H&R BLOCK INC
Form 10-K/A
August 05, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A
Amendment No. 1

(Mark One)

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: April 30, 2005

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 1-6089
H&R Block, Inc.
(Exact name of registrant as specified in its charter)

MISSOURI	**44-0607856**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

4400 Main Street, Kansas City, Missouri 64111
(Address of principal executive offices, including zip code)
(816) 753-6900
(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, without par value	New York Stock Exchange Pacific Exchange

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, without par value
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

The aggregate market value of the registrant s Common Stock (all voting stock) held by non-affiliates of the registrant, computed by reference to the price at which the stock was sold on October 31, 2004, was $7,683,275,768.

Number of shares of registrant s Common Stock, without par value, outstanding on June 30, 2005: 331,940,594.

Documents incorporated by reference

The definitive proxy statement relating to the registrant s Annual Meeting of Shareholders, to be held September 7, 2005, is incorporated by reference in Part III to the extent described therein.

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Explanatory Note

This Amendment No. 1 on Form 10-K/A (Form 10-K/A) to the company s Annual Report on Form 10-K for the year ended April 30, 2005, initially filed with the Securities and Exchange Commission on August 1, 2005, is being filed primarily to amend and revise the following:

- Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations
  - Fiscal 2006 Outlook for Mortgage Services
  - Financial Condition, Contractual Obligations and Commercial Commitments with respect to our shelf registration statement
- Item 8. Financial Statements and Supplementary Data, note 22

Additionally, as this Form 10-K/A was filed after the record date for our two-for-one stock split, which is effective August 22, 2005, we have adjusted all share and par share amounts to reflect the retroactive effect of the stock split.

H&R BLOCK

2005 FORM 10-K AND ANNUAL REPORT
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INTRODUCTION AND FORWARD LOOKING STATEMENTS

We have again chosen to combine our Annual Report on Form 10-K, which we are required to file annually with the Securities and Exchange Commission (SEC), and our Annual Report to Shareholders. We hope that by including all of this information in one document, you will find this Annual Report more useful and informative.

On June 7, 2005, we determined it was appropriate to restate our previously issued consolidated financial statements, including financial statements for the nine months ended January 31, 2005 and financial statements for the fiscal years ended April 30, 2004 and 2003 and all related interim periods. The details of the restatement, including the issues and amounts, are presented in Item 8, note 2 to our consolidated financial statements.

Specified portions of our proxy statement, which will be filed in August 2005, are listed as incorporated by reference in response to certain items. Our proxy statement will be printed within our Annual Report and mailed to shareholders in August 2005 and will also be available on our website at *www.hrblock.com.*

In this report, and from time to time throughout the year, we share our expectations for the Company s future performance. These forward-looking statements are based upon current information, expectations, estimates and projections regarding the Company, the industries and markets in which we operate, and our assumptions and beliefs at that time. These statements speak only as of the date on which they are made, are not guarantees of future performance, and involve certain risks, uncertainties and assumptions, which are difficult to predict. Therefore, actual outcomes and results could materially differ from what is expressed, implied or forecast in these forward-looking statements. Words such as believe, will, plan, expect, intend, estimate, approximate, and similar expressio identify such forward-looking statements.

PART I

ITEM 1. BUSINESS

GENERAL DEVELOPMENT OF BUSINESS ...

H&R Block is a diversified company with subsidiaries delivering tax, investment, mortgage and business services and products. For 50 years, we have been developing relationships with millions of tax clients and our strategy is to expand on these relationships. Our 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 in Canada, Australia and the United Kingdom. We also offer investment services and securities products through H&R Block Financial Advisors, Inc. (HRBFA). Our Mortgage Services segment offers a full range of home mortgage services through Option One Mortgage Corporation (Option One) and H&R Block Mortgage Corporation (HRBMC). RSM McGladrey Business Services, Inc. (RSM) is a national accounting, tax and consulting firm primarily serving mid-sized businesses.

H&R BLOCK S MISSION ...

To 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.

H&R Block, Inc. was organized as a corporation in 1955 under the laws of the State of Missouri, and is a holding company with operating subsidiaries providing financial services and products to the general public. H&R Block, the Company, we, our and us are used interchangeably to refer to H&R Block, Inc. or to H&R Block, Inc. and its subsidiaries, as appropriate to the context.

RECENT DEVELOPMENTS ... On October 26, 2004, we issued $400.0 million of 5.125% Senior Notes under our shelf registration statements. The Senior Notes are due on October 30, 2014. The proceeds from the notes were used to repay our $250.0 million in $6^{3}/4\%$ Senior Notes, which were due on November 1, 2004. The remaining proceeds were used for working capital, capital expenditures, repayment of other debt and other general corporate purposes. As of April 30, 2005, we had $850.0 million available under our shelf registration statements.

On June 8, 2005, our Board of Directors declared a two-for-one stock split of the Company s Common Stock in the form of a 100% stock distribution, effective August 22, 2005, to shareholders of record as of the close of business on August 1, 2005. All share and per share amounts in this document have been adjusted to reflect the retroactive effect of the stock split.

Developments during fiscal year 2005 within our operating segments are described below in Description of Business.

FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS
See discussion below and in Item 8, note 20 to our consolidated financial statements.

DESCRIPTION OF BUSINESS
TAX SERVICES
GENERAL ... Our Tax Services segment is primarily engaged in providing tax return preparation and related services and products in the United States and its territories, Canada, Australia and the United Kingdom. Revenues include fees earned for services performed at company-owned retail tax offices, royalties from franchise retail tax offices, sales of Peace of Mind (POM) guarantees, sales of tax preparation and other software, fees from online tax preparation, and participation in refund anticipation loans (RALs). Segment revenues constituted 53.4% of our consolidated revenues for fiscal year 2005, 51.6% for 2004, and 52.2% for 2003.

Retail income tax return preparation and related services are provided by tax professionals via a system of retail offices operated directly by us or by franchisees. In addition to our retail offices, we offer a number of digital tax preparation alternatives.

TaxCut® from H&R Block enables do-it-yourself users to prepare their federal and state tax returns easily and accurately. Our software products may be purchased through third-party retail stores, direct mail or online.

Clients also have many online options: multiple versions of do-it-yourself tax preparation, professional tax review, tax advice and tax preparation through a tax professional, whereby the client completes a tax organizer and sends it to a tax professional for preparation and/or signature.

By offering professional and do-it-yourself tax preparation options through multiple channels, we can serve our clients in the manner in which they choose to be served.

We also offer clients a number of options for receiving their income tax refund, including a check directly from the Internal Revenue Service (IRS), an electronic deposit directly to their bank account, a refund anticipation check or a RAL.

The following are some of the services we offer with our tax preparation service:

PEACE OF MIND GUARANTEE ... The POM guarantee is offered to U.S. clients, whereby we (1) represent our clients if audited by the IRS, and (2) assume the cost, subject to certain limits, of additional taxes owed by a client resulting from errors attributable to one of our tax professionals. The POM program has a per client cumulative limit of $5,000 in additional taxes assessed with respect to the federal, state and local tax returns we prepared for the taxable year covered by the program.

RALs ... RALs are offered to our U.S. clients by a designated bank through a contractual relationship with HSBC Holdings plc (HSBC). An eligible, electronic filing client may apply for a RAL at one of our offices. After meeting certain eligibility criteria, clients are offered the opportunity to apply for a loan from HSBC in amounts up to $9,999 based upon their anticipated federal income tax refund. We simultaneously transmit the income tax return information to the IRS and the lending bank. Within a few days or less after the filing date, the client receives a check or direct deposit in the amount of the loan, less the bank s transaction fee, our tax return preparation fee and other fees for client-selected services. Additionally, qualifying electronic filing clients are eligible to receive their RAL proceeds, less applicable fees, in approximately one hour after electronic filing using the Instant Money service. For a RAL to be repaid, the IRS directly deposits the participating client s federal income tax refund into a designated account at the lending bank. See related discussion of RAL participations below.

RACs ... Refund Anticipation Checks (RACs) are offered to U.S. clients who may not wish to obtain a RAL or do not qualify for the RAL program, but who would like to either (1) receive their refund faster and do not have a bank account for the IRS to direct deposit their refund or (2) have their tax preparation fees paid directly out of their refund. A RAC is not a loan and is provided through a contractual relationship with HSBC.

EASY PAY LOANS ... EasyPay revolving loans are offered through a contractual relationship with HSBC to clients whose tax returns reflect a balance due to the IRS. The loan has same as cash terms for approximately 90 days.

EXPRESS IRAs ... Individual retirement accounts (Express IRAs), invested in FDIC-insured money market accounts, are offered to U.S. clients as a tax-advantaged retirement savings tool. HRBFA acts as custodian on the accounts, with the funds being invested at insured depository institutions paying competitive money market interest rates.

TAX RETURN PREPARATION COURSES ... We offer income tax return preparation courses to the public, which teach taxpayers how to prepare income tax returns and provide us with a source of trained tax professionals.

SOFTWARE PRODUCTS ... We develop and market TaxCut income tax preparation software, H&R Block DeductionPro^{tm}, Kiplinger s Home and Business Attorney and Kiplinger s WILLPower[SM] software products.

TaxCut offers a simple step-by-step tax preparation interview, data imports from money management software and tax preparation software, calculations, completion of the appropriate tax forms, checking for errors and, for an additional charge, electronic filing.

H&R Block DeductionPro helps taxpayers track and accurately value their charitable deductions by providing fair-market valuations for hundreds of commonly donated household goods.

ONLINE TAX PREPARATION ... We offer a comprehensive range of tax services and products, from tax advice to complete professional and do-it-yourself tax return preparation and electronic filing, through our website at *www.hrblock.com* and *www.taxcut.com.* These websites allow clients to prepare their federal and state income tax returns using the Online Tax Program (OTP), access tax tips, advice and tax-related news and use calculators for tax planning.

Beginning with the fiscal year 2003 tax season, we participated in the Free File Alliance (FFA). This alliance was created by the tax return preparation industry and the IRS, and allows filers to prepare and file their federal return online at no charge. We feel that this program increases our visibility with new clients, while also providing an opportunity to offer our state return preparation services to these new clients at our regular prices.

CASHBACK PROGRAM ... We offer a refund discount (CashBack) program to our customers in Canada. Canadian law specifies the procedures we must follow in conducting the program. In accordance with current Canadian regulations, if a customer s tax return indicates the customer is entitled to a tax refund, we issue a check to the client. The client assigns to us the full amount of the tax refund to be issued by Revenue Canada and the refund check is then sent by Revenue Canada directly to us. In accordance with the law, the discount is deemed to include both the tax return preparation fee and the fee for tax refund discounting. This program is financed by short-term borrowings. The number of returns discounted under the CashBack program in fiscal year 2005 was approximately 581,000, compared to 552,000 in 2004 and 531,000 in 2003. See discussion of the Canadian tax season extension under Seasonality of Business.

CLIENTS SERVED ... We, together with our franchisees, served approximately 21.4 million clients worldwide during fiscal year 2005, compared to 21.6 million in 2004 and 21.7 in 2003. See discussion of the Canadian tax season extension under Seasonality of Business. We served 19.1 million clients in the U.S. during fiscal year 2005, compared to 19.3 million in 2004 and 19.5 million in 2003. Clients served includes taxpayers for whom we prepared income tax returns in offices, federal software units sold, online completed and paid federal returns and paid online state returns when no federal return was purchased, as well as taxpayers for whom we provided only paid electronic filing services. Returns for our U.S. clients constituted 15.5% of an IRS estimate of total individual income tax returns filed as of April 29, 2005, compared to 15.7% in 2004 and 16.0% in 2003.

OWNED AND FRANCHISED OFFICES ... A summary of our company-owned and franchise offices is as follows:

April 30,	**2005**	2004	2003
U.S. OFFICES ...			
Company-owned offices	**5,811**	5,172	4,688
Company-owned shared locations [(1)]	**1,296**	996	607
Total company-owned offices	**7,107**	6,168	5,295
Franchise offices	**3,528**	3,418	3,967
Franchise shared locations [(1)]	**526**	323	95

Total franchise offices	**4,054**	3,741	4,062
	11,161	9,909	9,357
INTERNATIONAL OFFICES ...			
Canada	**912**	891	910
Australia	**378**	378	362
Other	**10**	7	6
	1,300	1,276	1,278

(1) Shared locations include offices located within Wal-Mart, Sears or other third-party businesses.

Offices in shared locations include 947 offices operated in Wal-Mart stores and 757 offices in Sears stores operated as H&R Block at Sears. The Wal-Mart agreement is in the process of being extended, with the new agreement expected to expire in May 2007, and the Sears license agreement expires in July 2007, both subject to termination rights.

