

information and belief based on, among other things, the investigation made by its attorneys, alleges as follows:

NATURE OF THE ACTION

1. This action is brought by Styling against its former outside auditor, defendant Arthur Andersen, LLP (“Andersen”), two Andersen partners, Jay Ozer (“Ozer”) and Dan Nahom (“Nahom”), one of Andersen’s former employees, Bradley J. Schmidt (“Schmidt”) and their respective spouses. Styling seeks to recover damages it suffered as a result of defendants’ negligence in failing to comply with the standards of conduct required of them as professionals in the areas of auditing and business consulting and for Andersen’s breach of its agreement with Styling to provide consulting services.

2. Defendants held themselves out as professionals who would conduct audits of Styling’s financial statements in accordance with applicable standards of conduct for professionals in the auditing industry, as well as standards of professional conduct established by the Arizona Board of Accountancy.

3. Styling hired Andersen to be its auditors for two main purposes. The first was to serve as a watchdog, to ensure that no rogue employee at Styling would do anything unlawful and inappropriate. The second was to ensure that all of the accounting that was done by Styling was proper under Generally Accepted Accounting Principles (“GAAP”) and other rules and regulations governing accounting and financial reporting by public companies.

4. Defendants failed miserably on both accounts. Instead of being an independent watchdog, Andersen was a willing accomplice to the accounting misconduct by two rogue employees, Styling’s Chief Financial Officer, Richard R. Ross (“Ross”), whom Andersen put in that position, and, Philip Teal (“Teal”), Styling’s Body Drench Division’s brand manager whom Ross pressured to book false sales and inflate reported revenues.

5. Andersen's negligent audit procedures fostered an environment in which Styling's GAAP violations implemented by Ross and Teal could continue undetected, which they did for three years, until Styling's Board of Directors was first alerted to the misconduct. Ozer, Schmidt and Nahom repeatedly ignored numerous "red flags" and allowed Ross to misuse GAAP when reporting on Styling's financial condition.

6. Despite the fact that Styling's financial statements for 1997 and 1998 were not prepared in accordance with GAAP, Andersen certified all of them as such and each year issued reports to the Board of Directors of Styling that in its opinion, based upon its audit, the financial statements fairly presented the financial condition of Styling in accordance with GAAP.

7. By turning a blind eye to the misconduct committed by Styling's rogue employees, and worse, by actively assisting Ross and Teal in distorting Styling's financial results, Andersen was able to obtain a multi-million dollar consulting project for Styling.

8. Specifically, Andersen's Business Consulting Group entered into an extremely lucrative consulting and servicing agreement with Styling whereby Andersen was responsible for designing and implementing the Oracle system, the Company's new accounting data and financial information system, as part of the Company's strategic consolidation project.

9. Andersen held itself out as an expert in the area of business consulting services. Styling trusted Andersen to provide those consulting services to it in a professional manner. Andersen's Phoenix office and Ozer personally were lauded by Andersen's home office for generating nearly \$5 million in billings as a result of its systems conversion consulting project.

10. Unfortunately, Andersen failed to carry out its consulting services in a professional manner. As a result, Styling's accounting and information systems were not delivered in a timely manner, and once delivered, did not work. Thus, Styling spent 1999 without the necessary management information to run its business and was saddled with paying inflated general and

administrative expenses because of the need to run redundant systems. The result was a failure of Styling's "consolidation" plan, leading to Styling's precipitous financial ruin.

11. On August 31, 2000, Styling filed for protection under Chapter 11 of the United States Bankruptcy Code. Styling's Plan of Reorganization was approved on August 21, 2002 and as part of that plan Styling will be liquidating its remaining assets.

12. Styling's financial ruin resulted directly from Andersen's negligence in connection with its annual audits and the systems conversion consulting engagement for which Andersen was retained. Absent Andersen's negligence and other wrongdoing, Styling's demise could have been averted. The Board of Directors of Styling would have taken appropriate and timely remedial measures to stop the misuse of accounting practices which Andersen should have addressed and to ensure that the appropriate people (other than Andersen staff) implemented the Oracle system conversion.

JURISDICTION AND VENUE

13. Defendant Andersen at all times relevant to the claims being asserted herein, conducted business in Arizona and caused events to occur in Maricopa County out of which the claims being asserted herein arose.

14. Defendants Jay Ozer and Jane Doe Ozer, husband and wife, are and were, at all times relevant to the claims being asserted herein, residents of Maricopa County, did business in Arizona and caused events to occur in Maricopa County out of which the claims being asserted herein arose.

15. Defendants Dan Nahom and Jane Doe Nahom, husband and wife, are and were, at all times relevant to the claims being asserted herein, residents of Maricopa County, did business in Arizona and caused events to occur in Maricopa County out of which the claims being asserted herein arose.

16. Defendants Bradley J. Schmidt and Jane Doe Schmidt, husband and wife, are and were, at all times relevant to the claims being asserted herein, residents of Maricopa County, did business in

Arizona and caused events to occur in Maricopa County out of which the claims being asserted herein arose.

17. The Court has jurisdiction over all the defendants and the claims set forth below. Defendants have damaged Plaintiffs in an amount not less than the minimum jurisdictional amount of this Court. Venue is proper in Maricopa County.

PARTIES

18. Plaintiff Styling is a Delaware corporation headquartered in Scottsdale, Arizona. Styling was a developer, producer, and marketer of professional salon products, including hair, nail, skin, and body care products. Styling's strategy was to buy many small beauty product companies, put them together into one larger company, and increase the sales and lower the costs of each company compared to what each company could do on a stand-alone basis.

19. Defendant Andersen is a limited liability partnership of licensed professional accountants with offices located worldwide, including within this county in Phoenix, Arizona. At all relevant times Andersen provided outside auditing services to Styling. Andersen audited Styling's annual financial statements for the years ended December 31, 1997, December 31, 1998 and December 31, 1999, which were, with Andersen's knowledge and approval, included in each of Styling's Forms 10-K filed with the U. S. Securities and Exchange Commission ("SEC"). Andersen certified that those financial statements were prepared in compliance with GAAP. Andersen also reviewed each of Styling's quarterly financial statements filed with the SEC on Form 10-Q.

20. Defendant Jay Ozer was the Engagement Partner on the 1996, 1997 and 1998 audits. Ozer was also responsible for convincing Styling to retain Andersen as its consultant on the Oracle implementation project.

21. Defendant Bradley J. Schmidt was the Manager on the 1997 and 1998 audits, and the Senior Staff Accountant on the 1996 audit.

22. Defendant Dan Nahom was the Engagement Partner on the 1999 audit, the Concurring Partner on the 1998 audit and the Engagement Partner on the audit of the restated 1997 and 1998 financial results.

23. Ozer, Schmidt and Nahom are collectively referred to as the “Individual Defendants” and, together with Andersen, the “Defendants.”

24. The Individual Defendants and their respective spouses named as defendants herein are and were acting on behalf of themselves and on behalf of their respective marital communities.

