

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF MISSOURI

PHYLLIS J. WINTERS, on behalf of herself and all  
others similarly situated,

Plaintiff,

v.

H&R BLOCK, INC., MARK A. ERNST, FRANK J.  
COTRONEO, and WILLIAM L. TRUBECK,

Defendants.

CASE NO. \_\_\_\_\_

JURY TRIAL DEMANDED

**CLASS ACTION COMPLAINT**

Plaintiff, Phyllis J. Winters (“Winters”), by her attorneys, on behalf of herself and all others similarly situated, alleges the following based upon the investigation of plaintiff’s counsel, except as to allegations specifically pertaining to plaintiff, which are based on personal knowledge. The investigation of counsel included, among other things, a review of H&R Block, Inc. (“HRB” or the “Company”) public filings with the United States Securities and Exchange Commission (“SEC”) and courts, press releases issued by the Company, public conference calls, media and news reports about the Company, court filings, and publicly available trading data relating to the price and volume of HRB’s securities.

**I. INTRODUCTION**

1. This is a federal class action brought on behalf of a class consisting of all persons who purchased the publicly traded securities of HRB between June 12, 2002 and March 15, 2006, inclusive (the “Class Period”).

2. This action is a securities fraud action brought under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Rule 10b-5 promulgated thereunder by the SEC by plaintiff on behalf of all those who purchased the publicly traded securities of HRB during the Class Period to recover damages caused to the Class by defendants’ violations of the securities laws.

3. HRB describes itself as a “diversified company with subsidiaries delivering tax, investment, mortgage and business services and products.” The Company’s Tax Services segment “provides income tax return preparation and other services and products related to tax return preparation to the general public in the United States, and . . . [w]e also offer investment services and securities products through H&R Block Financial Advisors, Inc. (“HRBFA”).”

4. The Company claims its “Mission” is “[t]o help our clients achieve their financial objectives by serving as their tax and financial partner.’ Key to achieving our mission is the enhancement of client experiences through consistent delivery of valuable services and advice. Operating through multiple lines of business allows us to better meet the changing financial needs of our clients.”

5. On February 23, 2006, after the close of trading, HRB disclosed its financial results for its fiscal quarter ended January 31, 2006 and stated, among other things, that it will restate its results for "fiscal years 2005 and 2004 as well as previously reported quarterly results for fiscal 2006. The restatement pertains principally to errors in determining the company's state effective income tax rate, resulting in a cumulative understatement of its state income tax liability of approximately \$32 million as of April 30, 2005."

6. On February 24, 2006, shares of HRB declined \$2.18 per share, from \$25.19 per share to \$23.01 per share, or approximately 9% on heavier than usual volume.

7. On March 15, 2006, in a Complaint filed by the New York State Attorney General in New York State Supreme Court, it is alleged that H&R Block abuses its relationship of trust with its customers by steering customers into an unsuitable, fraudulently marketed, poorly performing, fee-ridden "retirement vehicle" called the Express IRA: a retirement account that more often than not will shrink over time because its only investment option is a money market account with an interest rate that does not cover fees --fees that H&R Block fails to adequately disclose.

8. In the last four years H&R Block has opened more than 500,000 Express IRA accounts.

9. Although its own studies revealed that the Express IRA's interest rate was too low relative to its fees, H&R Block began falsely promoting the Express IRA as a "better way to save" with "great rates," despite knowing it earns a negative rate of return.

10. H&R Block's fees exceed the interest it pays for 85% of its Express IRA customers. Even taking into account as a "gain" the tax benefits of opening an IRA, analysis of the accounts opened in 2002 -- the year when the Express IRA was first available nationwide and for which the most data is available -- shows that as of now about 79% of H&R Block customers who opened accounts in 2002 have lost money.

11. H&R Block's senior management has been aware of the problem with the Express IRA from the beginning. Shortly after the 2002 tax season, H&R Block's Chief Executive Officer, Mark Ernst, was informed of the fundamental deficiency of the Express IRA through an e-mail by an H&R Block district manager:

I've been thinking about all the clients that we signed up for IRA's [sic] this past tax season. Our mission was to help these clients begin a savings plan since many of them had none. Many used \$300 from their refunds to fund the plan. My concern is the \$10 maintenance fee that they will be assessed. . . . Many of these clients do not have savings or checking accounts. Even those clients with checking don't always want others having access to them due to problems with possible bounced checks. So they will earn about \$1.50 in interest and be charged \$10 maintenance fee. This may result in a lot of clients electing to withdraw their money from the IRA. Then they will be assessed \$75 (25% of their initial investment). I really don't think the maintenance fees should exceed the amount of interest that we are paying on these accounts. Clients won't be happy seeing thier [sic] investments decreasing and not increasing.

12. The CEO forwarded the e-mail to the H&R Block product manager adding his own concerns:

The attached note (from a DM) reflects the general sense that I think exi[s]ts -- that Express IRA is the right thing for our clients, but the product is designed to nickel and dime clients to the

point where our field people don't [sic] feel as good about the product as they should. You should seriously look at whether, with a bank product design, we can eliminate the fees so that our people feel better about the offer.

13. There was apparently no action taken with respect to the CEO's concerns. Indeed, in nearly four years H&R Block has done nothing to fix the fundamental deficiency of the Express IRA – the interest paid still does not cover H&R Block's fees, especially for accounts owned by poorer customers who can only afford to deposit the minimum amount.

