both presentations (by nature or function) are allowable and neither has primacy over the other, as set out in IAS 1.
- 11.11 While to Mr Holgate the issue of hardware accounting disclosure is 'obvious' and one of 'common sense', it is apparent that based on the same circumstances different opinions have been reached by different accountants in relation to this issue (i.e. Deloitte and Mr Holgate). If the matter involved no accounting judgement as Mr Holgate suggests, no one could expect such different approaches to occur.
- 11.12 Given that the impact on Autonomy's gross margin of recognising hardware expenses in sales and marketing was a matter of a few percentage points only against an average gross margin of approximately 81% during the Relevant Period, I do not agree with Mr Holgate that for a user of the Autonomy's financial statements to have known that a proportion of hardware costs had been allocated to sales and marketing expenses would have been determinative.
- 11.13 Moreover, it remains that Autonomy's disclosure in this regard was considered by Deloitte as part of its audits/reviews and unqualified audit and/or review opinions were issued throughout the Relevant Period.
- 11.14 In the circumstances of this issue, therefore, I believe that Mr Holgate's position now is at odds with what was known, evaluated and considered at the time, including in the context of the relevant time. Accordingly, my overall opinions have not changed on this matter from those expressed in my First Report.

Morgan Stanley hardware transaction

- 11.15 So long as Autonomy held legal title to the hardware that it was selling to Morgan Stanley as at 30 June 2009, then from an accounting perspective it was possible for Autonomy to recognise revenue. This appears consistent with Deloitte's view at the time.
- 11.16 Subject to a legal determination of transfer of title to hardware from EMC to Autonomy⁸⁵⁸, the US\$6 million of revenue recognised by Autonomy as at 30 June 2009 was appropriate.

⁸⁵⁸ I assume that Autonomy was able to separately identify the US\$1 million balance of the sale from its own inventory, as claimed at the time.

11.17 In my view, Mr Holgate's analysis in proceeding from the factually incorrect second Holgate-Morgan Stanley Assumption leads to the wrong accounting conclusion.

11.18 Further, I also do not agree with the Claimants' voluntary particulars in respect of this transaction.

Reseller transactions

11.19 In general, the Claimants allege that the recognition of revenue in respect of the impugned reseller transactions was not compliant with IAS 18.14(a) (Transfer of significant risks and rewards of ownership), (b) (Entity retains neither continuing managerial involvement nor effective control) (in the majority of cases⁸⁵⁹) and (d) (Probable that economic benefits will flow to the entity)⁸⁶⁰.

11.20 As this allegation refers to IAS 18.14(a), (b) and (d) it can only relate to the licence element of the transaction (and not to the support and maintenance element). Accordingly, my analysis and conclusions focus on Autonomy's accounting treatment of the licence revenue in the income statement and with regard to these criteria under IAS 18.14, which I consider to be the key drivers for revenue recognition for this type of sale.

11.21 In undertaking my review of each of the 37 reseller transactions impugned by the Claimants I have set out in **Appendix 3.1** to **Appendix 3.37** to this report, where applicable:

- (a) my view of Autonomy's accounting treatment based on the information contained in Deloitte's contemporaneous audit and review working papers and underlying documents;
- (b) my opinion on the accounting treatment adopting the Holgate Assumptions, without any consideration of the underlying facts; and
- (c) my understanding of the facts applicable to the Holgate Assumptions, and my conclusion on the accounting treatment.

11.22 For each of the impugned reseller transactions, based on the contemporaneous evidence set out in Deloitte's working papers, I agree with Deloitte that IAS 18.14(a), (b) and (d) were met and it was appropriate for Autonomy to recognise revenue in respect of the

⁸⁵⁹ For the following transactions the Claimants assert in Schedule 3 to the Re-Re-Amended Particulars of Claim (pages 14, 18, 33 and 41) that only IAS 18.14(a) and (d) were not met: Transaction 5: MicroTech (DiscoverTech); Transaction 9: Sales Consulting (end-user Poste Italiane), Transaction 17: Comercializadora (end-user TV Azteca) and Transaction 22: Comercializadora (CISEN).