We offer franchises as a way to expand our presence in the market. Our franchise arrangements provide us with certain rights which are designed to protect our brand. Most of our franchisees receive signs, designated equipment, specialized forms, local advertising, initial training, and supervisory services, and pay us a percentage of gross tax return preparation and related service revenues as a franchise royalty.

From time to time, we have acquired the territories of existing franchisees and other tax return preparation businesses, and will continue to do so if future conditions warrant and satisfactory terms can be negotiated. During fiscal year 2004, we made payments of $243.2 million related to the acquisition of primarily assets and stock in the franchise territories of ten of our former major franchisees. One franchisee is continuing litigation challenging the post-expiration restrictive covenants and also disputing the payment due under the franchise agreement terms.

RAL PARTICIPATIONS AND 2003 TAX SEASON WAIVER … Since July 1996, we have been a party to agreements with HSBC and its predecessors to participate in RALs provided by a lending bank to H&R Block tax clients. The 1996 agreement was amended and restated in January 2003 and again in June 2003. In the June 2003 agreement, we obtained the right to purchase a 49.9% participation interest in RALs obtained through company-owned and regular franchise offices and a 25% interest in RALs obtained through major franchise offices. The current agreement continues through June 2006. Our purchases of the participation interests are financed through short-term borrowings, and we bear all of the credit risk associated with our interests in the RALs. Revenue from our participation is calculated as the rate of participation multiplied by the fee paid by the borrower to the lending bank. Our RAL participation revenue was $182.8 million and $168.4 million in fiscal years 2005 and 2004, respectively.

In January 2003, we entered into an agreement with Household Tax Masters, Inc. (Household, subsequently acquired by HSBC), whereby we waived our right to purchase any participation interests in and to receive fees related to RALs during the period January 1 through April 30, 2003. In consideration for waiving these rights, we received a series of payments from Household, subject to certain adjustments based on delinquency rates for the 2003 tax season. We recorded revenues totaling $138.2 million during fiscal year 2003. The initial payments were recognized as revenue over the waiver period. The waiver agreement only covered the 2003 tax season.

SEASONALITY OF BUSINESS … Because most of our clients file their tax returns during the period from January through April of each year, substantially all of our revenues from income tax return preparation and related services and products are received during this period. As a result, our tax segment generally operates at a loss through the first eight months of the fiscal year. Historically, these losses primarily reflect wages of year-round personnel, training of tax professionals, rental and furnishing of retail tax offices, and other costs and expenses relating to preparation for the upcoming tax season. Additionally, the tax business is affected by economic conditions and unemployment rates. Peak revenues occur during the applicable tax season, as follows:

United States and Canada	January April
Australia	July October

This year Revenue Canada extended the Canadian tax season to May 2, 2005. Clients served in our Canadian operations in fiscal year 2005 includes approximately 47,500 returns in both company-owned and franchise offices which were accepted by the client on May 1 and 2, 2005. The revenues related to these returns will be recognized in fiscal year 2006.

COMPETITIVE CONDITIONS … The retail tax services business is highly competitive. There are a substantial number of tax return preparation firms and accounting firms offering tax return preparation services. Many tax return preparation firms and many firms not otherwise in the tax return preparation business are involved in providing electronic filing and RAL services to the public. Commercial tax return preparers and electronic filers are highly competitive with regard to price, service and reputation for quality. In terms of the number of offices and personal tax returns prepared and electronically filed in offices, online and via our software, we are the largest company providing direct tax return preparation and electronic filing services in the U.S. We also believe we operate the largest tax return preparation businesses in Canada and Australia.

The Digital Tax Solutions businesses compete with a number of companies. Intuit, Inc. is the dominant supplier of tax preparation software and is also our primary competitor in the online tax preparation market. There are many smaller competitors in the online market, as well as free state-sponsored online filing programs. Price competition for tax preparation services increased in fiscal year 2005. In addition, we and Intuit, along with several other online companies participating in the FFA, began offering free online federal return preparation with no income limitations. As a result, the IRS indicated the number of free federal returns filed through the FFA increased 46%. We continue to believe the FFA offers us the opportunity to reach new clients; however, this year s free offer captured new clients who may have otherwise paid for a return through our online business.

GOVERNMENT REGULATION ... Primary efforts toward the regulation of U.S. commercial tax return preparers have historically been made at the federal level. Federal legislation requires income tax return preparers to, among other things, set forth their signatures and identification numbers on all tax returns prepared by them, and retain all tax returns prepared for three years. Federal laws also subject income tax return preparers to accuracy-related penalties in connection with the preparation of income tax returns. Preparers may be prohibited from further acting as income tax return preparers if they continuously and repeatedly engage in specified misconduct. With certain exceptions, the Internal Revenue Code also prohibits the use or disclosure by income tax return preparers of certain income tax return information without the prior written consent of the taxpayer. In addition, the Gramm-Leach-Bliley Act and

Federal Trade Commission regulations adopted thereunder require income tax preparers to adopt and disclose consumer privacy policies, and provide consumers a reasonable opportunity to opt-out of having personal information disclosed to unaffiliated third parties for marketing purposes. Some states have adopted or proposed strict opt-in requirements in connection with use or disclosure of consumer information.

We believe the federal legislation regulating commercial tax return preparers and consumer privacy has not had and will not have a material adverse effect on the operations of H&R Block. In addition, no present state statutes of this nature have had a material adverse effect on our business. We cannot, however, predict what the effect may be of the enactment of new statutes or adoption of new regulations.

The federal government regulates the electronic filing of income tax returns in part by requiring individuals and businesses to be accepted into the electronic filing program. Once accepted, electronic filers must comply with all publications and notices of the IRS applicable to electronic filing, provide certain information to the taxpayer, comply with advertising standards for electronic filers, and be subjected to possible monitoring by the IRS, penalties for disclosure or use of income tax return preparation and other preparer penalties, and suspension from the electronic filing program. States that have adopted electronic filing programs for state income tax returns have also enacted laws regulating electronic filers and the advertising and offering of electronic filing services.

Federal statutes and regulations also regulate an electronic filer s involvement in RALs. Electronic filers must clearly explain the RAL is a loan and not a substitute for or a quicker way of receiving an income tax refund. Federal laws place restrictions on the fees an electronic filer may charge in connection with RALs. In addition, some states and localities have enacted laws and adopted regulations for RAL facilitators and/or the advertising of RALs. There are also many states that have statutes regulating, through licensing and other requirements, the activities of brokering loans, providing credit services and offering credit repair services to consumers for a fee (Loan Activity Statutes). We believe the procedures under which we facilitate RALs are structured so our activities are not included within the scope of the activities regulated by these Loan Activity Statutes. There can be no assurances, however, that states with these Loan Activity Statutes will not contend successfully that these statutes apply to the RAL business and that we will need to become licensed under the Loan Activity Statutes, otherwise comply with statutory requirements, or modify procedures so that the Loan Activity Statutes are inapplicable.

Many states have statutes requiring the licensing of persons offering contracts of insurance. We have received from certain state insurance regulators inquiries about our POM guarantee program and the applicability of the state insurance statutes. In states where the inquiries are closed, the regulators affirmed our position that the POM guarantee is not a contract of insurance and is therefore not subject to state insurance licensing laws. In the few states where inquiries are pending, we believe there are no insurance laws under which the POM guarantee constitutes a contract of insurance. There can be no assurances, however, that the product, or other similar products we may offer in the future, will not be scrutinized as potential insurance products and held to be subject to various insurance laws and regulations.

Many of our income tax courses are regulated and licensed in select states. Failure to obtain a tax school license could limit our ability to develop interest in tax preparation as a career or obtain qualified tax professionals.

We believe the federal, state and local laws and legislation regulating electronic filing, RALs and the facilitation of RALs, loan brokers, credit services, credit repair services, insurance products, and proprietary schools have not, and will not in the future, have a material adverse effect on our operations. We cannot predict, however, what the effect may be of the enactment of new statutes or the adoption of new regulations pertaining to these matters.

As noted above under Owned and Franchised Offices, many of the income tax return preparation offices operating in the U.S. under the name H&R Block are operated by franchisees. Certain aspects of the franchisor/franchisee relationship have been the subject of regulation by the Federal Trade Commission and by various states. The extent of regulation varies, but relates primarily to disclosures to be made in connection with the grant of franchises and limitations on termination by the franchisor under the franchise agreement. To date, no such regulation has materially affected our business. We cannot predict, however, the effect of applicable statutes or regulations that may be enacted or adopted in the future.

We also seek to determine the applicability of all government and self-regulatory organization statutes, ordinances, rules and regulations in the international countries in which we operate (collectively, Foreign Laws) and to comply with these Foreign Laws. We cannot predict what effect the enactment of future Foreign Laws, changes in interpretations of existing Foreign Laws, or the results of future regulator inquiries regarding the applicability of Foreign Laws may have on our segments, any particular subsidiary, or our consolidated financial statements.

Statutes and regulations relating to income tax return preparers, electronic filing, franchising and other areas affecting the income tax business also exist in other countries in which we operate. In addition, the Canadian government regulates the refund-discounting program in Canada. These laws have not materially affected our international operations.

See discussion in Risk Factors for additional information.

MORTGAGE SERVICES

GENERAL ... Our Mortgage Services segment originates mortgage loans, services non-prime mortgage loans and sells and securitizes mortgage loans and residual interests in the U.S. Revenues primarily consist of gains from sales and securitizations of mortgage assets, accretion on residual interests and servicing fee income. Segment revenues constituted 28.2% of our consolidated revenues for fiscal year 2005 and 31.2% for 2004 and 30.8% for 2003.

We originate both non-prime and prime mortgage loans. Non-prime mortgages are those that may not be offered through government-sponsored loan agencies and typically involve borrowers with limited income documentation, high levels of consumer debt or past credit problems. Even though these borrowers have credit problems, they also tend to have equity in the property that will be used to secure the loan. Prime mortgages are those that may be offered through government sponsored loan agencies. We conduct business through four channels:

- Option One s wholesale origination channel works with independent brokers throughout the U.S. to fund non-prime mortgage loans through a national branch network. Wholesale originations represent the majority of Option One s total loan production.
- HRBMC originates residential mortgage loans directly to retail consumers through various sales channels, including 37 loan production offices, of which four are regional offices, in 26 states in fiscal year 2005.
- Option One s national accounts channel forms partnerships with financial institutions, including national and regional banks, to allow them to offer non-prime loans.
- Option One s bulk acquisitions channel specializes in the purchase of performing non-prime mortgage loan pools.

Option One is headquartered in Irvine, California and operates in 48 states by serving 42,000 mortgage broker locations and through its network of 36 wholesale loan production branches and six national accounts branches. HRBMC, a wholly-owned subsidiary of Option One, is a retail mortgage lender for prime, non-prime and government loans and is licensed to conduct business in all 50 states. HRBMC is an approved seller/servicer for Fannie Mae and Freddie Mac and is HUD authorized to originate and underwrite FHA and VA mortgage loans.

LOAN ORIGINATION ... The following table details our originations by channel for fiscal years 2005, 2004 and 2003:

			(in 000s)
Year Ended April 30,	**2005**	2004	2003
Wholesale	**$ 21,841,783**	$ 16,828,138	$ 11,434,138
Retail	**4,023,914**	3,105,021	2,918,378
National accounts	**3,974,224**	2,642,944	1,814,092
Bulk acquisitions	**1,161,803**	679,910	411,013
	$ 31,001,724	$ 23,256,013	$ 16,577,621

Information regarding our non-prime loan originations is as follows:

			(dollars in 000s)
Year Ended April 30,	**2005**	2004	2003
Loan type:			
2-year ARM	**61.6%**	63.4%	70.3%
3-year ARM	**4.0%**	5.2%	5.1%
Fixed 1st	**17.7%**	28.7%	23.9%
Fixed 2nd	**3.8%**	1.6%	0.7%
Interest only 1st	**12.6%**	0.7%	%
Other	**0.3%**	0.4%	%
Loan purpose:			
Cash-out refinance	**63.5%**	67.1%	64.9%
Purchase	**30.8%**	26.0%	26.9%
Rate or term refinance	**5.7%**	6.9%	8.2%
Loan characteristics:			
Average loan size	**$ 160**	$ 151	$ 144
Weighted-average loan-to-value	**78.9%**	78.1%	78.7%
Weighted-average FICO score	**614**	608	604

WHOLESALE. Wholesale loan originations involve an independent broker who assists the borrower in completing the loan application, which includes securing information regarding their assets, liabilities, income, credit history, employment history and personal information. We require a credit report on each applicant from an industry-recognized credit reporting company. In evaluating an applicant s credit history, we use credit bureau risk scores, generally known as a FICO score, which is a statistical ranking of likely future credit performance developed by Fair, Isaac & Company and provided by the three national credit data repositories. Qualified independent appraisers are required to appraise mortgaged properties used to secure mortgage loans. The broker then identifies a lender who offers a loan product best suited to the borrower s financial

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needs. No one broker currently originates more than 0.6% of our total non-prime production.