14. Not only does the Express IRA lose money for H&R Block's customers, it is marketed to them in a grossly misleading way. H&R Block failed to disclose the full extent of the fees associated with the Express IRA; failed to adequately warn its customers that these fees will reduce their principal over time unless they make large or repeated deposits; failed to adequately warn customers that an Express IRA is inappropriate for short-term savings needs; and failed to provide its low-income consumers with adequate guidance in determining whether the Express IRA is a suitable investment.

15. On March 15, 2006, shares of HRB declined from \$22.00 to \$20.63 per share, a decline of approximately 6%, on unusually heavy volume.

## **II. JURISDICTION AND VENUE**

16. The claims asserted arise under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder. Jurisdiction is conferred by Section 27 of the Exchange Act. Venue is proper pursuant to Section 27 of the Exchange Act as defendant HRB and/or the Individual Defendants conduct business in and the wrongful conduct took place in this District.

## **III. THE PARTIES**

17. Plaintiff Winters purchased HRB's publicly traded securities as detailed in the attached Certification and was damaged thereby.

18. Defendant HRB is a Missouri Corporation with its principal place of business at 4400 Main Street, Kansas City, Missouri 64111.

19. Defendant Mark A. Ernst ("Ernst") has served as Chairman of the Board of the Company since September 2002, Chief Executive Officer of the Company since January 2001 and as President of the Company since September 1999.

20. Defendant Frank J. Cotroneo ("Cotroneo") was Senior Vice President and Chief Financial Officer of HRB until his resignation from the Company on October 31, 2003.

21. Defendant William L. Trubeck ("Trubeck") has served as Executive Vice President and Chief Financial Officer beginning on October 4, 2004.

22. The individuals named as defendants in ¶¶ 19-21 are referred to herein as the "Individual Defendants." The Individual Defendants, because of their positions with the Company, possessed the power and authority to control the contents of HRB's quarterly reports, press releases and presentations to securities analysts, money and portfolio managers and institutional investors, *i.e.*, the market. Each defendant was provided with copies of the Company's reports and press releases alleged herein to be

misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Because of their positions and access to material non-public information available to them but not to the public, each of these defendants knew that the adverse facts specified herein had not been disclosed to and were being concealed from the public and that the positive representations which were being made were then materially false and misleading. The Individual Defendants are liable for the false statements pleaded herein.

#### **IV. CLASS ACTION ALLEGATIONS**

23. Plaintiff brings this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and 23(b)(3) on behalf of a class of all persons who purchased the publicly traded securities of HRB during the period from June 12, 2002 through March 15, 2006, inclusive (the "Class").

24. The members of the Class are so numerous that joinder of all members is impracticable. While the exact number of Class members is unknown to plaintiff at the present time and can only be ascertained through appropriate discovery, plaintiff believes that there are hundreds of members of the Class located throughout the United States. Throughout the Class Period, HRB had over 165 million shares of Common Stock, which were actively traded on the NYSE in an efficient market.

25. Plaintiff's claims are typical of the claims of the members of the Class. Plaintiff and all members of the Class have sustained damages because of defendants' unlawful activities alleged herein. Plaintiff has retained counsel competent and experienced in class and securities litigation and intends to pursue this action vigorously. The interests of the Class will be fairly and adequately protected by plaintiff. Plaintiff has no interests which are contrary to or in conflict with those of the Class that plaintiff seeks to represent.

26. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy. Plaintiff knows of no difficulty to be encountered in the management of this action that would preclude its maintenance as a class action.

27. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are:

- (a) whether the federal securities laws were violated by defendants' acts and omissions as alleged herein;
- (b) whether defendants misstated and/or omitted to state material facts in their public statements and filings with the SEC;
- (c) whether defendants participated directly or indirectly in the course of conduct complained of herein; and
- (d) whether the members of the Class have sustained damages and the proper measure of such damages.

#### **V. FALSE AND MISLEADING STATEMENTS**

28. The Class Period begins on June 12, 2002, when the Company issued a press release stating, among other things, that:

H&R Block Inc. (NYSE: HRB) today reported record revenues and net earnings for the fiscal year ended April 30. Revenues totaled \$3.3 billion, an increase of 11.3 percent over the prior year. Net earnings increased 55 percent to \$434.4 million, up from \$281.2 million. Net earnings per diluted share increased 52 percent to \$2.31, an increase of 79 cents per share from the prior year's \$1.52 per diluted share.

\* \* \*

"Our mix of businesses allowed us to perform very well despite a difficult economic environment in the United States. "We're also making progress in building multi--service relationships with our clients," Ernst said. "At the end of the year we had more than 265,000 clients with both tax and financial service relationships."

\* \* \*

More than 160,000 new accounts were opened for H&R Block tax clients, including more than 130,000 IRA accounts.

29. On July 29, 2002, HRB filed its annual report with the SEC on Form 10-K for the fiscal year-ended April 30, 2002.

The Form 10-K, signed by defendants Ernst and Cotroneo, included the Company's financial results for the fiscal year-ended April 30, 2002 and stated the following:

In fiscal year 2002, H&R Block expanded the availability of the Express IRA nationwide, compared to its availability in 14 states in fiscal year 2001. With the Express IRA product, tax preparation clients can open an IRA with HRBFA by using all or part of their tax refund, or by writing a personal check for the amount deposited into the IRA. The Express IRA is invested in an FDIC-Insured money market account through Reserve Management Corporation at an insured depository institution paying competitive money market interest rates. Clients funded approximately 130,000 Express IRAs in fiscal year 2002, compared to 25,000 in fiscal year 2001.

30. On August 27, 2002, the Company issued a press release stating, among other things, that:

H&R Block Inc. (NYSE: HRB) reported a first quarter loss of \$9.5 million, or 5 cents per basic share, compared with a loss of \$30.8 million, or 17 cents per share last year. The company typically reports a loss in its first quarter due to the seasonal nature of its tax service businesses.