⁸⁶⁰ In respect of Transaction 5: MicroTech (DiscoverTech) the Claimants allege that IAS 18.14, IFRS 3.51 and IFRS 3.52 were not met. In respect of Transaction 29: Computer Trading (end-user Poste Italiane) the Claimants allege non-compliance with IAS 18.20(b). See pages 14 and 52 of Schedule 3 to the Re-Re-Amended Particulars of Claim.

software licenses sold at the time, except for the transactions set out below where I consider that either:

- (a) IAS 18.14(d) was not met; or
- (b) I have insufficient information to enable me to conclude whether Autonomy's accounting treatment was appropriate.

IAS 18.14(d) not met

11.23 All five criteria under IAS 18.14 must be met in order that revenue can be recognised.

11.24 For two transactions impugned by the Claimants:

- (a) I agree with Deloitte that IAS 18.14(d) was not met;
- (b) therefore, I agree with Mr Holgate that no revenue should have been recognised in respect of these transactions; and
- (c) accordingly, I disagree with Autonomy's accounting treatment in respect of the software licences.

11.25 These transactions are:

- (a) Transaction 9: Sales Consulting (end-user: Post Italiane)⁸⁶¹, which relates to €1.5 million in respect of software licences and €225,000 for one year of support⁸⁶²; and
- (b) Transaction 22: Comercializadora (end-user CISEN)⁸⁶³, which relates to US\$1.0 million in respect of software licences and US\$100,000 for one year of support⁸⁶⁴.

Insufficient information

11.26 For the following four transactions impugned by the Claimants there is insufficient information to reach the conclusion that Autonomy's accounting treatment in respect of the licences was inappropriate:

- (a) Transaction 1: Microlink (various end-users) - this comprises 11 individual transactions totalling US\$15.3 million⁸⁶⁵. I have identified Deloitte working papers for seven of the transactions⁸⁶⁶ (amounting to US\$14.8 million) and I agree with Deloitte that IAS 18.14(a), (b) and (d) were met and it was appropriate to recognise

⁸⁶¹ See Appendix 3.9 to this report.

⁸⁶² Schedule 3 to the Re-Re-Amended Particulars of Claim, page 18.

⁸⁶³ See Appendix 3.22 to this report.

⁸⁶⁴ Schedule 3 to the Re-Re-Amended Particulars of Claim, page 41.

⁸⁶⁵ See Appendix 3.1, paragraph 8.

⁸⁶⁶ See Appendix 3.1, paragraph 10.

a sale in respect of the licences sold under these transactions⁸⁶⁷. For the remaining four transactions, amounting to US\$0.5 million, I have not identified any Deloitte working papers (although I have not seen any evidence that would suggest that IAS 18.14(a), (b) and (d) were not met for these transactions).⁸⁶⁸

- (b) Transaction 14: Auxilium (end-user BAV)⁸⁶⁹, which relates to €2.5 million in respect of software licences and €125,000 in respect of support of maintenance⁸⁷⁰;
- (c) Transaction 19: Red Ventures (end-user Poste Italiane et al)⁸⁷¹, which relates to €2.0 million in respect of software licences and €100,000 in respect of support and maintenance⁸⁷²; and
- (d) Transaction 29: Computer Trading (end-user Poste Italiane)⁸⁷³, which relates to €340,000 in respect of support and maintenance⁸⁷⁴.

Holgate Assumptions in respect of reseller transactions

11.27 In section 6 of this report I consider in general each of the 13 Holgate Assumptions that Mr Holgate has been instructed to adopt in respect of the impugned reseller transactions.

11.28 I also consider these Holgate Assumptions with regard to each individual reseller transaction (to the extent that Mr Holgate has been instructed that they apply) in **Appendix 3.1 to Appendix 3.37** to this report.