Upon receipt of an application from a broker, a credit report and an appraisal report, one of our branch offices processes and underwrites the loan. Our underwriting guidelines require mortgage loans be underwritten in a standardized procedure that complies with federal and state laws and regulations. The guidelines are primarily intended to assess the value of the mortgaged property, evaluate the adequacy of the property as collateral for the mortgage loan, and assess the creditworthiness of the related borrower. Based upon this assessment, we advise the broker whether the loan application meets our underwriting guidelines and product description by issuing a loan approval or denial. In some cases, we issue a conditional approval, which requires the submission of additional information or clarification. The mortgage loans are underwritten with a view toward resale in the secondary market.

RETAIL. HRBMC originates our retail mortgage loans. In fiscal year 2005, 75% of our retail originations were non-prime and 25% were prime, compared to 59% and 41%, respectively, in 2004. These loans are processed by loan officers in HRBMC offices. Approximately one-third of these offices are co-located with our retail tax offices. The co-located offices are key to working towards our mission of becoming our clients tax and financial partner. During fiscal year 2005, approximately 35% of HRBMC s loans were made to existing H&R Block clients compared to 49% in 2004.

The application and approval process in our retail locations is similar to those described above under Wholesale. Retail mortgage loans are originated with the intent to sell.

SALE AND SECURITIZATION OF LOANS ... Substantially all non-prime mortgage loans are sold daily to qualifying special purpose entities (Trusts). See discussion of our loan sale and securitization process in Item 7, under Off-Balance Sheet Financing Arrangements.

Substantially all of our retail prime mortgage loans are sold to Countrywide Home Loans, Inc. (Countrywide). The majority of mortgage loans sold to Countrywide are underwritten through an automated system under which Countrywide assumes our representations and warranties, which comply with Countrywide s underwriting guidelines. This agreement allows us to achieve improved execution due to price, efficiencies in delivery, and elimination of redundancies in operations. We do not retain servicing rights related to the prime mortgage loans. HRBMC non-prime mortgage loans are sold to Option One. See discussion of our prime warehouse line in Item 7, under Capital Resources and Liquidity by Segment.

SERVICING ... Loan servicing involves collecting and remitting mortgage loan payments, making required advances, accounting for principal and interest, holding escrow for payment of taxes and insurance and contacting delinquent borrowers. We receive loan-servicing fees monthly over the life of the mortgage loans. We only service non-prime mortgage loans. At the end of fiscal year 2005, we serviced 435,290 loans totaling $68.0 billion, compared to 324,364 loans totaling $45.3 billion at April 30, 2004 and 246,463 loans totaling $31.3 billion at April 30, 2003.

The following table summarizes our servicing portfolio by origin and includes related mortgage servicing rights (MSRs) as of April 30, 2005 and the rate we earned on each type of servicing during fiscal year 2005:

(dollars in 000s)

Type of Servicing	Principal Balance	MSR Balance	Rate Earned
Originated	**$ 47,376,295**	**$ 166,614**	**0.41%**
Sub-servicing	**20,450,482**		**0.22%**
Purchased	**167,687**		**0.51%**
Total	**$ 67,994,464**	**$ 166,614**	**0.36%**

When non-prime loans are sold or securitized, we generally retain the right to service the loans, which results in MSR assets and liabilities being recorded on our balance sheet. Assumptions used in estimating the value of MSRs are discussed in Item 8, note 1 to our consolidated financial statements. In addition to servicing loans we originate, we also service non-prime loans originated by other lenders, designated in the above table as sub-servicing. MSRs are recorded only in conjunction with our originated or purchased loan-servicing portfolio.

GEOGRAPHIC DISTRIBUTION ... The following table details the percent of non-prime loan origination volume and our loan origination branches by state, excluding our Retail channel, for fiscal years 2005 and 2004:

	2005		2004	
State	Percent of Volume	Number of Branches	Percent of Volume	Number of Branches
California	**21.8%**	**8**	18.8%	5
New York	**11.5%**	**2**	14.4%	2
Massachusetts	**8.4%**	**2**	10.2%	1
Florida	**7.2%**	**4**	6.4%	4
New Jersey	**5.3%**	**3**	5.1%	3
Other	**45.8%**	**23**	45.1%	25

COMPETITIVE CONDITIONS ... Both the non-prime and prime sectors of the residential mortgage loan market are highly competitive. The principal methods of competition are price, service and product differentiation. There are a substantial number of companies competing in the residential loan market, including mortgage banking companies, commercial banks, savings associations, credit unions and other financial institutions. There are also numerous companies competing in the business of servicing non-prime loans. No one firm is a dominant supplier of non-prime and prime mortgage loans or a dominant servicer of non-prime loans. *Inside B&C Lending* ranked Option One as the number seven originator, based on market share as of December 31, 2004, and the number four servicer, based on servicing volume as of December 31, 2004, of non-prime loans in the industry.

SEASONALITY OF BUSINESS ... Residential mortgage volume is not subject to significant seasonal fluctuations. The mortgage business is cyclical, however, and directly affected by national economic conditions, trends in business and finance and is impacted by changes in interest rates.

GOVERNMENT REGULATION ... Mortgage loans purchased, originated and/or serviced are subject to federal laws and regulations, including:

- The federal Truth-in-Lending Act, as amended, and Regulation Z promulgated thereunder;
- The Equal Credit Opportunity Act, as amended, and Regulation B promulgated thereunder;
- The Fair Credit Reporting Act, as amended;
- The federal Real Estate Settlement Procedures Act, as amended, and Regulation X promulgated thereunder;
- The Home Ownership Equity Protection Act (HOEPA);
- The Soldiers and Sailors Civil Relief Act of 1940, as amended;
- The Home Mortgage Disclosure Act (HMDA) and Regulation C promulgated thereunder;
- The federal Fair Housing Act;
- The Gramm-Leach-Bliley Act and regulations adopted thereunder; and
- Certain other laws and regulations.

Under environmental legislation and case law applicable in certain states, it is possible that liability for environmental hazards in respect of real property may be imposed on a holder of a deed to the property, which may impair the underlying collateral.

Applicable state laws generally regulate interest rates and other charges pertaining to non-prime loans. These states also require certain disclosures and require originators of certain mortgage loans to be licensed unless an exemption is available. In addition, most states have other laws, public policies and general principles of equity relating to consumer protection, unfair and deceptive practices, and practices that may apply to the origination, servicing and collection of mortgage loans.

In recent years, there has been a noticeable increase in state, county and municipal statutes, ordinances and regulations that prohibit or regulate so-called predatory lending practices. Predatory lending statutes such as HOEPA, regulate high-cost loans, which are defined separately by each state, county or municipal statute, regulation or ordinance, but generally include mortgage loans with interest rates exceeding a (1) specified margin over the Treasury Index for a comparable maturity, or (2) designated percentage of points and fees. Statutes, ordinances and regulations that regulate high-cost loans generally prohibit mortgage lenders from engaging in certain defined practices, or require mortgage lenders to implement certain practices, in connection with any mortgage loans that fit within the definition of a high-cost loan. We do not originate loans which meet the definition of high-cost loans under any law.

Certain state laws restrict or prohibit prepayment penalties on mortgage loans, and we relied on the federal Alternative Mortgage Transactions Parity Act (Parity Act) and related rules issued in the past by the Office of Thrift Supervision (OTS) to preempt state limitations on prepayment penalties. In September 2003, the OTS released a new rule that reduced the scope of the Parity Act preemption effective July 1, 2004 and, as a result, we can no longer rely on the Parity Act to preempt state restrictions on prepayment penalties. The elimination of this federal preemption requires compliance with state restrictions on prepayment penalties. These restrictions prohibit us from charging any prepayment penalty in six states and restrict the amount or duration of prepayment penalties that we may impose in an additional eleven states. This places us at a competitive disadvantage relative to financial institutions that continue to enjoy federal preemption of such state restrictions. Such institutions can charge prepayment penalties without regard to state restrictions and, as a result, may be able to offer loans with interest rate and loan fee structures that are more attractive than the interest rate and loan fee structures that we are able to offer.

See discussion in Risk Factors for additional information.

BUSINESS SERVICES

GENERAL ... Our Business Services segment offers middle-market companies accounting, tax and consulting services. We have continued to expand the services we offer our clients by adding wealth management, retirement resources, payroll services, corporate finance and financial process outsourcing. Segment revenues constituted 13.0% of our consolidated revenues for fiscal year 2005, 11.8% for 2004 and 11.6% for 2003.

This segment consists primarily of RSM McGladrey, Inc., which provides tax, accounting, and business consulting services in more than 90 offices in 23 states and offers services in 18 of the top 25 U.S. markets.

Services are also provided by the following wholly-owned subsidiaries:

- RSM McGladrey Retirement Resources administers retirement plans, helps clients design the best plan for their needs, and provides retirement plan investment advice, year-end compliance, tax reporting and consulting.
- RSM EquiCo, Inc. is an investment banking firm specializing in business valuations, acquisitions and divestitures for private middle-market businesses.
- RSM McGladrey Employer Services, Inc. (formerly known as MyBenefitSource, Inc.) is a provider of payroll and benefits administration services to middle-market businesses.
- RSM McGladrey Financial Process Outsourcing, Inc. is a provider of accounting, reporting, payroll and bill paying services to distributors/franchisors and their population of retailers/franchisees.
- PDI Global, Inc. provides marketing, communications and visibility programs, tax and financial planning guides, and marketing and management consulting services to accountants, consultants, lawyers, banks, insurers, and other financial service providers.

RELATIONSHIP WITH MCGLADREY & PULLEN, LLP ... By regulation, we cannot provide audit and attest services. McGladrey & Pullen, LLP (M&P), a public accounting firm, provides audit and review services and other services in which M&P issues written reports on client financial statements. Through an administrative services agreement with M&P, we provide accounting, payroll, human resources and other administrative services to M&P and receive a management fee for these services. We also have a cost-sharing arrangement with M&P, whereby they reimburse us for the costs of certain items, mainly supplies and for the use of RSM owned property and equipment. M&P is a limited liability partnership with its own governing body and, accordingly, is a separate legal entity and is not an affiliate. Some partners and employees of M&P are also our employees.

SEASONALITY OF BUSINESS ... Revenues for this segment are largely seasonal in nature, with peak revenues occurring during January through April.

COMPETITIVE CONDITIONS ... The accounting, tax and consulting business is highly competitive. The principal methods of competition are price, service and reputation for quality. There are a substantial number of accounting firms offering similar services at the international, national, regional and local levels. As our focus is on middle-market businesses, our principal competition is with national and regional accounting firms. We believe we have a competitive advantage in the geographic areas in which we are currently located based on the breadth of services we can offer to these clients above and beyond what a traditional accounting firm can offer.

GOVERNMENT REGULATION ... Many of the same federal and state regulations relating to tax preparers and the information concerning tax reform discussed above in the Government Regulation section of Tax Services apply to the Business Services segment as well. However, accountants are not subject to the same prohibition on the use or disclosure of certain income tax return information as tax professionals. Accounting firms are also subject to state and federal regulations governing accountants, auditors and financial planners. Various legislative and regulatory proposals have been made relating to auditor independence and accounting oversight, among others. Some of these proposals, if adopted, could have an impact on RSM s operations. We believe current state and federal regulations and known legislative and regulatory proposals do not and will not have a material adverse effect on our operations, but we cannot predict what the effect of future legislation, regulations and proposals may be.

Independence rules established by the SEC and the Public Company Accounting Oversight Board (PCAOB) apply to M&P as a public accounting firm. In applying its auditor independence rules, the SEC views us and M&P as a single entity and requires that we abide by its independence rules for M&P to be deemed independent of any SEC audit client. The SEC regards any financial interest or business relationship we have with a client of M&P as a financial interest or business relationship between M&P and the client for purposes of applying its auditor independence rules.

We and M&P have jointly developed and implemented policies, procedures and controls designed to safeguard M&P s independence and integrity as an audit firm in compliance with applicable regulations and professional responsibilities. These policies, procedures and controls are designed to monitor and prevent violations of applicable independence rules and include, among others, (1) informing our officers, directors and other members of management concerning auditor independence matters, (2) procedures for monitoring securities ownership, (3) communicating with SEC audit clients regarding the SEC s interpretation and application of relevant independence rules and guidelines, and (4) requiring RSM employees to comply with M&P s independence and relationship policies (including M&P s independence compliance questionnaire procedures). We believe these policies, procedures and controls are adequate, although there can be no assurances they will ensure compliance with applicable independence rules and requirements. Any

noncompliance could cause M&P to lose the ability to perform audits of financial statements filed with the SEC.
See discussion in Risk Factors for additional information.