The company's revenues increased 31.1 percent to \$431.4 million for the quarter, up from last year's \$329 million. The loss for the quarter includes an \$18 million non-cash impairment charge in the company's investment services segment, reflecting the significant decline in market values at July 31 for comparable businesses. Excluding this charge, the company earned \$1.3 million, or 1 cent per share.

"H&R Block enjoyed solid operating performance for the quarter, led by our mortgage operation's outstanding results," said Mark A. Ernst, president and chief executive officer.

Cash earnings improved \$40 million over the prior year's quarter to \$18.6 million, or 10 cents per basic and diluted share, compared with a net loss of \$21.4 million, or 12 cents per basic share last year. The company defines cash earnings as net earnings from operations, excluding the after-tax effect of amortization expense of acquired intangible assets and the impairment charge.

"Based on the continued strength of our mortgage operations, expectations for a solid tax filing season and cost controls across our businesses, we expect that earnings per share for fiscal 2003 will be in the range of \$2.80 to \$3," Ernst said. "We expect overall annual revenue growth to be within our target range of 10 to 15 percent."

The company had previously estimated full year earnings per share to be in the range of \$2.60

to \$2.75. The expected results represent growth of 21 to 30 percent from fiscal 2002, when H&R Block earned \$2.31 per diluted share.

31. On September 13, 2002, HRB filed its quarterly report with the SEC on Form 10-Q for the period ended July 31, 2002. The Form 10-Q, signed by defendant, Cotroneo included the Company's financial results for the period ended July 31, 2002 and stated "the Company's U.S. Tax Operations segment offers individual retirement account products (Express IRAs) to its clients through HRBFA."

32. On November 26, 2002, the Company issued a press release stating, among other things, that:

H&R Block Inc. (NYSE: HRB) today reported a net loss of \$37.3 million, or 21 cents per basic and diluted share, for the second quarter ended Oct. 31. Revenues for the quarter increased 26.1 percent to \$471.4 million. The company typically reports a loss in its second quarter due to the seasonal nature of its tax service businesses.

Excluding the effect of two previously announced non-recurring charges, the company's net loss was \$8.7 million, or 5 cents per basic and diluted share. In the same quarter last year, H&R Block reported a net loss of \$28 million, or 15 cents per basic and diluted share.

The two non-recurring charges include an after-tax charge of \$25 million, or 14 cents per share, relating to the pending settlement of a Texas class action lawsuit related to refund anticipation loans, and a charge of \$6 million, or 3 cents per share, related to goodwill impairment in the company's investment services segment.

The company updated its earnings guidance for the fiscal year, based on the expectation of a solid tax filing season, continued strength of its mortgage operations, a previously announced third quarter gain from the sale of mortgage residual assets and cost controls across its businesses. "We expect that GAAP earnings per share for fiscal 2003 will be in the range of \$2.90 to \$3.10," Chairman and Chief Executive Officer Mark A. Ernst said. "We expect revenue growth to be within our target range of 10 to 15 percent."

The new guidance expects results that represent growth of 26 to 34 percent in earnings from fiscal 2002, when H&R Block earned \$2.31 per diluted share.

33. On December 16, 2002, HRB filed its quarterly report with the SEC on Form 10-Q for the fiscal quarter ended October 31, 2002. The Form 10-Q, signed by defendant Cotroneo, included the Company's financial results for the period ended October 31, 2002 and stated that "clients of the Company's U.S. Tax Operations segment are given the opportunity to open an individual retirement account (Express IRA) through HRBFA as a part of the income tax return preparation process. The Express IRA is invested in an FDIC insured money market account through Reserve Management Corporation at a federally insured depository institution paying competitive money market interest rates."

34. On February 23, 2003, the Company issued a press release stating, among other things, that:

H&R Block Inc. (NYSE: HRB) today reported record third quarter revenues and earnings due to solid performance in its U.S. tax segment and outstanding performance in its mortgage segment. The company said it expects to exceed its previously announced earnings guidance for the fiscal year ending April 30, 2003. In addition, the company declared its quarterly dividend of 18 cents.

For the third quarter ended Jan. 31, 2003, H&R Block's earnings increased to \$132.3 million, or 73 cents per diluted share, up from \$29.6 million, or 16 cents per diluted share, last year. These results include a gain of 43 cents per diluted share from the sale of mortgage residual assets announced on Nov. 18. Excluding this gain, the company nearly doubled earnings from operations to 30 cents per diluted share . . .

"We had an outstanding third quarter," said Mark A. Ernst, H&R Block's chairman and chief executive officer. "We had a solid start to the tax-filing season along with continued great performance in our mortgage segment."

"While it's still early in the tax season, trends thus far indicate that our overall strategy to enhance service to our clients while carefully controlling our costs is working well," Ernst said. "Coupled with the continued strength of our mortgage operations, we're on track to beat our previous guidance for full year results. We now expect earnings per share to be in the range of \$3.10 to \$3.25, up 34 to 41 percent from fiscal 2002, when H&R Block earned \$2.31 per diluted share. Revenues will likely exceed our target growth range of 10-to-15 percent for the year."

35. On March 17, 2003, HRB filed its quarterly report with the SEC on Form 10-Q for the period ended January 31, 2003. The Form 10-Q, signed by defendant Cotroneo included the Company's financial results for the period ended January 31, 2003 and stated "clients of the Company's U.S. Tax Operations segment are given the opportunity to open an individual retirement account (Express IRA) through HRBFA as a part of the income tax return preparation process. The Express IRA is invested in an FDIC insured money market account through Reserve Management Corporation at a federally insured depository institution paying competitive money market interest rates."

