Message

From: Sushovan Hussain [sushovanh@autonomy.com]
Sent: 08/07/2010 12:01:21
To: 'Mike Lynch' [mrl@autonomy.com]; 'Andrew Kanter' [andrewk@autonomy.com]
Subject: FW: Email from Director of Revenue

Importance: High

Richard

I have gone through these assertions with Lee Welham. There is nothing new here (again) and they are immaterial. And he has not discussed any of these with me.

1. Lilly / Capax – we have gone through this in detail with the auditors and all the statements made in management's response stands.
2. Maintenance revenue accrual – Lee and Steve discussed the Eli maintenance accrual before I believe and we will be adjusting in Q2. The Etalk maintenance – this is part of the judgment call that head office makes, the auditors audit the judgment call based on evidence. Percy and Brent's assertion that the accrual is over by $500k is in my opinion wrong.
3. Bad debt provision – in accordance with group procedures all provisions are made at the group level and a full discussion takes place with the auditors every quarter end.
4. Capax EAS and EDD – generally each quarter we announce on the quarterly calls that we have removed services. Our relationship with Capax as a trusted partner is good so we will sub contract to them when necessary EDD overflow services. This is part of our normal business.

I reiterate again – there's nothing new nor material in these assertions.

Regards
Sushovan

From: Knights, Richard (UK - Cambridge) [mailto:rknights@deloitte.co.uk]
Sent: 08 July 2010 09:42
To: Sushovan Hussain; Stephen Chamberlain; Mercer, Nigel (UK - London); Knight, Rob (UK - St Albans)
Cc: Welham, Lee (UK - Cambridge)
Subject: FW: Email from Director of Revenue
Importance: High

As per my earlier email –

Can you review and comment.

Richard

From: Brent Hogenson [mailto:Brent.Hogenson@autonomy.com]
Sent: 08 July 2010 00:35
To: auditcommittee@autonomy.com
Cc: Knights, Richard (UK - Cambridge); Knight, Rob (UK - St Albans); Andy Kanter
Subject: Email from Director of Revenue
Importance: High

To the Audit Committee,

I received the email below from Percy Tejeda, Director of Revenue in the Americas since April 2010, which I am sending you as directed by the Whistle Blower Policy I received from Andy Kanter. Since I have not heard a response from the Audit Committee, I am copying Deloitte to ensure this email is received. Please provide me with guidance as to how I should respond to Percy's update request.

Regards,

Brent

From: Percy Tejeda
Sent: Wednesday, July 07, 2010 4:20 PM
To: Brent Hogenson
Cc: Percy Tejeda
Subject: Finance concerns

Hi Brent,

I wanted to follow up with you regarding certain items that I noted during the review process related to the reorganization of the Americas finance organization (effective late April 2010). As we have discussed during the periodic meetings we have had throughout May and June 2010 related to this review process, I have been reviewing the processes and calculations performed by the revenue teams of Autonomy Inc (San Francisco), Zantaz (Pleasanton) and e-Talk (Dallas). This review was to make sure I understood the current policies and procedures in place for each unit, so as to further my understanding of the applicable revenue cycles. During this review, I noted 4 areas of concerns that I raised to you during these meetings, which I felt warranted further scrutiny. Can you provide me with an update on the status of these areas of concerns? Specifically, I want to make sure that these concerns have been heard at the appropriate level of Autonomy, to ensure that the accounting for the transactions described below is correct or, if it is not, that appropriate accounting adjustments are made. The following is a summary of these concerns and some background as well.
<u>Concern 1 - Eli Lilly/Capax resale license order</u>
In May 2010, as part of my increased responsibility regarding Autonomy Americas revenue contracts, I was sent by Livius Guiao (Autonomy Corporate Counsel), a draft of a license agreement between Autonomy, Inc. and Eli Lilly that was currently being negotiated. I reviewed the contract and identified certain clauses in such contract that I believed would affect the revenue recognition of the transaction, as currently drafted. I sent the draft contract and my revenue recognition concerns – i.e. extended warranty and product acceptance—to Steve Chamberlain for his input and guidance, as this was one of the first transactions that I was reviewing for non-Interwoven business. Steve responded back to me that I needed a bit of background on this deal and followed-up with a phone call, telling me that the license revenue associated with the Eli Lilly license transaction had already been recognized in Q4 2009 (in the amount of $6.0 million in license revenue), and that he would send me the contract from Q4 2009 (between Autonomy and Capax) – which he did. He then stated that he noted that there would be a shortfall in license revenue between the license transaction with Capax in Q4 2009 and the contract currently being negotiated between Autonomy and Eli Lilly – and that Matt Stephan (Autonomy Finance Manager) should raise such shortfall to Sushovan Hussain.
I raised this to your attention, since I had concerns regarding the timing of revenue recognition associated with the Q4 2009 transaction, and whether this was indicative of a practice of Autonomy (and could there be more).
In mid June 2010, I was notified that the license agreement between Autonomy and Eli Lilly did close, and such contract included the acceptance language for one of the products and specific warranty for another. During the week of June 21, I received various e-mails from Steve instructing me to reach out to Livius in Autonomy Legal to determine how a discount included in the Autonomy / Eli Lilly contract should be allocated between the fees for the product subject to acceptance and the rest of the fees. Once such determination was done by Livius, Steve asked me to then create a proforma invoice for the fees that would not be subject to acceptance and send such proforma invoice to Capax, so that they could then send an invoice on their paper to Eli Lilly, to get paid and then, presumably, to pay Autonomy on the invoices due from the Q4 2009 license transaction. I responded back to Steve that I was not comfortable with doing that. He then proceeded to call me at least 4 times and walked me through on the phone what needed to be done. I did not create such proforma invoice nor contact Capax. Instead, I forwarded to you the e-mails I had received from Steve related to the Q4 2009 transaction, as well as the instructions he had sent me.
On June 25, the Order Entry team reached out to me regarding the system status of the Autonomy/Eli Lilly contract signed in June, as the order had been entered as a new order. I sent a note to Steve to provide guidance and he responded back stating that Autonomy should not be billing this order and then asked Joel Scott (COO of Autonomy Americas) whether Autonomy should ship the software to Eli Lilly. Joel responded on June 28 that delivery to Eli Lilly should occur. During the week of June 28, Mark Langowski (VP Operations of Autonomy) stated that the June order in the system could not stay as "contingent" in the Autonomy order entry system and needed to be moved forward. He directed the Order Entry team to process the order. I believe I sent you these e-mails as well.
The Autonomy / Eli Lilly order from June 2010 was not billed by Autonomy and my understanding is that license revenue on such June 2010 contract was not recognized.

