HP claims fraud prompted $5B overpayment for co. (Update 3)

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In this Aug. 21, 2012 photo, the Hewlett-Packard Co. logo is seen outside the company's headquarters in Palo Alto, Calif. HP said Autonomy Corporation PLC, a British company it bought for $10 billion last year, lied about its finances, resulting in a massive write-down of the value of the business. HP's net loss for the fiscal fourth quarter, which ended Oct. 31, amounted to $6.85 billion, or $3.49 per share. (AP Photo/Paul Sakuma)

Hewlett-Packard Co. said on Tuesday that it's the victim of a multi-billion dollar fraud at the hands of a British company it bought last year that lied about its finances.

HP CEO Meg Whitman said executives at Autonomy Corporation PLC "willfully" boosted the company's figures through various accounting tricks, which convinced HP to pay $9.7 billion for the company in October 2011.

Autonomy's former CEO said HP's allegations are false.

HP is now taking an $8.8 billion charge to align Autonomy's purchase price with what HP now says is its real value. More than $5 billion of that charge is due to false accounting, HP said.

The revelation is another blow for HP, which is struggling to reinvent itself as PC and printer sales shrink. The company's stock hit a 10-year low in morning trading.

Among other things, Autonomy makes search engines that help companies find vital information stored across computer networks. Acquiring it was part of an attempt by HP to strengthen its portfolio of high-value products and services for corporations and government agencies. The deal was approved by Whitman's predecessor, Leo Apotheker, but closed three weeks into Whitman's tenure as chief executive. Whitman was a member of HP's board of directors when Apotheker initiated the Autonomy purchase.

Among the tricks used at Autonomy, Whitman said: The company had been booking the sale of computers as software revenue and claiming the cost of making the machines as a marketing expense. Revenue from long-term contracts was booked up front, instead of over time.

The allegations are serious, according to accounting experts.

"According to GAAP (generally accepted accounting principles), the overstatement of revenue under any tax code is illegal," said Mark Williams, a finance professor at Boston University and a former bank examiner for the Federal Reserve.

As a result of its alleged accounting practices, Autonomy appeared to be more profitable than it was and seemed to be growing its core software business faster than was actually the case. The moves were apparently designed to groom the company for an acquisition, Whitman said.

Once HP bought the company, Autonomy's reported revenue growth and profit margin quickly declined. Autonomy CEO Mike Lynch continued to run the company as part of HP, but Whitman forced him out on May 23 because it was not living up to expectations.

"Little did I know that there was more than met the eye," Whitman said.

With Lynch gone, a senior Autonomy executive volunteered information about the alleged accounting irregularities, prompting an internal investigation, Whitman said.

The case has been referred to the U.S. Securities and Exchange Commission and the UK's Serious Fraud Office, she said. The company will also try to recoup some of the cash it paid for Autonomy through lawsuits.

In a statement to the Financial Times, Lynch said "The former management team of Autonomy was shocked to see this statement today, and flatly rejects these allegations, which are false."

"It took 10 years to build Autonomy's industry-leading technology and it is sad to see how it has been mismanaged since its acquisition by HP," he added.

On a conference call with Whitman following the earnings report, analyst Ben Reitzes of Barclays Capital asked who will be held responsible internally for the disastrous acquisition.

Whitman answered that the two executives who should have been held responsible—Apotheker and strategy chief Shane Robison—are gone. But the deal was also approved by the board of directors.

"Most of the board was here and voted for this deal, and we feel terribly about that," Whitman said. "What I will say is that the board relied on audited financials. Audited by Deloitte—not 'Brand X' accounting firm, but Deloitte. During our very extensive due diligence process, we hired KPMG to audit Deloitte. And neither of them saw what we now see after someone came forward to point us in the right direction."

Apotheker told The Associated Press on Tuesday that he was "stunned and disappointed" to learn of the allegations against Autonomy, and pointed out that they had gone undiscovered by HP's auditors, executives and directors.

Deloitte UK said it could not comment on the matter because of client confidentiality rules.

Whitman said she still views Autonomy as a "growth engine for HP software," albeit a weaker one than initially thought. HP has been attempting to morph itself into a company that not only makes computer hardware but one that delivers software and services, too.

HP's stock dipped $1.59, or 12 percent, to close at $11.71 in Tuesday's trading. Just after the market's open, the stock hit $11.35, its lowest level since 2002.

HP's net loss for the fiscal fourth quarter, which ended Oct. 31, amounted to $6.85 billion, or $3.49 per share. That compares with net income of $239 million, or 12 cents per share, in the same period last year.

It was the second mammoth loss in a row for HP. In the third fiscal quarter, it lost a record $8.86 billion, or $4.49 per share. That was due to a charge for another acquisition—that of Electronic Data Systems, a technology consulting service that it bought for $13 billion in 2009. In that case, HP didn't blame improper accounting, just results that didn't live up to expectations.

Excluding the charges in the latest quarter, HP earned $1.16 per share in the latest quarter, just above the average analyst forecast of $1.14 per share, as polled by FactSet.

HP's revenue was $30.0 billion, down 7 percent from last year. That was below analyst expectations at $30.5 billion.

The Palo Alto, California, company stuck to its previously given earnings forecast for the fiscal year that just started, but it issued a forecast for this quarter that was well below analyst expectations. It expects earnings, excluding items, to be 68 cents to 71 cents per share, while analysts were looking for 85 cents, according to FactSet.

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