

H&R BLOCK INC
Form 10-Q
March 14, 2007

Table of Contents

**SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended January 31, 2007

OR

☐ **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

**(State or other jurisdiction of
incorporation or organization)**

44-0607856

**(I.R.S. Employer
Identification No.)**

One H&R Block Way

Kansas City, Missouri 64105

(Address of principal executive offices, including zip code)

(816) 854-3000

(Registrant's telephone number, including area code)

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 ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer.

See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The number of shares outstanding of the registrant's Common Stock, without par value, at the close of business on February 28, 2007 was 322,926,550 shares.

Form 10-Q for the Period Ended January 31, 2007
Table of Contents

	Page
PART I Financial Information	
<u>Item 1. Condensed Consolidated Balance Sheets January 31, 2007 and April 30, 2006</u>	1
<u>Condensed Consolidated Statements of Income and Comprehensive Income Three and Nine Months Ended January 31, 2007 and 2006</u>	2
<u>Condensed Consolidated Statements of Cash Flows Nine Months Ended January 31, 2007 and 2006</u>	3
<u>Notes to Condensed Consolidated Financial Statements</u>	4
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	45
<u>Item 4. Controls and Procedures</u>	46
<u>PART II Other Information</u>	
<u>Item 1. Legal Proceedings</u>	46
<u>Item 1A. Risk Factors</u>	49
<u>Item 2. Unregistered Sales of Equity Securities</u>	49
<u>Item 6. Exhibits</u>	49
<u>SIGNATURES</u>	52
<u>Omnibus Amendment and Consent Agreement</u>	
<u>Amendment Number Five to the Second Amended and Restated Sale and Servicing Agreement</u>	
<u>Amendment Number Nine to the Amended and Restated Indenture</u>	
<u>Omnibus Amendment and Consent Agreement</u>	
<u>Waiver and Amendment</u>	
<u>Second Amended and Restated Sale and Servicing Agreement</u>	
<u>Second Amended and Restated Note Purchase Agreement</u>	
<u>Indenture</u>	
<u>Omnibus Amendment and Consent Agreement</u>	
<u>Waiver</u>	
<u>Amendment Number Two to the Amended and Restated Sale and Servicing Agreement</u>	
<u>Amendment Number Two to the Note Purchase Agreement</u>	
<u>Omnibus Amendment and Consent Agreement</u>	
<u>Omnibus Agreement</u>	
<u>Omnibus Amendment Number Four</u>	
<u>Omnibus Amendment and Consent Agreement</u>	
<u>Omnibus Amendment and Consent Agreement</u>	
<u>Omnibus Amendment and Consent Agreement</u>	
<u>Omnibus Amendment and Consent Agreement</u>	

Supplemental Indenture No. 2

Amendment Number One to the Sale and Servicing Agreement

Sale and Servicing Agreement

Note Purchase Agreement

Indenture

Joinder and First Amendment to Program Contracts

Second Amendment to Program Contracts

First Amended and Restated HSBC Refund Anticipation Loan

First Amended and Restated HSBC Settlement Products Servicing Agreement

Credit and Guarantee Agreement

First Amendment to the Five-Year Credit and Guarantee Agreement

First Amendment to the Amended and Restated Five-Year Credit and Guarantee Agreement

Separation and Release Agreement

Certification of CEO Pursuant to Section 302

Certification of CFO Pursuant to Section 302

Certification of CEO Pursuant to Section 906

Certification of CFO Pursuant to Section 906

Table of Contents**CONDENSED CONSOLIDATED BALANCE SHEETS**

	(amounts in 000s, except share amounts)	
	January 31, 2007	April 30, 2006
	(Unaudited)	
ASSETS		
Cash and cash equivalents	\$ 1,082,666	\$ 677,204
Cash and cash equivalents restricted	432,524	385,623
Receivables from customers, brokers, dealers and clearing organizations, net	424,874	496,577
Receivables, less allowance for doubtful accounts of \$54,974 and \$64,480	2,376,846	482,144
Prepaid expenses and other current assets	202,309	152,701
Current assets of discontinued operations, held for sale	988,060	594,187
Total current assets	5,507,279	2,788,436
Mortgage loans held for investment, net	1,069,626	
Property and equipment, at cost less accumulated depreciation and amortization of \$645,913 and \$627,181	392,706	356,812
Intangible assets, net	184,290	219,494
Goodwill, net	982,598	947,985
Other assets	386,986	375,395
Noncurrent assets of discontinued operations, held for sale	836,493	1,301,013
Total assets	\$ 9,359,978	\$ 5,989,135

LIABILITIES AND STOCKHOLDERS' EQUITY**Liabilities:**

Commercial paper and other short-term borrowings	\$ 2,926,421	\$
Current portion of long-term debt	512,333	506,992
Accounts payable to customers, brokers and dealers	684,475	781,303
Customer banking deposits	1,632,875	
Accounts payable, accrued expenses and other current liabilities	496,084	612,181
Accrued salaries, wages and payroll taxes	249,243	270,303
Accrued income taxes	71,079	505,690
Current liabilities of discontinued operations, held for sale	497,749	216,967
Total current liabilities	7,070,259	2,893,436
Long-term debt	416,183	417,539
Other noncurrent liabilities	343,362	530,361
Total liabilities	7,829,804	3,841,336

Stockholders' equity:

Common stock, no par, stated value \$.01 per share, 800,000,000 shares authorized, 435,890,796 shares issued at January 31, 2007 and April 30, 2006	4,359	4,359
Additional paid-in capital	662,297	653,053
Accumulated other comprehensive income	6,975	21,948
Retained earnings	3,015,880	3,492,059
Less cost of 113,071,487 and 107,377,858 shares of common stock in treasury	(2,159,337)	(2,023,620)
Total stockholders' equity	1,530,174	2,147,799
Total liabilities and stockholders' equity	\$ 9,359,978	\$ 5,989,135

See Notes to Condensed Consolidated Financial Statements

-1-

Table of Contents**CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

	Three months ended January 31,		(Unaudited, amounts in 000s, except per share amounts) Nine months ended January 31,	
	2007	2006	2007	2006
Revenues:				
Service revenues	\$ 758,005	\$ 706,159	\$ 1,420,029	\$ 1,214,895
Other revenues:				
Product and other revenues	160,894	135,332	192,064	167,775
Interest income	36,217	18,762	92,429	51,311
	955,116	860,253	1,704,522	1,433,981
Operating expenses:				
Cost of services	587,873	559,082	1,377,919	1,175,869
Cost of other revenues	69,962	40,281	115,002	59,176
Selling, general and administrative	269,393	297,401	592,155	586,700
	927,228	896,764	2,085,076	1,821,745
Operating income (loss)	27,888	(36,511)	(380,554)	(387,764)
Interest expense	(12,066)	(12,211)	(36,292)	(37,031)
Other income, net	3,031	3,708	15,097	13,951
Income (loss) from continuing operations before tax benefit	18,853	(45,014)	(401,749)	(410,844)
Income tax benefit	(6,112)	(14,766)	(172,726)	(158,391)
Net income (loss) from continuing operations	24,965	(30,248)	(229,023)	(252,453)
Net income (loss) from discontinued operations	(85,217)	42,361	(119,066)	155,323
Net income (loss)	\$ (60,252)	\$ 12,113	\$ (348,089)	\$ (97,130)
Basic earnings (loss) per share:				
Net income (loss) from continuing operations	\$ 0.08	\$ (0.09)	\$ (0.71)	\$ (0.77)
Net income (loss) from discontinued operations	(0.27)	0.13	(0.37)	0.47
Net income (loss)	\$ (0.19)	\$ 0.04	\$ (1.08)	\$ (0.30)
Basic shares	322,350	327,289	322,588	328,017

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Diluted earnings (loss) per share:

Net income (loss) from continuing operations	\$ 0.08	\$ (0.09)	\$ (0.71)	\$ (0.77)
Net income (loss) from discontinued operations	(0.26)	0.13	(0.37)	0.47

Net income (loss)	\$ (0.18)	\$ 0.04	\$ (1.08)	\$ (0.30)
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Diluted shares	326,048	327,289	322,588	328,017
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Dividends per share	\$ 0.14	\$ 0.13	\$ 0.40	\$ 0.36
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Comprehensive income (loss):

Net income (loss)	\$ (60,252)	\$ 12,113	\$ (348,089)	\$ (97,130)
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Change in unrealized gain on available-for-sale securities, net	(14,350)	(3,002)	(15,194)	(32,466)
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Change in foreign currency translation adjustments	(268)	(7,820)	221	(2,611)
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Comprehensive income (loss)	\$ (74,870)	\$ 1,291	\$ (363,062)	\$ (132,207)
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See Notes to Condensed Consolidated Financial Statements

-2-

Table of Contents**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

Nine months ended January 31,	(Unaudited, amounts in 000s)	
	2007	2006
Cash flows from operating activities:		
Net loss	\$ (348,089)	\$ (97,130)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	119,909	111,396
Tax benefits from stock-based compensation	(12,314)	19,967
Excess tax benefits from stock-based compensation	(2,379)	
Change in participation in tax client loans receivable	(1,691,351)	(843,146)
Net cash provided by (used in) operating activities of discontinued operations	573,201	(478,015)
Other, net of acquisitions	(1,417,241)	(407,464)
Net cash used in operating activities	(2,778,264)	(1,694,392)
Cash flows from investing activities:		
Mortgage loans originated or purchased for investment, net	(1,073,012)	
Purchases of property and equipment, net	(129,905)	(134,328)
Payments made for business acquisitions, net of cash acquired	(24,670)	(209,816)
Net cash provided by investing activities of discontinued operations	18,322	72,247
Other, net	30,542	17,625
Net cash used in investing activities	(1,178,723)	(254,272)
Cash flows from financing activities:		
Repayments of commercial paper	(4,901,618)	(2,632,444)
Proceeds from issuance of commercial paper	6,397,656	4,678,392
Repayments of other short-term borrowings	(889,722)	
Proceeds from other short-term borrowings	2,320,105	550,000
Customer deposits	1,632,875	
Dividends paid	(128,088)	(118,665)
Acquisition of treasury shares	(188,562)	(260,078)
Excess tax benefits from stock-based compensation	2,379	
Proceeds from exercise of stock options	19,183	95,930
Net cash provided by financing activities of discontinued operations	172,301	
Other, net	(74,060)	(9,349)
Net cash provided by financing activities	4,362,449	2,303,786
Net increase in cash and cash equivalents	405,462	355,122
Cash and cash equivalents at beginning of the period	677,204	1,072,299
Cash and cash equivalents at end of the period	\$ 1,082,666	\$ 1,427,421

Supplementary cash flow data:

Income taxes paid	\$	378,377	\$	224,774
Interest paid		103,252		62,980

See Notes to Condensed Consolidated Financial Statements

-3-

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

1. Basis of Presentation

The condensed consolidated balance sheet as of January 31, 2007, the condensed consolidated statements of income and comprehensive income for the three and nine months ended January 31, 2007 and 2006, and the condensed consolidated statements of cash flows for the nine months ended January 31, 2007 and 2006 have been prepared by the Company, without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows at January 31, 2007 and for all periods presented have been made. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

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.

Certain reclassifications have been made to prior year amounts to conform to the current year presentation. These reclassifications had no effect on our results of operations or stockholders' equity as previously reported.

In March 2006, the Office of Thrift Supervision (OTS) approved the charter of H&R Block Bank (HRB Bank). HRB Bank commenced operations on May 1, 2006, at which time we realigned certain segments of our business to reflect a new management reporting structure. The previously reported Investment Services segment and HRB Bank were combined in the Consumer Financial Services segment.

On November 6, 2006 we announced we would evaluate strategic alternatives for Option One Mortgage Corporation (OOMC), including a possible sale or other transaction through the public markets. On January 20, 2007, our Board of Directors approved the plan to sell OOMC and its wholly-owned subsidiary, H&R Block Mortgage Corporation (HRBMC). As of January 31, 2007, we met the criteria requiring us to present the assets and liabilities of OOMC and HRBMC, as held-for-sale and the related financial results as discontinued operations in the condensed consolidated financial statements for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in our April 30, 2006 Annual Report to Shareholders on Form 10-K.

Operating revenues of the Tax Services and Business Services segments are seasonal in nature with peak revenues occurring in the months of January through April. Therefore, results for interim periods are not indicative of results to be expected for the full year.

2. Earnings (Loss) Per Share

Basic and diluted loss per share is computed using the weighted average shares outstanding during each period. The dilutive effect of potential common shares is included in diluted earnings per share except in those periods with a loss from continuing operations. The computations of basic and diluted earnings (loss) per share from continuing operations are as follows:

	(in 000s, except per share amounts)			
	Three months ended		Nine months ended January	
	January 31,		31,	
	2007	2006	2007	2006
Net income (loss) from continuing operations	\$ 24,965	\$ (30,248)	\$ (229,023)	\$ (252,453)
Basic weighted average common shares	322,350	327,289	322,588	328,017
	3,696			

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Potential dilutive shares from stock options and
restricted stock

Convertible preferred stock 2

Dilutive weighted average common shares	326,048	327,289	322,588	328,017
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Earnings (loss) per share from continuing
operations:

Basic	\$ 0.08	\$ (0.09)	\$ (0.71)	\$ (0.77)
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Diluted	0.08	(0.09)	(0.71)	(0.77)
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-4-

Table of Contents

Diluted earnings per share excludes the impact of shares of common stock issuable upon the lapse of certain restrictions or the exercise of options to purchase 28.0 million shares for the nine months ended January 31, 2007 and 29.3 million shares of stock for the three and nine months ended January 31, 2006, as the effect would be antidilutive due to the net loss from continuing operations during each period.

The weighted average shares outstanding for the three and nine months ended January 31, 2007 decreased to 322.4 million and 322.6 million, respectively, from 327.3 million and 328.0 million last year, primarily due to purchases of treasury shares. The effect of these purchases was partially offset by the issuance of treasury shares related to our stock-based compensation plans.

During the nine months ended January 31, 2007 and 2006, we issued 2.8 million and 6.3 million shares of common stock, respectively, pursuant to the exercise of stock options, employee stock purchases and awards of nonvested shares, in accordance with our stock-based compensation plans.

During the nine months ended January 31, 2007, we acquired 8.5 million shares of our common stock, of which 8.1 million shares were purchased from third parties with the remaining shares swapped or surrendered to us, at an aggregate cost of \$188.6 million. During the nine months ended January 31, 2006, we acquired 9.2 million shares of our common stock, of which 9.0 million shares were purchased from third parties with the remaining shares swapped or surrendered to us, at an aggregate cost of \$260.1 million.