11.29 In summary, in my opinion none of the Holgate Assumptions makes any difference to the initial accounting for the impugned reseller transactions save for:

- (a) Holgate Assumption 8, specifically, if Autonomy continued efforts to make a direct sale to the end-user with the intention of relieving the reseller of the debt; and
- (b) potentially, Holgate Assumption 10, the responsibility for payment.

11.30 In respect of Holgate Assumption 6 revenue should not have been recognised if it was known at the time of the sale that a reseller was unable (and would never be able) to pay for the goods being sold. In such a situation, in my opinion the transaction would fail to meet IAS18.14(d) and the revenue could not be recognised until such time as it became probable that the goods would be paid for. However, this is not the same as Holgate Assumption 6 which states that the reseller did not have the ability to pay in the absence

⁸⁶⁷ See **Appendix 3.1**, paragraph 41.

⁸⁶⁸ See **Appendix 3.1**, paragraph 43.

⁸⁶⁹ See **Appendix 3.14** to this report.

⁸⁷⁰ Schedule 3 to the Re-Re-Amended Particulars of Claim, page 27.

⁸⁷¹ See **Appendix 3.19** to this report.

⁸⁷² Schedule 3 to the Re-Re-Amended Particulars of Claim, page 36.

⁸⁷³ See **Appendix 3.29** to this report.

⁸⁷⁴ Schedule 3 to the Re-Re-Amended Particulars of Claim, page 52.

of an onward sale, not that it would never be able to pay. I explain this further in section 6 of this report.

- 11.31 With regard to the reseller's ability to pay Autonomy in respect of its debts, I have reviewed Deloitte's contemporaneous audit and review working papers for each transaction (where available), in particular Deloitte's comments as to collectability. I set out my comments in this regard, as part of my consideration of whether IAS 18.14(d) was met for each of the reseller transactions impugned by the Claimants, in sections 7 to 43 of this report.
- 11.32 In respect of Holgate Assumption 8, if at the time of the sale to the reseller, Autonomy intended to continue to attempt to sell direct to the end-user, and if it intended to cancel the sale to the reseller (or otherwise relieve the reseller of the debt) on a subsequent successful direct sale (or no sale) then no revenue should be recognised in the income statement until such time as, for example, a sale to the end-user made probable the flow of economic benefits to Autonomy.
- 11.33 However, Holgate Assumption 8 is only relevant to the accounting treatment in these particular circumstances described above.
- 11.34 In respect of Holgate Assumption 10, the key part is the assumption that the reseller would not be required to satisfy any liability to Autonomy from its own resources. If it were found that there was a side agreement to this effect, in my opinion the transaction would lack economic substance and would fail to meet at least IAS 18.14(a) and (d) (and likely (b)). In these circumstances, no entries at all in respect of revenue associated with Autonomy's transaction with the reseller should have been recognised in the accounting records, until such time, for example, as a sale to an end-user made probable the flow of economic benefits to Autonomy.

My overall conclusion on reseller transactions

- 11.35 In conclusion, in my opinion, it was appropriate for Autonomy to recognise revenue in respect of the software licences sold under the impugned reseller transactions provided that:
- (a) it was probable that the reseller would be able to pay within a reasonable time, even if at the time of the sale it did not have money in the bank to make payment immediately;
 - (b) Holgate Assumption 8 does not apply in the particular circumstances described at paragraph 6.172; and
 - (c) Holgate Assumption 10 does not apply.

11.36 In such cases (save for the exceptions I refer to at paragraphs 11.23 to 11.26), in my opinion, the recognition of the revenue by Autonomy was valid.

Alleged reciprocal transactions

11.37 In my opinion, a key point in considering the alleged reciprocal transactions is that, even if they are considered “linked” by reference to IAS 18.13, this does not necessarily invalidate the revenue recognised by Autonomy. I set out the required accounting treatment for such transactions in section 7 of this report.

