

HP Finance Chief Fought Autonomy Deal

Catherine Lesjak's objections to the ill-advised acquisition of a British software firm may prove prophetic for HP.

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In the end, the hero of the ongoing saga of the accounting scandal involving Hewlett-Packard (<http://www.google.com/finance?q=NYSE:HPO>)'s acquisition of Autonomy Corp (<http://www.google.com/finance?q=NYSE:HPO>), may well turn out to have been HP's CFO, Catherine Lesjak (http://en.wikipedia.org/wiki/Catherine_A._Lesjak).

At a July 2011 HP board meeting, "Lesjak vehemently opposed the acquisition to the full HP Board in July 2011[,] stating, in part, 'I'm putting a line down. This is not in the best interests of the company,'" according to court documents.

The CFO was one of only a few board members who spoke out against HP's proposed acquisition of Autonomy, a British software company. But the die appears to have been cast when HP tapped Léo Apotheker (http://en.wikipedia.org/wiki/L%C3%A9o_Apotheker) as its chief executive officer. "[E]xhausted by [abundant] infighting," as one HP director put it, the board took the unusual action of unanimously picking Apotheker in September 2010 even though a majority of members had not met the man.

Four months after taking over as CEO in November 2010, Apotheker declared his attention to quickly "transform" HP from a hardware producer into a software and services supplier. By April 2011, he was meeting with Autonomy founder and then-CEO Michael Lynch to discuss a possible acquisition of the software firm. "Apotheker aggressively pushed the acquisition on the Board over Lesjak's objections," according to the plaintiffs in one of three class-action suits later filed against HP. The \$10.2 billion acquisition was announced in August 2011.

Unfortunately for the computer company, HP's due diligence had proceeded at breakneck speed. Conducted by KPMG, the vetting was allegedly limited to Autonomy's publicly reported financial statements (previously audited by Deloitte Touche Tohamtsu) and about 25 sales contracts.

Apparently, the acquirer didn't know the target company as well as it thought it did. About a year after the acquisition, HP announced it was taking an \$8.8 billion writedown because of accounting improprieties at Autonomy, and its share price began to plummet. In the interim, both Apotheker and Lynch departed, the latter after allegedly earning \$800 million in cash on the sale of his company.

Faced with probes of the merger by the Department of Justice, the Securities and Exchange Commission and the U.K. Serious Fraud Office, HP has placed the blame squarely on its subsidiary, claiming that much of the revenue Autonomy was claiming in the run-up to the merger didn't derive from software, but from the resale of hardware. "While HP eventually learned that a portion of Autonomy's revenues were related to hardware sales, we knew nothing of the accounting improprieties, misrepresentations and disclosure failures related to such sales until after a senior Autonomy executive came forward and HP conducted an extensive investigation," HP asserted in a February 19 statement in response to a question from CFO

HP's probe showed that "Autonomy often resold generic hardware at a loss in the last few days of the quarter with the sole purpose of masking its real financial performance," according to the statement.

Further, the firm allegedly "engaged in improper transactions with certain value-added resellers to create the appearance of software licensing revenue at the end of each quarter. In some instances, these transactions were used to accelerate revenue, and on numerous occasions, these were fabricated transactions with no real end-user."

The lesson for CFOs? If a company is interested in an acquisition, it should perform much more due diligence on the product the target is selling and the accounting documenting those sales than HP apparently did, says George Victor, a partner with Giambalvo Stalzer & Company, a Great River, New York-based accounting firm.

Finance chiefs, in Victor's view, would do well to find out, "What is the reputation of the product on the street? Is the product really selling?" The answers should be based on discussions with actual customers who can reveal whether they're happy with the product or have chosen to give it a pass.

Second, acquirers should look closely at how revenue is actually recognized, "because maybe the accounting has been helped a little bit because the product isn't as stellar as it was [claimed] to be," he says.

Because such scrutiny seems to have been lacking, there's a greater likelihood that Catherine Lesjak's assessment of the Autonomy deal will turn out to be true.

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