3. Receivables

Receivables consist of the following:

	January 31, 2007	January 31, 2006	(in 000s) April 30, 2006
Participation in tax client loans	\$ 1,733,155	\$ 900,230	\$ 41,804
Business Services accounts receivable	330,157	312,087	336,532
Receivables for tax-related fees	119,186	115,906	23,154
Loans to franchisees	62,962	60,185	45,062
Royalties from franchisees	68,153	50,575	793
Software receivables	20,662	18,938	17,700
Other	97,545	70,367	81,579
	2,431,820	1,528,288	546,624
Allowance for doubtful accounts	(54,974)	(34,144)	(64,480)
	\$ 2,376,846	\$ 1,494,144	\$ 482,144

4. Goodwill and Intangible Assets

Changes in the carrying amount of goodwill for the nine months ended January 31, 2007 consist of the following:

	April 30, 2006	Additions	Other	(in 000s) January 31, 2007
Tax Services	\$ 376,515	\$ 9,902	\$ (162)	\$ 386,255
Business Services	397,516	28,619	(3,746)	422,389
Consumer Financial Services	173,954			173,954
Total	\$ 947,985	\$ 38,521	\$ (3,908)	\$ 982,598

We test goodwill for impairment annually at the beginning of our fourth quarter, or more frequently if events occur indicating it is more likely than not the fair value of a reporting unit's net assets has been reduced below its carrying value. No such events were identified within any of our segments during the nine months ended January 31, 2007. Goodwill totaling \$152.5 million is included in assets held for sale on our condensed consolidated balance sheets.

-5-

Table of Contents

Intangible assets consist of the following:

	January 31, 2007			April 30, 2006			(in 000s)
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net	
Tax Services:							
Customer relationships	\$ 30,900	\$ (13,602)	\$ 17,298	\$ 27,257	\$ (10,842)	\$ 16,415	
Noncompete agreements	20,329	(18,038)	2,291	18,879	(17,686)	1,193	
Trade name	25		25				
Business Services:							
Customer relationships	157,129	(91,665)	65,464	153,844	(81,178)	72,666	
Noncompete agreements	33,460	(16,739)	16,721	32,534	(14,300)	18,234	
Trade name amortizing	4,050	(2,849)	1,201	4,050	(1,823)	2,227	
Trade name non-amortizing	55,637	(4,868)	50,769	55,637	(4,868)	50,769	
Consumer Financial Services:							
Customer relationships	293,000	(262,479)	30,521	293,000	(235,010)	57,990	
Total intangible assets	\$ 594,530	\$ (410,240)	\$ 184,290	\$ 585,201	\$ (365,707)	\$ 219,494	

Amortization of intangible assets for the three and nine months ended January 31, 2007 was \$16.4 million and \$45.7 million, respectively. Amortization of intangible assets for the three and nine months ended January 31, 2006 was \$16.7 million and \$47.3 million, respectively. Estimated amortization of intangible assets for fiscal years 2007 through 2011 is \$58.3 million, \$40.9 million, \$17.7 million, \$15.1 million and \$13.6 million, respectively.

In October 2005, we acquired all outstanding common stock of American Express Tax and Business Services, Inc. for an aggregate purchase price of \$190.7 million. The purchase price is subject to certain contractual post-closing adjustments, which may or may not reduce the final purchase price. These adjustments have not been finalized and any future adjustment would be made to goodwill. During the nine months ended January 31, 2007, we adjusted deferred tax balances initially recorded in connection with this acquisition resulting in an increase of \$17.7 million to goodwill.

5. Stock-Based Compensation

Beginning May 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004),

Share-Based Payment, (SFAS 123R) under the modified prospective approach. Under SFAS 123R, we continue to measure and recognize the fair value of stock-based compensation consistent with our past practice under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, which we adopted on May 1, 2003 under the prospective transition method. The adoption of SFAS 123R did not have a material impact on our consolidated financial statements.

The following is a comparison of reported and pro forma results had compensation cost for all stock-based compensation grants been determined in accordance with SFAS 123 for the three and nine months ended January 31, 2006.

(in 000s, except per share amounts)

Three months	Nine months ended
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	ended January 31, 2006	January 31, 2006
Net income (loss) as reported	\$ 12,113	\$ (97,130)
Add: Stock-based compensation expense included in reported net income (loss), net of related tax effects	9,916	21,927
Deduct: Total stock-based compensation expense determined under fair value method for all awards, net of related tax effects	(12,460)	(29,558)
Pro forma net income (loss)	\$ 9,569	\$ (104,761)
Basic and diluted earnings (loss) per share:		
As reported	\$ 0.04	\$ (0.30)
Pro forma	0.03	(0.32)

-6-

Table of Contents

Stock-based compensation expense of \$13.7 million and \$35.5 million and the related tax benefits of \$4.7 million and \$12.1 million are included in our results for the three and nine months ended January 31, 2007.

SFAS 123R requires the reclassification, in the statement of cash flows, of the excess tax benefits from stock-based compensation from operating cash flows to financing. As a result, we classified \$2.4 million as a cash inflow from financing activities rather than as an operating activity for the nine months ended January 31, 2007.

We have four stock-based compensation plans which have been approved by our shareholders. As of January 31, 2007, we had approximately 25.6 million shares reserved for future awards under these plans. We issue shares from our treasury stock to satisfy the exercise or release of stock-based awards.

Our 2003 Long-Term Executive Compensation Plan provides for awards of options (both incentive and nonqualified), nonvested shares, performance nonvested share units and other stock-based awards to employees. These awards entitle the holder to shares or the right to purchase shares of common stock as the award vests, typically over a three-year period with one-third vesting each year. Nonvested shares receive dividends during the vesting period and performance nonvested share units receive cumulative dividends at the end of the vesting period. We measure the fair value of options on the grant date or modification date using the Black-Scholes option valuation model. We measure the fair value of nonvested shares and performance nonvested share units based on the closing price of our common stock on the grant date. Generally, we expense the grant-date fair value, net of estimated forfeitures, over the vesting period on a straight-line basis. Upon adoption of SFAS 123R, awards granted to employees who are of retirement age, or reach retirement age at least one year after the grant date but prior to the end of the service period of the award, are expensed over the shorter of the two periods. Options are granted at a price equal to the fair market value of our common stock on the grant date and have a contractual term of ten years.

Our 1999 Stock Option Plan for Seasonal Employees provides for awards of nonqualified options to employees. These awards are granted to seasonal employees in our Tax Services segment and entitle the holder to the right to purchase shares of common stock as the award vests, typically over a two-year period. We measure the fair value of options on the grant date using the Black-Scholes option valuation model. We expense the grant-date fair value, net of estimated forfeitures, over the service period. Options are granted at a price equal to the fair market value of our common stock on the grant date, are exercisable during September through November in each of the two years following the calendar year of the grant and have a contractual term of 29 months.

Our 1989 Stock Option Plan for Outside Directors provides for awards of nonqualified options to outside directors. These awards entitle the holder to the right to purchase shares of common stock. We measure the fair value of options on the grant date using the Black-Scholes option valuation model. These awards vest immediately upon issuance and are therefore fully expensed on the grant date. Options are granted at a price equal to the fair market value of our common stock on the grant date and have a contractual term of ten years.

Our 2000 Employee Stock Purchase Plan (ESPP) provides employees the option to purchase shares of our Common Stock through payroll deductions. The purchase price of the stock is 90% of the lower of either the fair market value of our Common Stock on the first trading day within the Option Period or on the last trading day of the Option Period. The Option Periods are six-month periods beginning on January 1 and July 1 each year. We measure the fair value of options on the grant date utilizing the Black-Scholes option valuation model in accordance with FASB Technical Bulletin 97-1, Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option. We expense the grant-date fair value over the six-month vesting period.

Table of Contents

A summary of options for the nine months ended January 31, 2007 is as follows:

			(in 000s, except per share amounts)	
		Weighted Average	Weighted Average	Aggregate Intrinsic Value
	Shares	Exercise Price	Remaining Contractual Term	
Outstanding, beginning of period	26,048	\$ 21.40		
Granted	5,036	23.84		
Exercised	(1,246)	15.52		
Forfeited or expired	(4,201)	23.82		
Outstanding, end of period	25,637	21.77	5 years	\$ 101,483
Exercisable, end of period	18,821	\$ 20.66	4 years	\$ 97,171
Exercisable and expected to vest	24,535	21.63	5 years	100,784

The total intrinsic value of options exercised during the nine months ended January 31, 2007 and 2006 was \$9.6 million and \$41.0 million, respectively. We utilize the Black-Scholes option pricing model to value our options on the grant date. We estimated the expected volatility using our historical stock price data. We also used historical exercise and forfeiture behaviors to estimate the options expected term and our forfeiture rate. The following assumptions were used to value options during the periods:

Nine months ended January 31,	2007	2006
Options management and director:		
Expected volatility	21.70% - 29.06%	26.40% - 27.81%
Expected term	4-7 years	5 years
Dividend yield	2.15% - 2.62%	1.71% - 2.15%
Risk-free interest rate	4.33% - 5.10%	3.65% - 4.30%
Weighted-average fair value	\$ 5.15	\$ 7.39
Options seasonal:		
Expected volatility	20.05%	23.28%
Expected term	2 years	2 years
Dividend yield	2.26%	1.71%
Risk-free interest rate	5.11%	3.61%
Weighted-average fair value	\$ 3.17	\$ 4.16
ESPP options:		
Expected volatility	26.30%	24.52%
Expected term	0.5 years	0.5 years
Dividend yield	2.26%	1.71%
Risk-free interest rate	5.24%	3.37%
Weighted-average fair value	\$ 4.20	\$ 4.99

A summary of nonvested shares and performance nonvested share units for the nine months ended January 31, 2007 is as follows:

	Shares	(shares in 000s) Weighted Average Grant Date Fair Value
Outstanding, beginning of period	2,455	\$ 25.27
Granted	1,205	23.42
Released	(1,040)	24.94
Forfeited	(306)	24.85
Outstanding, end of period	2,314	24.93

The total fair value of shares vesting during the nine months ended January 31, 2007 and 2006 was \$24.6 million and \$17.2 million, respectively. Upon the grant of nonvested shares and performance nonvested share units, unearned compensation cost is recorded as an offset to additional paid in capital and is amortized as compensation expense over the vesting period. As of January 31, 2007, we had \$47.6 million of total unrecognized compensation cost related to these shares. This cost is expected to be recognized over a weighted-average period of two years.

-8-

Table of Contents**6. Regulatory Requirements****Registered Broker-Dealer**

HRBFA is subject to regulatory requirements intended to ensure the general financial soundness and liquidity of broker-dealers. At January 31, 2007, HRBFA's net capital of \$126.1 million, which was 27.7% of aggregate debit items, exceeded its minimum required net capital of \$9.1 million by \$117.0 million.

Pledged securities at January 31, 2007 totaled \$38.7 million, an excess of \$2.6 million over the margin requirement.

Banking

HRB Bank is subject to various regulatory capital guidelines and requirements administered by Federal banking agencies. Failure to meet minimum capital requirements can trigger certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on HRB Bank's operations. Under these capital adequacy guidelines and the regulatory framework for prompt corrective action, HRB Bank must meet specific capital guidelines that involve quantitative measures of HRB Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. HRB Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require HRB Bank to maintain minimum amounts and ratios of capital to assets. As shown in the table below, at December 31, 2006, the most recent date of reporting to Federal banking agencies, HRB Bank is categorized as "well capitalized" for regulatory purposes, which is the highest classification. There are no conditions or events since December 31, 2006 that management believes have changed HRB Bank's category. At January 31, 2007, management believes that HRB Bank meets all capital adequacy requirements to which it is subject. However, events beyond management's control, such as fluctuations in interest rates or a downturn in the economy in areas in which HRB Bank's loans or securities are concentrated, could adversely affect future earnings and consequently, HRB Bank's ability to meet its future capital requirements.

HRB Bank's capital amounts and ratios as of December 31, 2006 are presented in the table below:

	Actual		(dollars in 000s) Minimum Required to Qualify as Well Capitalized	
	Amount	Ratio	Amount	Ratio
Tier 1 capital to adjusted total assets (leverage)	\$163,670	17.4%	\$46,900	5.0%
Total risk-based capital to total risk-weighted assets	\$165,714	36.0%	\$46,071	10.0%

Additionally, H&R Block, Inc. is now subject to a three percent minimum ratio of adjusted tangible capital to adjusted total assets, as defined by the OTS. As of January 31, 2007 our ratio of adjusted tangible capital to adjusted total assets was approximately 1%. We fell below the minimum required ratio due to losses in our mortgage operations and seasonal fluctuations in our consolidated balance sheet. We notified the OTS of our failure to meet this requirement and the OTS requested that we provide a plan and expected timeframe for regaining compliance. We provided the OTS a corrective action plan stating our belief that our noncompliance would be remedied by February 28, 2007. We have agreed to provide the OTS with the calculation of this ratio as of February 28, 2007, although it is normally required only at the end of our fiscal quarters. We have not received further requests from the OTS as of the date of this filing. We believe we have the ability to meet the required minimum ratio on an ongoing basis.

7. Commitments and Contingencies

We entered into a \$3.0 billion line of credit agreement with HSBC Finance Corporation (HSBC Finance) effective January 2, 2007 for use as an alternate funding source for the purchase of refund

-9-

Table of Contents

anticipation loan (RAL) participations. This line is subject to various covenants that are substantially similar to our primary unsecured committed lines of credit (CLOCs), and is secured by our RAL participations. The balance outstanding on this facility at January 31, 2007 was \$1.4 billion.

We entered into a \$300.0 million committed line of credit agreement with BNP Paribas for the period January 2 through February 23, 2007 to cover our peak liquidity needs. This line is subject to various covenants that are substantially similar to those of our primary unsecured CLOCs. There was no balance outstanding on this line at January 31, 2007.

Our Canadian commercial paper issuances are supported by a credit facility provided by one bank in scheduled amounts ranging from \$1.0 million to \$225.0 million (Canadian) based on anticipated operational needs. The Canadian CLOC was renewed in November 2006 for an additional 364 days.

Changes in the deferred revenue liability related to our Peace of Mind (POM) program are as follows:

		(in 000s)
Nine months ended January 31,	2007	2006
Balance, beginning of period	\$ 141,684	\$ 130,762
Amounts deferred for new guarantees issued	20,971	20,533
Revenue recognized on previous deferrals	(59,085)	(55,932)
Balance, end of period	\$ 103,570	\$ 95,363

The following table summarizes certain of our other contractual obligations and commitments:

As of	January 31, 2007	(in 000s) April 30, 2006
Commitment to fund Franchise Equity Lines of Credit	\$ 82,203	\$ 75,909
Media advertising purchase obligation	48,006	
Contingent business acquisition obligations	16,319	24,482

On November 1, 2006 we entered into an agreement to purchase \$57.2 million in media advertising between November 1, 2006 and June 30, 2009. During our third quarter, we purchased \$9.2 million in advertising for our retail tax business, leaving a remaining commitment of \$48.0 million at January 31, 2007. We expect to make payments totaling \$19.4 million, \$20.6 million and \$17.2 million during fiscal years 2007, 2008 and 2009, respectively.