36. On June 11, 2003, the Company issued a press release stating, among other things, that:

H&R Block Inc. (NYSE: HRB) today reported record revenues and net income for both its fourth quarter and fiscal year ended April 30.

Fourth quarter earnings per diluted share increased 10.2 percent to \$2.71. Consolidated net income for the quarter increased 6.7 percent to \$494.6 million. Fourth quarter revenues totaled \$1.9 billion, a 2.0 percent increase over the same quarter last year. Fourth quarter results included a goodwill impairment charge of 6 cents per share in the business services segment.

For the fiscal year, earnings per diluted share increased 36.4 percent to \$3.15. Consolidated net income for the fiscal year increased 33.5 percent to \$580.1 million. Fiscal year revenues increased 13.9 percent to \$3.8 billion.

"Our mix of businesses allowed us to perform well despite a challenging economy," said H&R Block Chairman and Chief Executive Officer Mark A. Ernst. "Our consolidated income growth was strong as a result of outstanding results in our mortgage segment and good financial performance in our U.S. tax segment."

37. On July 16, 2003, HRB filed its annual report with the SEC on Form 10-K for the fiscal year-ended April 30, 2003. The Form 10-K, signed by defendants Ernst and Cotroneo, included the Company's financial results for the fiscal year-ended April 30, 2003 and stated the following:

Express IRA . Tax professionals routinely discuss with clients any tax advantages of saving for retirement through an individual retirement account ("IRA"). In fiscal years 2003 and 2002, H&R Block offered the Express IRA nationwide, compared to its availability in 14 states in fiscal year 2001. With the Express IRA product, tax preparation clients can fund an IRA through H&R Block Financial Advisors, Inc. by using all or part of their tax refund, or by writing a personal check for the amount deposited into the IRA. The Express IRA is invested in an FDIC Insured money market account through Reserve Management Corporation at an insured depository institution paying competitive money market interest rates. Clients funded approximately 126,000 Express IRAs in fiscal year 2003, compared to 130,000 in fiscal year 2002 and 25,000 in fiscal year 2001.

38. On August 26, 2003, the Company issued a press release stating, among other things, that:

H&R Block Inc. (NYSE:HRB) today reported first-quarter earnings of \$10.6 million, or 6 cents per diluted share, compared with a loss of \$9.5 million, or 5 cents per share, last year.

Revenues increased 14.7 percent to \$494.8 million for the quarter, which ended on July 31.

First-quarter earnings were the result of strong performance in the company's mortgage segment, effective off-season cost control measures in the U.S. tax segment, and improvement in the investment services segment. H&R Block has historically reported a loss in its first quarter due to the seasonal nature of its tax service businesses.

"Our first-quarter results show the strength we have in our mix of businesses. Our fiscal year is off to a solid start. We're on track with our plans to meet our growth objectives this year," said Mark A. Ernst, chairman and chief executive officer.

39. On September 15, 2003, HRB filed its quarterly report with the SEC on Form 10-Q for the fiscal quarter ended July 31, 2003. The Form 10-Q, signed by defendant Cotroneo, included the Company's financial results for the period ended July 31, 2003 and stated "clients of the Company's U.S. Tax Operations segment are given the opportunity to open an Express IRA through HRBFA as a part of the income tax return preparation process."

40. On November 25, 2003, the Company issued a press release stating, among other things, that:

H&R Block Inc. (NYSE:HRB) today reported net income of \$10.4 million, or 6 cents per basic and diluted share, for the second quarter ended Oct. 31.

Last year, the company reported a second-quarter loss of \$37.3 million, or 21 cents per share.

Second-quarter revenues increased to \$579.9 million, up 23 percent from \$471.4 million last year.

The company has never previously reported a profitable second quarter. H&R Block typically reports losses in its first and second quarters due to the seasonal nature of its tax service businesses. Earlier this year, the company's first quarter was profitable for only the second time in company history.

"Achieving profitability in the second quarter highlights the continued strength of H&R Block's mix of businesses, combined with very solid execution across all of our business segments. We're now preparing intently for tax season 2004 and looking forward to demonstrating how our services offer clients unique and compelling value," said Chairman and Chief Executive Officer Mark A. Ernst.

"Our second-quarter results were achieved through continued strong performance in our mortgage businesses, solid management and cost controls within our tax businesses, improved results in our business and investment services segments, and a good tax season in Australia,"

41. On December 10, 2003, HRB filed its quarterly report with the SEC on Form 10-Q for the period ended October 31, 2002. The Form 10-Q, signed by defendant Ernst, included the Company's financial results for the period ended October 31, 2003 and stated that "clients of the Company's U.S. Tax Operations segment are given the opportunity to open an Express IRA through HRBFA as a part of the income tax return preparation process."

42. On February 24, 2004, the Company issued a press release stating, among other things, that:

KANSAS CITY, Mo. – H&R Block Inc. (NYSE:HRB) today reported net income of \$106.7 million, or 59 cents per diluted share, and record revenues of \$977.2 million for the third quarter ended Jan. 31.

Third quarter revenues increased 2 percent from \$958.4 million last year. Third quarter net income declined \$25.6 million or 19.3 percent compared with last year when the company reported third quarter earnings of \$132.3 million, or 73 cents per diluted share. Third quarter 2004 results include a \$17 million gain on sale of certain mortgage assets. Third quarter 2003 results include a \$130.9 million gain on a similar transaction. Excluding the effect of these gains, third quarter net income increased \$42.9 million or 80.2 percent over the prior year.

