

FORENSIC ACCOUNTING'S GROWING IMPORTANCE

Investigation News

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Homestore:
"One company that
did it right."



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The client:

Homestore, Inc. supplies online media and technology solutions to the home and real estate industry. Located in Westlake Village, California, the company offers a family of websites including REALTOR.com, as well as sites promoting new construction, apartments, mortgage financing and more.

The investigation:

The audit committee of Homestore's board requested an internal investigation of scores of transactions to determine if revenues for the first three quarters of 2001 (and later, for all of 2000) had been improperly reported.

The team:

The New York law firm Cahill, Gordon & Reindel LLP was engaged; the attorneys sought out members of FTI's Los Angeles office to perform the forensic accounting.

When Attorney General John Ashcroft stepped up to the microphones one September day in 2002, corporate America held its breath. With companies from Adelphia to Xerox under scrutiny, the news couldn't be good.

In addition to announcing the indictments of three prior Homestore employees, however, the Attorney General had praise for Homestore—and indirectly, its attorneys and forensic accountants.

Like many other prominent corporations, the company had been the subject of an SEC investigation. Unlike some others, the board and new management took immediate action to investigate and correct Homestore's transgressions. In Ashcroft's words, Homestore showed "how it should be done."

Here's what happened:

By April of 2001, Homestore had been crowned "the king of online real estate" by *Business Week* online, which described it as a "so-far meltdown-resistant dot.com."

There was plenty of evidence to support that view: the most visitors to the site, most homes listed and plenty of profitable partnerships including the National Association of Realtors and America Online.

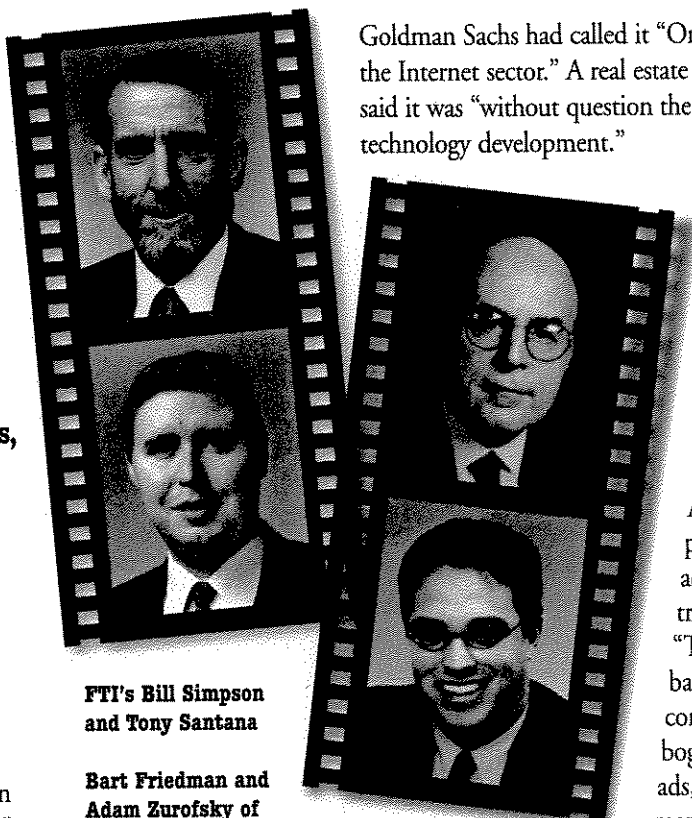
Its family of housing-oriented websites had attracted the largest online audience of home consumers, more than eight million individuals a month. At a time when many dot.com shares sold for pennies, Homestore stock traded at \$30 a share in the first quarter of 2001.

Goldman Sachs had called it "One of the best defensive names in the Internet sector." A real estate analyst with Robertson Stephens said it was "without question the lead dog in terms of listing and technology development."

"At the time, Wall Street was happiest when dot.com revenues rose steadily from quarter to quarter," says FTI managing director Tony Santana. "Clearly, some members of the Homestore management felt pressure to create increased revenue."

And they showed whopping results, primarily by accounting for barter advertising deals as regular ad sales transactions, a violation of SEC rules. "There are certain requirements for barter transactions, to preclude companies from reporting as revenue bogus or otherwise improper barter ads," says Bill Simpson, FTI's senior managing director and head of the forensic accounting team.

Board suspicions were raised and by November 2001, the audit committee had swung into action. Within a month, out were certain key executives, including the CFO; in came the law firm Cahill Gordon to assist the audit committee in its investigation.



FTI's Bill Simpson and Tony Santana

Bart Friedman and Adam Zurofsky of Cahill, Gordon & Reindel LLP

"We've done a lot of work representing boards and companies," says Cahill's lead attorney, Bart Friedman. "A Homestore director we knew called, told us the story and asked our reaction. We immediately flew out there.

“We chose FTI because we needed a firm with depth and breadth to participate in what would be a very broad-based, complex and sophisticated investigation. We felt very comfortable with their integrity, credibility, and meticulous attention to detail. They more than met our expectations.”

"Under new SEC guidelines, it was critical to bring in independent firms to conduct the investigation," says Bill. "In October 2001, the SEC had laid out criteria that it would consider in crediting a company's cooperation with an investigation. A company's adherence to Rule 21 (a) could have a big impact on the SEC's response—from reduced charges and lighter sanctions to no action at all.

"Basically, among others, the SEC wants to know three things: what steps the company took when it learned of the misconduct, how prompt and complete was the disclosure and who performed the review—employees or outside personnel."