HRB Bank is a member of the Federal Home Loan Bank (FHLB) of Des Moines, which extends credit to member banks based on eligible collateral. At January 31, 2007, HRB Bank had FHLB advance capacity of \$594.0 million, and there was no outstanding balance on this facility.

We routinely enter into contracts that include embedded indemnifications that have characteristics similar to guarantees, including obligations to protect counterparties from losses arising from the following: (a) tax, legal and other risks related to the purchase or disposition of businesses; (b) penalties and interest assessed by Federal and state taxing authorities in connection with tax returns prepared for clients; (c) indemnification of our directors and officers; and (d) third-party claims relating to various arrangements in the normal course of business. Typically, there is no stated maximum payment related to these indemnifications, and the term of indemnities may vary and in many cases is limited only by the applicable statute of limitations. The likelihood of any claims being asserted against us and the ultimate liability related to any such claims, if any, is difficult to predict. While we cannot provide assurance that such claims will not be successfully asserted, we believe the fair value of these guarantees and indemnifications is not material as of January 31, 2007.

Table of Contents

8. Litigation and Related Contingencies

We have been named as a defendant in numerous lawsuits throughout the country regarding our refund anticipation loan programs (the RAL Cases). The RAL Cases have involved a variety of legal theories asserted by plaintiffs. These theories include allegations that, among others, (i) disclosures in the RAL applications were inadequate, misleading and untimely; (ii) the RAL interest rates were usurious and unconscionable; (iii) we did not disclose that we would receive part of the finance charges paid by the customer for such loans; (iv) untrue, misleading or deceptive statements in marketing RALs; (v) breach of state laws on credit service organizations; (vi) breach of contract, unjust enrichment, unfair and deceptive acts or practices; (vii) violations of the federal Racketeer Influenced and Corrupt Organizations Act; (viii) violations of the federal Fair Debt Collection Practices Act and unfair competition regarding debt collection activities; and (ix) we owe, and breached, a fiduciary duty to our customers in connection with the RAL program.

The amounts claimed in the RAL Cases have been very substantial in some instances. We have successfully defended against numerous RAL cases, some of which 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 have been settled, with one settlement resulting in a pretax expense of \$43.5 million in fiscal year 2003 and the combined pretax expense for such settlements in fiscal year 2006 totaling \$70.2 million.

Other putative RAL class action cases and a state attorney general lawsuit are still pending, with the amounts claimed on a collective basis being very substantial. The ultimate cost of this litigation could be substantial. We believe we have meritorious defenses to the remaining RAL Cases and we intend to defend them vigorously. There can be no assurances, however, as to the outcome of the pending RAL Cases individually or in the aggregate or the associated impact on our financial statements.

We are also a party to claims, lawsuits and investigations pertaining to our electronic tax return filing services, our Peace of Mind guarantee program, our Express IRA product, tax planning services and RSM EquiCo business valuation services. These claims, lawsuits and investigations include actions by state attorneys general, individual plaintiffs, and 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. We intend to continue defending these cases vigorously, although there are no assurances as to their outcome.

We and certain of our current and former directors and officers are party to a putative class action alleging violations of certain securities laws. The putative securities class action currently alleges, among other things, deceptive, material and misleading financial statements, failure to prepare financial statements in accordance with generally accepted accounting principles and concealment of the potential for lawsuits stemming from the allegedly fraudulent nature of our operations. The amount claimed in the putative securities class action is substantial, and the ultimate liability is difficult to predict. We intend to continue defending this case vigorously, although there are no assurances as to its outcome.

In addition to the aforementioned types of cases, we are parties to claims and lawsuits that we consider to be ordinary, routine disputes incidental to our business (Other Claims and Lawsuits), including claims and lawsuits concerning the preparation of customers' income tax returns, tax planning services, the fees charged customers for various services, investment products, relationships with franchisees, contract disputes, employment matters and civil actions, arbitrations, regulatory inquiries and investigations and class actions arising out of our business as a broker-dealer and provider of investment products and as a servicer of mortgage loans. We believe we have meritorious defenses to each of the Other Claims and Lawsuits and are defending them vigorously. Although we cannot provide assurance we will ultimately prevail in each instance, we believe that amounts, if any, required to be paid in the discharge of liabilities or settlements pertaining to Other Claims and Lawsuits will not have a material adverse effect on our consolidated financial statements. Regardless of outcome, claims and litigation can adversely affect us due to defense costs, diversion of management attention and time, and publicity related to such matters.

Table of Contents**9. Segment Information**

Information concerning our operations by reportable operating segment is as follows:

	Three months ended		Nine months ended	
	January 31,		January 31,	
	2007	2006	2007	2006
(in 000s)				
Revenues:				
Tax Services	\$ 628,051	\$ 548,494	\$ 776,183	\$ 686,498
Business Services	215,895	235,840	650,129	529,491
Consumer Financial Services	107,511	73,176	267,888	211,177
Corporate	3,659	2,743	10,322	6,815
	\$ 955,116	\$ 860,253	\$ 1,704,522	\$ 1,433,981
Pretax income (loss):				
Tax Services	\$ 59,333	\$ (6,332)	\$ (261,257)	\$ (293,702)
Business Services	(1,425)	(1,035)	(34,734)	(9,943)
Consumer Financial Services	10,959	(7,668)	5,572	(23,126)
Corporate	(50,014)	(29,979)	(111,330)	(84,073)
Income (loss) of continuing operations before taxes	\$ 18,853	\$ (45,014)	\$ (401,749)	\$ (410,844)

HRB Bank commenced operations on May 1, 2006, at which time we realigned certain segments of our business to reflect a new management reporting structure. The previously reported Investment Services segment and HRB Bank are now reported in the Consumer Financial Services segment. Presentation of prior-year results reflects the new segment alignment.

The Consumer Financial Services segment is primarily engaged in offering advice-based brokerage services and investment planning through HRBFA and full-service banking through HRB Bank. HRBFA offers 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. HRB Bank offers traditional banking services including checking and savings accounts, home equity lines of credit, individual retirement accounts, certificates of deposit and prepaid debit card accounts. HRB Bank also purchases loans from OOMC, HRBMC and other lenders to hold for investment purposes. All intersegment transactions are eliminated in consolidation.

As of January 31, 2007, we met the criteria requiring us to present the assets and liabilities of OOMC and its wholly-owned subsidiary, HRBMC, as held-for-sale and the related financial results as discontinued operations in the condensed consolidated financial statements for all periods presented. See note 11 for additional information.

10. New Accounting Pronouncements

In February 2007, Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115, (SFAS 159), was issued. This standard allows a company to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities on a contract-by-contract basis, with changes in fair value recognized in earnings. The provisions of this standard are effective as of the beginning of our fiscal year 2009. We are currently evaluating what effect the adoption of SFAS 159 will have on our consolidated financial statements.

In September 2006, Statement of Financial Accounting Standards No. 157, Fair Value Instruments, (SFAS 157), was issued. The provisions of this standard include guidelines about the extent to which companies measure assets and liabilities at fair value, the effect of fair value measurements on earnings, risk-adjusted fair value and establishes a fair value hierarchy that prioritizes the information used in developing assumptions when valuing an asset or liability. The provisions of this standard are effective as of the beginning of our fiscal year 2009. We are currently evaluating what effect the adoption of SFAS 157 will have on our consolidated financial statements.

In September 2006, Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108), was issued. SAB 108 provides guidance on how prior year misstatements should be quantified when determining if current year financial statements are materially misstated. These provisions are effective for the current fiscal year, with earlier interim period adoption permitted. We are currently evaluating what effect the adoption of SAB 108 will have on our consolidated financial statements.

Table of Contents

In June 2006, FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), was issued. The interpretation requires that a tax position meet a more-likely-than-not recognition threshold for the benefit of the uncertain tax position to be recognized in the financial statements and provides guidance on the measurement of the benefit. The interpretation also requires interim period estimated tax benefits of uncertain tax positions to be accounted for in the period of change rather than as a component of the annual effective tax rate. The provisions of this standard are effective as of the beginning of our fiscal year 2008. We are currently evaluating what effect the adoption of FIN 48 will have on our consolidated financial statements.

In June 2006, Emerging Issues Task Force Issue No. 06-3, *How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)* (EITF 06-3) was issued. EITF 06-3 requires disclosure of the presentation of taxes on either a gross (included in revenues and costs) or a net (excluded from revenues) basis as an accounting policy decision. The provisions of this standard are effective for interim and annual reporting periods beginning after December 15, 2006. We do not expect the adoption of EITF 06-3 to have a material impact on our consolidated financial statements.

In March 2006, Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets* An Amendment of FASB Statement No. 140, (SFAS 156), was issued. The provisions of this standard require mortgage servicing rights to be initially valued at fair value. SFAS 156 allows servicers to choose to subsequently measure their servicing rights at fair value or to continue using the amortization method under SFAS 140. The provisions of this standard are effective as of the beginning of our fiscal year 2008. We are currently evaluating what effect the adoption of SFAS 156 will have on our consolidated financial statements.

In February 2006, Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Instruments* An Amendment of FASB Statements No. 133 and 140 (SFAS 155), was issued. The provisions of this standard establish a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. The standard permits a hybrid financial instrument to be accounted for in its entirety if the holder irrevocably elects to measure the hybrid financial instrument at fair value, with changes in fair value recognized currently in earnings. The provisions of this standard are effective as of the beginning of our fiscal year 2008. Our residual interests typically have interests in derivative instruments embedded within the securitization trusts. If we elect to account for our residual interests on a fair value basis, changes in fair value will impact earnings in the period in which the change occurs. We are currently evaluating what effect the adoption of SFAS 155 will have on our consolidated financial statements.

11. Discontinued Operations**Financial Statement Presentation**

On November 6, 2006, we announced we would evaluate strategic alternatives for OOMC, including a possible sale or other transaction through the public markets. On January 20, 2007, our Board of Directors approved the plan to sell OOMC and its wholly-owned subsidiary, HRBMC. As of January 31, 2007, we met the criteria requiring us to present the assets and liabilities of OOMC and HRBMC as held-for-sale and the related financial results as discontinued operations in the condensed consolidated financial statements. The financial statements for all periods presented have been reclassified to present discontinued operations as well. Based upon non-binding correspondence received from interested parties in connection with the planned sale, we currently believe we will recover our recorded investment in net assets held for sale. This process is not complete and the ultimate outcome may differ materially from our current expectations.

Overhead costs previously allocated to these businesses, which totaled \$3.1 million and \$9.4 million for the three and nine months ended January 31, 2007, respectively, and \$2.7 million and \$7.8 million for the three and nine months ended January 31, 2006, respectively, are included in continuing operations. OOMC was previously reported in our Mortgage Services segment and HRBMC was reported in our Consumer Financial Services segment.

Table of Contents

The major classes of assets and liabilities reported as held-for-sale are as follows:

	(in 000s)	
	January 31, 2007	April 30, 2006
Cash and cash equivalents	\$ 120,454	\$ 25,600
Mortgage loans held for sale	363,016	236,399
Prepaid expenses and other current assets	504,590	332,188
Current assets of discontinued operations	\$ 988,060	\$ 594,187
Beneficial interest in Trusts	\$ 175,220	\$ 188,014
Residual interests in securitizations	110,594	159,058
Mortgage servicing rights	263,140	272,472
Mortgage loans held for investment		407,538
Goodwill, net	152,467	152,467
Other assets	135,072	121,464
Noncurrent assets of discontinued operations	\$ 836,493	\$ 1,301,013
Accounts payable, accrued expenses and deposits	\$ 450,553	\$ 156,324
Other liabilities	47,196	60,643
Current liabilities of discontinued operations	\$ 497,749	\$ 216,967

The financial results of discontinued operations are as follows:

	(in 000s)			
	Three months ended January 31,		Nine months ended January 31,	
	2007	2006	2007	2006
Revenue	\$ 56,146	\$ 296,494	\$ 410,760	\$ 942,802
Income (loss) before income tax (benefit)	(161,982)	70,422	(222,831)	257,254
Income tax (benefit)	(76,765)	28,061	(103,765)	101,931
Net income (loss) from discontinued operations	\$ (85,217)	\$ 42,361	\$ (119,066)	\$ 155,323

Mortgage Banking Activities

Trading residuals valued at \$231.9 million were securitized in net interest margin (NIM) transactions during the current year, with net cash proceeds of \$192.5 million received in connection with NIM transactions. In the prior year, trading residuals valued at \$234.5 million were securitized with net cash proceeds of \$195.2 million received on the transactions. There were no residual interests classified as trading securities as of January 31, 2007 or April 30, 2006. Cash received on trading residual interests is included in operating activities of discontinued operations in the condensed consolidated statements of cash flows.

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Cash flows from available-for-sale residual interests of \$13.1 million and \$74.9 million were received from the securitization trusts for the nine months ended January 31, 2007 and 2006, respectively, and is included in investing activities of discontinued operations in the condensed consolidated statements of cash flows.

The following transactions were treated as non-cash investing activities in the condensed consolidated statement of cash flows:

		(in 000s)
Nine months ended January 31,	2007	2006
Residual interest mark-to-market	\$ 2,861	\$ 38,930
Additions to residual interests	39,379	39,378

Aggregate unrealized gains on available-for-sale residual interests not yet accreted into income totaled \$19.3 million at January 31, 2007 and \$44.1 million at April 30, 2006. These unrealized gains are recorded net of deferred taxes in other comprehensive income, and may be recognized in income in future periods either through accretion or upon further securitization or sale of the related residual interest.

-14-

Table of Contents

Activity related to mortgage servicing rights (MSRs) consists of the following:

		(in 000s)
Nine months ended January 31,	2007	2006
Balance, beginning of period	\$ 272,472	\$ 166,614
Additions	134,216	196,245
Amortization and impairment of fair value	(143,548)	(100,490)
Balance, end of period	\$ 263,140	\$ 262,369

Estimated amortization of MSRs for fiscal years 2007 through 2011 is \$44.1 million, \$121.7 million, \$58.3 million, \$25.4 million and \$9.0 million, respectively.