The profitable third quarter marks the first time in the company's history that it has reported a profit in each of the first three quarters of its fiscal year. H&R Block typically reports losses in its first and second quarters, and often in its third quarter as well, due to the seasonal nature of its tax and business services units.

"All of our business segments executed effectively and delivered improved performance. We saw double-digit revenue growth in each of our businesses, excluding the mortgage asset sales that we've noted," said Chairman and Chief Executive Officer Mark A. Ernst.

43. On March 16, 2004, HRB filed its quarterly report with the SEC on Form 10-Q for the period ended January 31, 2004. The Form 10-Q, signed by defendant Ernst, included the Company's financial results for the period ended January 31, 2004 and stated "U.S. Tax Operations clients are also given the opportunity to open an Express IRA through HRBFA as a part of the income tax return preparation process."

44. On June 9, 2004, the Company issued a press release stating, among other things, that:

KANSAS CITY, Mo. -- H&R Block Inc. (NYSE: HRB) today reported record revenues and net income for both its fourth quarter and fiscal year ended April 30.

Fourth quarter revenues totaled \$2.2 billion, a 14.8 percent increase over the fourth quarter last year. Consolidated net income for the quarter increased 16.4 percent to \$575.6 million. Fourth quarter earnings per diluted share increased 19.2 percent to \$3.23.

Fiscal year revenues increased 12.3 percent to \$4.2 billion. Consolidated net income for the fiscal year increased 20.3 percent to \$697.9 million. Earnings per diluted share increased 23.8 percent to \$3.90, excluding a change in accounting principle. After the change in accounting principle, earnings per share increased 22.5 percent to \$3.86. The company adopted Emerging Issues Task Force No. 00-21 (EITF 00-21) in its second quarter.

"Fourth quarter results completed a year that saw record revenues, record earnings and balanced growth from our mix of businesses," said H&R Block Chairman and Chief Executive Officer Mark A. Ernst. "We experienced improved results across all business lines in our fourth quarter.

"H&R Block's combined annual growth rate for earnings per share has increased 29 percent in the past five years. Our mix of businesses has generated solid results, even in challenging business environments," Ernst said.

45. On July 2, 2004, HRB filed its annual report with the SEC on Form 10-K for the fiscal year-ended April 30, 2004. The Form 10-K, signed by defendant Ernst, included the Company's financial results for the fiscal year-ended April 30, 2004 and stated "As previously discussed in "U.S. Tax Operations," we offer our tax clients the opportunity to open an Express IRA through HRBFA as a part of the tax return preparation process. Clients funded approximately 215,000 Express IRAs during tax season 2004, approximately 126,000 in tax season 2003 and approximately 130,000 in tax season 2002."

46. On August 24, 2004, the Company issued a press release stating, among other things, that:

KANSAS CITY, Mo. -- H&R Block Inc. (NYSE: HRB) today reported a \$44.1 million net loss for its first quarter, compared with earnings of \$5.2 million last year. Revenues totaled \$482.7

million, a 2.6 percent decline from last year. The company reported a loss of 26 cents per diluted share, compared to 3 cents of earnings last year.

The decline in earnings was primarily due to decreased mortgage segment income and additional off-season costs associated with expanding the company's tax business.

"The first quarter loss is in line with our internal expectations, and consistent with our annual earnings guidance range of \$4 to \$4.25 per share," said H&R Block Chairman and Chief Executive Officer Mark A. Ernst. "This quarter we also repurchased 7.5 million shares in accordance with our objective to return excess capital to shareholders."

47. On September 9, 2004, HRB filed its quarterly report with the SEC on Form 10-Q for the fiscal quarter ended July 31, 2004. The Form 10-Q, signed by defendant Ernst, included the Company's financial results for the period ended July 31, 2004.

48. On November 23, 2004, the Company issued a press release stating, among other things, that:

KANSAS CITY, Mo. -- H&R Block Inc. (NYSE: HRB) today reported a \$52.2 million net loss for the second quarter of its 2005 fiscal year, compared with earnings of \$10.4 million in the second quarter last year. Revenues totaled \$539.3 million, a 5.2 percent decline from last year. The company reported a loss of 32 cents per diluted share, compared with 6 cents of earnings last year.

49. On December 8, 2004, HRB filed its quarterly report with the SEC on Form 10-Q for the period ended October 31, 2004. The Form 10-Q, signed by defendants Ernst and Trubeck, included the Company's financial results for the period ended October 31, 2004.

50. On February 24, 2005, the Company issued a press release stating, among other things, that:

KANSAS CITY, Mo. – H&R Block Inc. (NYSE:HRB) today reported net income of \$91.7 million, or 55 cents per diluted share, for the third quarter ended Jan. 31, 2005. Revenues in the third quarter were a record \$1.03 billion, a 7.2 percent increase over the prior year's quarter.

"A strong start to the tax season combined with solid performances from our mortgage and business services segments were highlights of a good quarter," said Mark A. Ernst, chairman and chief executive officer. "I'm particularly pleased that the strategic actions taken in our tax and mortgage businesses are generating success in their respective markets."

51. On March 18, 2005, HRB filed its quarterly report with the SEC on Form 10-Q for the period ended July 4, 2003. The Form 10-Q, signed by defendants Ernst and Trubeck, included the Company's financial results for the period ended January 31, 2005 and stated that "service revenues increased \$8.1 million primarily as a result of additional revenues associated with . . . Express IRAs . . . ."