SUBSTANTIVE ALLEGATIONS

I. ANDERSEN WAS INTIMATELY FAMILIAR WITH STYLING FROM ITS INCEPTION

25. Andersen was there from the beginning and facilitated Styling in its efforts to complete its initial public offering and the initial acquisitions. Starting in early 1996, Andersen served as a business advisor to Styling’s chief executive officer, Samuel Leopold, by conducting exploratory investigative work on potential acquisition targets.

26. In addition, Andersen: a) conducted due diligence necessary to establish the price that Styling would pay for the companies that Styling would acquire; b) audited three years of financial statements for the original four companies for inclusion in Styling’s registration statement; and c) assisted Styling in preparing the Form S-1 and other documents necessary for its initial public offering (“IPO”). Ozer was the Andersen audit partner, Ross was the manager, and Schmidt was the senior on those engagements.

27. The IPO was completed in November 1996. Styling financed the acquisition of the first four professional salon products businesses with the proceeds from its IPO. The first four to be acquired were Kotchammer Investments, Inc. which became Styling Research; Gena Laboratories, Inc.; JDS Manufacturing Co., Inc.; and, the Body Drench Division of Designs by Norvell, Inc. (“Body

Drench”).

28. In connection with the IPO, Andersen issued its report of its audit of the financial statements of Styling and the four acquired companies as of November 26, 1996, in which it stated that the financial statements presented fairly, in all material respects, the financial position of Styling and those divisions in conformity with GAAP.

29. The same Andersen team that worked on Styling’s IPO also did the audit for Styling’s year ended December 31, 1996, including a roll-forward of each division’s financial results, and reviewed Styling’s financial statements for quarter ended March 31, 1997. In reporting its opinion on the financial results for year 1996, Andersen certified that the financial statements presented fairly, in all material respects, the financial position of Styling in conformity with GAAP.

30. To solidify Andersen’s relationship with Styling, Ozer persuaded Styling to hire Ross as Chief Financial Officer. Ross had been the Andersen manager on all of the acquisition audits and due diligence assignments as well as the 1996 audit and the first quarter 1997 review. Ross became Chief Financial Officer (“CFO”) in April 1997 and in June 1997, he was also named Vice President, Treasurer and Secretary of the Company.

31. As soon as he became the Company’s CFO, Ross took over the financial reporting and accounting reigns and immediately began to carry out many improper accounting practices. Ross also quickly became responsible for high pressure sales goals placed upon the Company’s brand managers including Teal. Throughout the relevant period, Ross maintained a close relationship with the Andersen personnel working on the Styling audit.

32. Schmidt worked as a senior staff auditor at Andersen reporting to Ross on the IPO. When Ross left for Styling in 1997, Schmidt moved up the ranks to become the Manager on Styling's 1997 and 1998 audits. Schmidt’s professional relationship with Ross remained very close while Ross served as Styling’s CFO. Then, in April 1999, Ozer and Ross installed Schmidt as Styling’s Vice

President of Accounting and Finance.

II. ANDERSEN LEARNED OF MAJOR PROBLEMS AT STYLING EARLY ON

33. In preparing for the IPO with Styling, in selecting companies to be acquired, in conducting all of its audit work in 1996 and early 1997, Andersen had every opportunity to “kick the tires” and to ask the hard questions to determine whether the financial information on the books of this newly formed company, and the constituent companies that made up Styling, comported with GAAP.

34. As part of the due diligence for Body Drench, Andersen reviewed the books of Body Drench and sent auditors to the Body Drench warehouse to inspect the inventory. Andersen’s review and analyses were completely lacking. Body Drench was plagued with improper revenue recognition and an inventory bloated with obsolete product. Andersen made no determination regarding the “saleability” of the products in the warehouse and did not catch bogus sales that Body Drench recorded on its books.

35. Body Drench’s financial problems were readily apparent to anyone who really looked. David Zeigler, Styling’s original Chief Financial Officer, found major problems upon visiting the Body Drench warehouse immediately after the IPO. Zeigler prepared a report of his findings and, during Andersen’s 1996 audit, Zeigler told Ozer, Schmidt and others at Andersen about Body Drench’s obvious fraud. Andersen reviewed Zeigler’s report, and that work resulted in the adjustment of Styling’s financial statements for 1996. This revelation resulted in a dispute over adjustments to the purchase price that Styling sought pursuant to the Body Drench sales contract which quickly lead to litigation between Styling and Norvell, from whom Styling acquired Body Drench.

36. By virtue of this blunder, Andersen caused Styling to pay too much for Body Drench

given that the final purchase price was set, in part, based on the audited financial statements. In fact, Andersen failed to seriously test the books and records of any of the four companies Styling originally acquired. Rather than confessing to this, Andersen blessed what would become Ross' systemic, egregious accounting manipulations that did not end until nearly three years later when Styling came under SEC scrutiny.

III. ANDERSEN APPROVED OF ALL OF ROSS' ACCOUNTING PRACTICES DESPITE KNOWING THAT SUCH PRACTICES WERE INAPPROPRIATE

37. Once Zeigler was discharged and Ross was put at the helm of the financial systems and controls, Ozer and Nahom, with Schmidt's active assistance, allowed Ross to misuse GAAP by, among other things: recognizing revenues and sales in the wrong periods, booking false sales; not reserving for or writing off accounts receivable and obsolete inventory; recording to goodwill and reserves numerous items that should have been expensed; and using cookie jar reserves to hide ordinary course expenses.

A. Andersen Approved Recording Of Bogus
Sales and Improper "Bill-and-Hold" Sales

38. In 1997 and again in 1998, the Andersen audit team identified revenue recognition as one of the most significant audit risks in the Styling audit. By identifying revenue recognition as an audit risk, Andersen was acknowledging that this was an area which was particularly prone to fraud or material misstatements which would effect the financial statements of Styling.

39. To meet sales goals, Teal invoiced sales for product that were either not shipped, or shipped to off-site warehouses for later distribution to Styling's customers. These invoices were booked as sales even though they were not true sales.

40. Although Andersen had an obligation to test the material invoices before expressing an opinion on Styling's financial statements, it either failed to do such testing, or performed such testing in a

negligent manner. In so doing, Andersen violated Generally Accepted Auditing Standards (“GAAS”).

41. Had Andersen field auditors shown any professional skepticism, they would have quickly learned of the bogus sales.

42. In fact, Teal expressly told Andersen personnel that some sales were not “clean.” This was a glaring red flag that should have led to much more extensive testing and analysis of the revenue recognized by Styling.

43. Despite the obvious red flags that existed in Styling’s division level financial data, Andersen did not conduct appropriate third party verification required in an audit, did not verify that the sales process was in fact complete on many of the invoices as required to properly book a transaction as a sale, and did not do an adequate job of determining whether the invoices being booked were, in fact, “real” sales.

44. Almost all of Styling’s divisions were engaging in a process known as “bill-and-hold.” These “bill-and-hold” transactions totaled well over ten million dollars in revenue. A “bill-and-hold” transaction is a sale for which a buyer has been billed, but the buyer, due to circumstances arising out of the ordinary course of business, requests that the seller hold the product for later shipment. The SEC has established seven criteria that must be met in order to properly record a bill-and-hold sale. Nearly all of Styling’s “bill-and-hold” transactions failed to meet the very strict criteria established by the SEC.