Once engaged, FTI staffers worked seven days a week for over three months. "We weren't going to win any popularity contests," admits Tony. "It was a huge task. Bill and I had done similar investigations, but what was different here was the scope."

According to Cahill Gordon attorney Adam Zurofsky, "The investigation involved not just one question or one person. There was systematic broad-scale wrongdoing over nearly two years."

"Working with FTI was a very good and positive experience," Adam says. "There was a real camaraderie among us; they were people I liked and respected. That's critical when you're working very closely on a high-stakes matter, staying up long hours and eating room service food."

"There were marathon four-hour phone calls, and of course, we worked right through the holidays," says FTI director Amy Workman. "That meant serious Christmas shopping difficulties—thank heaven for the Internet!"

What proved helpful was "being able to tap into FTI's corporate resources," says Amy. "We grabbed talent from all over the country." Besides staffers from their Los Angeles office, Bill and Tony called on FTI expertise everywhere from Dallas to DC.

Amy was the key contact person between FTI and Homestore's own accounting group. "Only a certain number of Homestore employees knew who we were and why we were there. But they were told to help in any way, and they did. Still, we were constantly in their hair, asking for information, retracing the steps of those who were no longer around. The company's livelihood was at stake; they just wanted to put any problems behind them and move on."



FTI's investigative muscle strengthened by Ten Eyck

"In the past year the SEC has taken unprecedented, aggressive steps to investigate possible wrongdoing, propose tough new regulations and fully implement the Sarbanes-Oxley Act," according to the US Securities and Exchange Commission website.

Such scrutiny is bound to continue. And, FTI will continue to guide corporate America's response with the added expertise of Ten Eyck Associates.

"It's an expanding market," says Jack Dunn, FTI's chairman and chief executive officer. "Combining the two firms increases our depth and critical mass in Sarbanes-Oxley, as well as related forensic and investigative consulting services."

Ten Eyck is a highly regarded consulting group specializing in litigation consulting, SEC accounting and enforcement matters and accountant malpractice disputes. At the core of the practice is a team of seasoned professionals with an average of more than twenty-five years' experience at national accounting firms, businesses, and the SEC.

With offices in Washington, DC and King of Prussia, Pennsylvania, Ten Eyck's client list is a "who's who" of corporate luminaries, law firms and government agencies. The firm's recent growth has been due to its specialized SEC expertise and a growing demand for services resulting from Sarbanes-Oxley accounting requirements, Public Company Accounting Oversight Board and SEC-related actions.

"Ten Eyck's established relationships offer significant opportunities for FTI Consulting," says Stewart Kahn, FTI's president and chief operating officer. "We'll have the expertise, size and national scope to meet the needs of even the largest engagements, and continue to grow our investigative business."

Even with the grueling seven-day-a-week schedule, the workload was crushing. "Take just the electronic evidence," says FTI director Sue Anne Muselli. "Wow, it was a lot of work! We reviewed over half-a-million emails and documents retrieved from the company's network and employee computers."

Further complications arose from the fact that so many people involved in the suspect round-trip transactions were no longer with the company, according to FTI managing director Peter Salomon, and that "the number of transactions was so vast. Considering the massive scale of the revenue overstatements, how did the Homestore executives ever think they would get away with it?"

Along with the attorneys from Cahill Gordon, Bill Simpson and Tony Santana represented Homestore to various regulators and other participants in the marketplace. "We gathered documents, did interviews and appeared before the SEC staff," says Bill. "We kept the regulators apprised.

"Meanwhile, the company was trying to cut costs and brought in a new management team. NASDAQ had initiated delisting procedures. There were lots of moving pieces. In fact," says Bill, "the SEC sent staff to Homestore to hear status reports from us and the attorneys. We laid everything out, including the most troublesome materials. That's what the board and new management wanted—to air it all out."

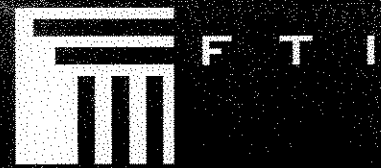
While the paperwork may have been voluminous, the people-work took its toll as well. Interviewing both current and former staff was critical—skills that aren't covered in Accounting 101. "It was fascinating, nonetheless," according to Tony. "People's explanations contradicted each other and stories often changed on the fly. We saw our share of tears and tension-filled rooms."

The conclusion? Homestore's financial statements were amended to reflect revenue adjustments of over \$165 million for the years 2000 and 2001. "There's no question that the company's been hurt," says Bill, "but they have good resources, good products and great management."

“The good news is that there were no SEC sanctions whatsoever. In fact, the SEC considers Homestore a role model for other companies to follow.”

"The results could have been entirely different," says Adam. "There was nothing off the table. Outcomes could have ranged from a pass to criminal indictment, and the company would cease to exist."

"Now, when we attend professional workshops and seminars, Homestore is used by governmental and other speakers as an example of how things should be done," says Sue Anne. "Forensic accounting is a hot topic right now, and Homestore is always labeled 'one company that did it right.'"



Multiple Disciplines, a Single source

FTI is the premier provider of corporate finance/restructuring, forensic accounting, economic consulting, and trial services. Strategically located in 24 of the major US cities and London, we employ over 1,000 professionals consisting of numerous PHDs, MBAs, CPAs, CIRAs and CFEs who are committed to delivering the highest level of service to our clients. These clients include the world's largest corporations, financial institutions and law firms in matters involving financial and operational improvement and major litigation.

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