The key weighted average assumptions we used to estimate the cash flows and values of the residual interests initially recorded during the nine months ended January 31, 2007 and 2006 are as follows:

Nine months ended January 31,	2007	2006
Estimated credit losses	3.24%	2.85%
Discount rate	21.91%	20.34%
	LIBOR forward curve at closing date	
Variable returns to third-party beneficial interest holders		

The key weighted average assumptions we used to estimate the cash flows and values of the residual interests and MSRs at January 31, 2007 and April 30, 2006 are as follows:

	January 31, 2007	April 30, 2006
Estimated credit losses	3.22%	3.07%
Discount rate residual interests	24.32%	21.98%
Discount rate MSRs	18.00%	18.00%
	LIBOR forward curve at valuation date	
Variable returns to third-party beneficial interest holders		

We originate both adjustable and fixed rate mortgage loans. A key assumption used to estimate the cash flows and values of the residual interests and MSRs is average annualized prepayment speeds. Prepayment speeds include voluntary prepayments, involuntary prepayments and scheduled principal payments. Prepayment rate assumptions used during the current fiscal quarter are as follows:

	Prior to Initial Rate Reset Date	Months Outstanding After Initial Rate Reset Date Zero - 3	Remaining Life
Adjustable rate mortgage loans:			
With prepayment penalties	31%	71%	38%
Without prepayment penalties	37%	54%	34%
Fixed rate mortgage loans:			
With prepayment penalties	29%	45%	34%

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For fixed rate mortgages without prepayment penalties, we use an average prepayment rate of 30% over the life of the loans. Prepayment rate is projected based on actual paydown including voluntary, involuntary and scheduled principal payments.

Expected static pool credit losses are as follows:

Mortgage Loans Securitized in Fiscal Year

	Prior to 2002	2002	2003	2004	2005	2006	2007
As of:							
January 31, 2007	5.12%	2.41%	2.12%	2.35%	2.21%	3.59%	3.26%
April 30, 2006	4.75%	2.69%	2.13%	2.18%	2.48%	3.05%	
April 30, 2005	4.52%	2.53%	2.08%	2.30%	2.83%		
April 30, 2004	4.46%	3.58%	4.35%	3.92%			

-15-

Table of Contents

Static pool credit losses are calculated by summing the actual and projected future credit losses and dividing them by the original balance of each pool of assets.

At January 31, 2007, the sensitivities of the current fair value of the residual interests and MSR to 10% and 20% adverse changes in the above key assumptions are as presented in the following table. These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also in this table, the effect of a variation of a particular assumption on the fair value of the retained interest is calculated without changing any other assumptions; in reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

(dollars in 000s)				
Residential Mortgage Loans				
		Available-for-Sale Residuals	Beneficial Interest in Trusts	MSRs
Carrying amount/fair value		\$ 110,594	\$ 175,220	\$ 263,140
Weighted average remaining life (in years)		3.2	2.2	1.3
Prepayments (including defaults):				
Adverse 10%	\$impact on fair value	\$ (7,772)	\$ (5,447)	\$ (21,890)
Adverse 20%	\$impact on fair value	(5,687)	(8,402)	(41,755)
Credit losses:				
Adverse 10%	\$impact on fair value	\$ (32,323)	\$ (6,302)	Not applicable
Adverse 20%	\$impact on fair value	(57,732)	(11,571)	Not applicable
Discount rate:				
Adverse 10%	\$impact on fair value	\$ (5,522)	\$ (4,491)	\$ (6,869)
Adverse 20%	\$impact on fair value	(10,594)	(8,797)	(13,444)
Variable interest rates (LIBOR forward curve):				
Adverse 10%	\$impact on fair value	\$ 988	\$ (40,717)	Not applicable
Adverse 20%	\$impact on fair value	1,972	(82,550)	Not applicable

Increases in prepayment rates related to available-for-sale residuals can generate a positive impact to fair value when reductions in estimated credit losses and increases in prepayment penalties exceed the adverse impact to accretion from accelerating the life of the available-for-sale residual interest.

Mortgage loans that have been securitized and mortgage loans held for sale at January 31, 2007 and April 30, 2006, past due sixty days or more and the related credit losses incurred are presented below:

(in 000s)		
Total Principal Amount of Loans Outstanding	Principal Amount of Loans 60 Days or More Past Due	Credit Losses (net of recoveries)

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	January 31, 2007	April 30, 2006	January 31, 2007	April 30, 2006	Three months ended January 31, 2007	April 30, 2006
Securitized mortgage loans	\$ 12,445,576	\$ 10,046,032	\$ 1,252,052	\$ 1,012,414	\$ 41,925	\$ 35,307
Mortgage loans in warehouse Trusts	5,982,538	7,845,834				
Mortgage loans held for sale	432,949	255,224	316,348	98,906	135,924	33,504
Total loans	\$ 18,861,063	\$ 18,147,090	\$ 1,568,400	\$ 1,111,320	\$ 177,849	\$ 68,811

-16-

Table of Contents**Derivative Instruments**

A summary of our derivative instruments as of January 31, 2007 and April 30, 2006, and gains or losses incurred during the three and nine months ended January 31, 2007 and 2006 is as follows:

	Asset (Liability) Balance at		Gain (Loss) for the Three Months Ended January		Gain (Loss) for the Nine Months Ended January	
	January 31, 2007	April 30, 2006	2007	2006	2007	2006
Rate-lock equivalents	\$ (3,563)	\$ (317)	\$ (9,237)	\$ 34	\$ (5,207)	\$ (705)
Forward loan sale commitments		1,961	(2,493)			
Put options on Eurodollar futures	2,119	3,282	400		(1,657)	
Prime short sales	(301)	777	(131)	(1,266)	864	221
Interest rate swaps	6,262	8,831	46,640	6,292	26,372	91,578
Interest rate caps						802
	\$ 4,517	\$ 14,534	\$ 35,179	\$ 5,060	\$ 20,372	\$ 91,896

The notional amount of interest rate swaps to which we were a party at January 31, 2007 and April 30, 2006 was \$7.7 billion and \$8.8 billion, respectively, with a weighted average duration at each date of 1.9 years. At January 31, 2007 we had no forward loan sale commitments. At April 30, 2006 the notional value and the contract value of our forward loan sale commitments was \$3.1 billion.

None of our derivative instruments qualify for hedge accounting treatment as of January 31, 2007 or April 30, 2006.

Commitments and Contingencies

The following table summarizes certain of our contractual obligations and commitments related to our discontinued operations:

	(in 000s)	
As of	January 31, 2007	April 30, 2006
Commitment to fund mortgage loans	\$ 3,558,184	\$ 4,032,045
Commitment to sell mortgage loans		3,052,688

In the normal course of business, we maintain recourse with standard representations and warranties customary to the mortgage banking industry. Violations of these representations and warranties, such as early payment defaults by borrowers, may require us to repurchase loans previously sold. Repurchased loans are normally sold in subsequent sale transactions. The following table summarizes our loan repurchase activity:

	(dollars in 000s)	
	Three months ended January 31, 2007	2006
	Nine months ended January 31, 2007	2006
	Fiscal year ended April 30, 2006	

Loans repurchased from loan sales	\$403,502	\$104,774	\$812,293	\$223,258	\$297,606
Repurchase reserves added during period	\$111,122	\$13,076	\$251,083	\$49,547	\$64,098
Repurchase reserves added as a percent of originations	1.77%	0.15%	1.18%	0.15%	0.18%

We established a liability, related to the potential loss we expect to incur on repurchase of loans previously sold and premium recapture, totaling \$44.8 million and \$33.4 million at January 31, 2007 and April 30, 2006, respectively. On an ongoing basis, we monitor the adequacy of our repurchase liability, which is established upon the initial sale of the loans, and is included in current liabilities held for sale in the condensed consolidated balance sheets. During the nine months ended January 31, 2007, we experienced higher early payment defaults, resulting in an increase in actual and expected loan repurchase activity. As a result, we increased our reserves accordingly. In establishing our reserves, we've assumed all loans that are currently delinquent and subject to contractual repurchase terms will be repurchased, and that 6% of loans previously sold but not yet subject to contractual repurchase terms will be repurchased. Based on historical experience, we assumed 10% of all loans we repurchase will cure with no loss incurred, and of those that do not cure, we assumed an average 29% loss severity for loans on balance sheet as of January 31, 2007.

-17-

Table of Contents

During the third quarter, we amended our warehouse facility with Citigroup Global Markets Realty Corp (Citigroup) to split OOMC's existing warehouse financing arrangement with Citigroup into two separate warehouse facilities, one of which is an on-balance sheet facility with capacity of \$500.0 million and the other an off-balance sheet facility. Loans totaling \$172.3 million were held on the on-balance sheet line at January 31, 2007, with the related loans and liability reported in assets and liabilities held for sale.

OOMC has guaranteed up to a maximum amount equal to approximately 10% of the aggregate principal balance of mortgage loans held by the Trusts before ultimate disposition of the loans by the Trusts. This obligation can be called upon in the event adequate proceeds are not available from the sale of the mortgage loans to satisfy the current or ultimate payment obligations of the Trusts. No losses have been sustained on this commitment since its inception. The total principal amount of Trust obligations outstanding as of January 31, 2007, April 30, 2006 and January 31, 2006 was \$5.9 billion, \$7.8 billion and \$11.2 billion, respectively. The fair value of mortgage loans held by the Trusts as of January 31, 2007, April 30, 2006 and January 31, 2006 was \$5.9 billion, \$7.9 billion and \$11.4 billion, respectively. Under the warehouse agreements, we may be required to provide funds in the event of declining loan values, but only to the extent of the 10% guaranteed amount. At January 31, 2007, April 30, 2006 and January 31, 2006 funds provided totaled \$164.2 million, \$19.7 million and \$54.6 million, respectively, and were applied to reduce the Trusts' payment obligations.

As of January 31, 2007, OOMC did not meet the minimum net income financial covenant contained in eight of its warehouse facilities. This covenant requires OOMC to maintain a cumulative minimum net income of at least \$1 for the four consecutive fiscal quarters ended January 31, 2007. On January 24, 2007, OOMC obtained waivers of the minimum net income financial covenants through April 27, 2007 from each of the applicable warehouse facility providers. We anticipate that OOMC will not meet this financial covenant at April 30, 2007, however we believe we will be able to obtain waivers for that date from a sufficient number of warehouse providers to allow OOMC to continue its off-balance sheet financing activities. If OOMC cannot obtain the waivers, warehouse facility providers would have the right to terminate their future funding obligations under the applicable warehouse facilities, terminate OOMC's right to service the loans remaining in the applicable warehouse or request funding of the 10% guarantee mentioned above. While this termination could adversely impact OOMC's ability to fund new loans, we believe this risk is mitigated by options available to H&R Block.

Restructuring Charge

During fiscal year 2006, we initiated a restructuring plan to reduce costs within our mortgage operations. On November 6, 2006, we announced an additional restructuring plan, also within our mortgage operations, which will be recorded primarily during our third and fourth quarters. Charges incurred during the current quarter related to the additional restructuring plan totaled \$6.5 million and are included in other adjustments in the table below. Changes in our restructuring charge liability during the nine months ended January 31, 2007 are as follows:

	Accrual Balance as of April 30, 2006	Cash Payments	Other Adjustments	(in 000s) Accrual Balance as of January 31, 2007
Employee severance costs	\$ 1,737	\$ (3,626)	\$ 3,179	\$ 1,290
Contract termination costs	5,821	(3,864)	5,709	7,666
	\$ 7,558	\$ (7,490)	\$ 8,888	\$ 8,956

The remaining liability related to this restructuring charge is included in liabilities held for sale on our condensed consolidated balance sheet and relates to lease obligations for vacant space resulting from branch office closings and employee severance costs.

Table of Contents**12. Subsequent Event**

Effective February 5, 2007, we acquired the assets and assumed certain liabilities of a group of commercial tax preparation software providers for an aggregate purchase price of \$65.8 million. The purchase price is subject to a post-closing adjustment based upon determination of the final February 5, 2007 net asset value. The assets and liabilities related to this acquisition will be included in our Tax Services segment.

13. Condensed Consolidating Financial Statements

Block Financial Corporation (BFC) is an indirect, wholly owned consolidated subsidiary of the Company. BFC is the Issuer and the Company is the Guarantor of the Senior Notes issued on April 13, 2000 and October 26, 2004. These condensed consolidating financial statements have been prepared using the equity method of accounting. Earnings of subsidiaries are, therefore, reflected in the Company's investment in subsidiaries account. The elimination entries eliminate investments in subsidiaries, related stockholder's equity and other intercompany balances and transactions.

Condensed Consolidating Income Statements

	(in 000s)				
Three months ended	H&R Block, Inc.	BFC	Other		Consolidated H&R Block
January 31, 2007	(Guarantor)	(Issuer)	Subsidiaries	Elims	
Total revenues	\$	\$ 255,407	\$ 703,198	\$ (3,489)	\$ 955,116
Cost of services		46,651	541,254	(32)	587,873
Cost of other revenues		60,453	9,509		69,962
Selling, general and administrative		94,184	177,087	(1,878)	269,393
Total expenses		201,288	727,850	(1,910)	927,228
Operating income (loss)		54,119	(24,652)	(1,579)	27,888
Interest expense		(11,811)	(255)		(12,066)
Other income, net	18,853	(3,958)	6,989	(18,853)	3,031
Income (loss) from continuing operations before tax (benefit)	18,853	38,350	(17,918)	(20,432)	18,853
Income tax (benefit)	(6,112)	28,043	(33,378)	5,335	(6,112)
Net income from continuing operations	24,965	10,307	15,460	(25,767)	24,965
Net loss from discontinued operations	(85,217)	(87,293)		87,293	(85,217)
Net income (loss)	\$ (60,252)	\$ (76,986)	\$ 15,460	\$ 61,526	\$ (60,252)
Three months ended	H&R Block, Inc.	BFC	Other		Consolidated H&R Block
January 31, 2006	(Guarantor)	(Issuer)	Subsidiaries	Elims	

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Total revenues	\$	\$ 196,137	\$ 667,754	\$ (3,638)	\$ 860,253
Cost of services		53,787	505,266	29	559,082
Cost of other revenues		19,655	20,626		40,281
Selling, general and administrative		86,186	212,497	(1,282)	297,401
Total expenses		159,628	738,389	(1,253)	896,764
Operating income (loss)		36,509	(70,635)	(2,385)	(36,511)
Interest expense		(11,810)	(401)		(12,211)
Other income, net	(45,014)		3,708	45,014	3,708
Income (loss) from continuing operations before tax (benefit)	(45,014)	24,699	(67,328)	42,629	(45,014)
Income tax (benefit)	(14,766)	10,393	(24,210)	13,817	(14,766)
Net income (loss) from continuing operations	(30,248)	14,306	(43,118)	28,812	(30,248)
Net income from discontinued operations	42,361	40,925		(40,925)	42,361
Net income (loss)	\$ 12,113	\$ 55,231	\$ (43,118)	\$ (12,113)	\$ 12,113