INVESTMENT SERVICES

GENERAL ... Our Investment Services segment provides brokerage services and investment planning through HRBFA to our clients in the U.S. Services offered to our customers include traditional brokerage services, as well as annuities, insurance, fee-based accounts, online account access, equity research and focus lists, model portfolios, asset allocation strategies, and other investment tools and information. Segment revenues constituted 5.4% of our consolidated revenues for fiscal years 2005, 2004 and 2003.

HRBFA is a registered broker-dealer with the SEC and is a member of the New York Stock Exchange (NYSE), other national securities exchanges, Securities Investor Protection Corporation (SIPC), and the National Association of Securities Dealers, Inc. (NASD). HRBFA is also a registered investment advisor.

The integration of investment advice with our tax client base allows us to leverage an already established relationship. In the past two years, new service offerings have allowed us to shift our focus from a transaction-based client relationship to a more advice-based focus.

CUSTOMER ACTIVITY ... Customer trades in fiscal year 2005 totaled approximately 0.9 million, compared to approximately 1.0 million in 2004 and approximately 0.9 million in 2003. Average revenue per trade increased to $123.33 in fiscal year 2005, up from $119.36 in 2004 and $120.15 in 2003. We had 431,749 traditional brokerage accounts at April 30, 2005, compared to 463,736 at 2004 and 501,001 at 2003.

FINANCIAL SERVICES OFFERINGS ... We offer a full range of financial services, including financial planning, college savings products, flexible brokerage accounts with cash management features, and a comprehensive line of insurance annuity products. Clients may also open professionally managed accounts.

As previously discussed in Tax Services, 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.

We act as a dealer in fixed income markets including corporate and municipal bonds, various U.S. Government and U.S. Government Agency securities and certificates of deposit.

FINANCIAL ADVISORS ... Key to our future success is retention and recruiting productive financial advisors. One of our key initiatives in fiscal year 2005 was to build revenues through the addition of financial advisors. During fiscal years 2005 and 2004, we added 258 and 255 advisors, respectively. These additions were offset by attrition of 233 and 230 advisors, respectively. Our overall retention rate for fiscal year 2005 was approximately 77%, essentially flat with the prior year. The retention rate for our higher-producing advisors was approximately 92%, down slightly from 93% in 2004. Advisor productivity by recruitment class is as follows:

		(in 000s)
	Revenue Per Advisor	Total Production Revenues
Fiscal year 2005 ...		
Pre-2003 class	**$ 230**	**$ 121,342**
2003 recruits	**114**	**16,416**
2004 recruits	**98**	**19,941**
2005 recruits	**65**	**8,203**

Fiscal year 2004 ...		
Pre-2003 class	$ 216	$ 135,128
2003 recruits	84	17,717
2004 recruits	61	7,664

Financial advisors generally reach full productivity levels approximately 24 to 36 months after they join our company.

PARTNERING WITH TAX PROFESSIONALS ... The H&R Block Preferred Partner Program[sm] facilitates strategic, referral-based partnerships between tax professionals and financial advisors. The program includes the Licensed Referral Tax Professional (LRTP) program and, new for fiscal year 2005, a non-licensed option, which allows non-licensed tax professionals to gain additional rewards and recognition when making qualified client referrals to financial advisor partners. The LRTP program helps tax professionals become licensed to sell securities, teaming them with a financial advisor and providing a commission to the LRTP for business referred to Investment Services.

As of April 30, 2005, our Preferred Partner Program had 6,442 active tax partners, of which 686 were licensed. We had 461 licensed tax partners at the end of fiscal year 2004. As a result of this initiative, we added 18,164 new customer accounts and assets totaling $573.0 million during the current fiscal year. We will continue to increase the number of tax partners in the coming year.

INTEGRATED ONLINE SERVICES ... We have an online investment center on our website at *www.hrblock.com.* Online users have the opportunity to open accounts, obtain research, create investment plans, buy and sell securities, and view the status of their accounts.

OFFICE LOCATIONS ... HRBFA is authorized to do business as a broker-dealer in all 50 states, the District of Columbia and Puerto Rico. At the end of fiscal year 2005, we operated 257 branch offices, compared to approximately 358 offices in 2004 and 600 in 2003. The reduced number of branch offices is primarily due to the evolution of our tax-partnering program, which now locates financial advisors in retail tax offices. At April 30, 2005, we had 94 offices co-located with retail tax and mortgage offices. We believe the existence of these locations contributes to our growth and client satisfaction.

COMPETITIVE CONDITIONS ... HRBFA competes directly with a broad range of companies seeking to attract consumer financial assets, including full-service brokerage firms, discount and online brokerage firms, mutual fund companies, investment banking firms, commercial and savings banks, insurance companies and others. The financial services industry has become considerably more concentrated as numerous securities firms have been acquired by or merged into other firms. Some of these competitors have greater financial resources than HRBFA and offer additional financial services. In addition, we expect competition from domestic and international commercial banks and larger securities firms to continue to increase as a result of legislative and regulatory initiatives in the U.S., including the passage of the Gramm-Leach-Bliley Act in November 1999 and the implementation of the U.S.A. Patriot Act in April 2002. These initiatives strive to remove or relieve certain restrictions on mergers between commercial banks and other types of financial services providers and extend privacy provisions and anti-money laundering procedures across the financial services industry.

Discount brokerage firms and online-only financial services providers compete vigorously with HRBFA with respect to commission charges. Some full-commission brokerage firms also offer greater product breadth, discounted commissions and more robust online services to selected retail brokerage customers. Additionally, some competitors in both the full-commission and discount brokerage industries have substantially increased their spending on advertising and direct solicitation of customers.

Competition in the online trading business has become similarly intense as recent expansion and customer acceptance of conducting financial transactions online has attracted new brokerage firms to the market.

We compete based on quality of service, breadth of services offered, prices, accessibility through delivery channels, technological innovation and expertise and integration with our tax services relationships.

SEASONALITY OF BUSINESS ... The Investment Services segment does not, as a whole, experience significant seasonal fluctuations. The securities business is cyclical, however, and directly affected by national and global economic and political conditions, trends in business and finance and changes in the conditions of the securities markets in which our clients invest.

GOVERNMENT REGULATION ... The securities industry is subject to extensive regulation covering all aspects of the securities business, including registration of our offices and personnel, sales methods, the acceptance and execution of customer orders, the handling of customer funds and securities, trading practices, capital structure, record keeping policies and practices, margin lending, execution and settlement of transactions, the conduct of directors, officers and employees, and the supervision of employees. The various governmental authorities and industry self-regulatory organizations that have supervisory and regulatory jurisdiction over us generally have broad enforcement powers to censure, fine, issue cease-and-desist orders or suspend or expel a broker-dealer or any of its officers or employees who violate applicable laws or regulations.

The SEC is the federal agency responsible for the administration of the federal securities laws. The SEC has delegated much of the regulation of broker-dealers to self-regulatory organizations, principally the NASD, Inc., Municipal Securities Rulemaking Board and the NYSE, which has been designated as HRBFA s primary regulator. These self-regulatory organizations adopt rules, subject to SEC approval, governing the industry and conduct periodic examinations of HRBFA s brokerage operations and clearing activities. Securities firms are also subject to regulation by state securities administrators in states in which they conduct business.

As a registered broker-dealer, HRBFA is subject to the Net Capital Rule (Rule 15c3-1) promulgated by the SEC and adopted through incorporation by reference in NYSE Rule 325. The Rule, which specifies minimum net capital requirements for registered brokers and dealers, is designed to measure the financial soundness and liquidity of a broker-dealer and requires at least a minimum portion of its assets be kept in liquid form. Additional discussion of this requirement and HRBFA s calculation of net capital is located in Item 7, under Capital Resources and Liquidity by Segment.

See discussion in Risk Factors for additional information.

SERVICE MARKS, TRADEMARKS AND PATENTS ...
We have made a practice of selling our services and products under service marks and trademarks and of obtaining protection for these by all available means. Our service marks and trademarks are protected by registration in the U.S. and other countries where our services and products are marketed. We consider these service marks and trademarks, in the aggregate, to be of material importance to our business, particularly our business segments providing services and products under the H&R Block brand.

We have no registered patents that are material to our business.

EMPLOYEES ...
We have approximately 13,400 regular full-time employees. The highest number of persons we employed during the fiscal year ended April 30, 2005, including seasonal employees, was approximately 133,800.

RISK FACTORS ...
In this report, and from time to time throughout the year, we share our expectations for the Company s future performance. The following explains the critical risk factors impacting our business and reasons actual results may differ from our expectations. This discussion does not intend to be a comprehensive list and there may be other risks and factors that may have an effect on our business.

LIQUIDITY AND CAPITAL ... We use capital primarily to fund working capital requirements, pay dividends, repurchase shares of our common stock and acquire businesses. We are dependent on the use of our off-balance sheet arrangements to fund our daily non-prime originations and the secondary market to securitize and sell mortgage loans and residual interests. See Item 7, under Off-Balance Sheet Financing Arrangements. We are also dependent on commercial paper issuances and/or bank lines to fund RAL participations and seasonal working capital needs. A disruption in such markets could adversely affect our access to these funds. To meet our future financing needs, we may issue additional debt or equity securities.

LITIGATION ... We are involved in lawsuits in the normal course of our business related to RALs, our Peace of Mind guarantee program, electronic filing of tax returns, Express IRAs, losses incurred by customers in their investment accounts, mortgage lending activities and other matters. Adverse outcomes related to litigation could result in substantial damages and could adversely affect our results of operations. Negative public opinion can also result from our actual or alleged conduct in such claims, possibly damaging our reputation and adversely affecting the market price of our stock. See Item 3, Legal Proceedings for additional information.

PRIVACY OF CLIENT INFORMATION ... We manage highly sensitive client information in all of our operating segments, which is regulated by law. Problems with the safeguarding and proper use of this information could result in regulatory actions and negative publicity, which could adversely affect our reputation and results of operations.

INTERNAL CONTROL CERTIFICATION ... We have documented and tested our internal control procedures in accordance with various SEC rules governing Section 404 of the Sarbanes-Oxley Act (SOX 404). SOX 404 requires us to assess the effectiveness of our internal controls over financial reporting annually, and obtain an opinion on these controls from our Independent Registered Public Accounting Firm. We may encounter problems or delays in completing the review and evaluation, the implementation of improvements and the receipt of a positive attestation, or any attestation at all, by our independent auditors. Additionally, management s assessment of our internal controls over financial reporting may identify deficiencies that need to be addressed in our internal controls over financial reporting or other matters that may raise concerns for investors. As a part of Management s assessment of our internal controls over financial reporting as of April 30, 2005, a material weakness was identified in the Company s accounting for income taxes. The material weakness in internal controls resulted from insufficient resources in the corporate tax function to accurately identify, evaluate and report, in a timely manner, non-routine and complex transactions. The

Company also determined that it had not completed the requisite historical analysis and related reconciliations to ensure tax balances were appropriately stated prior to the completion of the Company s internal control activities. These deficiencies resulted in errors in the Company s accounting for income taxes. These errors were corrected prior to issuance of the consolidated financial statements as of and for the year ended April 30, 2005. As a result, KPMG has issued an adverse opinion with respect to our internal controls over financial reporting and their report is included in Item 8. Should we, or our independent auditors, determine in future periods that we have additional material weaknesses in our internal controls over financial reporting, our results of operations or financial condition may be adversely affected and the price of our common stock may decline.

OPERATIONAL RISK ... There is a risk of loss resulting from inadequate or failed processes or systems, theft or fraud. These can occur in many forms including, among others, errors, business interruptions, inappropriate behavior of or misconduct by our employees or those contracted to perform services for us, and vendors that do not perform in accordance with their contractual agreements. These events can potentially result in financial losses or other damages. We rely on internal and external information and technological systems to manage our operations and are exposed to risk of loss resulting from breaches in the security, or other failures of these systems. Replacement of our major operational systems could have a significant impact on our ability to conduct our core business operations and increase our risk of loss resulting from disruptions of normal operating processes and procedures that may occur during the implementation of new information and transaction systems.

TAX SERVICES

COMPETITIVE POSITION ... Increased competition for tax preparation clients in our retail offices, online and software channels could adversely affect our current market share and limit our ability to grow our client base. See clients served statistics included in Item 7, under Tax Services.