11.38 With regard to the first five alleged reciprocal transactions⁸⁷⁵, in my opinion, it appears that the sales and purchases transactions in each case may have been “linked”, but not necessarily in such a way that they could not be understood without reference to the series of transactions as a whole. I say this because, based on the evidence I have seen, there appears to be a commercial rationale for both the sales and the purchases, and each can be understood on its own terms. It appears that the linkage could have been, in substance, the exchange of dissimilar goods or services that should be accounted for by reference to IAS 18.12, which requires that 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.

11.39 Whether Autonomy had any need for, or received any value from, the products and services it purchased from the counterparties in these transactions is a matter of disputed fact. Clearly neither I nor Mr Holgate is in a position to opine on Autonomy’s need for or the value of those products and services.

11.40 If there was no substance to the purchases made by Autonomy and they were carried out solely to channel funds to the counterparties to pay for Autonomy products and with no anticipated economic benefit to Autonomy, then that would imply that the fair value of the purchases was nil.

11.41 However, if Autonomy was in fact paying for valuable products and services, then the transaction would be recorded at fair value.

11.42 With regard to two of the alleged reciprocal transactions⁸⁷⁶ I make the observation that, as part of its audit and review work, Deloitte explicitly considered whether the transactions were linked and considered the fair value of each of the purchases at the time. Deloitte concluded that it concurred with Autonomy’s accounting treatment.

11.43 In the case of Transaction 6: MicroTech, Mr Holgate does not refer to the transactions as being “linked”, but describes a “*structure*” being put in place by Autonomy by which, it is

⁸⁷⁵ As set out in Schedule 5 to the Re-Re-Amended Particulars of Claim, i.e. Capax, VMS, Filetek, Vidient and EMC.

⁸⁷⁶ VMS and Filetek - see **Appendix 5.2** and **Appendix 5.3**.

alleged, MicroTech was put in funds by Autonomy (via the MicroTech Assignment) to pay Autonomy in respect of a software sale (MicroTech Sale).⁸⁷⁷

- 11.44 Of course, if at the time of the MicroTech Sale, it was intended that the MicroTech Assignment was only being entered into so as to put MicroTech in funds to pay Autonomy for the software sold under the MicroTech sale, then this would call into question the substance of both transactions. However, such an assertion does not take into account the fact that the MicroTech Assignment provided for MicroTech to provide services to Bank of America (whether directly or via Autonomy) and that there is evidence that the software purchased by MicroTech under the MicroTech Sale was needed by MicroTech to undertake those services.

Hosting

- 11.45 As I understand it, the main areas of dispute between the parties in this matter with regard to the accounting treatment of the impugned hosting transactions are:
- (a) whether the Digital Safe software licences were a separately identifiable component of the hybrid hosting transactions, including whether such licences had independent value to the customer, and therefore whether the requirements of IAS 18.14 were met; and
 - (b) whether the fair value of the e-Discovery services could be distinguished from the value of an e-Discovery licence, and therefore whether revenue on a sale for a licence of e-Discovery licence software could be reliably measured by reference to IAS 18.14(c).

Digital Safe hosting arrangements

- 11.46 From my review of the witness evidence on this matter, it is very clear there is a large factual divide between the parties as to whether, even where in fact a customer did take Digital Safe on site at its own premises, the Digital Safe licence could be run independently without Autonomy support; and / or whether it required Autonomy authorisation, installation, implementation and management, even if it could be provided 'on premise'.
- 11.47 The Defendants' witness evidence suggests that the licence component of the hybrid arrangements could justifiably be considered a separately identifiable component to the overall hosting services transaction.
- 11.48 It is on the above basis that both Autonomy, and Autonomy's auditors, concluded on the revenue recognition accounting treatment adopted. As set out in section 8 to this report,

⁸⁷⁷ See **Appendix 5.6** to this report.

I consider both Autonomy and Deloitte to be justified in reaching their conclusions in respect of that accounting treatment, if indeed the facts claimed are so determined.