45. Despite the fact that Andersen’s audit team was well aware of the SEC criteria for recognizing revenue for “bill-and-hold” transactions, it certified Styling’s financial statements in which Ross included sales that did not meet the SEC’s “bill-and-hold” criteria.

46. Despite the fact that Ozer and Schmidt were aware of these revenue recognition issues (the bogus sales at Body Drench and the “bill-and-hold” transactions throughout Styling), they were not brought to the Board of Directors’ attention as issues that could lead to materially false financial statements if not properly resolved.

47. In spite of the obvious improper accounting methods that Ross used to artificially boost Styling's and Body Drench's revenues and profits, Andersen issued unqualified opinions on STC's 1997, 1998 and 1999 financials. In reality, Styling's sales were dramatically overstated for 1997 and 1998.

48. Had Andersen conducted a proper audit of the financial statements for 1997 and 1998, Styling's Board of Directors would have learned: (a) that sales were not what they appeared to be; (b) that Styling lacked the internal controls to catch the inappropriate use of "bill-and-hold" transactions as well as bogus sales; and (c) that Andersen had recommended a crooked chief financial officer. Instead, Styling's Board of Directors was lulled into a false sense of security that: (a) the Company's sales were growing at a healthy pace; (b) Styling had adequate internal controls; and (c) Styling had an adequate and honest chief financial officer.

A. Andersen Let Ross Cause Styling To Prematurely Recognize Revenue in Violation Of GAAP

49. In planning for the 1997 and 1998 audits, Andersen recognized that an unusual increase in revenues at quarter-end was a red flag that revenue might not be recorded in the proper period. Andersen also understood that when product is billed but shipment does not occur until a later date, that raises revenue recognition issues.

50. As a result of Teal's frantic, eleventh-hour booking of bogus sales, Body Drench's sales increased ten-fold from November to December 1997. Sales at Styling's ABBA division soared 268% from November to December 1997. Given the history of bill-and-hold invoices from the previous year at Body Drench and the sales cut-off difficulties historically encountered, these huge increases in sales in the last month (and mostly on the last day) of the year should have prompted greater scrutiny by the auditors. Instead, Ozer, Nahom and Schmidt completely ignored these red flags.

51. For example, Teal caused Body Drench to record four large sales made on December 31, 1997 totaling \$944,000 or nearly 27% of sales for that month. The nature and timing of these sales should

have triggered further review and much more scrutiny by the auditors. For two of these sales the product had not even been shipped. The Company's revenue recognition policy as stated in the notes to the 1997 financial statements was that "the company recognizes revenue from sales when the product is shipped." Astonishingly, Andersen deemed the unshipped sales as proper and permitted Body Drench to record revenues for these sales. A similar situation at Body Drench happened in 1998.

52. The cut-off testing performed by Andersen at ABBA revealed that approximately \$1.1 million of the \$2.1 million of sales tested had not been shipped until after year-end, a clear reflection that the sales should have been recorded in the subsequent year. Yet, no audit adjustment was proposed for this clear violation of GAAP accounting.

53. Instead, Ozer and Schmidt stepped in to assist Ross to find a creative way to justify the improper timing of revenue recognition. Styling's publicly disclosed, unambiguous policy was to recognize revenue from sales only when the product is shipped. Ozer and Schmidt understood that the policy prevented Styling from recognizing revenues from these many "eleventh-hour" sales. Thus, in February 1999, Andersen orchestrated a change in Styling's revenue recognition policy, effectively redefining what constitutes a "sale," and applied this changed policy retroactively.

54. Andersen violated SEC rules by not disclosing this change in policy and by not providing a letter to the SEC stating that the new policy was preferable.

C. Andersen Failed To Challenge Ross' Representations That Accounts Receivable Reserves Did Not Need To Be Increased

55. Auditing is not simply asking questions of management and accepting those answers blindly. However, that is exactly what Andersen did with regard to the collectibility of accounts receivable.

56. For the years 1995 and 1996, Body Drench's receivables were outstanding for an average of 43 days. By the end of 1997, Body Drench's receivables were outstanding, on average, for 146 days.

57. This tripling of the age of accounts receivable was a red flag that there were serious problems at Styling, and that a substantial write-off of accounts receivable should have been taken as part of the 1997 year end financials. Rather than require a significant write-off of these aging receivables, or do independent testing of their collectibility, Ozer and Schmidt simply relied on representations from the likes of Ross that all of the receivables were collectible.

58. By the end of 1998, Body Drench had \$6.7 million over 90 days old, or 48% of the total accounts receivable balance of \$13.8 million. And yet, of this \$6.7 million, only \$539,000 was specifically reserved for. Andersen's justification for not taking a write-down to accounts receivable in the 1998 financials was that "management," including Ross, assured them that the receivables were collectible.

59. In February and March 1999, Ross, with Ozer's and Schmidt's consent, told Teal to send letters to customers to have them acknowledge their accounts receivable obligations, stating, in part: "Consistent with our standard return policy, this debt may also be satisfied by return of merchandise or the release of such merchandise for further disposition." Andersen accepted the description of these letters as "notes" from customers. In fact, these letters were "confirmations" that had been faxed to customers and then faxed back to Styling. Andersen adopted these letters as their rationale for not requiring Styling to appropriately increase reserves. GAAS requires that the confirmation process to be done completely independent and away from the client to eliminate the chance of tampering with the audit evidence. The "signed notes" were not independently obtained as required to satisfy the rules of obtaining audit evidence, and should not have been considered reliable. Moreover, the unconditional right of return required, at a minimum, that a reserve be taken for the estimated returns. No such reserve was ever taken, or requested, by Andersen.

D. Andersen Allowed Styling To Abuse Acquisitions Accounting

60. Ross caused Styling to engage in aggressive policies with regard to purchase accounting. Ross clearly informed Andersen, including Ozer and Schmidt, that he intended to employ these policies, and he did so with Andersen's blessing.

61. Andersen failed to comply with GAAS in testing Styling's use of acquisition accounting and goodwill and to keep a close check on Ross' application of purchase accounting policies. In almost every acquisition, Andersen ensured that the goodwill recorded was nearly 100% of the purchase price. Andersen then permitted Ross to take costs that should have been expensed immediately on the income statement and instead write them off against goodwill, recording them on the balance sheet and amortizing them over twenty five years. Ross, with Andersen's blessings, also caused Styling to increase reserves against which Styling charged costs that should have been expensed.

62. Looking for all sorts of other ways to capitalize costs on the balance sheet instead of taking the earnings impact up front by expensing them on the income statement, Andersen allowed Ross to add such things to goodwill in year 1997 as Ziegler's severance, three law firms' fees, and the salaries of two employees of a Styling division who had left at some unspecified prior date.

63. Andersen also allowed Ross to use purchase accounting to mask obsolete inventory and questionable accounts receivable by allowing goodwill to be increased and allowing reserves to be set up for receivables and inventory. Andersen approved of Ross attributing two-thirds of doubtful accounts to goodwill, and one-third to bad debt expense in year 1997; the goodwill portion of which would be capitalized and amortized over 25 years. Through 1998, Andersen allowed Ross to book almost \$4 million to goodwill for inventory adjustments and accounts receivable in direct contravention of SEC rules, thereby allowing Styling to avoid a hit to its income statement that would have wiped out all profits for 1996 through 1998.