REFUND ANTICIPATION LOANS ... Changes in government regulation related to RALs could adversely affect our ability to offer RALs or our ability to purchase participation interests. Changes in IRS practices could adversely affect our ability to use the IRS debt indicator to limit our bad debt exposure. Changes in any of these, as well as possible litigation related to RALs, may adversely affect our results of operations. See discussion of RAL litigation in Item 3, Legal Proceedings.

MORTGAGE SERVICES

COMPETITIVE POSITION ... The majority of our mortgage loan applications are submitted through a network of brokers who have relationships with many other mortgage lenders. Unfavorable changes in our pricing, service or other factors could result in a decline in our mortgage origination volume. A decline in our servicer ratings could adversely affect our pricing and origination volume. Increased competition among mortgage lenders can also result in a decline in coupon rates offered to our borrowers, which in turn lowers margins and could adversely affect our gains on sales of mortgage loans.

MARKET RISKS ... Our day-to-day operating activities of originating and selling mortgage loans have many aspects of interest rate risk. Additionally, the valuation of our retained residual interests and mortgage servicing rights includes many estimates and assumptions made by management surrounding interest rates, prepayment speeds and credit losses. Variation in interest rates or the factors underlying our assumptions could affect our results of operations. See Item 7A, under Mortgage Services, for discussion of interest rate risk, and Item 7, under Critical Accounting Policies, for discussion of our valuation methodology.

LEGISLATION AND REGULATION ... Several states and cities are considering or have passed laws, regulations or ordinances aimed at curbing predatory lending and servicing practices. The federal government is also considering legislative and regulatory proposals in this regard. In general, these proposals involve lowering the existing federal HOEPA thresholds for defining a high-cost loan and establishing enhanced protections and remedies for borrowers who receive such loans. If unfavorable laws and regulations are passed, it could restrict our ability to originate loans. If rating agencies refuse to rate our loans, loan buyers may not want to purchase loans labeled as high-cost, and it could restrict our ability to sell our loans in the secondary market. Accordingly, all of these items could adversely affect our results of operations.

In 2002, the Federal Reserve Board adopted changes to Regulation C promulgated under the HMDA. Among other things, the new regulations require lenders to report pricing data on loans with annual percentage rates that exceed the yield on treasury bills with comparable maturities by 3%. The expanded reporting takes effect in 2004 for reports filed in 2005. We anticipate that a majority of our loans would be subject to the expanded reporting requirements. The expanded reporting does not provide for additional loan information such as credit risk, debt-to-income ratio, loan-to-value ratio, documentation level or other salient loan features. However, reported information may lead to increased litigation as the information could be misinterpreted by third parties and could adversely affect our results of operations.

COUNTERPARTY CREDIT RISK ... Derivative instruments involve counterparty credit risk, which is the risk that a counterparty may fail to perform on its contractual obligations. We manage this risk through the use of a policy that includes credit standard guidelines, counterparty diversification, monitoring of counterparty financial condition, use of master netting agreements with counterparties, and exposure limits based on counterparty credit, exposure amount and management risk tolerance. The policy is reviewed on an annual basis and as conditions warrant. See Item 7A, under Mortgage Services, and Item 8, note 9 to our consolidated financial statements for discussion of our derivative instruments.

REAL ESTATE MARKET ... Our residual interests and beneficial interest in Trusts are secured by mortgage loans, which are in turn secured by residential real estate. Any material decline in real estate values would likely result in higher delinquencies, defaults and foreclosures. Additionally, a significant portion of the mortgage loans we originate or service is secured by properties in California. A decline in the economy or the residential real estate market values, or the occurrence of a natural disaster not covered by standard homeowners insurance policies, such as an earthquake, hurricane or wildfire, could decrease the value of mortgaged properties in California. Any sustained period of increased delinquencies, foreclosures or losses could harm our ability to originate and sell loans, the prices we receive on our loans, or the values of our mortgage servicing rights and residual interests in securitizations, which could adversely affect our financial condition and results of operations.

BUSINESS SERVICES

ALTERNATIVE PRACTICE STRUCTURE WITH M&P ... Our relationship with M&P requires us to comply with applicable auditor independence rules and requirements. In addition, our relationship with M&P closely links our RSM McGladrey brand with M&P. If M&P were to encounter problems concerning its independence as a result of its relationship with us or if significant litigation arose concerning M&P or its services, our brand reputation and our ability to realize the mutual benefits of our relationship, such as the ability to attract and retain quality professionals, could be impaired.

INVESTMENT SERVICES

REGULATORY ENVIRONMENT ... The broker-dealer industry has recently come under increased scrutiny by federal and state regulators and self-regulatory agencies and, as a result, more focus has been placed on compliance issues. If we do not comply with these regulations, it could result in regulatory actions and negative publicity, which could adversely affect our results of operations and our ability to recruit and retain qualified advisors. Negative public opinion about our industry could damage our reputation even if we are in compliance with such regulations.

INTEGRATION INTO THE H&R BLOCK BRAND ... We are working to foster an advice-based relationship with our tax clients through our retail tax office network. This advice-based relationship is key to the integration of Investment Services into the H&R Block brand and deepening our current client relationships. If we are unable to successfully integrate, it may significantly impact our ability to differentiate our business from other tax providers and grow our client base.

RECRUITING AND RETENTION OF FINANCIAL ADVISORS ... Attracting and retaining experienced financial advisors is extremely competitive in the investment industry. Additionally, in this industry, clients tend to follow their advisors, regardless of their affiliated investment firm. The inability to recruit and retain qualified and productive advisors, may adversely affect our results of operations.

RECURRING OPERATING LOSSES ... Continuing operating losses in our Investment Services segment may impact the valuation of goodwill and intangible assets. Such losses could also necessitate additional capital contributions to comply with regulatory requirements. The inability to operate this segment in a profitable manner may adversely affect our results of operations.

AVAILABILITY OF REPORTS AND OTHER INFORMATION ...

Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports filed with or furnished to the SEC are available, free of charge, through our website at *www.hrblock.com* as soon as reasonably practicable after such reports are electronically filed with or furnished to the SEC.

Copies of the following corporate governance documents are posted on our website: (1) The Amended and Restated Articles of Incorporation of H&R Block, Inc., (2) The Amended and Restated Bylaws of H&R Block, Inc., (3) The H&R Block, Inc. Corporate Governance Guidelines, (4) the H&R Block, Inc. Code of Business Ethics and Conduct, (5) the H&R Block, Inc. Audit Committee Charter, (6) the H&R Block, Inc. Governance and Nominating Committee Charter, and (7) the H&R Block, Inc. Compensation Committee Charter. If you would like a printed copy of any of these corporate governance documents, please send your request to the Office of the Secretary, H&R Block, Inc., 4400 Main Street, Kansas City, Missouri 64111.

Information contained on our website does not constitute any part of this report.

ITEM 2. PROPERTIES

We own our corporate headquarters, which are located in Kansas City, Missouri. We have leased additional office space for corporate, Tax Services and Investment Services personnel, as necessary, in Kansas City, Missouri.

Most of our tax offices, except those in shared locations, are operated under leases throughout the U.S. Our Canadian executive offices are located in a leased office in Calgary, Alberta. Our Canadian tax offices are operated under leases throughout Canada.

Option One s executive offices are located in leased offices in Irvine, California. HRBMC is headquartered in leased offices in Lake Forest, California. Option One and HRBMC also lease offices for their loan origination and servicing centers and branch office operations throughout the U.S.

The executive offices of HRBFA are located in leased offices in Detroit, Michigan. Branch offices are operated throughout the U.S., in a combination of leased and owned facilities.

RSM s executive offices are located in leased offices in Bloomington, Minnesota. Its administrative offices are located in leased offices in Davenport, Iowa. RSM also leases office space throughout the U.S.

We began construction of new corporate headquarters during fiscal year 2005, which will allow us to consolidate the majority of our Kansas City-based personnel into one facility. The new building will be located in downtown Kansas City, Missouri and we expect it to be completed in fiscal year 2007.

All current leased and owned facilities are in good repair and adequate to meet our needs.

ITEM 3. LEGAL PROCEEDINGS

The information below should be read in conjunction with the information included in Item 8, note 18 to our consolidated financial statements.

RAL LITIGATION ... We have been named as a defendant in numerous lawsuits throughout the country regarding our refund anticipation loan programs (collectively, RAL Cases). Plaintiffs in the RAL Cases have alleged, among other things, that disclosures in the RAL applications were inadequate, misleading and untimely; that the RAL interest rates were usurious and unconscionable; that we did not disclose that we would receive part of the finance charges paid by the customer for such loans; breach of state laws on credit service organizations; breach of contract; unjust enrichment; unfair and deceptive acts or practices; violations of the Racketeer Influenced and Corrupt Organizations Act; violations of the Fair Debt Collection Practices Act; and that we owe, and breached, a fiduciary duty to our customers in connection with the RAL program. In many of the RAL Cases, the plaintiffs seek to proceed on behalf of a class of similarly situated RAL customers, and in certain instances the courts have allowed the cases to proceed as class actions. In other cases, courts have held that plaintiffs must pursue their claims on an individual basis, and may not proceed as a class action. The amounts claimed in the RAL Cases have been very substantial in some instances.

We have successfully defended against numerous RAL Cases, although several of the RAL Cases are still pending. Of the RAL Cases that are no longer pending, some were dismissed on our motions for dismissal or summary judgment and others were dismissed voluntarily by the plaintiffs after denial of class certification. Other cases were settled, with one settlement resulting in a pretax expense of $43.5 million in fiscal year 2003 (the Texas RAL Settlement).

We believe we have meritorious defenses to the RAL Cases and we intend to defend the remaining RAL Cases vigorously. There can be no assurances, however, as to the outcome of the pending RAL Cases individually or in the aggregate. Likewise, there can be no assurances regarding the impact of the RAL Cases on our financial statements. We have accrued our best estimate of the probable loss related to the RAL Cases. The following is updated information regarding the pending RAL Cases that are class actions or putative class actions:

Lynne A. Carnegie, et al. v. Household International, Inc., H&R Block, Inc., et al., (formerly Joel E. Zawikowski, et al. v. Beneficial National Bank, H&R Block, Inc., Block Financial Corporation, et al.) Case No. 98 C 2178, United States District Court for the Northern District of Illinois, Eastern Division, instituted on April 18, 1998. In March

2004, the court either dismissed or decertified all of the plaintiffs claims other than part of one count alleging violations of the racketeering and conspiracy provisions of the Racketeer Influenced and Corrupt Organizations Act. On May 9, 2005, the parties agreed to a settlement, subject to court approval. The settlement agreement provided for (i) the defendants to pay $110 million in cash and $250 million face value in freely transferable rebate coupons and (ii) all persons who applied for and obtained a RAL through an H&R Block office or certain lenders from January 1, 1987 through April 29, 2005 (the Carnegie Settlement Class) to release all claims against us regarding RALs or certain services provided in connection with RALs. The settlement agreement also specified required business practices, procedures, disclosures and forms for use in making RALs and barred members of the Carnegie Settlement Class from commencing any other claims or actions against us regarding RALs made pursuant to such practices, procedures, disclosures and forms (the Forward Looking Protections). In negotiating the settlement, we ascribed significant value to the Forward-Looking Protections and the expanded class of plaintiffs to be covered by the settlement in determining the amount of consideration we were willing to pay in settling the case. On May 26, 2005, the court denied approval of the proposed settlement. As discussed in our Form 8-K dated May 9, 2005, we initially recorded litigation reserves of approximately $38.0 million, after taxes, based on the May 9, 2005 proposed settlement. As a result of the May 26, 2005 court ruling to deny the settlement, we reversed our legal reserves to amounts representing our assessment of our probable loss. This class action case is scheduled to go to trial on October 17, 2005. We intend to continue defending the case vigorously, but there are no assurances as to its outcome.

Sandra J. Basile, et al. v. H&R Block, Inc., et al, April Term 1992 Civil Action No. 3246 in the Court of Common Pleas, First Judicial District of Pennsylvania, Philadelphia County, instituted on April 23, 1993. The court decertified the class on December 31, 2003. Plaintiffs appealed the decertification, and the Pennsylvania appellate court denied the plaintiff s appeal. The Pennsylvania appellate court subsequently granted plaintiff s motion for *en banc* review of its earlier denial of plaintiff s appeal. Re-argument is expected to occur in September 2005.

Levon and Geral Mitchell, et al. v. H&R Block and Ruth R. Wren, Case No.CV-95-2067, in the Circuit Court of Mobile County, Alabama, instituted on June 13, 1995. Plaintiffs motion for class certification was granted, and defendants appealed the certification. The appeal is pending before the Alabama Supreme Court.