-19-

Table of Contents

Nine months ended January 31, 2007	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Total revenues	\$	\$ 540,530	\$ 1,173,192	\$ (9,200)	\$ 1,704,522
Cost of services		139,531	1,238,387	1	1,377,919
Cost of other revenues		99,040	15,962		115,002
Selling, general and administrative		192,512	404,340	(4,697)	592,155
Total expenses		431,083	1,658,689	(4,696)	2,085,076
Operating income (loss)		109,447	(485,497)	(4,504)	(380,554)
Interest expense		(35,429)	(863)		(36,292)
Other income, net	(401,749)	5	15,092	401,749	15,097
Income (loss) from continuing operations before tax (benefit)	(401,749)	74,023	(471,268)	397,245	(401,749)
Income tax (benefit)	(172,726)	45,114	(215,904)	170,790	(172,726)
Net income (loss) from continuing operations	(229,023)	28,909	(255,364)	226,455	(229,023)
Net loss from discontinued operations	(119,066)	(124,067)		124,067	(119,066)
Net loss	\$ (348,089)	\$ (95,158)	\$ (255,364)	\$ 350,522	\$ (348,089)
Nine months ended January 31, 2006	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Total revenues	\$	\$ 406,294	\$ 1,038,594	\$ (10,907)	\$ 1,433,981
Cost of service revenues		146,755	1,028,953	161	1,175,869
Cost of other revenues		30,545	28,631		59,176
Selling, general and administrative		181,419	408,996	(3,715)	586,700
Total expenses		358,719	1,466,580	(3,554)	1,821,745
Operating income (loss)		47,575	(427,986)	(7,353)	(387,764)
Interest expense		(35,431)	(1,600)		(37,031)
Other income, net	(410,844)		13,951	410,844	13,951
Income (loss) from continuing operations before tax (benefit)	(410,844)	12,144	(415,635)	403,491	(410,844)

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Income tax (benefit)	(158,391)	4,518	(159,996)	155,478	(158,391)
Net income (loss) from continuing operations	(252,453)	7,626	(255,639)	248,013	(252,453)
Net income from discontinued operations	155,323	150,883		(150,883)	155,323
Net income (loss)	\$ (97,130)	\$ 158,509	\$ (255,639)	\$ 97,130	\$ (97,130)

-20-

Table of Contents*Condensed Consolidating Balance Sheets*

	(in 000s)				
January 31, 2007	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Cash & cash equivalents	\$	\$ 778,197	\$ 304,469	\$	\$ 1,082,666
Cash & cash equivalents restricted		419,000	13,524		432,524
Receivables from customers, brokers and dealers, net		424,874			424,874
Receivables, net	569	1,845,236	531,041		2,376,846
Mortgage loans held for investment		1,069,626			1,069,626
Intangible assets and goodwill, net		207,117	959,771		1,166,888
Investments in subsidiaries	4,710,589		498	(4,710,589)	498
Assets held for sale		1,824,553			1,824,553
Other assets		243,759	737,737	7	981,503
Total assets	\$ 4,711,158	\$ 6,812,362	\$ 2,547,040	\$ (4,710,582)	\$ 9,359,978
Short-term borrowings	\$	\$ 2,909,425	\$ 16,996	\$	\$ 2,926,421
Accts. payable to customers, brokers and dealers		684,475			684,475
Customer deposits		1,632,875			1,632,875
Long-term debt		398,177	18,006		416,183
Liabilities held for sale		497,749			497,749
Other liabilities	2	778,273	893,790	36	1,672,101
Net intercompany advances	3,180,982	(1,763,237)	(1,417,716)	(29)	
Stockholders' equity	1,530,174	1,674,625	3,035,964	(4,710,589)	1,530,174
Total liabilities and stockholders' equity	\$ 4,711,158	\$ 6,812,362	\$ 2,547,040	\$ (4,710,582)	\$ 9,359,978
April 30, 2006	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Cash & cash equivalents	\$	\$ 134,407	\$ 542,797	\$	\$ 677,204
Cash & cash equivalents restricted		368,999	16,624		385,623
Receivables from customers, brokers and dealers, net		496,577			496,577
Receivables, net	161	107,079	374,904		482,144
		234,727	932,752		1,167,479

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Intangible assets and goodwill, net					
Investments in subsidiaries	5,237,611		456	(5,237,611)	456
Assets held for sale		1,895,200			1,895,200
Other assets		421,026	463,966	(540)	884,452
Total assets	\$ 5,237,772	\$ 3,658,015	\$ 2,331,499	\$ (5,238,151)	\$ 5,989,135
Accts. payable to customers, brokers and dealers	\$	\$ 781,303	\$	\$	\$ 781,303
Long-term debt		398,001	19,538		417,539
Liabilities held for sale		216,967			216,967
Other liabilities	2	825,644	1,599,881		2,425,527
Net intercompany advances	3,089,971	(355,358)	(2,734,567)	(46)	
Stockholders' equity	2,147,799	1,791,458	3,446,647	(5,238,105)	2,147,799
Total liabilities and stockholders' equity	\$ 5,237,772	\$ 3,658,015	\$ 2,331,499	\$ (5,238,151)	\$ 5,989,135

-21-

Table of Contents*Condensed Consolidating Statements of Cash Flows*

	(in 000s)				
Nine months ended January 31, 2007	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Net cash provided by (used in) operating activities:	\$ 32,882	\$ (1,589,010)	\$ (1,222,136)	\$	\$ (2,778,264)
Cash flows from investing:					
Mortgage loans originated for investment, net		(1,073,012)			(1,073,012)
Purchase property & equipment		(3,407)	(126,498)		(129,905)
Payments for business acquisitions			(24,670)		(24,670)
Net intercompany advances	247,754			(247,754)	
Investing cash flows from discontinued operations		18,322			18,322
Other, net		3,955	26,587		30,542
Net cash provided by (used in) investing activities	247,754	(1,054,142)	(124,581)	(247,754)	(1,178,723)
Cash flows from financing:					
Repayments of commercial paper		(4,893,093)	(8,525)		(4,901,618)
Proceeds from commercial paper		6,372,135	25,521		6,397,656
Repayments of short-term borrowings		(889,722)			(889,722)
Proceeds from short-term borrowings		2,320,105			2,320,105
Customer deposits		1,632,875			1,632,875
Dividends paid	(128,088)				(128,088)
Acquisition of treasury shares	(188,562)				(188,562)
Proceeds from stock options	19,183				19,183
Excess tax benefits on stock-based compensation	2,379				2,379
Net intercompany advances		(1,413,234)	1,165,480	247,754	
Financing cash flows from discontinued operations		172,301			172,301
Other, net	14,452	(14,425)	(74,087)		(74,060)
Net cash provided by (used in) financing activities	(280,636)	3,286,942	1,108,389	247,754	4,362,449
Net increase (decrease) in cash		643,790	(238,328)		405,462
Cash beginning of period		134,407	542,797		677,204

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Cash	end of period	\$	\$ 778,197	\$ 304,469	\$	\$ 1,082,666
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-22-

Table of Contents

Nine months ended January 31, 2006	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Net cash provided by (used in) operating activities:	\$ 43,228	\$ (1,198,372)	\$ (539,248)	\$	\$ (1,694,392)
Cash flows from investing:					
Purchase property & equipment		1,226	(135,554)		(134,328)
Payments for business acquisitions		(3,140)	(206,676)		(209,816)
Net intercompany advances	229,755			(229,755)	
Investing cash flows from discontinued operations		72,247			72,247
Other, net		328	17,297		17,625
Net cash provided by (used in) investing activities	229,755	70,661	(324,933)	(229,755)	(254,272)
Cash flows from financing:					
Repayments of commercial paper		(2,610,432)	(22,012)		(2,632,444)
Proceeds from commercial paper		4,636,188	42,204		4,678,392
Proceeds from short-term borrowings		550,000			550,000
Dividends paid	(118,665)				(118,665)
Acquisition of treasury shares	(260,078)				(260,078)
Proceeds from common stock	95,930				95,930
Net intercompany advances		(1,335,289)	1,105,534	229,755	
Other, net	9,830	5,642	(24,821)		(9,349)
Net cash provided by (used in) financing activities	(272,983)	1,246,109	1,100,905	229,755	2,303,786
Net increase in cash		118,398	236,724		355,122
Cash beginning of period		135,069	937,230		1,072,299
Cash end of period	\$	\$ 253,467	\$ 1,173,954	\$	\$ 1,427,421

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

H&R Block is a diversified company delivering tax services and financial advice, investment, and banking services, and business and consulting services. For more than 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 services, electronic filing services and other services and products related to income tax return preparation to the general public primarily in the United States, Canada and Australia. RSM McGladrey Business Services, Inc. (RSM) is a national accounting, tax and business consulting firm primarily serving midsize businesses. Our Consumer Financial Services segment offers investment services through H&R Block Financial Advisors, Inc. (HRBFA) and full-service banking through H&R Block Bank (HRB Bank).

On November 6, 2006 we announced we would evaluate strategic alternatives for Option One Mortgage Corporation (OOMC), including a possible sale or other transaction through the public markets. On January 20, 2007, our Board of Directors approved the plan to sell OOMC and its wholly-owned subsidiary, H&R Block Mortgage Corporation (HRBMC). As of January 31, 2007, we met the criteria requiring us to present the assets and liabilities of OOMC and HRBMC as held-for-sale and the related financial results as discontinued operations in the condensed consolidated financial statements for all periods presented.

Our 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.

-24-

Table of Contents**TAX SERVICES**

This segment primarily consists of our income tax preparation businesses retail, online and software.

Tax Services Operating Statistics (U.S. only)

			(in 000s, except average charge)
Period November 1 through January 31,	2007		2006
Clients served:			
Company-owned operations	2,507		2,390
Franchise operations	1,485		1,406
Instant Money Advance Loans (IMALs) only ⁽¹⁾	344		
Total retail operations	4,336		3,796
Digital tax solutions	1,279		1,157
	5,615		4,953
Net average fee per retail client: ⁽²⁾			
Company-owned operations	\$ 169.47	\$	157.48
Franchise operations	147.42		135.51
	\$ 161.27	\$	149.35
Offices:			
Company-owned	6,669		6,387
Company-owned shared locations ⁽³⁾	1,488		1,473
Total company-owned offices	8,157		7,860
Franchise	3,784		3,703
Franchise shared locations ⁽³⁾	843		602
Total franchise offices	4,627		4,305
	12,784		12,165

⁽¹⁾ Clients who received an IMAL but have not yet returned for tax preparation and/or e-filing services.

⁽²⁾

Calculated as
net tax
preparation fees
divided by retail
clients served,
excluding
IMAL-only
clients.

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

Tax Services Operating Results

	Three months ended January 31,		Nine months ended January 31,	
	2007	2006	2007	2006
(in 000s)				
Service revenues:				
Tax preparation fees	\$ 437,473	\$ 389,040	\$ 507,467	\$ 452,862
Other services	47,673	32,516	113,912	93,747
	485,146	421,556	621,379	546,609
Royalties	59,631	53,706	67,012	60,263
Loan participation fees and related revenue	55,409	42,616	55,709	42,893
Other	27,865	30,616	32,083	36,733
Total revenues	628,051	548,494	776,183	686,498
Cost of services:				
Compensation and benefits	224,336	189,053	329,479	283,562
Occupancy	89,014	79,516	226,841	201,112
Depreciation	10,777	11,132	29,740	31,629
Other	63,205	55,185	153,607	134,217
	387,332	334,886	739,667	650,520
Provision for RAL litigation		71,700		71,700
Other, selling, general and administrative	181,386	148,240	297,773	257,980
Total expenses	568,718	554,826	1,037,440	980,200
Pretax income (loss)	\$ 59,333	\$ (6,332)	\$ (261,257)	\$ (293,702)

Three months ended January 31, 2007 compared to January 31, 2006

Tax Services revenues increased \$79.6 million, or 14.5%, for the three months ended January 31, 2007 compared to the prior year.

Table of Contents

Tax preparation fees increased \$48.4 million, or 12.4%, for the current quarter. This increase is primarily due to an increase of 7.6% in the net average fee per U.S. retail client served and a 4.9% increase in tax returns prepared and/or e-filed in company-owned offices. Results for our third quarter represent only a small portion of the tax season and are not indicative of the results we expect for the entire fiscal year. We do not expect to maintain this level of client growth throughout the remainder of the tax season.

Other service revenues increased \$15.2 million, or 46.6%, primarily due to \$12.8 million in additional license fees earned from bank products.

Royalty revenue increased \$5.9 million, or 11.0%, due to an 8.8% increase in the net average fee and a 5.6% increase in tax returns prepared and/or e-filed in franchise offices.

Loan participation fees and related revenues increased \$12.8 million during the current quarter, primarily due to the introduction of our IMAL, an early-season loan product, which increased our participation revenues \$12.1 million.

Other revenues decreased \$2.8 million, or 9.0%, primarily due to the elimination of revenues associated with our supply sales to franchises. Our franchises now order directly from the supplier, which resulted in a reduction of \$12.6 million in revenues in the current quarter. This decline was partially offset by customer fees earned in connection with an agreement with HRB Bank for our new H&R Block Emerald Prepaid MasterCard program, under which this segment shares in the revenues and expenses associated with the program.

Total expenses increased \$13.9 million, or 2.5%, for the three months ended January 31, 2007. Cost of services increased \$52.4 million, or 15.7%, from the prior year. Our real estate expansion efforts have contributed to a total increase of \$5.0 million across all cost of services categories. Compensation and benefits increased \$35.3 million, or 18.7%, primarily due to higher wages associated with increased revenues, costs associated with our earlier office openings and initiatives addressing operational readiness for the tax season. Occupancy expenses increased \$9.5 million, or 11.9%, primarily as a result of higher rent expenses due to a 4.8% increase in company-owned offices under lease and a 5.6% increase in the average rent. Other cost of services increased \$8.0 million, or 14.5%, due to higher claims expenses associated with our POM guarantees.

Other, selling, general and administrative expenses increased \$33.1 million, or 22.4%, primarily due to an \$18.0 million increase in marketing expenses, \$11.9 million in additional corporate shared services and \$7.5 million in additional bad debt expenses. These increases were partially offset by a decline of \$11.2 million in cost of supply sales to franchises, as previously discussed.

Higher overall expenses were partially offset by the \$71.7 million of litigation settlement charges and related legal fees recorded in the prior year.

Pretax income for the three months ended January 31, 2007 totaled \$59.3 million, compared to a loss of \$6.3 million in the prior year.

Nine months ended January 31, 2007 compared to January 31, 2006

Tax Services revenues increased \$89.7 million, or 13.1%, for the nine months ended January 31, 2007 compared to the prior year.

Tax preparation fees increased \$54.6 million, or 12.1%, for the current period. This increase is primarily due to an increase of 7.6% in the net average fee per U.S. retail client served and a 4.9% increase in tax returns prepared and/or e-filed in company-owned offices during the current tax season. These results represent only a small portion of the tax season and are not indicative of the results we expect for the entire fiscal year. We do not expect to maintain this level of client growth throughout the remainder of the tax season.

Other service revenues increased \$20.2 million, or 21.5%, primarily due to \$14.1 million in additional license fees earned from bank products, coupled with an increase in the recognition of deferred fee revenue from our POM guarantees, which resulted from an increase in claims.