64. In addition to turning a blind eye to Ross' overly aggressive use of purchase accounting for all of the new companies that Styling acquired, Andersen let Ross add to goodwill and reserves for prior acquisitions throughout the period 1996 through at least 1998. These additional costs which were added to goodwill included Andersen's fees, Styling's law firms' fees, inventory adjustments, severance for employees whose termination was unrelated to any acquisition, and a host of other costs incurred in the ordinary course. These costs amounted to more than \$13 million, and should have been expensed in the period incurred.

65. Andersen knew the accounting rules applicable to goodwill and acquisition accounting. Nevertheless, Andersen allowed Ross to violate GAAP and certified the financial statements which contained those GAAP violations.

E. Andersen Created A Cover-Up For Styling's Non-Collectible Aged Accounts Receivable

66. For the quarter ended June 30, 1999, Styling reported that it would take a \$5.1 million write off of receivables. Styling attributed this write off to accounts receivable that would not be collected from distributors who were about to be terminated as part of a restructuring of the Body Drench division. By attributing the write off to a restructuring, Andersen showed the \$5.1 million as an extraordinary one-time charge, thereby not affecting operating earnings. This was a cover-up, manufactured by Ozer, to remove from Styling's books the accounts receivable that were generated from bogus sales without having it affect earnings or having to explain how those bogus receivables got on Styling's books in the first place.

67. The "restructuring" cover-up was hatched in response to an inquiry made by General Electric Capital Corporation ("GECC"). GECC was considering establishing a \$90 million line of credit for Styling in June 1999. As part of its due diligence, GECC had a conference call in which Ozer participated. GECC questioned why Body Drench's accounts receivable in excess of 90 days

old had grown so substantially. GECC expressed concern that while those receivables were not part of the lending base, it could be an indication of problems. Ozer responded that the large amount of aged accounts receivable were due to the number of small distributors that Body Drench had used to distribute its products and that Body Drench was about to revamp the way it did business, terminate a number of small distributors and use only a limited number of distributors in the future.

68. It was Ozer who made the connection, for accounting purposes, between the restructuring of Body Drench and the uncollectible accounts receivable. The receivables to be written off, in truth, had no relationship to the alleged termination of distributors; the decision of which distributors to cancel did not occur until months after the announcement of the write off.

69. Thus, the \$5.1 million write off hid the fact that: (1) Styling's operating earnings for 1997 and 1998 were substantially less than reported because Ross had included in Styling's financial results certain sales that never should have been recorded in those years; (2) the write off was due to events that occurred in the ordinary course of business and not due to a one-time extraordinary event; and (3) that Andersen was aware of the bogus sales but did nothing about it.

IV. ANDERSEN'S GAAS VIOLATIONS

70. Andersen knew of, or was negligent in failing to recognize, the aforementioned accounting practices even though such practices were contrary to GAAP. Nor were the numerous deficiencies in the Company's accounting systems which Andersen knew about ever reported. These reportable conditions related directly to the types of irregular accounting practices described above that led to the overstatement of net sales and net income during 1997 and 1998.

71. Andersen represented that it had audited Styling's annual financial statements in accordance with GAAS and that the financial statements presented fairly, in all material respects, the financial position of Styling at each respective year-end and the results of its operations and cash flows for each of those years in conformity with GAAP.

72. As Styling's independent auditor, Andersen owed a duty to Styling to comply with the auditing standards of the AICPA, of which Andersen is a member firm, and the standards for auditors established by the Arizona Board of Accountancy, and to use due diligence to ensure that Styling's financial statements fairly presented, in all material respects, Styling's financial position, results of operation, and cash flows.

73. GAAS is comprised of auditing standards approved by the AICPA in effect at the time of the audit as well as the AICPA's Statements on Auditing Standards ("SAS") that interpret those standards. The auditing standards are codified in the AICPA Codification of Statements on Accounting Standards. (AU Section 100, *et seq.*). GAAS and GAAP represent only minimum standards.

74. Andersen either negligently failed to recognize or knowingly ignored numerous "red flags" in Styling's financial statements. In failing to recognize and/or report the false and misleading misrepresentations in Styling's financial statements, Andersen either negligently or fraudulently failed to comply with GAAP and GAAS. If Andersen had conducted its audits in compliance with GAAS, it would have detected the improper accounting practices occurring in Styling's divisions and the resulting overstatement of net sales would have been reported to Styling's Board of Directors.

75. GAAS requires that an auditor exercise due professional care in performing an audit and in preparing the audit report. GAAS also requires that each audit be planned and performed with an attitude of professional skepticism. Andersen negligently failed to adequately plan and supervise its audits of Styling. The auditors assigned to work on the Styling audits were young and inexperienced. These auditors were unable or unwilling to detect Ross' obvious departure from GAAP.

76. In addition, Andersen was aware that prior to the implementation of the Oracle system, the Company had, at various times, as many as five different computer operating systems in place within the various divisions and that those computer systems were not compatible with the system at the Styling home office or with each other. Therefore, Andersen knew, or was negligent in failing to

discover, that the financial statements prepared using data received from the various computer systems were likely to be materially false and misleading and that the only way to determine if the financial information was material false and misleading was to examine the financial data of the individual divisions.

77. Andersen failed to exercise due professional care in the performance of its audit of Styling's financial statements for 1997, 1998 and 1999. Among other ways, Andersen failed to adhere to professional standards by: inadequately planning its audit; inadequately staffing and supervising its audit; failing to understand Styling's internal control structures sufficiently; failing to obtain sufficient competent evidential matter; improperly issuing unqualified audit reports; and failing to act with appropriate independence.

A. Andersen Negligently Failed to Plan its Audit Adequately

78. GAAS provides that an audit is to be adequately planned. Audit planning involves developing an overall strategy for the expected conduct and the scope of the audit. In planning an audit, the auditor must obtain knowledge of the matters which relate to the nature of the entity's business, its organization, and operating characteristics. The auditor is required to design the audit with professional skepticism (AU, Section 316) in order to provide reasonable assurance of detecting errors and irregularities (AU 311.03), material misstatements (AU 312) or fraud (AU 316). The auditor also must design the audit plan to account for the possibility that an entity may be unable to continue as a going concern (AU 341).

79. Andersen was negligent in failing to comply with GAAS because it failed to design its audit plan to provide reasonable assurance of detecting material error as required by Statement of Auditing Standards No. 82, *The Auditor's Responsibility to Detect and Report Errors and Irregularities* (AU 316A).

80. Andersen either knew or was negligent in not knowing that Ross was improperly

recognizing revenue and that Styling did not have the internal controls necessary to prevent the improper practices nor the accounting systems necessary to track the problems with the accounts receivable, all in violation of GAAP. Despite these obvious issues, Andersen failed to develop an adequate strategy for the conduct and scope of the audit of the Company's revenue reporting. Further, Andersen sent young and inexperienced auditors to conduct the audits of Styling's financials and failed to supervise and evaluate the work of its assistants so as to establish and carry out effective procedures reasonably designed to detect the existence of errors and irregularities which materially affected the Company's financial statements.