52. On June 8, 2005, the Company issued a press release stating, among other things, that:

KANSAS CITY, Mo. – H&R Block Inc. (NYSE:HRB) today reported record fourth quarter results, driven by revenue growth in each of its lines of business. Fourth quarter revenues increased 7.2 percent over the prior year's quarter to \$2.4 billion. Revenues for the fiscal year were \$4.4 billion, a 4.1 percent increase over the prior year. Consolidated net income for the fourth quarter increased 6.9 percent to \$616.5 million. Consolidated net income for the fiscal year declined 10.5 percent to \$635 million. Earnings per diluted share for the fourth quarter increased 13 percent to \$3.66. For the fiscal year, earnings per diluted share decreased 4.1 percent to \$3.76.

"We finished our fiscal year on a very high note," said Mark A. Ernst, H&R Block's chairman and chief executive officer. "We successfully completed an important transition year in our tax

business, saw our mortgage business returning to more normalized levels of profitability, finished a stellar year at RSM McGladrey, and achieved important changes in our investment services organization during the quarter.”

53. On August 1, 2005, HRB filed its annual report with the SEC on Form 10-K for the fiscal year-ended April 30, 2005. The Form 10-K, signed by defendants Ernst and Trubeck, included the Company’s financial results for the fiscal year-ended April 30, 2005. The annual report stated that “we offer our tax clients the opportunity to open an Express IRA through HRBFA as a part of the tax return preparation process. Clients opened approximately 106,500 Express IRAs during tax season 2005, approximately 145,400 in 2004 and approximately 105,400 in 2003.”

54. On September 1, 2005, the Company issued a press release stating, among other things, that:

KANSAS CITY, Mo. – H&R Block Inc. (NYSE:HRB) today reported a 26 percent increase in first quarter revenue to \$615 million, up from \$486.6 million last year. A net loss of \$28.3 million for the first quarter of fiscal 2006 was 23 percent better than the \$36.7 million loss posted last year. The current year quarterly loss of 9 cents per diluted share compared favorably to a loss of 11 cents per share last year.

“We’ve started the year with a strong first quarter, highlighted by double-digit revenue increases in all business segments,” said Mark A. Ernst, chairman and chief executive officer. “Even with our continuing investment in new tax offices, we saw an improvement over the loss posted last year.”

55. On September 8, 2005, HRB filed its quarterly report with the SEC on Form 10-Q for the period ended July 31, 2005. The Form 10-Q, signed by defendants Ernst and Trubeck, included the Company’s financial results for the period ended July 31, 2005 and stated “service revenues increased \$4.0 million primarily as a result of additional revenues associated with Express IRAs . . . .”

56. On November 17, 2005, the Company issued a press release stating, among other things, that:

KANSAS CITY, Mo. – H&R Block Inc. (NYSE: HRB) today reported a net loss of \$72.2 million, or 22 cents per share, for the second quarter of fiscal 2006 compared with a loss of \$49.9 million, or 15 cents per share, in the year-ago quarter. Revenues in the quarter rose 14 percent to \$620.4 million from \$542.0 million in the prior-year period, with all business segments contributing to top-line growth.

“Good performance in our Tax Services, RSM McGladrey and Financial Advisors businesses was offset by weak mortgage earnings,” said Mark A. Ernst, chairman and chief executive officer. “Though mortgage originations and revenues were up during the second quarter, industry pricing pressure and rising funding rates combined to limit mortgage earnings.”

57. On December 12, 2005, HRB filed its quarterly report with the SEC on Form 10-Q for fiscal quarter ended October 31, 2005. The Form 10-Q, signed by defendants Ernst and Trubeck included the Company’s financial results for the period ended October 31, 2005 and stated “service revenues increased \$2.9 million primarily as a result of additional revenues associated with . . . Express IRAs.”

58. The statements referenced above in ¶¶ 28-57, were each materially false and misleading when made as they misrepresented and/or omitted the following adverse facts which then existed and disclosure of which was necessary to make the statements made not false and/or misleading, including:

- (a) HRB knowingly engaged in fraudulent business practices by steering low and middle-income customers to its Express IRA – a retirement account in which most customers have lost money because the Express IRA’s fees exceeded the return on interest earned on the account.
- (b) HRB marketed the Express IRA in a fraudulent manner by, for example, failing to adequately disclose fees;
- (c) HRB failed: (1) to adequately disclose that the Express IRA earned a negative rate of return because of fees, but instead, falsely described the rate as “great” and the account as a “better way to save”; (2) to adequately disclose the fees associated with the Express IRA in a format comprehensible to customers and falsely claimed fees were lower than they in fact were; (3) to inform customers that the value of their accounts would decline over time unless they made large and continuing contributions to the Express IRA because the fees far exceeded the low rate of return; and (4) to disclose the tax consequences and penalties associated with early withdrawal of funds from the Express IRA.
- (d) The Company experienced material weaknesses in internal controls relating accounting for state income taxes;
- (e) The Company would have to restate its financial statements for the fiscal years-ended April 30, 2004 and April 30, 2005 because HRB understated its state income taxes by at least \$32 million; and
- (f) That the Company’s financial statements were not prepared in accordance with GAAP.

## **VI. THE TRUTH BEGINS TO EMERGE**

59. On February 23, 2006, after the close of trading, HRB disclosed the following:

H&R Block Inc. (NYSE: HRB) today reported that revenues rose 12 percent in its fiscal third quarter to \$1.2 billion from \$1.0 billion in the prior-year period. Slightly lower revenues in Mortgage Services were offset by higher revenues in all other segments of the company’s operations.