Royalty revenue increased \$6.7 million, or 11.2%, due to an 8.8% increase in the net average fee and a 5.6% increase in tax returns prepared and/or e-filed in franchise offices during the current tax season.

Table of Contents

Loan participation fees and related revenues increased \$12.8 million during the current year, primarily due to the introduction of our IMAL, an early-season loan product, which increased our participation revenues \$12.1 million.

Other revenues decreased \$4.7 million, or 12.7%, primarily due to the revenues associated with our supply sales to franchises. Our franchises now order directly from the supplier, which resulted in a reduction of \$15.0 million in revenues in the current year, and was partially offset by customer fees earned in connection with an agreement with HRB Bank for our new H&R Block Emerald Prepaid MasterCard program, under which this segment shares in the revenues and expenses associated with the program.

Total expenses increased \$57.2 million, or 5.8%, for the nine months ended January 31, 2007. Cost of services increased \$89.1 million, or 13.7%, from the prior year. Our real estate expansion efforts have contributed to a total increase of \$17.2 million across all cost of services categories. Compensation and benefits increased \$45.9 million, or 16.2%, primarily due to higher wages associated with increased revenues, costs associated with our earlier office openings and initiatives addressing operational readiness for the tax season. Occupancy expenses increased \$25.7 million, or 12.8%, primarily as a result of higher rent expenses due to a 7.9% increase in company-owned offices under lease and a 4.7% increase in the average rent. Other cost of services increased \$19.4 million, or 14.4%, due to increases in claims expenses associated with our POM guarantee, travel expenses and additional corporate shared services for information technology projects.

Other, selling, general and administrative expenses increased \$39.8 million, or 15.4%, primarily due to an increase of \$18.5 million in marketing expenses, coupled with increases of \$16.0 million, \$7.7 million and \$5.2 million in corporate shared services, bad debt expense and corporate wages, respectively. These increases were partially offset by a decline of \$14.8 million in cost of supply sales to franchises, as previously discussed.

Higher overall expenses were partially offset by \$71.7 million of litigation settlement charges and related legal fees recorded in the prior year.

The pretax loss of \$261.3 million for the nine months ended January 31, 2007 compared to a loss of \$293.7 million in the prior year.

RAL Litigation

We are named as a defendant in putative class-action lawsuits and a pending state attorney general lawsuit alleging that we engaged in wrongdoing with respect to the RAL program. We believe we have meritorious defenses to these lawsuits and will vigorously defend our position. Nevertheless, the amounts claimed in these lawsuits are, in some instances, very substantial. In fiscal year 2006, we entered into settlement agreements regarding several RAL Cases, with the combined pretax expense for such settlements totaling \$70.2 million. There can be no assurances as to the ultimate outcome of the remaining pending RAL Cases, or as to their impact on our financial statements. See additional discussion of RAL Litigation in note 8 to the consolidated financial statements and in Part II, Item 1, Legal Proceedings.

BUSINESS SERVICES

This segment offers middle-market companies accounting, tax and consulting services, wealth management, retirement resources and corporate finance.

Business Services Operating Statistics

	Three months ended January 31,		Nine months ended January 31,	
	2007	2006	2007	2006
Accounting, tax and consulting:				
Chargeable hours	1,024,572	1,107,398	3,245,598	2,467,355
Chargeable hours per person	305	314	894	895
Net billed rate per hour	\$ 147	\$ 145	\$ 146	\$ 141
Average margin per person	\$ 23,216	\$ 25,154	\$ 67,997	\$ 65,567

-27-

Table of Contents**Business Services Operating Results**

	Three months ended January 31,		Nine months ended January 31,	
	2007	2006	2007	2006
(in 000s)				
Service revenues:				
Accounting, tax and consulting	\$ 162,618	\$ 187,154	\$ 515,014	\$ 392,772
Capital markets	6,818	13,567	36,925	44,394
Payroll, benefits and retirement services	21,478	8,796	36,880	25,690
Other services	12,584	16,898	28,391	37,893
	203,498	226,415	617,210	500,749
Other	12,397	9,425	32,919	28,742
Total revenues	215,895	235,840	650,129	529,491
Cost of services:				
Compensation and benefits	107,135	130,490	371,166	297,031
Occupancy	18,533	18,339	57,370	37,514
Other	29,861	29,519	78,081	59,955
	155,529	178,348	506,617	394,500
Amortization of intangible assets	6,160	5,157	15,165	12,765
Other, selling, general and administrative	55,631	53,370	163,081	132,169
Total expenses	217,320	236,875	684,863	539,434
Pretax loss	\$ (1,425)	\$ (1,035)	\$ (34,734)	(9,943)

Three months ended January 31, 2007 compared to January 31, 2006

Business Services revenues for the three months ended January 31, 2007 decreased \$19.9 million, or 8.5%, from the prior year, primarily due to a \$24.5 million decline in our accounting, tax and consulting revenues. Accounting, tax and consulting revenues declined primarily as a result of a change in organizational structure between the businesses we acquired from American Express Tax and Business Services, Inc. (AmexTBS) and the attest firms that, while not affiliates of our company, also serve our clients. As a result, we no longer record the revenues and expenses associated with leasing employees in these offices to the attest firms.

Capital markets revenues decreased \$6.7 million, or 49.7%, from the prior year due to a decline in demand for our valuation services.

Payroll, benefits and retirement services revenues increased \$12.7 million from the prior year primarily due to fees received upon conversion of certain clients to another service provider in connection with the wind-down of our payroll business.

Other service revenues decreased \$4.3 million primarily due to a decline in revenue in our financial process outsourcing business.

Total expenses decreased \$19.6 million, or 8.3%, for the three months ended January 31, 2007 compared to the prior year. Cost of services decreased \$22.8 million, due to a decrease in compensation and benefits. Compensation and benefits decreased \$23.4 million, primarily due to the change in organizational structure of the AmexTBS offices, as discussed above.

The pretax loss for the three months ended January 31, 2007 of \$1.4 million compares to a pretax loss of \$1.0 million in the prior year.

Nine months ended January 31, 2007 compared to January 31, 2006

Business Services revenues for the nine months ended January 31, 2007 increased \$120.6 million, or 22.8%, from the prior year. This increase was due to \$122.2 million in additional accounting, tax and consulting revenues, primarily resulting from the acquisition of AmexTBS.

Capital markets revenues decreased \$7.5 million, or 16.8%, from the prior year due to a decline in demand for our valuation services, partially offset by an increase in the number of capital market transactions.

Payroll, benefits and retirement services increased \$11.2 million, or 43.6%, from the prior year primarily due to fees received upon conversion of certain clients to another service provider in connection with the wind-down of our payroll business.

-28-

Table of Contents

Other service revenues decreased \$9.5 million primarily due to a decline in revenue from our financial process outsourcing business.

Total expenses increased \$145.4 million, or 27.0%, for the nine months ended January 31, 2007 compared to the prior year. Cost of services increased \$112.1 million, primarily due to increases in compensation and benefits and occupancy expenses. Compensation and benefits increased \$74.1 million, primarily due to the AmexTBS acquisition. Increases in the number of personnel and the average wage per employee, driven by marketplace competition for professional staff, also contributed to the increase. Occupancy expenses and other expenses increased \$19.9 million and \$18.1 million, respectively, primarily due to the AmexTBS acquisition.

Selling, general and administrative expenses increased \$30.9 million primarily due to acquisitions and additional costs associated with our business development and marketing initiatives.

The pretax loss for the nine months ended January 31, 2007 of \$34.7 million compares to a pretax loss of \$9.9 million in the prior year.

CONSUMER FINANCIAL SERVICES

This segment is primarily engaged in offering advice-based brokerage services and investment planning through HRBFA, and full-service banking through HRB Bank. HRBFA, and HRB Bank, our Block-branded businesses, are focused on increasing client loyalty and retention by offering expanded financial services to our retail tax clients. HRBFA offers 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. HRB Bank offers traditional banking services including checking and savings accounts, home equity lines of credit, individual retirement accounts, certificates of deposit and prepaid debit card accounts. HRBFA utilizes HRB Bank for certain FDIC-insured deposits for its clients and HRB Bank also purchases loans from OOMC, HRBMC and other lenders to hold for investment purposes. In the event that HRB Bank can no longer purchase loans from OOMC and HRBMC, the main source of future loan purchases would be other third-party loan originators.

Consumer Financial Services Operating Statistics

	Three months ended January 31,		Nine months ended January 31,	
	2007	2006	2007	2006
Broker-dealer:				
Traditional brokerage accounts ⁽¹⁾	394,767	426,699	394,767	426,699
New traditional brokerage accounts funded by HRB Tax clients	2,270	2,947	7,425	10,871
Cross-service revenue as a percent of total production revenue	14.8%	14.2%	16.1%	15.7%
Average assets per traditional brokerage account	\$ 81,774	\$ 72,914	\$ 81,774	\$ 72,914
Average margin balances (millions)	\$ 390	\$ 529	\$ 414	\$ 554
Average client payable balances (millions)	\$ 630	\$ 769	\$ 626	\$ 801
Number of advisors	911	956	911	956
Banking:				
Efficiency ratio ⁽²⁾	36%	N/A	37%	N/A
Annualized net interest margin ⁽³⁾	2.52%	N/A	2.79%	N/A
Annualized return on average assets ⁽⁴⁾	2.63%	N/A	1.96%	N/A
Total assets (millions)	\$ 1,814	N/A	\$ 1,814	N/A
Loans purchased from affiliates (millions)	\$ 278	N/A	\$ 1,002	N/A

(1) Includes only accounts with a positive

balance.

- (2) Defined as non-interest expense divided by revenue net of interest expense. See Reconciliation of Non-GAAP Financial Information at the end of Part I, Item 2.
- (3) Defined as annualized net interest revenue divided by average assets. See Reconciliation of Non-GAAP Financial Information at the end of Part I, Item 2.
- (4) Defined as annualized pretax banking income divided by average assets. See Reconciliation of Non-GAAP Financial Information at the end of Part I, Item 2.

Table of Contents**Consumer Financial Services Operating Results**

			(in 000s)	
	Three months ended January		Nine months ended January	
	31,		31,	
	2007	2006	2007	2006
Service revenues:				
Financial advisor production revenue	\$ 52,843	\$ 48,378	\$ 145,306	\$ 139,878
Other	15,844	8,169	33,424	24,440
	68,687	56,547	178,730	164,318
Net interest revenue on:				
Margin lending	13,278	14,158	40,173	40,460
Banking activities	6,188		14,309	
	19,466	14,158	54,482	40,460
Provision for loan loss reserves	(1,684)		(3,386)	
Other	7,175	682	7,764	1,993
Total revenues ⁽¹⁾	93,644	71,387	237,590	206,771
Cost of services:				
Compensation and benefits	35,145	35,901	99,467	99,112
Occupancy	5,112	5,283	15,020	15,635
Other	4,494	5,626	14,852	16,102
	44,751	46,810	129,339	130,849
Amortization of intangible assets	9,157	9,157	27,469	27,469
Selling, general and administrative	28,777	23,088	75,210	71,579
Total expenses	82,685	79,055	232,018	229,897
Pretax income (loss)	\$ 10,959	\$ (7,668)	\$ 5,572	\$ (23,126)

⁽¹⁾ Total revenues, less interest expense and loan loss reserves on mortgage loans held for investment.

Three months ended January 31, 2007 compared to January 31, 2006

Consumer Financial Services revenues, net of interest expense and provision for loan loss reserves, for the three months ended January 31, 2007 increased \$22.3 million, or 31.2%, from the prior year.

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Financial advisor production revenue, which consists primarily of fees earned on assets under administration and commissions on client trades, was up \$4.5 million, or 9.2%, from the prior year primarily due to higher revenues from closed end funds. The following table summarizes the key drivers of production revenue:

Three months ended January 31,	2007	2006
Client trades	234,417	255,879
Average revenue per trade	\$ 139.25	\$ 113.83
Ending balance of assets under administration (billions)	\$ 32.6	\$ 31.4
Annualized productivity per advisor	\$237,000	\$201,000

Other service revenues increased \$7.7 million, or 94.0%, primarily due to \$4.2 million in underwriting fees and \$3.2 million resulting from positive sweep account rate variances during the current quarter.

Net interest revenue on banking activities totaled \$6.2 million for the three months ended January 31, 2007. The following table summarizes the key drivers of net interest revenue on banking activities:

		(in 000s)
	Average Balance	Average Rate Earned (Paid)
Loans	\$ 817,578	6.91%
Investments	\$ 136,999	5.31%
Deposits	\$ 787,160	(4.77)%

Other revenues increased \$6.5 million primarily due to revenues earned from our new H&R Block Emerald Prepaid MasterCard program.

Total segment expenses increased \$3.6 million, or 4.6%, from the prior year. Selling, general and administrative expenses increased \$5.7 million, or 24.6%, primarily due to the expenses of HRB Bank, which opened May 1, 2006.

-30-

Table of Contents

Pretax income for Consumer Financial Services for the three months ended January 31, 2007 was \$11.0 million compared to the prior year loss of \$7.7 million.

Nine months ended January 31, 2007 compared to January 31, 2006

Consumer Financial Services revenues, net of interest expense and provision for loan loss reserves, for the nine months ended January 31, 2007 increased \$30.8 million, or 14.9%, from the prior year.

Financial advisor production revenue, which consists primarily of fees earned on assets under administration and commissions on client trades, increased \$5.4 million, or 3.9%, over the prior year due to higher annuitized revenues, which were partially offset by fewer client trades. The following table summarizes the key drivers of production revenue:

Nine months ended January 31,	2007	2006
Client trades	673,754	715,519
Average revenue per trade	\$ 124.86	\$ 120.94
Ending balance of assets under administration (billions)	\$ 32.6	\$ 31.4
Annualized productivity per advisor	\$207,000	\$187,000

Other service revenues increased \$9.0 million, or 36.8%, primarily due to \$6.7 million resulting from positive sweep account rate variances, coupled with \$1.4 million in underwriting fees.

Net interest revenue on banking activities totaled \$14.3 million for the nine months ended January 31, 2007. The following table summarizes the key drivers of net interest revenue on banking activities:

	Average Balance	Average Rate Earned (Paid) (in 000s)
Loans	\$ 603,051	6.92%
Investments	\$ 65,596	5.24%
Deposits	\$ 509,394	(5.01%)

Other revenues increased \$5.8 million primarily due to revenues earned from our new H&R Block Emerald Prepaid MasterCard program.

Total segment expenses increased \$2.1 million, or 0.9%, over the prior year. Selling, general and administrative expenses increased \$3.6 million, or 5.1%, primarily due to the expenses of HRB Bank.

Pretax income for Consumer Financial Services for the nine months ended January 31, 2007 was \$5.6 million compared to the prior year loss of \$23.1 million.