81. In developing its audit plan, GAAS required Andersen to consider the so called "audit risk" that Andersen might fail to recognize that the Company's financial statements were materially overstated as a result of errors or irregularities. (AU Section 312.02, note 1.)

82. Andersen either: (1) failed to recognize red flags and to plan and implement an adequate audit that took into account those audit risks, or (2) if it had an adequate audit plan, it failed to follow it, or (3) if it had an adequate plan and followed it, Andersen ignored the results of its findings and issued its unqualified opinions anyway.

B. Andersen Failed to Supervise its Audit Adequately

83. GAAS requires that the auditor adequately supervise employees conducting the fieldwork (SAS # 22, AU Section 311).

84. Supervision involves directing the efforts of assistants involved in accomplishing the objectives of the audit and determining whether those objectives were accomplished. The work performed by each assistant must be reviewed for adequacy and evaluated to determine whether the audit results are consistent with the conclusions expressed in the auditor's reports.

85. Andersen failed to follow these required standards in its audits of the Company's financial statements. Andersen violated GAAS by: (1) failing to provide adequate

direction to staff personnel to gather the required evidential matter that would have unveiled the accounting violations described above; and (2) failing to perform adequate review of the work performed by staff members in connection with the audit, which would have uncovered the failure of Andersen personnel to inspect supporting documentation for the improper recognition of revenue.

C. Andersen Failed to Understand Styling’s Internal Control Structure Sufficiently

86. GAAS Standard of Field Work No. 2 requires the auditor to make a proper study of existing internal controls, including accounting, financial and managerial controls, to determine whether reliance on those controls was justified, and if such controls are not reliable, to expand the nature and scope of the auditing procedures to be applied. A company’s internal control structure consists of policies and procedures established by the company to provide reasonable assurance that its objectives will be achieved. The auditor must focus on the substance of management’s policies and procedures, not their form, because management may establish appropriate policies and procedures but not act on them.

87. An auditor must perform procedures to obtain a sufficient understanding of the three elements of a company’s internal control structure: the control environment, the accounting system, and control procedures. The control environment, which includes management’s integrity and ethical values, is the foundation of internal control and sets the tone of the organization. The auditor must assess control risk – the risk that a material misstatement contained in the company’s financial statements will not be detected and prevented on a timely basis by the company’s internal control structure policies. Indeed, the ultimate purpose of assessing control risk is to aid the auditor in evaluating the risk that material misstatements exist in the financial statements.

88. In the course of auditing Styling’s financial statements, Andersen knew or was negligent in not knowing sufficient facts to obtain an understanding of Styling’s internal control structure and control risk. Styling’s internal control weaknesses and deficiencies were pervasive. Among other things, the computer systems that ordinarily would bring to light the pattern of improper accounting practices were unable to do so.

89. Despite this, Andersen failed to expand the scope of its procedures adequately, and as a result, issued unqualified audit opinions on Styling’s financial statements when such statements materially overstated the Company’s revenues and net income.

D. Andersen Failed to Obtain Sufficient Competent Evidential Matter

90. GAAS provides that accounting data alone is insufficient to support an opinion on financial statements. (SAS Nos. 31 and 48, AU Section 326.16, SAS No. 1 Standard of Field Work). Before rendering an opinion on financial statements, the auditor must obtain sufficient, competent “evidential matter” to afford a reasonable basis for the opinion. (AU 326) “Evidential matter” consists of the underlying accounting data and all corroborating information available to the auditor. (AU Section 326.15.) Corroborating evidential matter includes both documentation obtained during the field work (e.g., checks, invoices, contracts, and independent confirmations) and information obtained from inquiry, observation, inspection and physical examination. (AU Section 326.17).

91. Management’s representations are not a valid substitute for the application of audit procedures to form a reasonable basis for an auditor’s opinion of financial statements (SAS No. 19). An auditor must establish and perform a confirmation process with third parties to verify information utilized in the audit models (SAS No. 67). Where a random sampling audit reveals material discrepancies or errors, the audit procedures should be expanded to determine the magnitude of such errors, or the auditors should consider

alternative procedures that would provide sufficient evidence to form a conclusion pursuant to Financial Accounting Standards Board Statement on Accounting Standards 31, 39.

92. In the course of auditing Styling's financial statements, Andersen either knew or was negligent in not knowing facts which indicated that it had failed to obtain sufficient competent evidential matter to afford a reasonable basis in opining on Styling's financial statements. Andersen's staff was frequently present at Styling corporate headquarters and had access to Styling internal corporate books and records. In addition, Andersen's staff had access to Styling's private and confidential financial and business information. Despite the availability of such records and information, Andersen failed to obtain, through inspection, observations, inquiries, confirmations and other audit procedures, sufficient competent evidential matter to afford a reasonable basis for its opinions on Styling's financial statements. As a result, Andersen issued unqualified opinions on Styling's financial statements for 1997 and 1998 when such financial statements materially overstated the Company's net sales and improperly audited Styling's reported 1999 financial results which incorrectly reflected losses that should have been reported in the restated 1997 and 1998 results.

93. Since many of the accounting manipulations caused by Ross and Teal were effected by the use of bill-and-hold invoices, many of which were extremely large, occurred at the end of a period, and were without any support or verification, an examination of those invoices (as required by GAAS) would, by itself, have raised numerous red flags. Andersen either failed to examine these invoices or failed to make inquiries or obtain third party confirmation regarding the validity of those invoices. In any event, Andersen clearly failed to make any effort to obtain sufficient, competent corroborating data to support the invoices as required by GAAS. (SAS Nos. 31, 48, and 80, AU Section 326.16.)

V. ANDERSEN'S VIOLATIONS OF THE ARIZONA STATUTORY STANDARDS OF PROFESSIONAL CONDUCT

94. Subsection (A) of Regulation 4-1-455 of the Arizona Administrative Code promulgated by the Arizona Board of Accountancy mandates independence of certified public accountants, public accountants and firms of which they are partners by prohibiting them from expressing an opinion on financial statements of an enterprise unless they and their firms are independent with respect to the enterprise.

95. Subsection (B) of Regulation 4-1-455 of the Arizona Administrative Code requires integrity and objectivity of certified public accountants, public accountants and firms by prohibiting them from knowingly or recklessly misrepresenting facts when engaged in the practice of public accounting, including the rendering of management advisory services.

96. The Arizona Board of Accountancy also mandates level of competency and compliance with technical standards. Regulation 4-1-455.01 provides in relevant part:

A. Competence: Registrants shall not undertake any engagement for the performance of professional services which they cannot reasonably expect to complete with due professional competence, including compliance, where applicable, with subsections (B) and (C).

B. Auditing standards: Registrants shall not permit their names to be associated with financial statements in such a manner as to imply that they are acting with independence with respect to the financial statements unless they have complied with applicable generally accepted auditing standards.