<u>Concern 2 – Quarter-end Maintenance Revenue Accrual</u>

As part of our review process associated with the reorganization of the Americas Finance organization, I requested copies of the Q1 2010 revenue schedules submitted to Corporate for the Autonomy, Inc., Zantaz and e-Talk groups, as well as the related supporting calculations. In reviewing the maintenance revenue schedules, I identified that a large portion of the quarterly maintenance revenue booked by Autonomy, Inc./Verity, Zantaz and e-Talk had historically been booked by posting a journal entry at the end of the quarter, to accrue maintenance revenue for maintenance contracts that had not yet been renewed but that were likely to renew. Since the dollar amount of such journal entries were significant when compared to the total quarterly maintenance revenue (approx. 25% - 50%), I raised this to your attention.

To better understand the support for these journal entries, I reviewed and discussed (in May 2010) the calculation and the source reports used in such calculations with the accounting staff that booked such entries. I identified the following:

- Autonomy, Inc. – Such calculation was done by Cynthia Watkins at the end of Q1. She used a "configurations" report out of Oracle that would identify the support contracts that were showing as "Active" in the system. She would then calculate the applicable maintenance revenue associated for the period from the last expiration date through the quarter-end date, and use such report to support her journal entry. She referred to such journal entry amount as a standing journal entry and that the amount was somewhat fixed and the report was just used to support such amount. I asked her if she consulted with the Autonomy Renewals team in determining the likelihood of the renewals and whether the "configurations" report was accurate. She mentioned that she did not consult with the Renewals team. When she walked me through the report, we noticed that for the March report, the report included a line item for a renewal for Eli Lilly, which had approximately $1.5 million of back maintenance revenue associated with it. Cynthia stated that the line item was an error, as Eli Lilly had done a deal in Q3 2009, that no longer made the maintenance renewal opportunity for Eli Lilly valid – and could be viewed as a potential error. Based on that observation, I inquired with the Autonomy Renewals team to understand the "configurations" report in more detail (as this one potential error could signal that there were more potential errors in such source report) and Emily Raynal, Autonomy Renewals specialist, stated that such report could have potentially erroneous data, as a renewal that had been declined would need to be updated manually within the system to show as "declined" but that this practice of correcting the status within Oracle may not consistently happen. She also mentioned that she was not usually consulted by Cynthia when such accrual calculation was done.