Deandra D. Cummins, et al. v. H&R Block, Inc., et al., Case No. 03-C-134 in the Circuit Court of Kanawha County, West Virginia, instituted on January 22, 2003. This class action case is scheduled to go to trial on October 17, 2005.

Lynn Becker v. H&R Block, Case No. CV-2004-03-1680 in the Court of Common Pleas, Summit County, Ohio, instituted on April 15, 2004. The case was removed to federal court, and plaintiffs moved to remand the case back to state court. The case currently is stayed pending the U.S. District Court s ruling on plaintiff s motion to remand and defendant s motion to compel arbitration.

Joyce Green, et al. v. H&R Block, Inc., Block Financial Corporation, et al., Case No. 97195023, in the Circuit Court for Baltimore City, Maryland, instituted on July 14, 1997. This case is awaiting trial. No trial date has been set.

PEACE OF MIND LITIGATION ... *Lorie J. Marshall, et al. v. H&R Block Tax Services, Inc., et al.*, Civil Action 2003L000004, in the Circuit Court of Madison County, Illinois, is a class action case filed on January 18, 2003, that was granted class certification on August 27, 2003. Plaintiffs claims consist of five counts relating to the POM program under which the applicable tax return preparation subsidiary assumes liability for additional tax assessments attributable to tax return preparation error. The plaintiffs allege that the sale of POM guarantees constitutes (i) statutory fraud by selling insurance without a license, (ii) an unfair trade practice, by omission and by cramming (*i.e.*, charging customers for the guarantee even though they did not request it or want it), and (iii) a breach of fiduciary duty. In August 2003, the court certified the plaintiff classes consisting of all persons who from January 1, 1997 to final judgment (i) were charged a separate fee for POM by H&R Block or a defendant H&R Block class member; (ii) reside in certain class states and were charged a separate fee for POM by H&R Block or a defendant H&R Block class member not licensed to sell insurance; and (iii) had an unsolicited charge for POM posted to their bills by H&R Block or a defendant H&R Block class member. Persons who received the POM guarantee through an H&R Block Premium office and persons who reside in Alabama are excluded from the plaintiff class. The court also certified a defendant class consisting of any entity with names that include H&R Block or HRB, or are otherwise affiliated or associated with H&R Block Tax Services, Inc., and that sold or sells the POM product. The trial court subsequently denied the defendants motion to certify class certification issues for interlocutory appeal. Discovery is proceeding. No trial date has been set.

There is one other putative class action pending against us in Texas that involves the Peace of Mind guarantee. This case is being tried before the same judge that presided over the Texas RAL Settlement and involves the same plaintiffs attorneys that are involved in the Marshall litigation in Illinois and substantially similar allegations. No class has been certified in this case.

We believe the claims in the POM action are without merit, and we intend to defend them vigorously. The amounts claimed in the POM actions are substantial, however, and there can be no assurances, as to the outcome of these pending actions individually or in the aggregate. Likewise, there can be no assurances regarding the impact of these actions on our consolidated financial statements.

OTHER CLAIMS AND LITIGATION ... As reported in a current report on Form 8-K dated November 8, 2004, the NASD brought charges against HRBFA regarding the sale by HRBFA of

Enron debentures in 2001. A hearing for this matter is scheduled for May 2006. Two private civil actions subsequently were filed against HRBFA concerning the matter raised in the NASD s charges. Both of these private actions subsequently were dismissed without prejudice, although one of the actions has since been refiled. We intend to defend the NASD charges vigorously, although there can be no assurances regarding the outcome and resolution of the matter.

As part of an industry-wide review, the IRS is investigating tax-planning strategies that certain RSM clients utilized during fiscal years 2000 through 2003. Specifically, the IRS is examining these strategies to determine whether RSM complied with tax shelter registration and listing regulations and whether such strategies were appropriate. If the IRS were to determine that these strategies were inappropriate, clients that utilized the strategies could face penalties and interest for underpayment of taxes. Some of these clients are seeking, or may attempt to seek, recovery from RSM. While there can be no assurance regarding the outcome of this matter, we do not believe its resolution will have a material adverse effect on our operations or consolidated financial statements.

As reported in current report on Form 8-K dated December 12, 2003, the SEC informed our outside counsel on December 11, 2003 that the Commission had issued a Formal Order of Investigation concerning our disclosures, in and before November 2003, regarding RAL litigation to which we were and are a party. There can be no assurances as to the outcome and resolution of this matter.

We have from time to time been party to claims and lawsuits not discussed herein arising out of our business operations. These claims and lawsuits include actions by individual plaintiffs, as well as cases in which plaintiffs seek to represent a class of similarly situated customers. The amounts claimed in these claims and lawsuits are substantial in some instances, and the ultimate liability with respect to such litigation and claims is difficult to predict. Some of these claims and lawsuits pertain to RALs, the electronic filing of customers income tax returns and the POM guarantee program. We believe we have meritorious defenses to each of these claims, and we are defending or intend to defend them vigorously, although there is no assurance as to their outcome.

In addition to the aforementioned types of cases, we are parties to claims and lawsuits that we consider to be ordinary, routine litigation incidental to our business, including claims and lawsuits (Other Claims) concerning investment products, the preparation of customers income tax returns, the fees charged customers for various products and services, losses incurred by customers with respect to their investment accounts, relationships with franchisees, denials of mortgage loans, contested mortgage foreclosures, other aspects of the mortgage business, intellectual property disputes, and contract disputes. We believe we have meritorious defenses to each of the Other Claims, and we are defending, or intend to defend, them vigorously. While we cannot provide assurance that we will ultimately prevail in each instance, we believe the amount, if any, we are required to pay in the discharge of liabilities or settlements in these Other Claims will not have a material adverse effect on our consolidated financial statements.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of fiscal year 2005. Information regarding executive officers is contained in Item 10 of this report.

PART II

ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

H&R Block s common stock is traded principally on the NYSE and is also traded on the Pacific Exchange. The information called for by this item with respect to H&R Block s common stock appears in Item 8, note 21 to our consolidated financial statements. The remaining information called for by this item relating to Securities Authorized for Issuance under Equity Compensation Plans is reported in Item 8, note 13 to our consolidated financial statements.

On July 5, 2005, there were 30,909 shareholders of record and the closing stock price on the NYSE was $29.37 per share.

A summary of our purchases of H&R Block common stock during the fourth quarter of fiscal year 2005, excluding the impact of the stock split, is as follows:

(shares in 000s)

	Total Number of Shares Purchased[2]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[1]	Maximum Number of Shares that May Be Purchased Under the Plans or Programs[1]
February 1 February 28	**1**	**$ 50.82**		**15,104**
March 1 March 31	**2**	**$ 51.87**		**15,104**
April 1 April 30	**1**	**$ 50.70**		**15,104**

(1) On June 11, 2003, our Board of Directors approved the repurchase of 20 million shares of H&R Block common stock. This authorization has no expiration date. On June 9, 2004, our Board of Directors approved the additional repurchase of 15 million shares of H&R Block common stock. This authorization has no expiration date.

(2) The total number of shares purchased were purchased in connection with funding employee income tax withholding obligations arising upon the exercise of stock options or the lapse of restrictions on restricted shares.

ITEM 6. SELECTED FINANCIAL DATA

We derived the selected historical consolidated financial data presented below as of and for each of the five years in the period ended April 30, 2005 from our consolidated financial statements. The data for the periods prior to fiscal year 2005 has been restated to reflect corrections to gain on sale accounting, incentive compensation accruals, lease accounting, capitalization of certain branch office costs, acquisition accounting and income taxes as more fully described in Item 8, note 2 to our consolidated financial statements. The data set forth below should be read in conjunction with Item 7 and our consolidated financial statements.

The impact of the restatement on fiscal year 2002 resulted in an increase in net income of $6.9 million, or $.02 per basic and diluted share, and a decrease of $9.5 million in total assets. The impact on fiscal year 2001 resulted in an increase in net income of $1.5 million, or $.00 per basic and diluted share, and an increase of $4.9 million in total assets.

(in 000s, except per share amounts)

April 30,	**2005**	Restated 2004	Restated 2003	Restated 2002	Restated 2001
Revenues	**$ 4,420,019**	$ 4,247,880	$ 3,731,126	$ 3,311,943	$ 2,982,157
	635,857	715,608	477,615	441,287	278,211

Net income before change in accounting principle					
Net income	**635,857**	709,249	477,615	441,287	282,625
Basic earnings per share:					
Net income before change in accounting principle	**$ 1.92**	$ 2.02	$ 1.33	$ 1.21	$ .76
Net income	**1.92**	2.00	1.33	1.21	.77
Diluted earnings per share:					
Net income before change in accounting principle	**$ 1.88**	$ 1.98	$ 1.30	$ 1.17	$ .75
Net income	**1.88**	1.96	1.30	1.17	.76
Total assets	**$ 5,539,283**	$ 5,232,732	$ 4,666,502	$ 4,396,731	$ 4,170,980
Long-term debt	**923,073**	545,811	822,302	868,387	870,974
Dividends per share	**$ .43**	$ .39	$ .35	$ .32	$ .29

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The accompanying Management s Discussion and Analysis of Financial Condition and Results of Operations reflects the restatement of previously issued financial statements, as discussed in Item 8, note 2 to our consolidated financial statements. All share and per share amounts in this document have been adjusted to reflect the retroactive effect of the stock split.

We are a diversified company with subsidiaries delivering tax, investment, mortgage and business services and products. We are the only major company offering a full range of software, online and in-office tax preparation solutions, combined with personalized financial advice concerning retirement savings, home ownership and other opportunities to help clients build a better financial future.

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Our key strategic priorities can be summarized as follows:

- Tax Services continue expanding our office network, improve our client service and satisfaction scores, focus on advice that supports client growth and increased brand loyalty.
- Mortgage Services continue growing origination volumes while lowering our cost of origination, distinguish our service quality, minimize risk and volatility in performance and optimize value from secondary markets.
- Business Services continue expansion of our national accounting, tax and consulting business, add extended services to middle-market companies and enhance our client service culture.
- Investment Services work to align the segment s cost structure with its revenues, attract and retain productive advisors, serve the broad consumer market through advisory relationships and integrate the Tax Services client base into this segment.

OVERVIEW ...

A summary of our fiscal year 2005 results is as follows:

- Revenues grew 4.1% over the prior year, primarily due to our Tax Services and Business Services segments, with this growth somewhat offset by a revenue decline at our Mortgage Services segment.
- Diluted earnings per share declined 4.1% from fiscal year 2004 to $1.88, primarily due to lower profitability in our Mortgage Services segment. Current year results included a non-operating gain of $0.03 per diluted share for legal recoveries.
- Tax Services fell short of its target client levels, although increases in our pricing and the complexity of returns prepared allowed the segment s revenue growth to continue. Segment revenues increased 7.6% over the prior year and segment pretax income increased $25.0 million, or 3.9%.
- Mortgage Services origination volumes of $31.0 billion were at record levels, but margin compression drove gains on sales of mortgage assets to decline 10.5% to $822.1 million.
- Business Services revenues and pretax income increased 14.8% and 54.7%, respectively, over the prior year. The increase was primarily due to higher demand for traditional accounting, tax and consulting services.
- Investment Services reported a pretax loss of $75.4 million compared to $75.6 million in the prior year. Operating results for the fourth quarter of fiscal year 2005 showed marked improvement, which we hope will continue into the fiscal year 2006.

Consolidated Results of Operations (in 000s, except per share amounts)

Year ended April 30,	2005	Restated 2004	Restated 2003
REVENUES ...			
Tax Services	**$ 2,358,293**	$ 2,191,177	$ 1,946,763
Mortgage Services	**1,246,018**	1,323,709	1,150,080
Business Services	**573,316**	499,210	434,140
Investment Services	**239,244**	229,470	200,794
Corporate	**3,148**	4,314	(651)
	$ 4,420,019	$ 4,247,880	$ 3,731,126
PRETAX INCOME (LOSS) ...			
Tax Services	**$ 663,518**	$ 638,493	$ 556,703

Mortgage Services	**496,093**	688,523	656,324
Business Services	**29,871**	19,312	(16,033)
Investment Services	**(75,370)**	(75,614)	(219,421)
Corporate	**(96,397)**	(107,739)	(122,009)
	1,017,715	1,162,975	855,564
Income taxes	**381,858**	447,367	377,949
Net income before change in accounting principle	**635,857**	715,608	477,615
Cumulative effect of change in accounting principle		(6,359)	
Net income	**$ 635,857**	$ 709,249	$ 477,615
Basic earnings per share	**$ 1.92**	$ 2.00	$ 1.33
Diluted earnings per share	**1.88**	1.96	1.30

CRITICAL ACCOUNTING POLICIES ...