C. Accounting principles: Registrants shall not express an opinion that financial statements are presented in conformity with generally accepted accounting principles if the financial statements contain any departure from the accounting principle which has a material effect on the financial statements taken as a whole, unless the registrants can demonstrate that by reason of unusual circumstances the financial statements would otherwise have been misleading. In such case, the registrants' reports shall describe the departure, the approximate effects fo the departure, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

* * *

F. In expressing an opinion on representations in financial statements which they have examined, certified public accountants, public accountants, or firms have

violated A.R.S. Section 32-741(A)(4) [which provides for disciplinary action due to, inter alia, gross or continuing negligence in the practice of accounting] if they:

1. Fail to disclose a material fact known to them which makes the financial statements misleading;
2. Fail to report any material misstatement known to them to appear in the financial statement;
3. Are materially negligent in the conduct of their examination or in making their report on the examination;
4. Fail to acquire sufficient information to warrant expression of an opinion, or their exceptions are sufficiently material to negate the expression of an opinion; or
5. Fail to direct attention to any material departure from generally accepted accounting principles or disclose any material omission of generally accepted auditing procedure applicable under the circumstances.

97. Subsection (A) of Regulation 4-1-455.03 of the Arizona Administrative Code prohibits certified public accountants, public accountants and firms from committing “discreditable acts” which is any act that reflects adversely on their fitness to engage in the practice of public accounting, including violations of any of the provisions of R4-1-455 through R4-1-455.04 and any violation of a fiduciary duty or trust relationship with respect to any person.

98. For the reasons alleged in detail above, Andersen, Ozer, Schmidt and Nahom violated the foregoing regulations promulgated by the Arizona Board of Accountancy.

VI. ANDERSEN FAILED TO DELIVER ON ITS CONSULTING PROJECT

99. In 1998, Styling began to plan to consolidate a number of its divisions into a new shared services facility in Scottsdale. In connection with the Company’s consolidation plan, Andersen recommended to Styling’s Board of Directors and management that the Company convert all of the various computer systems into one system and recommended that the system used be an Oracle ERP (Enterprise Resource Planning) system. Upon implementing the Oracle system, the costs to run Styling’s division level accounting, purchasing, distribution and general administrative functions,

among others, was to be eliminated and all of Styling's businesses would be converted to one system.

100. In or about September 1998, Andersen and Styling entered into a consulting agreement whereby Andersen would lead Styling through the Oracle implementation project. Unfortunately, Andersen did not have the knowledge or experience to implement the Oracle System successfully or in a timely fashion.

A. Andersen Had No Experience Or Expertise In Implementing The Oracle System

101. Andersen pitched itself as the most qualified consultants to carry out the Oracle conversion, thereby eliciting Styling's trust and confidence. Styling was under the belief, fostered by Andersen through Ozer's sales tactics, that Andersen would provide a team of qualified professionals to integrate and implement the Oracle software system into Styling's unique business.

102. Andersen also claimed that its proprietary Application Implementation Methodology ("AIM Plus") would accomplish the work in the most effective manner. Andersen told Styling that it had developed that methodology to help its clients implement Oracle applications in a cost effective and timely manner. Andersen led Styling to believe that the AIM Plus methods had been used successfully on dozens of Andersen's other Oracle engagements and that its common tools and methods would help Styling to share the lessons Andersen learned from its previous implementations. These representations were false.

103. At the time Andersen began the Styling consulting engagement, Andersen had no expertise or experience whatsoever with the version of software required for the project, Oracle's Release 11.0. Release 11.0 was a substantial change from prior Oracle releases. Any experience that Andersen may have had with the prior iterations of the Oracle software was not sufficient.

104. Moreover, the employees that Andersen staffed on the project were almost all

inexperienced. Many were fresh out of college. The senior managers on the project were not qualified either. Larry Harris, who was responsible for day-to-day projects was inept. Larry Abramson, another senior manager from Andersen's Oracle consulting practice, who was to provide regular guidance to the project team, made only token appearances at Styling.

105. The Andersen staff and managers were training on the job, at Styling's expense. Andersen was completely unqualified to carry out the Oracle Implementation project.

B. Andersen Demanded That It, Rather Than Oracle, Be The Primary Implementer

106. In most projects involving Oracle infrastructure, the Oracle organization serves as the primary contractor on the project. However, for the Styling engagement, Andersen required that it, and not Oracle, be the lead contact for all aspects of planning, implementation and problem solving. Andersen relegated Oracle to a mere third-party information resource and utilized only four consultants from Oracle Consulting on the entire engagement. In contrast, Andersen staffed the project with fifteen or more Andersen full-time employees, with over fifty different Andersen employees billing to the project over time. Throughout the engagement, Andersen kept Oracle at a "safe" distance from Styling.

107. However, Andersen was not competent to handle the project. It glossed over major problems raised by the consultants assigned to the project from Oracle Consulting, and instead focused on trivial issues. Andersen's judgment on the severity of problems and their choice of issues to address was seriously flawed but it refused to relinquish its control over the project, lest its expertise be exposed for what it truly was – woefully inadequate.

108. Oracle Consulting staff on the project only had access to Styling's employees through Andersen and vice versa. As a result of Andersen's insinuation of itself in every communication between Oracle consultants and Styling personnel, Styling suffered a marked loss of solution

capabilities since issues got lost in the Andersen shuffle and answers arrived too late.

109. Yet, Andersen could not wait to get rid of Oracle Consulting. It prematurely terminated Oracle's involvement in the project. By late July 1999, there were no more Oracle consultants available to work through the many problems. Andersen arrogantly believed it was sufficiently staffed. One Oracle employee, Kurt Harless, moved over to Styling as an employee. With all of the other Oracle consulting staff gone at Andersen's behest, the critical decisions as to what issues and areas to concentrate on were left to the young, inexperienced and overworked Andersen staff, who left major issues unaddressed.

110. The Andersen staff needed to use Oracle Consulting's technical support line for assistance to fix even rudimentary problems. Even when Andersen got the solutions that they needed from Oracle Consulting, they misunderstood the information and invariably left the problems for Mr. Harless to resolve.

111. Had Andersen properly staffed the project and had it properly utilized Oracle Consulting in a meaningful way, the implementation project could have been completed in six months from the initial engagement, with full functionality.

112. Instead, the implementation that was supposed to be nearly complete by the end of the first quarter 1999 and completed by the end of the second quarter 1999, was still not done even through the end of 1999.

C. Andersen Takes Styling's Systems From Bad To Worse

113. The Oracle system was designed to provide accurate reports across all business lines on a real-time basis.

114. Oracle would likely have had Styling up and running by the end of the first quarter 1999.

115. With Andersen in control of the project, the system was not scheduled to be "live" until June 6, 1999. When the system went live, there were fourteen major, fundamental systems failures.

That was an inordinate number of systems errors for a program like Oracle. Over the ensuing months through the end of 1999, Styling had to fix numerous outstanding critical processes which was an extraordinary and costly undertaking. The many major problems with Andersen's implementation of the Oracle system led to a failure of the system to provide information on a timely and accurate basis through 1999 which, in turn, directly and significantly impeded operations throughout that year. Andersen's negligence caused major delays in reporting at a time when Styling could ill afford it.

116. In addition to Andersen's failure to provide experienced project managers to oversee the project, Andersen's technical staff members, including its software writers for data reporting, were completely unskilled in the Oracle Release 11.0 software applications. They employed basic tools to build the infrastructure in improper ways, and they took too long to do even that. As a result, when the Oracle system went live, it could not provide information across all divisions. Thus, rather than aiding the Company in viewing its overall financial picture, the system made it even more difficult to determine what the Company's true financial situation was.