- 11.49 As I have previously noted, many of the facts, issues and/or circumstances relating to the transactions in dispute are themselves subject to considerable dispute as evidenced by the competing evidence provided by the parties' witness statements. Significantly, there are substantial differences in the witness evidence that are fundamental to a full and proper consideration of the appropriate revenue recognition principles applicable for Digital Safe (and e-Discovery) transactions.
- 11.50 I would emphasise, however, that in my opinion, while it will be a question of fact to be determined, on the basis that Autonomy customers themselves ascribed a value to the licence rights, then prima face, from an accounting perspective, for example the Digital Safe licence was separable from the underlying archiving of customer data.

E-Discovery services

- 11.51 In summary, I agree with the accounting treatment adopted by Autonomy in respect of e-Discovery arrangements (and with which Deloitte also concurred at the time). I say this because I find it difficult to believe that the range of possible costs for these services was so wide that a reasonable estimate of the cost, and therefore the value (on a cost plus margin basis), could not be determined or that Autonomy had no idea of the costs associated with the various parts of its business.
- 11.52 In my experience the assessment of fair value does not require precision and IFRS confirms this. IFRS accepts it is possible in some circumstances to place reliance upon an estimate for fair value without that reliance resulting in a material error.

“Other” transactions

- 11.53 As set out in my First Report, with the exception of the “other” transaction in respect of Iron Mountain, I consider that the main area of disagreement between the parties is essentially the same in respect of the “other” transactions. This is because the Claimants consider that the economic substance of the transactions with Spurs, PRISA and Amgen was that of the provision of a “solution”, to which the provision of services was integral, and that either no revenue, or revenue only to the extent that costs were recoverable, should have been recognised, on the basis that no working solution had been provided to the customer by the end of the reporting period.⁸⁷⁸
- 11.54 This also appears to be the basis on which Mr Holgate forms his conclusions in respect of the transactions with Spurs, PRISA and Amgen.

⁸⁷⁸ Re-Re-Amended Particulars of Claim, paragraphs 115.2 to 115.2.2.

- 11.55 The disagreement between the parties regarding the Iron Mountain transaction is in respect of a fair value adjustment made to revenue on a sale to Iron Mountain on the same day as Autonomy acquired the Iron Mountain Digital Business. The parties disagree on whether such a fair value adjustment was appropriate.
- 11.56 In order to form an opinion on the appropriate accounting treatment for each of the “other” transactions, it is necessary to consider the underlying facts applicable to each transaction, including the contractual terms. As set out in the Joint Statement, both I and Mr Holgate agree that the facts relating to each transaction must be considered on an individual basis as they are highly relevant to its accounting treatment.⁸⁷⁹
- 11.57 With regard to the first three “other” transactions, I conclude as follows:
- (a) Transaction 1 - THS:
 - (i) in respect of Sale 1, I consider that the relevant conditions of IAS 18.14 were met and that it was appropriate to recognise revenue in respect of both the licences and the various services to be provided. I also consider that under IAS 18.13, the elements of Sale 1 could be accounted for separately, i.e. that the licence revenue was not subject to the provision of services, and therefore could be recognised before the services were provided. In addition, I do not consider that Sale 1 was linked to Purchase 1; and
 - (ii) in respect of Sale 2, in my opinion, no revenue should have been recognised in the income statement in relation to the licence fee.⁸⁸⁰
 - (b) Transaction 2 - PRISA: my initial conclusion as set out in my First Report remains unchanged, i.e. that Autonomy appropriately recognised the software licence revenue as at 31 December 2010⁸⁸¹.
 - (c) Transaction 3 - Amgen: in my opinion, Autonomy’s accounting treatment in respect of the licences was appropriate. However, I have seen insufficient information to determine whether IAS 18.20(c) and (d) were met in respect of the infrastructure and support fee and therefore, I cannot give an opinion on whether Autonomy’s accounting treatment in respect of the infrastructure and support fee was inappropriate.⁸⁸²
- 11.58 With regard to “other” Transaction 4: Iron Mountain, Mr Holgate and I agreed in the Joint Statement that, as a matter of accounting, we would both proceed on the basis that

⁸⁷⁹ Joint Statement, page 12, “Agreed view” on “Agenda Item” 3(a) and (b).