- E-Talk – Such calculation was done by Courtney Linxwiler, Controller of e-Talk. During my conversation with her, she walked me through her process, which included making an assessment (with consultation with the e-Talk Renewals and Collection teams) of the risk associated with non-renewal. The assessments were "low", "moderate" and "high" and Autonomy's policy was to accrue for the maintenance revenue associated with the renewal opportunities that had been assessed as "low" and "moderate". She mentioned that Autonomy had always been aggressive with such assessment and that for the March accrual 2010, she originally had submitted an revenue accrual amount of approximately $1.5M and was directed to review the calculation again to find more revenue, at which time she stated that she changed the assessment for certain accounts from "high" to "moderate", which resulted in a revised revenue accrual amount of approximately $1.7 million. In addition, when I reviewed the supporting schedule used in the calculation, I noted various renewal opportunity line items that dated back more than 1 year from the March 31, 2010 date, and asked Courtney why the team felt that such items were likely to renew. She said that once in a while, a renewal for a contract with an expiration date that is more than 1 year old would come in, so they left such items in the report.

- Zantaz - This calculation was performed by Ying Liu, Controller of Zantaz. During my conversation with her, she walked me through her process and we walked through the report that she used to make such calculation. She mentioned that she received the schedule from a financial analyst and then calculated the amount associated with any non-current contracts for the respective last expiration date until the applicable quarter-end. I asked her whether she consulted with the Renewals team to determine probability of renewal and she said no. I asked her if she verified the accuracy of the report and she said no. I discussed such report with Melissa Buhagiar, Autonomy Renewals specialist, and asked her whether such report was used by her to identify renewal opportunities and she stated that such report may not be accurate and may not be reflecting an accurate renewal status, given that such report is created and updated manually. I requested that Melissa do a quick review of the March 31, 2010 report and identify any potential errors in such report. The items identified by Melissa accumulated to a potential difference in maintenance revenue of approximately $500K.

<u>Concern 3 – Age of Invoices and Bad Debt Provisions</u>
As part of the review process related to the Finance reorganization, Reena Prasad and I requested copies of the March 31, 2010 accounts receivable aging reports and bad debt reserve detail. Upon reviewing such detail, it was noted that many invoices were significantly past due and that a specific provision for such invoices had not been assigned to them. Reena, as part of her review process, would look into such specific accounts and determine why such delinquent invoices had not been reserved for. I had not heard an update on this but this was concerning when I reviewed the aging reports and specific reserve items.

Concern 4 – Capax EAS support outsourcing arrangement

At the end of December 2009, Phil Smolek, Financial Analyst for Zantaz, left Autonomy and one of the duties that he did was assigned to my team (at the direction of Jim Crumbacher, Autonomy Associate General Counsel) as he needed someone to do the calculations.

As part of an arrangement that was entered into by Autonomy in October 2009, Autonomy agreed to outsource the support obligations for certain Autonomy EAS product customers to Capax, at a cost of 85% of the renewal value to be paid to Capax. Phil provided the workbook supporting his calculations and walked myself and Maureen Lara through the calculation. From December 2009 – March 2010, Maureen would do the calculation and identify the amount per the calculation. Commencing in January 2010, Jim Crumbacher would direct Maureen and me (or forward directions from Andy Kanter, COO of Autonomy) to add an additional monthly amount of $125,000 to the calculated amount needed to be paid to Capax. The explanation given to us at the time was that the expected outsourcing for EAS support was not going as originally projected. Such amount would be added to the PO request and such request was sent to Andy Kanter and Sushovan Hussain, CFO of Autonomy, and both approved each month's PO amount.

In February 2010, Jim requested a schedule of payments from Finance, which would show the amount of payments made by Autonomy to Capax under the EAS support outsourcing arrangement, as well as for EDD processing activities. Since Maureen nor I were involved in calculating the amounts for the EDD processing activities, we requested such amounts from Jane Allen, Zantaz Finance. In putting together the initial schedule, there were certain round amounts included in the EDD processing payment (including a $500,000 payment in December). When I asked Jim about this, he said just to list it as "EDD Services". In the schedule, such payments under both arrangements were then compared against payments made by Capax for a transaction where Capax was to pay approximately $12,450,000 to Autonomy. Such schedule then resulted in a net amount. We prepared the initial schedule in March 2010, and were requested to update such schedule on an as-requested basis.

In May 2010, when I first was made aware of the Capax / Eli Lilly arrangement from Q4 2009 (as detailed in Concern 1 above), I started to have concerns regarding the nature of the payments made to Capax (as Capax had been the reseller involved in the Q4 2009 Eli Lilly order) under the EAS outsourcing and EDD processing arrangements (many of which did not have supporting calculations, to the best of my knowledge), and, in the schedule template provided by Jim, such payments were netted against payments due/made by Capax under a payment schedule. I raised these concerns to you as there appeared to be the potential that such arrangements could be tied to each other.

Please advise if you have updates on these concerns I raised.

Kind regards,

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