CORPORATE, ELIMINATIONS AND INCOME TAXES ON CONTINUING OPERATIONS

The pretax loss recorded in our corporate operations for the three months ended January 31, 2007 was \$50.0 million compared to \$30.0 million in the prior year. The higher loss is primarily due to \$7.2 million of additional operating interest expense resulting from increased borrowings to cover operating losses coupled with higher interest rates, increases in legal, consulting and compensation costs. These increases were also the main drivers of the higher pretax loss for the nine-month period.

Income taxes for continuing operations included one-time benefits of \$13.6 million during the three months ended January 31, 2007. These benefits related to a permanent deduction for our investment in a foreign subsidiary in the amount of \$5.7 million, coupled with net adjustments primarily of our prior year estimated tax provision to tax liabilities in the 2005 tax returns as ultimately filed and tax reserves in the amount of \$7.9 million. Excluding these one-time benefits, our tax rate for continuing operations would have been approximately 40%, consistent with our expectations for the full fiscal year.

Table of Contents**DISCONTINUED OPERATIONS**

Discontinued operations includes OOMC and HRBMC, mortgage businesses primarily engaged in the origination and acquisition of non-prime and prime mortgage loans, the sale and securitization of mortgage loans and residual interests, and the servicing of non-prime loans. Income statement data presented below is net of eliminations of intercompany activities.

Discontinued Operations Operating Statistics

	(in 000s)			
	Three months ended January 31,		Nine months ended January 31,	
	2007	2006	2007	2006
Volume of loans originated:				
Non-prime	\$ 5,991,533	\$ 8,608,590	\$ 20,404,065	\$ 31,287,507
Prime	268,866	343,897	826,917	1,173,417
	\$ 6,260,399	\$ 8,952,487	\$ 21,230,982	\$ 32,460,924
Loan characteristics: ⁽¹⁾				
Weighted average FICO score	612	621	612	625
Weighted average interest rate for borrowers (WAC)	8.46%	8.27%	8.64%	7.71%
Weighted average loan-to-value	82.2%	80.0%	82.4%	80.6%
Origination margin (% of origination volume): ⁽²⁾				
Loan sale premium	0.39%	1.43%	1.16%	1.39%
Residual cash flows from beneficial interest in Trusts	0.36%	0.81%	0.41%	0.54%
Gain on derivative instruments	0.57%	0.06%	0.10%	0.28%
Loan sale repurchase reserves	(1.77%)	(0.15%)	(1.18%)	(0.15%)
Retained mortgage servicing rights	0.66%	0.67%	0.63%	0.60%
	0.21%	2.82%	1.12%	2.66%
Cost of acquisition	(0.19%)	(0.27%)	(0.13%)	(0.39%)
Direct origination expenses	(0.49%)	(0.69%)	(0.51%)	(0.60%)
Net gain on sale gross margin ⁽²⁾	(0.47%)	1.86%	0.48%	1.67%
Other cost of origination	(1.56%)	(1.43%)	(1.50%)	(1.32%)
Other	(0.37%)	(0.04%)	(0.06%)	(0.01%)
Net margin	(2.40%)	0.39%	(1.08%)	0.34%
Total cost of origination ⁽³⁾	2.05%	2.12%	2.01%	1.92%
Total cost of origination and acquisition	2.24%	2.39%	2.14%	2.31%
Loan delivery:				
Loan sales:				
Third-party buyers	\$ 6,052,256	\$ 8,924,788	\$ 20,492,913	\$ 32,265,319
HRB Bank	278,486		1,001,610	

	\$ 6,330,742	\$ 8,924,788	\$ 21,494,523	\$ 32,265,319
Execution price ⁽⁴⁾	1.23%	0.51%	1.45%	1.68%

- (1) Represents non-prime production.
- (2) 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.
- (3) See Reconciliation of Non-GAAP Financial Information at the end of Part I, Item 2.
- (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).

Table of Contents**Discontinued Operations Operating Results**

	Three months ended January 31,		Nine months ended January 31,	
	2007	2006	2007	2006
(in 000s)				
Components of gains on sales:				
Gain on mortgage loans	\$ 46,533	\$ 174,475	\$ 333,317	\$ 499,466
Gain on derivatives	35,179	5,060	20,372	91,896
Loan sale repurchase reserves	(111,122)	(13,076)	(251,083)	(49,547)
Gain on sales of residual interests	7,296		7,296	28,675
Impairment of residual interests	(43,557)	(8,562)	(73,059)	(29,175)
	(65,671)	157,897	36,843	541,315
Interest income	11,928	32,313	41,325	104,027
Loan servicing revenue	109,833	106,065	332,336	296,720
Other	56	219	256	740
Total revenues	56,146	296,494	410,760	942,802
Cost of services	77,040	83,076	235,353	215,279
Cost of other revenues	79,698	104,499	223,908	343,707
Selling, general and administrative	61,390	38,497	174,330	126,562
Total expenses	218,128	226,072	633,591	685,548
Pretax income (loss)	\$ (161,982)	\$ 70,422	\$ (222,831)	\$ 257,254

Three months ended January 31, 2007 compared to January 31, 2006

Revenues of discontinued operations decreased \$240.3 million, or 81.1%, for the three months ended January 31, 2007 compared to the prior year.

The following table summarizes the key drivers of loan origination volumes and related gains on sales of mortgage loans:

	Three months ended January 31,	
	2007	2006
(dollars in 000s)		
Application process:		
Total number of applications	58,686	75,103
Number of sales associates ⁽¹⁾	2,146	3,486
Closing ratio ⁽²⁾	48.3%	61.4%
Originations:		
Total number of loans originated	28,357	46,134
WAC	8.46%	8.27%
Average loan size	\$ 221	\$ 194
Total volume of loans originated	\$ 6,260,399	\$ 8,952,487

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Direct origination and acquisition expenses, net	\$	42,288	\$	85,974
Revenue (loan value):				
Net gain on sale gross margin ⁽³⁾		(0.47%)		1.86%

(1) Includes all direct sales and back office sales support associates.

(2) Percentage of loans funded divided by total applications in the period.

(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.

Gains on sales of mortgage loans and gains on derivative activities decreased \$97.8 million, primarily due to lower origination volumes and lower loan sale premiums.

Premium on loan sales decreased due to moderating demand by loan buyers and unfavorable interest rates, partially offset by a higher WAC. Market interest rates, based on the two-year swap, increased from an average of 4.83% last year to 5.12% in the current quarter. Our WAC only increased 19 basis points, up to 8.46% from 8.27% in the prior year.

To mitigate the risk of short-term changes in market interest rates related to our loan originations, including our rate-lock equivalents and beneficial interest in Trusts, we use interest rate swaps, put options on Eurodollar futures and forward loan sale commitments. We generally enter into interest rate swap arrangements related to existing loan applications and applications we expect to receive prior to our next anticipated change in rates charged to borrowers. During the quarter, we recorded a net \$35.2 million in gains, compared to \$5.1 million in the prior year, related to our various derivative instruments. The increase for the current quarter was caused by market interest rates, based on the two-year swap, increasing 27 basis points compared to an increase of 11 basis points during the prior year quarter. See note 11 to the condensed consolidated financial statements.

Table of Contents

The value of MSRs recorded in the current quarter decreased to 66 basis points from 67 basis points in the prior year due to changes in our assumptions used to value MSRs and other factors. This decrease, coupled with a decline in origination volumes, resulted in a net decrease of \$18.6 million in gains on sales of mortgage loans. See additional discussion of our MSR assumptions in Item 1, note 11 to the condensed consolidated financial statements and in Item 2, Critical Accounting Policies.

During the quarter we continued to experience higher early payment defaults, resulting in an increase in actual and expected loan repurchase activity. As a result, we recorded total loss provisions of \$111.1 million during the three months ended January 31, 2007 compared to \$13.1 million in the prior year. The provision recorded in the current quarter consists of \$18.3 million recorded on loans sold during the current quarter and, due primarily to increases in our estimated loss severity assumption, also included \$92.8 million related to loans sold in prior quarters. Loss provisions as a percent of loan volumes increased 162 basis points over the prior year. See additional discussion of our reserves and repurchase obligations in note 11 to our condensed consolidated financial statements.

During the current quarter, we recorded impairments of \$43.6 million in gains on sales of mortgage assets primarily due to recent market conditions and significant declines in the value of mortgage loans, including the value of non-performing loans. As a result, we performed a detailed evaluation of the underlying collateral. This change resulted in additional impairment of residual interests of \$29.2 million for the quarter.

We also recorded favorable pretax mark-to-market adjustments in other comprehensive income, which increased the fair value of our residual interests \$6.3 million during the quarter. These adjustments were recorded net of write-downs of \$11.6 million and deferred taxes of \$2.0 million, and will be accreted into income throughout the remaining life of those residual interests. Future changes in interest rates or other assumptions, based on market conditions or actual loan pool performance, could cause additional adjustments to the fair value of the residual interests and could cause changes to the accretion of these residual interests in future periods. In the current year we also recorded a \$7.3 million gain on the sale of residual interests.

Interest income decreased \$20.4 million from the prior year. This decrease is primarily due to lower accretion resulting from the sale of previously securitized residual interests during fiscal year 2006 and lower write-ups to residual interest balances, coupled with the write-off of accrued interest related to delinquent loans.

The following table summarizes the key metrics related to our loan servicing business:

	(dollars in 000s)	
Three months ended January 31,	2007	2006
Average servicing portfolio:		
With related MSRs	\$ 63,809,435	\$ 59,344,676
Without related MSRs	6,412,788	21,046,638
	\$ 70,222,223	\$ 80,391,314
Ending servicing portfolio:		
With related MSRs	\$ 63,942,819	\$ 60,787,507
Without related MSRs	3,589,355	15,994,170
	\$ 67,532,174	\$ 76,781,677
Number of loans serviced	395,390	466,026
Average delinquency rate	11.22%	5.58%
Weighted average FICO score	621	621
Weighted average interest rate (WAC) of portfolio	8.14%	7.63%
Carrying value of MSRs	\$ 263,140	\$ 262,369

Loan servicing revenues increased \$3.8 million, or 3.6%, compared to the prior year. The increase reflects an increase in late fee income on delinquent loans and, to a lesser extent, a higher annualized rate earned on our servicing portfolio. The annualized rate earned on our entire servicing portfolio was 39 basis points for the current quarter, compared to 34 basis points in the prior year. These increases were partially offset by a decline in our average servicing portfolio, which decreased 12.6%, to \$70.2 billion.

-34-

Table of Contents

Total expenses for the three months ended January 31, 2007 declined \$7.9 million, or 3.5%, from the prior year. Cost of services decreased \$6.0 million primarily due to lower headcount, partially offset by increased amortization of MSRs.

Cost of other revenues decreased \$24.8 million, primarily due to \$27.3 million in lower compensation and benefits as a result of the restructuring in the prior year.

Selling, general and administrative expenses increased \$22.9 million due primarily to severance and our ongoing restructuring plans, coupled with retention bonuses and higher consulting expenses.

The pretax loss for the three months ended January 31, 2007 was \$162.0 million compared to income of \$70.4 million in the prior year.

Nine months ended January 31, 2007 compared to January 31, 2006

Revenues of discontinued operations decreased \$532.0 million, or 56.4%, for the nine months ended January 31, 2007 compared to the prior year.

The following table summarizes the key drivers of loan origination volumes and related gains on sales of mortgage loans:

Nine months ended January 31,	(dollars in 000s)	
	2007	2006
Application process:		
Total number of applications	203,198	290,476
Number of sales associates ⁽¹⁾	2,146	3,486
Closing ratio ⁽²⁾	50.5%	61.8%
Originations:		
Total number of loans originated	102,544	179,439
WAC	8.64%	7.71%
Average loan size	\$ 207	\$ 181
Total volume of loans originated	\$ 21,230,982	\$ 32,460,924
Direct origination and acquisition expenses, net	\$ 135,442	\$ 321,177
Revenue (loan value):		
Net gain on sale gross margin ⁽³⁾	0.48%	1.67%

(1) Includes all direct sales and back office sales support associates.

(2) Percentage of loans funded divided by total applications in the period.

(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.

Gains on sales of mortgage loans and gains on derivative activities decreased \$237.7 million from the prior year. This decrease resulted primarily from lower origination volumes and lower loan sale premiums.

Premium on loan sales decreased due to moderating demand by loan buyers and unfavorable interest rates, partially offset by a higher WAC. Market interest rates, based on the two-year swap, increased from an average of 4.45% last year to 5.29% in the current year. Our WAC increased 93 basis points, up to 8.64% from 7.71% in the prior year. These changes caused our premium on loan sales to decrease 23 basis points, to 1.16% from 1.39% last year.

During the current year, we recorded a net \$20.4 million in gains, compared to \$91.9 million in the prior year, related to our various derivative instruments. The decline for the current year was caused by market interest rates, based on the two-year swap, declining 10 basis points compared to an increase of 93 basis points during the prior year. See note 11 to the condensed consolidated financial statements.

The value of MSRs recorded in the current year increased to 63 basis points from 60 basis points in the prior year due to changes in our assumptions used to value MSRs and other factors. However, this increase was offset by a decline in origination volumes, which resulted in a net decrease of \$62.0 million in gains on sales of mortgage loans. See additional discussion of our MSR assumptions in note 11 to the condensed consolidated financial statements and in Item 2, Critical Accounting Policies.

Table of Contents

During the current year we experienced higher early payment defaults, resulting in an increase in actual and expected loan repurchase activity. As a result, we recorded total loss provisions of \$251.1 million during the nine months ended January 31, 2007 compared to \$49.5 million in the prior year. The provision recorded in the current year consists of \$130.7 million recorded on loans sold during the current period and \$120.4 million related to loans sold in prior periods. Loss provisions as a percent of loan volumes increased 103 basis points over the prior year. See additional discussion of our reserves and repurchase obligations in note 11 to our condensed consolidated financial statements.

During the current year, we recorded impairments of \$73.1 million in gains on sales of mortgage assets primarily due to higher credit losses and interest rates. Additionally, recent market conditions resulted in significant declines in the value of mortgage loans, including the value of non-performing loans. As a result, we performed a detailed evaluation of the underlying collateral. This change resulted in additional impairment of residual interests of \$29.2 million.

We also recorded favorable pretax mark-to-market adjustments in other comprehensive income, which increased the fair value of our residual interests \$18.1 million during the current year. These adjustments were recorded net of write-downs of \$15.3 million and deferred taxes of \$1.1 million, and will be accreted into income throughout the remaining life of those residual interests. We also recorded gains of \$7.3 million and \$28.7 million in gains on the sale of residual interests for the nine months ended January 31, 2007 and 2006, respectively.

Interest income decreased \$62.7 million from the prior year. This decrease is primarily due to lower accretion resulting from the sale of previously securitized residual interests during fiscal year 2006 and lower write-ups to residual interest balances, coupled with the write-off of accrued interest related to delinquent loans.