117. Throughout the second half of 1999, Styling managers were relegated to using make-shift accounts receivable reports to create summaries in order to effectively deal with customers who were taking advantage of aging accounts receivable outstanding in one division and obtaining extended credit terms for purchases from other Styling divisions.

118. In addition, as a result of huge cost overruns, Andersen billed over three times the amount that the parties had originally contemplated for the Oracle project. The cost estimate was approximately \$1.75 million. Andersen actually billed Styling nearly \$5 million for the project, evidencing the significant cost overruns resulting from Andersen's negligence.

D. Andersen Jumps Ship

119. With the SEC investigation hovering over it, Andersen personnel started leaving

Andersen's consulting practice in droves, abandoning the Oracle implementation project en masse. By November 1999, Andersen was effectively off the project.

120. Andersen's staff departures made it all the more difficult to teach Styling personnel how to use Oracle, thereby exacerbating the limitations on the functionality and effectiveness of the Oracle system.

E. The Failure of The Oracle System To Function Led To Styling's Bankruptcy

121. Andersen's negligence in carrying out its duties and responsibilities in a professional and timely manner owed to Styling in regard to the Oracle implementation project was a direct cause of Styling's bankruptcy. Due to Andersen's failure to understand the systems and to implement the processes necessary for Styling to accurately account and reflect its consolidated financial condition, Styling had to continually chase down its data. It did not achieve a level of complete accurate reporting capabilities in 1999.

122. If Andersen had had the Oracle platform fully functioning by the end of the first quarter 1999, Styling would have been able to generate accurate real time reports with which Styling could manage its business. Management would have been able to understand the condition of Styling's sales, inventory and accounts receivable and therefore been able to deal with Styling's accounts receivable problems sooner. The Styling Board of Directors would have understood the relationship among sales, purchasing and inventory such that it would have detected the huge disparities among the amounts of product that Styling was ordering from manufacturers relative to inventory on the shelf and sales reported by its divisions. This would have caused Styling's Board of Directors to step in earlier and deal with the accounting problems caused by Ross and Teal.

123. The failure of Andersen to carry out its consulting responsibilities resulted in Styling's general and administrative costs being dramatically higher because the Company had to run not only the Oracle system for the home office but also had to run the divisions' localized systems. The use of

multiple systems for numerous different operating entities caused Styling to incur enormous overhead expenses. Had the Oracle system been running as planned by the end of 1998, Styling would not have run multiple systems and would not have incurred the significant general and administrative costs at each division, plus at its headquarters.

124. Styling reported \$52 million in losses in 1999, the same year in which it reported the highest level of sales in its operating history. This loss occurred as a direct result of the huge costs that Styling incurred from the Oracle system implementation.

125. Because Styling had to pay substantially higher general and administrative costs, and because Styling's management did not have accurate information to run the business, Styling quickly fell into financial ruin. Had Andersen effectively implemented the Oracle system by the end of the first quarter of 1999, Styling would not have gone into bankruptcy.

126. Because of Andersen's negligence, Styling had its enterprise value, which was in excess of \$200 million, almost completely wiped out.

COUNT ONE

PROFESSIONAL NEGLIGENCE (Against All Defendants for Malpractice as Auditors)

127. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

128. This Count is brought against all Defendants for professional negligence in their capacity as auditors and accountants.

129. Andersen is in the business of providing auditing services and certifying financial reports for the benefit of public companies, their investors and others.

130. Andersen, as Styling's independent auditor, and Ozer, Schmidt and Nahom, as certified public accountants (during the relevant time period) owed Styling a duty to render services with the

degree of skill and competence exercised by members of the accounting profession and in accordance with accepted professional standards.

131. The Defendants also owed Styling a duty to audit Styling's financial statements in accordance with GAAS and with regulations promulgated by the Arizona Board of Accountancy to determine whether Styling's financial statements were presented in accordance with GAAP.

132. Defendants knew that Styling was relying on them to conduct their audits in a professional manner to ensure that Styling's financial statements were accurate and that any material weaknesses in Styling's financial systems or internal controls were promptly reported.

133. In auditing Styling's financial statements for 1997, 1998 and 1999, Defendants disregarded GAAS and regulations governing standards of conduct of accountants and audit firms promulgated by the Arizona Board of Accountancy.

134. Had Defendants performed their audits in accordance with GAAS and discharged their duty as certified public accounts, the material misstatements in Styling's financial statements would have been disclosed to the Board of Styling, and the Board would have taken timely remedial measures to ensure that the wrongful conduct was terminated.

135. Defendants' negligence is the direct and proximate cause of the injuries suffered by Styling.

136. Accordingly, Defendants are liable to Styling for damages in an amount to be proven at trial.

COUNT TWO

NEGLIGENT MISREPRESENTATION **(Against All Defendants)**

137. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

138. This Count is brought against all Defendants for negligent misrepresentation.

139. Styling engaged Andersen to audit the financial statements of Styling for years 1997 and 1998 and to report to Styling whether the financial condition of Styling is fairly presented in accordance with GAAP. Andersen's audit report and Defendants' other communications were intended to be supplied to Styling's Board of Directors for its benefit and guidance in the oversight of Styling's affairs as a public company. Also during this period, Styling engaged Andersen to perform other consulting services and to report to Styling for its benefit and guidance in the conduct of its business. During these engagements, Styling's Board justifiably relied on Defendants' representations concerning Styling, including the ability of Styling to meet its business objectives as a result of the consolidation project and implementation of the Oracle system carried out by Andersen under the guidance of defendant Ozer. Throughout these engagements, Defendants had a duty to gather and to report all information necessary to make its representations complete, accurate and not misleading.

140. During the course of Andersen's audits and other engagements, Defendants failed to exercise reasonable care and competence in obtaining information and communicating information to Styling's Board of Directors. Defendants negligently gathered and communicated information to Styling when performing audits of Styling's financial statements because: (i) they were not performed in accordance with GAAS and regulations promulgated by the Arizona Board of Accountancy; (ii) they were not performed with the degree of skill and care commonly applied in the community by major accounting firms; (iii) they were not performed with the degree of expert skill and care that Andersen held itself out as possessing; and (iv) they were not performed with the degree of skill and care required under Andersen's own internal standards.

141. Defendants' failure to exercise reasonable care and competence includes, but is not limited to: (i) their negligent failure to perform sufficient auditing procedures to obtain reasonable

assurance about whether Styling's financial statements were free of material misstatement, whether caused by error or fraud; (ii) their negligent failure to disclose the misstatements in Styling's financial statements described herein and the weaknesses in Styling's internal controls to the Board of Styling; (iii) their negligent failure to investigate fully the various "red flags" warning of the material misstatements in Styling's financial results as described herein; (iv) their negligent failure to communicate to Styling's Board of Directors the "red flags" that warned of false accounting; (v) their negligent misrepresentation to Styling that Andersen conducted its audits of Styling in accordance with GAAS and that Styling's financial statements were presented fairly in accordance with GAAP; and (vi) the negligent manner in which they otherwise conducted Andersen's audits of Styling's financial statements.