⁸⁸⁰ See Appendix 7.1 to this report.

⁸⁸¹ See Appendix 7.2 to this report.

⁸⁸² See Appendix 7.3 to this report.

Autonomy's acquisition of Iron Mountain Digital and the sale of the software licence by Autonomy to Iron Mountain are linked, and that the sale of the software should be recognised at its fair value. The difference between our respective analyses of this transaction then comes down to the evidence that we have considered in respect of the fair value of the transaction as accounted for by Autonomy.⁸⁸³

- 11.59 As set out in my First Report⁸⁸⁴ (and referred to in summary in the Joint Statement⁸⁸⁵), Autonomy arrived at the fair value adjustment in respect of the Iron Mountain Licence by reference to an average of what it considered to be comparable transactions, based on information available at the time. Autonomy's valuation exercise was reviewed by Deloitte at the time, 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."*⁸⁸⁶
- 11.60 Absent any indication of "standard price" or price list, such an approach, i.e. by reference to comparable transactions, is, in my opinion, reasonable.

Claimants' Voluntary Particulars

- 11.61 As set out in section 10 of this report, in my opinion, the Claimants' accounting treatment set out in each of the individual reseller transaction voluntary particulars (and generally across the Voluntary Particulars as a whole) means that the Claimants acknowledge and confirm that each impugned reseller transaction had economic substance. This is inherent in the Claimants' recognition of a deferred revenue balance (and implicitly an associated asset balance) in relation to each of the impugned reseller transactions (where applicable).
- 11.62 As a result, there is a fundamental inconsistency in the Claimants' approach to the assessment of each reseller transaction, and its proposed accounting for the same transaction. This is then adopted and corroborated by Mr Holgate.
- 11.63 The same is also the case for the Claimants' accounting treatment set out in the Voluntary Particulars in relation to alleged reciprocal transactions. Again, the Claimants' proposed accounting treatment generally reflects yet further fundamental inconsistencies between the Claimants' allegations in the Re-Re-Amended Particulars of Claim and the Claimants' accounting treatment adopted in the Voluntary Particulars. Again, for the alleged reciprocal transactions, the Claimants' accounting treatment requires at least the sale transactions to have economic substance.

⁸⁸³ Appendix 7.4, paragraphs 22 to 23.

⁸⁸⁴ My First Report, paragraph 16.92(b).

⁸⁸⁵ Joint Statement, page 39.

⁸⁸⁶ Appendix 7.4, paragraphs 29 to 31.

- 11.64 Finally, for the other categories of transactions within the Voluntary Particulars, unless otherwise stated in my report, I do not agree with the Claimants' Voluntary Particulars, or any of the adjustments proposed for the individually impugned transactions or categories of impugned transactions.
- 11.65 With regard to "Column A" in the Claimants' voluntary particulars, unless otherwise stated in this report, and subject to subsequent determination of the facts and matters that are in dispute in this case, I agree with Autonomy's accounting treatment with regard to the recognition of revenue in respect of software licences (and, to the extent included in certain of the alleged reciprocal transactions, hardware).
- 11.66 I would also reiterate the comments I made in my First Report in that the application of certain accounting standards, and in particular the use of 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.

12 EXPERT'S DECLARATION

I Gervase MacGregor DECLARE THAT:

- 12.1 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.
- 12.2 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.
- 12.3 I know of no conflict of interest of any kind, other than any which I have disclosed in my report.
- 12.4 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.
- 12.5 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 12.3 and 12.4 above.
- 12.6 I have shown the sources of all information I have used.
- 12.7 I have exercised reasonable care and skill in order to be accurate and complete in preparing this report.
- 12.8 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.
- 12.9 I have not, without forming an independent view, included or excluded anything which has been suggested to me by others, including my instructing lawyers.
- 12.10 I will notify those instructing me immediately and confirm in writing if, for any reason, my existing report requires any correction or qualification.
- 12.11 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.

12.12 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.

12.13 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

12.14 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
23 March 2019