We consider the policies discussed below to be critical to securing an understanding of our financial statements, as they require the use of significant judgment and estimation in order to measure, at a specific point in time, matters that are inherently uncertain. Specific risks for these critical accounting policies are described in the following paragraphs. For all of these policies, we caution that future events rarely develop precisely as forecasted, and estimates routinely require adjustment and may require material adjustment.

REVENUE RECOGNITION ... We have many different revenue sources, each governed by specific revenue recognition policies. Our revenue recognition policies can be found in Item 8, note 1 to our consolidated financial statements. Additional discussion of our recognition of gains on sales of mortgage assets follows.

GAINS ON SALES OF MORTGAGE ASSETS ... We sell substantially all of the non-prime mortgage loans we originate to the Trusts, which are qualifying special purpose entities (QSPEs), with servicing rights generally retained. Prime mortgage loans are sold in whole loan sales, servicing released, to third-party buyers. Gains on sales of mortgage assets are recognized when control of the assets is surrendered (when loans are sold to Trusts) and are based on the difference between cash proceeds and the allocated cost of the assets sold.

We determine the allocated cost of assets sold based on the relative fair values of cash proceeds, MSRs and the beneficial interest in Trusts, which represents the ultimate expected outcome from the Trusts disposition of the loans. The relative fair value of the MSRs and the beneficial interest in Trust is determined using discounted cash flow models, which require various management assumptions, limited by the ultimate expected outcome from the disposition of the loans by the Trusts (see discussion below in Valuation of Residual Interests and Valuation of Mortgage Servicing Rights). The following is an example of a hypothetical gain on sale calculation:

		(in 000s)
Acquisition cost of underlying mortgage loans	$	1,000,000
Fair values:		
Net proceeds	$	990,000
Beneficial interest in Trusts		20,000
MSRs		9,000
	$	1,019,000
Computation of gain on sale:		
Net proceeds	$	990,000
Less allocated cost ($990,000/$1,019,000 × $1,000,000)		971,541
Recorded gain on sale	$	18,459
Recorded beneficial interest in Trusts ($20,000/$1,019,000 × $1,000,000)	$	19,627
Recorded value of MSRs ($9,000/$1,019,000 × $1,000,000)	$	8,832

Variations in the assumptions we use affect the estimated fair values, which would affect the reported gains on sales. Gains on sales of mortgage loans totaled $772.1 million, $915.6 million and $792.1 million for fiscal years 2005, 2004 and 2003, respectively.

See discussion in Off-Balance Sheet Financing Arrangements related to the disposition of the loans by the Trusts and subsequent securitization by the Company.

VALUATION OF RESIDUAL INTERESTS ... We use discounted cash flow models to determine the estimated fair values of our residual interests. We develop our assumptions for expected losses, prepayment speeds, discount rates and interest rates based on historical experience and third-party market sources. Variations in our assumptions could materially affect the estimated fair values, which may require us to record impairments or unrealized gains. In addition, variations will also affect the amount of residual interest accretion recorded on a monthly basis. Residual interests valued at $205.9 million and $211.0 million were recorded as of April 30, 2005 and 2004, respectively. We recorded $95.9 million in net write-ups in other comprehensive income and $12.2 million in impairments in the income statement related to our residual interests during fiscal year 2005 as actual performance differed from our assumptions. See Item 8, note 1 to our consolidated financial statements for our methodology used in valuing residual interests. See Item 8, note 6 to our consolidated financial statements for current assumptions and a sensitivity analysis of those assumptions. See Item 7A for sensitivity analysis related to interest rates.

VALUATION OF MORTGAGE SERVICING RIGHTS ... MSRs are carried at the lower of cost or fair value. We use discounted cash flow models to determine the estimated fair values of our MSRs. Fair values take into account the historical prepayment activity of the related loans and our estimates of the remaining future cash flows to be generated through servicing the underlying mortgage loans. Variations in our assumptions could materially affect the estimated fair values, which may require us to record impairments.

Prepayment speeds are somewhat correlated with the movement of market interest rates. As market interest rates decline there is a corresponding increase in actual and expected borrower prepayments as customers refinance existing mortgages under more favorable interest rate terms. This in turn reduces the anticipated cash flows associated with servicing resulting in a reduction, or impairment, to the fair value of the capitalized MSR. Prepayment rates are estimated based on historical experience and third-party market sources. Many non-prime loans have a prepayment penalty in place for the first two to three years, which has the effect of making prepayment speeds more predictable, regardless of market interest rate movements. If actual prepayment rates prove to be higher than the estimate made by management, impairment of the MSRs could occur.

MSRs valued at $166.6 million and $113.8 million were recorded as of April 30, 2005 and 2004, respectively. See Item 8, note 1 to our consolidated financial statements for our methodology used in stratifying and valuing MSRs. See Item 8, note 6 to our consolidated financial statements for current assumptions and a sensitivity analysis of those assumptions.

VALUATION OF GOODWILL ... Our goodwill impairment analysis is based on a discounted cash flow approach and market comparables, when available. This analysis, at the reporting unit level, requires significant management judgment with respect to revenue and expense growth rates, changes in working capital, and the selection and application of an appropriate discount rate.

Changes in the projections or assumptions could materially affect fair values. The use of different assumptions would increase or decrease estimated discounted future operating cash flows and could increase or decrease any impairment charge.

Our goodwill balance was $1.0 billion as of April 30, 2005 and $993.5 million as of April 30, 2004. No goodwill impairments were identified during fiscal years 2005 or 2004. In fiscal year 2003, a goodwill impairment charge of $108.8 million was recorded in the Investment Services segment due to unsettled market conditions. Also during 2003, our annual impairment test resulted in an impairment of $13.5 million for a reporting unit within the Business Services segment. No other impairments were identified.

LITIGATION ... Our policy is to routinely assess the likelihood of any adverse judgments or outcomes related to legal matters, as well as ranges of probable losses. A determination of the amount of the reserves required, if any, for these contingencies is made after thoughtful analysis of each known issue and an analysis of historical experience in accordance with Statement of Financial Accounting Standards No. 5, Accounting for Contingencies, and related pronouncements. Therefore, we have recorded reserves related to certain legal matters for which it is probable that a loss has been incurred and the range of such loss can be estimated. With respect to other matters, we have concluded that a loss is only reasonably possible or remote and, therefore, no liability is recorded.

STOCK-BASED COMPENSATION ... Stock-based compensation expense is determined based on the grant-date fair value and the number of equity instruments that vest. We use the Black-Scholes model to calculate the fair value for stock options and employee stock purchase plan (ESPP) shares using the following assumptions: stock volatility, expected life, risk-free interest rate and dividend yield. The fair value of restricted shares is the stock price on the date of the grant. We also estimate, based on historical data, the percent of equity instruments expected to vest. Variations in the assumptions used to calculate fair value could either positively or negatively affect the recorded expense. Variations between actual performance and the estimate of vesting could result in timing adjustments recorded at the end of the vesting period. Additionally, changes in accounting rules related to stock-based compensation could result in changes to our assumptions of fair value and expense recognition.

We began expensing all stock-based compensation awards under the prospective transition method beginning on May 1, 2003. Therefore, our income statements do not fully reflect the expense related to all of our stock options and restricted shares outstanding. We recorded $44.1 million, $25.7 million and $2.1 million in stock-based compensation expense during fiscal years 2005, 2004 and 2003, respectively.

INCOME TAXES ... We calculate our current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed during the applicable calendar year. Adjustments based on filed returns are recorded when identified. We file a consolidated federal tax return on a calendar year basis, generally in the second fiscal quarter of the subsequent year.

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. We have considered taxable income in carry-back periods, historical and forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate, and tax planning strategies in determining the need for a valuation allowance against our deferred tax assets. In the event we were to determine that we would not be able to realize all or part of our deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to earnings in the period in which we make such determination. Likewise, if we later determine that it is more likely than not that the deferred tax assets would be realized, we would reverse the applicable portion of the previously provided valuation allowance.

The amount of income taxes we pay is subject to ongoing audits by federal, state and foreign tax authorities, which may result in proposed assessments. Our estimate for the potential outcome for any uncertain tax issue is highly judgmental. We believe we have adequately provided for any reasonably foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved or when statutes of limitation on potential assessments expire. As a result, our effective tax rate may fluctuate on a quarterly basis. As discussed in Item 9A, Controls and Procedures, we reported a material weakness in our internal controls over accounting for income taxes as of April 30, 2005.

OTHER SIGNIFICANT ACCOUNTING POLICIES ... Other significant accounting policies, not involving the same level of measurement uncertainties as those discussed above, are nevertheless important to an understanding of the financial statements. These policies require difficult judgments on complex matters that are often subject to multiple sources of authoritative guidance. Certain of these matters are among topics currently under reexamination by accounting standard setters and regulators. Although no specific conclusions reached by these standard setters appear likely to cause a material change in our accounting policies, outcomes cannot be predicted with confidence. Also see Item 8, note 1 to our consolidated financial statements, which discusses accounting policies we have selected when there are acceptable alternatives.

RESULTS OF OPERATIONS ...

Our business is divided into four reportable segments: Tax Services, Mortgage Services, Business Services and Investment Services.

TAX SERVICES

This segment primarily consists of our income tax preparation businesses retail, online and software. The previously reported U.S. Tax Operations has been aggregated with the International Tax Operations segment in the Tax Services segment.

Tax Services Operating Statistics (in 000s, except average fee)

Year ended April 30,	2005	2004[1]	2003[1]
Clients served ...			
United States:			
Company-owned offices	**10,608**	10,627	10,105
Franchise offices	**5,428**	5,460	6,488
	16,036	16,087	16,593
Digital tax solutions:			
Software [2]	**1,804**	2,027	1,963
Online [3]	**1,213**	1,207	920
	19,053	19,321	19,476
International[4]	**2,333**	2,253	2,227
	21,386	21,574	21,703
Average fee per client served [5] ...			
Company-owned offices	**$ 158.19**	$ 146.34	$ 137.16
Franchise offices	**135.98**	127.91	118.05
	$ 150.67	$ 140.09	$ 129.69
RALs [6] ...			
Company-owned offices	**2,667**	2,713	2,768
Franchise offices	**1,499**	1,508	1,790
Digital tax solutions:			
Software	**2**	5	
Online	**32**	57	75
	4,200	4,283	4,633

(1) Company-owned and franchise data for fiscal years 2004 and 2003 have not been restated for franchise acquisitions.
(2) Includes TaxCut federal units sold.
(3) Includes online completed and paid federal returns, and state returns only when no payment was made for a federal return.
(4) The end of the Canadian tax season was extended from April 30 to May 2, 2005. Clients served in our international operations in fiscal year 2005 includes approximately 47,500 returns in both company-owned and franchise offices which were accepted by the client on May 1 and 2, 2005. The revenues related to these returns will be recognized in fiscal year 2006.
(5) Calculated as gross tax preparation and related fees divided by clients served (U.S. only).
(6) Data is for tax season (January 1 April 30) only.

Tax Services Financial Results (in 000s)

Year ended April 30,	**2005**	Restated 2004	Restated 2003
Service revenues:			
Tax preparation and related fees	**$ 1,718,867**	$ 1,589,439	$ 1,437,835
Online tax services	**49,515**	44,915	25,892
Other service revenues	**143,648**	127,602	97,794
	1,912,030	1,761,956	1,561,521
Royalties	**197,551**	184,882	174,659
RAL participation fees	**182,784**	168,375	896
RAL waiver fees		6,548	138,242
Software sales	**44,419**	43,823	39,314
Other	**21,509**	25,593	32,131
Total revenues	**2,358,293**	2,191,177	1,946,763
Cost of services:			
Compensation and benefits	**726,654**	672,066	591,556
Occupancy	**281,772**	255,516	225,045
Depreciation and amortization	**54,579**	48,808	42,505
Supplies	**47,703**	40,792	40,992
Bad debt	**33,046**	27,328	32,653
Other	**103,560**	92,137	125,653
	1,247,314	1,136,647	1,058,404
Cost of software sales	**37,819**	41,895	34,842
Selling, general and administrative	**409,642**	374,142	296,814
Total expenses	**1,694,775**	1,552,684	1,390,060
Pretax income	**$ 663,518**	$ 638,493	$ 556,703

FISCAL 2005 COMPARED TO FISCAL 2004 ...