142. By reporting to Styling's Board of Directors that it had conducted its audits in accordance with GAAS and that Styling's financial statements were fairly stated in accordance with GAAP, Defendants supplied false information to Styling's Board of Directors for guidance in Styling's business transactions.

143. Styling justifiably relied on Andersen to provide an independent audit and to comply with professional standards of care to detect accounting errors and irregularities. Defendants prepared Andersen's audit reports expressly for the benefit of Styling and its Board and intended for Styling and its Board to rely on these reports in the conduct of Styling's business.

144. Defendants' misrepresentations were the direct and proximate cause of the injuries suffered by Styling. Had Defendants obtained and communicated information in accordance with professional standards and Arizona law, the misstatements in Styling's financial statements would have been exposed and the Styling Board of Directors would have taken appropriate and timely measures to stop the GAAP violations.

145. Accordingly, Defendants are liable to Styling for damages in an amount to be proven at

trial.

COUNT THREE

NEGLIGENCE PER SE
(Against All Defendants)

146. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

147. This Count is brought against all Defendants for negligence per se based upon Defendants' violation of A.R.S. § 32-746.

148. A.R.S. § 32-746 makes fraudulent audit practices a felony when:

A. A person commits fraudulent audit practices if such person knowingly prepares, issues or offers or files with any public agency an audit report or certificate on any financial statement which is materially false or misleading or fraudulent, or which purports to fairly present the financial position, results of operations or changes in financial position of the person or entity reported on but fails to do so.

149. Defendants prepared Andersen's audit reports on Styling's financial statements for 1997 and 1998 knowing that such statements were materially false.

150. Defendants' fraudulent audit practices described herein constitute negligence per se.

151. Accordingly, Defendants are liable to Styling for damages in an amount to be proven at trial.

. . . .

COUNT FOUR

NEGLIGENCE PER SE
(Against All Defendants)

152. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

153. This Count is brought against all Defendants for negligence per se based upon Defendants' violation of Subsections (A) and (B) of Regulation 4-1-455 of the Arizona Administrative Code, Subsections (A), (B), (C) and (F) of Regulation 4-1-455.01 promulgated thereunder, and Subsection (A) of Regulation 4-1-455.03 of the Arizona Administrative Code.

154. As set forth in the above allegations and incorporated by reference herein, in preparing Andersen's audit reports on Styling's financial statements for 1997, 1998 and 1999, Defendants failed to comply with Subsections (A) and (B) of Regulation 4-1-455 of the Arizona Administrative Code, Subsections (A), (B), (C) and (F) of Regulation 4-1-455.01 promulgated thereunder, and Subsection (A) of Regulation 4-1-455.03 of the Arizona Administrative Code.

155. Defendants' negligent audit practices described herein constitutes negligence per se.

156. Accordingly, Defendants are liable to Styling for damages in an amount to be proven at trial.

COUNT FIVE

BREACH OF FIDUCIARY DUTY **(Against Andersen)**

157. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

158. This Count is brought against Andersen for breach of fiduciary duty.

159. Andersen served as Styling's outside, independent auditor for 1997 through 1999, and for Styling's restatement of its financial statements for 1997 and 1998. In that role, Andersen

. . .

rendered professional advice to Styling and entered into a special relationship of trust and confidence

with Styling based upon the services and advice that Andersen provided to Styling in the course of conducting its audits.

160. By serving as Styling's outside, independent auditor for 1997 through 1999, Andersen entered into a confidential, fiduciary and special relationship with Styling, and owed a duty of care and loyalty to Styling arising from its position of trust and confidence.

161. Andersen breached its fiduciary duty to Styling by conducting its audits in a matter that: (i) lacked due care in failing to discover the accounting improprieties that resulted in the material misstatement of Styling's financial results; and (ii) disregarded its duty of loyalty in failing to disclose the accounting improprieties to the Board of Styling in favor of its own interest in obtaining consulting assignments.

162. Andersen's breach of fiduciary duty has been the direct and proximate cause of injury to Styling.

163. Accordingly, Andersen is liable to Styling for damages in an amount to be proven at trial.

COUNT SIX

PROFESSIONAL NEGLIGENCE (Against Andersen for Malpractice as Consultants)

164. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

165. This Count is brought against Andersen for professional negligence in its capacity as business consultants.

166. Andersen is in the business of providing professional business consulting services to public companies.

167. Andersen held itself out as having the skills, experience and expertise required of a

business consultant that could oversee the implementation of Styling's plans for streamlining its accounting and financial information systems so that Styling could achieve improved efficiencies and growth.

168. Andersen owed Styling a duty to render business consulting services with the degree of skill and competence exercised by members of the business consulting profession.

169. Andersen knew that Styling was relying on it to conduct its consulting services in a manner to ensure that Styling's plans were carried out professionally.

170. Andersen conducted its consulting services in a negligent manner. In designing, implementing, coordinating and supervising Styling's conversion to the Oracle system, Andersen failed to comply with the standards of skill and competence of business consultants.

171. The failure of Andersen to perform its consulting duties in accordance with the degree of skill and care that Andersen held itself out as possessing caused Styling to be unable to reach the objectives of its strategic plans and led to Styling's eventual bankruptcy.

172. Accordingly, Andersen is liable to Styling for its damages in an amount to be proven at trial.

COUNT SEVEN

BREACH OF CONTRACT **(Against Andersen)**

173. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

174. This Count is brought against Andersen for breach of contract.

175. In or about September 1998, Andersen and Styling entered into a consulting agreement whereby Styling would pay substantial fees to Andersen for providing business consulting services in connection with Styling's strategic plan to consolidate operations at the Company's headquarters in

Scottsdale, Arizona, and to bring nearly all of its accounting and financial reporting systems under the Oracle system.

176. Pursuant to that agreement with Styling, Andersen promised to implement Styling's conversion to the Oracle system.

177. Andersen breached its agreement by failing to provide a fully functioning Oracle system.

178. Styling has suffered injuries as a direct consequence of Andersen's breach of its consulting agreement.

179. Accordingly, Andersen is liable to Styling for its damages in an amount to be proven at trial.

COUNT EIGHT

BREACH OF WARRANTY **(Against Andersen)**

180. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

181. This Count is brought against Andersen for breach of warranty.

182. When soliciting and contracting to perform the consulting services for Styling's Oracle implementation project, Andersen expressly warranted that its services would be performed in a professional and workmanlike manner in accordance with applicable professional standards. It also warranted that it would re-perform any work not in compliance with its warranty brought to its attention within three (3) months after that work was performed.

183. Andersen materially breached those warranties as alleged herein.

184. Styling has suffered injuries as a direct consequence of Andersen's breach of its warranties.

185. Accordingly, Andersen is liable to Styling for its damages in an amount to be proven at trial.

WHEREFORE, Plaintiff Styling Technology Corporation demands judgment against Defendants as follows:

- A. Awarding plaintiff compensatory damages, including lost enterprise value, in an amount to be established at trial, with interest thereon;
- B. Awarding plaintiff its costs and expenses in this litigation, including reasonable attorney's fees and expert fees and other costs and disbursements; and
- C. Granting such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMAND

Plaintiff requests a trial by jury on all issues so triable.

DATED: August 28, 2002

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