Net earnings were \$28.8 million, or 9 cents per diluted share, for the third quarter of fiscal 2006. The quarterly results include an after-tax charge of \$31.7 million, or 10 cents per share, for a previously announced proposed litigation settlement and associated legal costs. For the third quarter of 2005, net earnings were \$92.3 million, or 28 cents per share, which included the benefit of a \$10.1 million after-tax legal recovery representing 3 cents per share.

“As we head into our busiest quarter of the year, we’ve seen an industry-wide slower start to the tax filing season than in previous years,” said Mark A. Ernst, chairman and chief executive officer. “Early season operating challenges experienced in our tax business further hurt our January comparative results. Results since January have begun to reverse the effects of this later start.

\* \* \*

As part of its ongoing work to remediate control weaknesses in its corporate tax function, the company said *that it will restate its results for fiscal years 2005 and 2004, as well as previously reported quarterly results for fiscal 2006*. The restatement pertains principally to *errors in determining the company’s state effective income tax rate, resulting in a cumulative understatement of its state income tax liability of approximately \$32 million as of April 30, 2005. The company estimates that the restatement will result in a 7-cent decrease in earnings per share in fiscal 2005 and a 2-cent decrease in earnings per share in fiscal 2004*. The

company has not completed its analysis of the restatement adjustments, and, accordingly, the effects of the restatement on all prior periods are preliminary and subject to change. These adjustments are also being reviewed with the company's registered public accounting firm. The company will report in amended filings with the Securities and Exchange Commission the further restatement of results for fiscal years 2005 and 2004, and restatements for the first two quarters of fiscal 2006 for the income tax adjustments. (Emphasis added).

60. On February 24, 2006, the following trading day, shares of HRB declined from \$25.19 to \$23.01 per share, a decline of approximately 9%, on unusually heavy volume.

61. On March 15, 2006, after the opening of trading, the New York Attorney General filed a complaint in Supreme Court of the State of New York for New York County alleged "that H&R Block abuses its relationship of trust by steering its customers into an unsuitable, fraudulently marketed, poorly performing, fee-ridden 'retirement vehicle' called the Express IRA: a retirement account that more often than not will shrink over time because its only investment option is a money market account with an interest rate that does not cover fees --fees that H&R Block fails to adequately disclose."

## **VII. FALSE FINANCIAL STATEMENTS**

62. In order to inflate the price of HRB's publicly traded securities, defendants caused the Company to falsely report its results for its financial statements for its fiscal year 2004 through its 2Q 2006 financial statements (period ended January 31, 2006) through improper calculation of the Company's state effective income tax rate.

63. These results were included in 10-Qs, 10-Ks and press releases disseminated by defendants to the public during the Class Period.

64. HRB admitted that "[a]s part of its ongoing work to remediate control weaknesses in its corporate tax function, the company said that it will restate its results for fiscal years 2005 and 2004, as well as previously reported quarterly results for fiscal 2006. The restatement pertains principally to errors in determining the company's state effective income tax rate, resulting in a cumulative understatement of its state income tax liability of approximately \$32 million as of April 30, 2005. The company estimates that the restatement will result in a 7-cent decrease in earnings per share in fiscal 2005 and a 2-cent decrease in earnings per share in fiscal 2004."

65. At all relevant times during the Class Period, HRB represented that its financial statements were prepared in accordance with GAAP. GAAP are those principles recognized by the accounting profession as the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. Regulation S-X [17 C.F.R. §210.4-01(a)(1)] states that financial statements filed with the SEC that are not prepared in conformity with GAAP are presumed to be misleading and inaccurate, despite footnote or other disclosure. Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception that interim financial statements need not include disclosure which would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R. §210.10-01(a).

66. The representations by defendants that HRB's financial statements were prepared in accordance with GAAP were materially false and misleading because the defendants engaged in a fraudulent accounting practice which materially understated the Company's income tax during the Class Period.

67. The fact that HRB will restate its financial statements is an admission that the financial statements as originally issued were false and that the misstatement of revenues and income was material. Pursuant to GAAP, as set forth in Accounting Principles Board Opinion ("APB") No. 20, the type of restatement announced by HRB was to correct for material errors in its previously issued financial statements. *See* APB No. 20, ¶¶7-13. The restatement of past financial statements is a disfavored method of recognizing an accounting change as it dilutes confidence by investors in the financial statements, it makes it difficult to compare financial statements and it is often difficult, if not impossible, to generate the numbers when restatement occurs. *See* APB No. 20, ¶14. Thus, GAAP provides that financial statements should only be restated in limited circumstances.

68. Due to these accounting improprieties, the Company presented its financial results and statements in a manner which violated GAAP, including the following fundamental accounting principles:

- a. The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements was violated (APB No. 28, ¶10);
- b. The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions was violated (FASB Statement of Concepts No. 1, ¶34);
- c. The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events and circumstances that change resources and claims to those resources was violated (FASB Statement of Concepts No. 1, ¶40);
- d. The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASB Statement of Concepts No. 1, ¶50);
- e. The principle that financial reporting should provide information about an enterprise's financial performance during a period was violated. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (FASB Statement of Concepts No. 1, ¶42);

- f. The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASB Statement of Concepts No. 2, ¶¶58-59);
- g. The principle of completeness, which means that nothing is left out of the information that may be necessary to insure that it validly represents underlying events and conditions was violated (FASB Statement of Concepts No. 2, ¶79); and
- h. The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered was violated. (FASB Statement of Concepts No. 2, ¶¶95, 97).

69. Further, the undisclosed adverse information concealed by defendants during the Class Period is the type of information which, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information which is expected to be and must be disclosed.