Tax Services revenues increased $167.1 million, or 7.6%, compared to the prior year. Fiscal year 2005 was the first year of a multi-year strategy to expand our retail distribution network, to increase client growth by providing more convenient access to our services and to react to increased competition in the tax preparation market. In the U.S., we opened a net 1,252 new offices, 609 of which were part of the expansion of our company-owned retail distribution network. This expansion contributed incremental revenues of $24.9 million and pretax losses of $18.9 million. Clients served in our U.S. company-owned offices declined 0.2% from the prior year.

Tax preparation and related fees increased $129.4 million, or 8.1%. This increase is primarily due to an 8.1% increase in the average fee per U.S. client served, resulting from increases in our pricing and the complexity of returns prepared.

Online service revenues increased $4.6 million, or 10.2%, primarily as a result of a shift in the mix of services to those with higher prices. Increased competition in the online market, including national marketing campaigns and lower pricing by our competitors, coupled with a 46% increase in returns prepared through the FFA, limited our growth in online paid clients.

Other service revenues increased $16.0 million, or 12.6%, primarily as a result of additional revenues associated with RACs and Express IRAs.

Royalty revenues increased $12.7 million, or 6.9%, primarily due to a 6.3% increase in the average fee per client served at our franchise offices.

Revenues earned during the current year in connection with RAL participations increased $14.4 million, or 8.6%, over the prior year. This increase is primarily due to an increase in the dollar amount of loans in which we purchased participation interests, resulting from an increase in the fee charged by the lender, an increase in our clients average refund size and the maximum loan amount allowed by the lender.

A total of 3.3 million software units were sold during fiscal year 2005, a decrease of 13.5% compared to the prior year. Software units include TaxCut Federal, TaxCut State, DeductionPro, WillPower and Legal Advisor. The decline in unit sales was due to increased competition, but was offset by pricing increases and a shift to our premium product lines, which resulted in a 1.4% increase in revenues from software sales.

Cost of services for fiscal year 2005 increased $110.7 million, or 9.7%, over the prior year. Compensation and benefits increased $54.6 million primarily due to increased revenues and an increase in the number of tax professionals and support staff needed in new office locations. Stock-based compensation related to our seasonal associates also increased $4.1 million. Occupancy expenses increased $26.3 million, or 10.3%, as a result of an 11.4% increase in U.S. company-owned offices under lease, which also drove increases in depreciation and amortization and supply costs. Of the total increase in occupancy expenses, $10.7 million was due to our real estate expansion. Other cost of services increased $11.4 million primarily due to additional expenses associated with our POM guarantee and Express IRAs.

Selling, general and administrative expenses increased $35.5 million over the prior year primarily due to increased spending related to an $18.8 million increase in allocations from support departments and additional legal expenses of $10.2 million.

Pretax income of $663.5 million for fiscal year 2005 represents a 3.9% increase from the prior year. The segment s operating margin declined 100 basis points to 28.1% in fiscal year 2005.

FISCAL 2006 OUTLOOK ... In fiscal year 2006, we plan to continue our office expansion initiative by adding between 500 and 700 more offices across our company-owned and franchise network. We believe by investing in our office network, we will attract potential clients who are primarily motivated by convenience. Although we expect the additional tax offices to result in incremental clients and revenues during fiscal year 2006, due to the cost of expansion we expect incremental pretax losses from these newly added offices. We expect the performance of offices added during fiscal year 2005 to improve in the upcoming year.

We also plan to be more aggressive in our digital tax solutions marketing efforts to better compete in the market. We believe our multi-channel strategy not only allows clients to choose how they want to be served, but also allows us to appeal to a different client base than we do through our offices.

We expect overall revenue growth in this segment to be less than ten percent in the upcoming year, and we will continue to focus on cost containment to improve the segment s operating margin.

FISCAL 2004 COMPARED TO FISCAL 2003 ... Tax Services revenues increased $244.4 million, or 12.6%, for fiscal year 2004.

Tax preparation and related fees increased $151.6 million, or 10.5%, compared to fiscal year 2003. This increase is due to a 6.7% increase in the average fee per client served in U.S. offices, coupled with a 5.2% increase in clients served. The average fee per client served increased due to increases in our pricing and the complexity of returns prepared. Clients served in company-owned offices increased to 10.6 million as a result of the acquisition of businesses in former major franchise territories. Excluding the impact of our acquisitions of former major franchises, clients served declined 2.5%.

Online tax preparation revenues increased $19.0 million, or 73.5%, as a result of an increase in the average price and an increase in clients served.

Other service revenues for fiscal year 2004 increased $29.8 million, or 30.5%, primarily due to a change in accounting principle relating to our POM guarantee.

The average fee per client at our franchise offices increased 8.4%, while clients served declined 15.9%. The decline is due to the former major franchise territories being operated as company-owned for the majority of fiscal year 2004. This, coupled with the re-franchising of certain former major franchise territories at higher royalty rates, resulted in a 5.9% increase in royalty revenue.

Revenues earned during fiscal year 2004 in connection with RAL participations totaled $168.4 million. These revenues are approximately $30.1 million higher than waiver fees earned during fiscal year 2003. See discussion of the waiver below. Our RAL participation revenues benefited from the new company-owned operations in former major franchise territories. We participate in RALs at a rate of nearly 50% for company-owned offices compared to 25% in major franchise offices. This increased participation rate caused our revenues to increase, although the number of RALs declined.

During fiscal year 2003, we entered into an agreement with Household, whereby we waived our right to purchase any participation interests in and receive license fees for RALs during the period January 1 through April 30, 2003. In consideration for waiving these rights we received a series of payments from Household in fiscal year 2003, subject to certain adjustments in fiscal year 2004 based on delinquency rates. See discussion in Item 1, RAL Participations and 2003 Tax Season Waiver.

A total of 3.8 million software units were sold during fiscal year 2004, an increase of 11.2% compared to 3.4 million units in 2003. Revenues from software sales in fiscal year 2004 increased 11.5% as a result of the higher sales volume.

Cost of services for fiscal year 2004 increased $78.2 million, or 7.4%, from 2003. This increase was partially attributable to the operation of former major franchise territories as company-owned. Compensation and benefits increased $80.5 million as a result of the former major franchise acquisitions, increased field wages during the later part of the tax season and $13.7 million in expenses for stock options awarded to seasonal tax associates. Occupancy and equipment costs increased $30.5 million due primarily to a 5.7% increase in the average rent and a 3.4% increase in the number of U.S. offices under lease. Depreciation and amortization increased as a result of additional equipment purchased for new office locations opened during the period.

Selling, general and administrative expenses increased $77.3 million over 2003 due to $33.3 million in bad debt expense associated with RAL participations, which was not incurred in the prior year due to the waiver agreement. Intangible amortization increased $9.0 million from the acquisition of assets of former major franchisees. Marketing costs increased $20.7 million as a result of additional brand advertising campaigns. Allocated information technology costs increased $13.9 million as a result of additional technology projects. These increases were partially offset by a $62.4 million decrease in legal expenses, which is primarily a result of the Texas RAL litigation settlement and other cases in the prior year. See discussion in RAL Litigation below.

Pretax income for fiscal year 2004 increased $81.8 million, or 14.7%, over 2003. The segment s operating margin improved fifty basis points to 29.1% in fiscal year 2004. Excluding the 2003 RAL litigation reserve, pretax income increased 6.7% and our operating margin declined 160 basis points.

RAL LITIGATION ... In fiscal year 2003, we announced a settlement had been reached in the cases *Ronnie and Nancy Haese, et al. v. H&R Block, Inc., et al.*, Case No. CV96-4213, District Court of Kleberg County, Texas (Haese I) and *Ronnie and Nancy Haese, et al. v. H&R Block, Inc., et al*., Case No. CV-99-314-D, District Court of Kleberg County, Texas (Haese II), filed originally as one action on July 30, 1996. As a result of that settlement, we recorded a liability and pretax expense of $43.5 million during fiscal year 2003. This represented our best estimate of our share of the settlement, plaintiff class legal fees and expenses, tax products and associated mailing expenses. Our share of the settlement is less than the total amount awarded due to amounts recoverable from a co-defendant in the case.

We have been named as a defendant in a number of lawsuits alleging that we engaged in wrongdoing with respect to the RAL program. We believe we have strong defenses to the various RAL Cases and will vigorously defend our position. Nevertheless, the amounts claimed by the plaintiffs are, in some instances, very substantial, and there can be no assurances as to the ultimate outcome of the pending RAL Cases, or as to the impact of the RAL Cases on our financial statements. See Item 3, Legal Proceedings, for additional information.

MORTGAGE SERVICES

This segment is primarily engaged in the origination of non-prime mortgage loans through an independent broker network, the origination of non-prime and prime mortgage loans through a retail office network, the sale and securitization of mortgage loans and residual interests, and the servicing of non-prime loans.

Mortgage Services Operating Statistics (dollars in 000s)

Year Ended April 30,	**2005**	2004	2003
Volume of loans originated ...			
Wholesale (non-prime)	**$ 26,977,810**	$ 20,150,992	$ 13,659,243
Retail: Non-prime	**3,005,168**	1,846,674	1,220,563
Prime	**1,018,746**	1,258,347	1,697,815
	$ 31,001,724	$ 23,256,013	$ 16,577,621
Loan Characteristics ...			
Weighted average FICO score [1]	**614**	608	604
Weighted average interest rate for borrowers (WAC[1])	**7.36%**	7.39%	8.15%
Weighted average loan-to-value [1]	**78.9%**	78.1%	78.7%
Percentage of first mortgage loans owner-occupied	**92.6%**	92.9%	93.0%
Percentage with prepayment penalty	**70.8%**	73.7%	79.9%
Percentage of fixed-rate mortgages	**22.1%**	30.4%	24.4%
Percentage of adjustable-rate mortgages	**77.9%**	69.6%	75.6%
Origination margin (% of origination volume) [2] ...			
Loan sale premium	**2.77%**	4.21%	4.87%
Accretion on beneficial interest in Trusts	**0.63%**	0.72%	0.65%
Gain (loss) on derivatives	**0.15%**	(0.05%)	(0.02%)
Loan sale repurchase reserves	**(0.13%)**	(0.20%)	(0.13%)
MSR gain on sale	**0.44%**	0.36%	0.36%
	3.86%	5.04%	5.73%
Cost of acquisition	**(0.54%)**	(0.50%)	(0.36%)
Direct origination expenses	**(0.68%)**	(0.65%)	(0.62%)
Net gain on sale gross margin[3]	**2.64%**	3.89%	4.75%
Other revenues	**0.03%**	0.01%	(0.01%)
Other cost of origination	**(1.55%)**	(1.68%)	(1.91%)

Net margin	**1.12%**	2.22%	2.83%
Total cost of origination	**2.23%**	2.33%	2.53%
Total cost of origination and acquisition	**2.77%**	2.83%	2.89%
Loan delivery ...			
Loan sales	**$ 30,975,523**	$ 23,234,935	$ 17,225,774
Execution price: (4) ...			
Loans originated and sold	**3.01%**	4.09%	4.63%
Loans acquired and sold			.18%
	3.01%	4.09%	4.46%

(1) Represents non-prime production.

(2) As restated. See Reconciliation of Non-GAAP Financial Information at the end of Item 7.

(3) Defined as gain on sale of mortgage loans (including gain or loss on derivatives, mortgage servicing rights and net of direct origination and acquisition expenses) divided by origination volume.

(4) Defined as total premium received divided by total balance of loans delivered to third-party investors or securitization vehicles (excluding mortgage servicing rights and the effect of loan origination expenses).

Mortgage Services Financial Results (in 000s)

Year Ended April 30,	2005	Restated 2004	Restated 2003
Components of gains on sales:			
Gain on mortgage loans	**$ 772,061**	$ 915,628	$ 792,072
Gain (loss) on derivatives	**46,853**	(11,957)	(4,141)
Gain on sales of residual interests	**15,396**	40,689	93,307
Impairment of residual interests	**(12,235)**	(26,063)	(54,111)
	822,075	918,297	827,127
Interest income:			
Accretion-residual interests	**137,610**	186,466	146,343
Other	**11,850**	5,064	5,421
	149,460	191,530	151,764
Loan-servicing revenue	**273,056**	211,710	168,351
Other	**1,427**	2,172	2,838
Total revenues	**1,246,018**	1,323,709	1,150,080
Cost of services	**221,300**	193,018	141,419
Cost of non-service revenues:			
Compensation and benefits	**218,544**	190,499	146,907
Occupancy	**33,155**	25,635	22,701
Other	**72,803**	71,634	74,332
	324,502	287,768	243,940
Selling, general and administrative	**204,123**	154,400	108,397
Total expenses	**749,925**	635,186	493,756
Pretax income	**$ 496,093**	$ 688,523	$ 656,324