#### **VIII. LOSS CAUSATION/ECONOMIC LOSS**

70. During the Class Period, as detailed herein, defendants engaged in a scheme to deceive the market and a course of conduct that artificially inflated HRB's stock price and operated as a fraud or deceit on Class Period purchasers of HRB publicly traded securities by misrepresenting the Company's operating condition and future business prospects. Defendants achieved this by making positive statements about HRB's business and projecting strong earnings for the Company while they knew that the Company was suffering from a variety of adverse factors which were then negatively impacting its financial results, as detailed herein. Later, however, when defendants' prior misrepresentations were disclosed and became apparent to the market, the price of HRB stock fell precipitously as the prior artificial inflation came out of HRB's stock price. As a result of their purchases of HRB publicly traded securities during the Class Period, plaintiff and other members of the Class suffered economic loss, *i.e.*, damages under the federal securities laws.

#### **IX. FRAUD-ON-THE-MARKET DOCTRINE**

71. At all relevant times, the market for HRB publicly traded securities was an efficient market for the following reasons, among others:

- (a) The Company's Common Stock met the requirements for public listing and was listed and actively traded on the NYSE, a highly efficient market;
- (b) As a regulated issuer, the Company filed periodic public reports with the SEC; and
- (c) The Company regularly issued press releases which were carried by national news wires. Each of these releases was publicly available and entered the public marketplace.

72. As a result, the market for the Company's publicly traded securities promptly digested current information with respect to HRB from all publicly available sources and reflected such information in the price of the Company's securities. Under these circumstances, all purchasers of the Company's publicly traded securities during the Class Period suffered similar injury through their purchase of the publicly traded securities of HRB at artificially inflated prices and a presumption of reliance applies.

#### **X. ADDITIONAL SCIENTER ALLEGATIONS**

73. As alleged herein, defendants acted with scienter in that defendants knew that the public documents and statements issued or disseminated in the name of the Company were materially false and misleading; knew that such statements or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, defendants, by virtue of their receipt of information reflecting the true facts regarding HRB, their control over, and/or receipt and/or modification of HRB's allegedly materially misleading misstatements and/or their associations with the Company which made them privy to confidential proprietary information concerning HRB, participated in the fraudulent scheme alleged herein.

74. Defendants knew and/or recklessly disregarded the falsity and misleading nature of the information which they caused to be disseminated to the investing public. The ongoing fraudulent scheme described in this complaint could not have been perpetrated over a substantial period of time, as has occurred, without the knowledge and complicity of the personnel at the highest level of the Company, including the Individual Defendants.

75. Defendants had the motive and opportunity to perpetrate the fraudulent scheme and course of business described herein because the Individual Defendants were the most senior officers of HRB, issued statements and press releases on behalf of HRB and had the opportunity to commit the fraud alleged herein.

#### **XI. NO SAFE HARBOR**

76. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. Many of the specific statements pleaded herein were not identified as "forward-looking statements" when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, Defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, the particular speaker knew that the particular forward looking statement was false, and/or the forward-looking statement was authorized and/or approved by an executive officer of HRB who knew that those statements were false when made.

#### **FIRST CLAIM FOR RELIEF For Violation of Section 10(b) of the 1934 Act and Rule 10b-5 Against All Defendants**

77. Plaintiff incorporates ¶¶1-76 by reference.

78. During the Class Period, defendants disseminated or approved the false statements specified above, which they knew or recklessly disregarded were materially false and misleading in that they contained material misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

79. Defendants violated Section 10(b) of the 1934 Act and Rule 10b-5 in that they:

(a) Employed devices, schemes and artifices to defraud;

(b) Made untrue statements of material facts or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made not misleading; or

(c) Engaged in acts, practices, and a course of business that operated as a fraud or deceit upon plaintiff and others similarly situated in connection with their purchases of HRB publicly traded securities during the Class Period.

80. Plaintiff and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for HRB's publicly traded securities. Plaintiff and the Class would not have purchased HRB publicly traded securities at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by defendants' misleading statements.

81. As a direct and proximate result of these defendants' wrongful conduct, plaintiff and the other members of the Class suffered damages in connection with their purchases of HRB publicly traded securities during the Class Period.

**SECOND CLAIM FOR RELIEF**  
**For Violation of Section 20(a) of the 1934 Act**  
**Against the Individual Defendants**

82. Plaintiff incorporates ¶¶1-76 by reference.

83. The Individual Defendants acted as a controlling person of HRB within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high-level positions, and their ownership and contractual rights, participation in and/or awareness of the Company's operations and/or intimate knowledge of the statements filed by the Company with the SEC and disseminated to the investing public, the Individual Defendants had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Company, including the content and dissemination of the various statements which plaintiff contends are false and misleading. The Individual Defendants were provided with or had unlimited access to copies of the Company's reports, press releases, public filings and other statements alleged by plaintiff to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

84. In particular, the Individual Defendants had direct and supervisory involvement in the day-to-day operations of the Company and, therefore, are presumed to have had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

85. As set forth above, HRB and the Individual Defendants each violated Section 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their positions each as a controlling person, the Individual Defendants are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of HRB's and the Individual Defendants' wrongful conduct, plaintiff and other members of the Class suffered damages in connection with their purchases of the Company's securities during the Class Period.

**PRAYER FOR RELIEF**

WHEREFORE, plaintiff prays for judgment as follows: declaring this action to be a proper class action; awarding damages, including interest; awarding reasonable costs, including attorneys' fees; and such equitable/injunctive relief as the Court may deem proper.

**JURY DEMAND**

Plaintiff demands a trial by jury.

Dated: March 20, 2006

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