The following table summarizes the key metrics related to our loan servicing business:

	(dollars in 000s)	
Nine months ended January 31,	2007	2006
Average servicing portfolio:		
With related MSR	\$ 63,794,782	\$ 54,784,155
Without related MSR	8,728,890	21,210,097
	\$ 72,523,671	\$ 75,994,252
Ending servicing portfolio:		
With related MSR	\$ 63,942,819	\$ 60,787,507
Without related MSR	3,589,355	15,994,170
	\$ 67,532,174	\$ 76,781,677
Number of loans serviced	395,390	466,026
Average delinquency rate	9.03%	4.76%
Weighted average FICO score	621	621
Weighted average interest rate (WAC) of portfolio	8.04%	7.51%
Carrying value of MSR	\$ 263,140	\$ 262,369

Loan servicing revenues increased \$35.6 million, or 12.0%, compared to the prior year. The increase reflects an increase in late fee income on delinquent loans and, to a lesser extent, a higher annualized rate earned on our servicing portfolio. The annualized rate earned on our entire servicing portfolio was 37 basis points for the current year, compared to 34 basis points in the prior year. These increases were partially offset by a decline in our average servicing portfolio, which decreased 4.6%, to \$72.5 billion.

Total expenses for the nine months ended January 31, 2007 declined \$52.0 million, or 7.6%, from the prior year. Cost of services increased \$20.1 million primarily as a result of increased amortization of MSRs.

Cost of other revenues decreased \$119.8 million, primarily due to our ongoing restructuring plans.

Selling, general and administrative expenses increased \$47.8 million due primarily to severance and our ongoing restructuring plans, coupled with retention bonuses and higher consulting expenses.

The pretax loss for the nine months ended January 31, 2007 was \$222.8 million compared to income of \$257.3 million in the prior year.

FINANCIAL CONDITION

These comments should be read in conjunction with the condensed consolidated balance sheets and condensed consolidated statements of cash flows found on pages 1 and 3, respectively.

-36-

Table of Contents**CAPITAL RESOURCES & LIQUIDITY BY SEGMENT**

Our sources of capital include cash from operations, issuances of common stock and debt. We use capital primarily to fund working capital requirements, pay dividends, repurchase our shares and acquire businesses.

Cash From Operations. Cash used in operating activities from continuing operations for the first nine months of fiscal 2007 totaled \$2.8 billion, compared with \$1.7 billion for the same period of the prior fiscal year. The change was due primarily to \$882.7 million in additional receivables, resulting from higher RAL and IMAL balances, an increase of \$153.6 million in income tax payments and an increase of \$40.3 million in interest payments.

Issuance of Common Stock. We issue shares of common stock, in accordance with our stock-based compensation plans, out of treasury shares. Proceeds from the issuance of common stock totaled \$19.2 million and \$95.9 million for the nine months ended January 31, 2007 and 2006, respectively.

Dividends. Dividends paid totaled \$128.1 million and \$118.7 million for the nine months ended January 31, 2007 and 2006, respectively.

Share Repurchases. On June 7, 2006, our Board approved an additional authorization to repurchase 20.0 million shares. During the nine months ended January 31, 2007, we repurchased 8.1 million shares pursuant to this authorization and a prior authorization at an aggregate price of \$180.9 million or an average price of \$22.22 per share. There are 22.4 million shares remaining under these authorizations at January 31, 2007. We plan to continue to purchase shares on the open market in accordance with this authorization, subject to various factors including the price of the stock, the availability of excess cash, our ability to maintain liquidity and financial flexibility, securities law restrictions, targeted capital levels and other investment opportunities available.

Debt. We plan to refinance our \$500.0 million in Senior Notes, which are due in April 2007.

Restricted Cash. We hold certain cash balances that are restricted as to use. Cash and cash equivalents restricted totaled \$432.5 million at January 31, 2007 compared to \$385.6 million at April 30, 2006. Consumer Financial Services held \$369.0 million of this total segregated in a special reserve account for the exclusive benefit of its broker-dealer clients. Restricted cash of \$13.3 million at January 31, 2007 held by Business Services is related to funds held to pay payroll taxes on behalf of its clients. We also held \$50.3 million in restricted cash related to our \$3.0 billion line of credit with HSBC Finance Corporation (HSBC Finance).

Segment Cash Flows. A condensed consolidating statement of cash flows by segment for the nine months ended January 31, 2007 follows. Generally, interest is not charged on intercompany activities between segments.

	(in 000s)					
	Tax Services	Business Services	Consumer Financial Services	Corporate	Discontinued Operations	Consolidated H&R Block
Cash provided by						
(used in):						
Operations	\$ (2,107,883)	\$ 30,295	\$ (64,345)	\$ (1,090,466)	\$ 454,135	\$ (2,778,264)
Investing	(47,843)	(24,129)	(1,079,768)	(45,305)	18,322	(1,178,723)
Financing	(47,517)	(12,387)	1,618,450	2,631,602	172,301	4,362,449
Net intercompany	2,224,965	2,669	(238,894)	(1,764,227)	(224,513)	

Net intercompany activities are excluded from investing and financing activities within the segment cash flows. We believe that by excluding intercompany activities, the cash flows by segment more clearly depicts the cash generated and used by each segment. Had intercompany activities been included, those segments in a net lending situation would have been included in investing activities, and those in a net borrowing situation would have been included in financing activities.

Tax Services. Tax Services has historically been our largest provider of annual operating cash flows. The seasonal nature of Tax Services generally results in a large positive operating cash flow in the fourth quarter. Tax Services used \$2.1 billion in its current nine-month operations to cover off-season costs and working capital requirements. This segment used \$47.8 million in investing activities primarily related to capital expenditures and acquisitions, and used

\$47.5 million in financing activities related to book overdrafts.

-37-

Table of Contents

Business Services. Business Services funding requirements are largely related to receivables for completed work and work in process. We provide funding sufficient to cover their working capital needs. This segment provided \$30.3 million in operating cash flows during the first nine months of the year. Business Services used \$24.1 million in investing activities primarily related to capital expenditures and acquisitions and used \$12.4 million in financing activities primarily due to payments on acquisition debt.

Consumer Financial Services. In the first nine months of fiscal year 2007, Consumer Financial Services used \$64.3 million in cash from its operating activities primarily due to the timing of cash deposits that are restricted for the benefit of its broker-dealer clients. The segment also used \$1.1 billion in investing activities primarily for the purchase of mortgage loans held for investment and provided \$1.6 billion in financing activities due primarily to FDIC-insured deposits held at HRB Bank.

HRB Bank is a member of the FHLB of Des Moines, which extends credit to member banks based on eligible collateral. At January 31, 2007, HRB Bank had FHLB advance capacity of \$594.0 million, and no amount was outstanding on this facility.

We believe the funding sources for Consumer Financial Services are stable. Liquidity risk within this segment is primarily limited to maintaining sufficient capital levels to obtain securities lending liquidity to support margin borrowing by clients.

Discontinued Operations. These operations primarily generate cash as a result of the sale and securitization of mortgage loans and residual interests, and as residual interests begin to cash flow. Our discontinued operations provided \$454.1 million in cash from operating activities primarily due to loan sales exceeding loan originations during the nine months ended January 31, 2007. Cash flows provided by investing activities consist primarily of \$38.3 million in cash receipts on available-for-sale residual interests. Operating cash flows of discontinued operations in the table above includes the net loss from discontinued operations of \$119.1 million.

To finance our prime mortgage loan originations, we utilize an on-balance sheet warehouse facility with capacity up to \$25 million. As of January 31, 2007 and April 30, 2006, the balance outstanding under this facility was \$4.7 million and \$1.6 million, respectively.

See discussion of changes in the off-balance sheet arrangements of our discontinued operations below.

OFF-BALANCE SHEET FINANCING ARRANGEMENTS

During the three months ended January 31, 2007, total warehouse capacity was increased from \$16.0 billion to \$16.5 billion. Also during the third quarter, as reported in current report on Form 8-K dated January 31, 2007, we amended our warehouse facility with Citigroup Global Markets Realty Corp (Citigroup) to split OOMC's existing warehouse financing arrangement with Citigroup into two separate warehouse facilities, one of which is an on-balance sheet facility with capacity of \$500.0 million and the other an off-balance sheet facility. Loans totaling \$172.3 million were held on the on-balance sheet line at January 31, 2007, with the related loans and liability reported in assets and liabilities held for sale. At January 31, 2007, our total off-balance sheet capacity was \$16.0 billion, \$14.5 billion of which was committed.

As of January 31, 2007, OOMC did not meet the minimum net income financial covenant contained in eight of its committed warehouse facilities. This covenant requires OOMC to maintain a cumulative minimum net income of at least \$1 for the four consecutive fiscal quarters ended January 31, 2007. On January 24, 2007, OOMC obtained waivers of the minimum net income financial covenants through April 27, 2007 from each of the applicable warehouse facility providers. The parties to the waivers were OOMC, Option One Mortgage Capital Corporation, Option One Loan Warehouse Corporation, Option One Owner Trust 2001-1A; Option One Owner Trust 2001-2; Option One Owner Trust 2003-4, Option One Owner Trust 2003-5; Option One Owner Trust 2005-6; Option One Owner Trust 2005-7; Option One Owner Trust 2005-8; Option One Owner Trust 2005-9; Wells Fargo Bank National Association (as indenture trustee) and each of the following warehouse facility providers: Bank of America, N.A.; JPMorgan Chase Bank, N.A.; Park Avenue Receivables Company LLC; Falcon Asset Securitization Company LLC; JPMorgan Chase Bank, N.A.; Citigroup Global Markets Realty Corp.; DB Structured Products, Inc.; Gemini Securitization Corp., LLC; Greenwich Capital Financial Products, Inc.; HSBC Securities (USA) Inc.; HSBC Bank USA, N.A.; Lehman Brothers Bank; and Merrill Lynch Bank USA.

Table of Contents

Certain parties to the warehouse facilities have other relationships with us. Each of the warehouse facility providers (or their affiliates) are lending parties pursuant to credit facilities maintained by Block Financial Corporation (BFC), as borrower, and H&R Block, Inc., as guarantor, with various lenders. In addition, certain of the HSBC warehouse facility providers and their affiliates are parties to various agreements with us which (i) an HSBC affiliate originates RALs and IMALs and issues RACs to eligible clients of H&R Block company-owned and franchise offices and clients who utilize tax preparation products or services through other H&R Block distribution channels, (ii) BFC purchases participation interests in RALs and IMALs originated by certain HSBC affiliates, (iii) certain HSBC affiliates service RALs and IMALs in which BFC purchases participation interests and (iv) an HSBC affiliate provides a revolving credit facility to BFC for funding BFC's purchases of participation interests in RALs.

We anticipate that OOMC will not meet this financial covenant at April 30, 2007, however we believe we will be able to obtain waivers for that date from a sufficient number of warehouse providers to allow OOMC to continue its off-balance sheet financing activities. If OOMC can not obtain the waivers, warehouse facility providers would have the right to terminate their future funding obligations under the applicable warehouse facilities, terminate OOMC's right to service the loans remaining in the applicable warehouse or request funding of the 10% guarantee. See note 11 to our condensed consolidated financial statements. While this termination could adversely impact OOMC's ability to fund new loans, we believe this risk is mitigated by options available to H&R Block.

Other than the changes outlined above, there have been no material changes in our off-balance sheet financing arrangements from those reported at April 30, 2006 in our Annual Report on Form 10-K.

COMMERCIAL PAPER ISSUANCE AND SHORT-TERM BORROWINGS

We entered into a \$3.0 billion line of credit agreement with HSBC Finance effective January 2, 2007 for use as an alternate funding source for the purchase of RAL participations. This line is subject to various covenants that are substantially similar to our primary unsecured committed lines of credit (CLOCs), and is secured by our RAL participations. The balance outstanding on this facility at January 31, 2007 was \$1.4 billion.

We entered into a \$300.0 million committed line of credit agreement with BNP Paribas for the period January 2 through February 23, 2007 to cover our peak liquidity needs. This line is subject to various covenants that are substantially similar to our primary unsecured CLOCs. There was no balance outstanding on this line at January 31, 2007.

Our Canadian commercial paper issuances are supported by a credit facility provided by one bank in scheduled amounts ranging from \$1.0 million to \$225.0 million (Canadian) based on anticipated operational needs. The Canadian CLOC was renewed in November 2006 for an additional 364 days.

Other than the changes outlined above, there have been no material changes in our commercial paper program and short-term borrowings from those reported at April 30, 2006 in our Annual Report on Form 10-K.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

There have been no material changes in our contractual obligations and commercial commitments from those reported at April 30, 2006 in our Annual Report on Form 10-K.

REGULATORY ENVIRONMENT

In March 2006, the OTS approved the federal savings bank charter of HRB Bank. HRB Bank commenced operations on May 1, 2006, at which time H&R Block, Inc. became a savings and loan holding company. As a savings and loan holding company, H&R Block, Inc. is subject to regulation by the OTS. Federal savings banks are subject to extensive regulation and examination by the OTS, their primary federal regulator, as well as the Federal Deposit Insurance Corporation (FDIC). HRB Bank is subject to various OTS capital requirements and H&R Block, Inc. is now subject to a three percent minimum ratio of adjusted tangible capital to adjusted total assets, as defined by the OTS. As of January 31, 2007, our ratio of adjusted tangible capital to adjusted total assets was approximately 1%. We fell below the minimum required ratio due to losses in our mortgage

Table of Contents

operations and seasonal fluctuations in our consolidated balance sheet. We notified the OTS of our failure to meet this requirement and the OTS requested that we provide a plan and expected timeframe for regaining compliance. We have provided a corrective plan and indicated that we believed our noncompliance would be remedied by February 28, 2007. We have agreed to provide the OTS with the calculation of this ratio as of February 28, 2007, although it is normally required only on a quarterly basis. We have not received further requests from the OTS as of the date of this filing.

A banking institution's capital category depends upon where its capital levels are in relation to relevant capital measures, which include a risk-based capital measure, a leverage ratio capital measure, a tangible equity ratio measure, and certain other factors. See note 6 to the condensed consolidated financial statements for additional discussion of regulatory capital requirements and classifications.

HRB Bank is an indirect wholly-owned subsidiary of H&R Block, Inc. and is insured by the FDIC. If an insured institution fails, claims for administrative expenses of the receiver and for deposits in U.S. branches (including claims of the FDIC as subrogee of the failed institution) have priority over the claims of general unsecured creditors. In addition, the FDIC has authority to require H&R Block, Inc. to reimburse it for losses it incurs in connection with the failure of HRB Bank or with the FDIC's provision of assistance to a banking subsidiary that is in danger of failure.

Other than the items discussed above, there have been no material changes in our regulatory environment from those reported at April 30, 2006 in our Annual Report on Form 10-K.

CRITICAL ACCOUNTING POLICIES

The following discussion is an update to previous disclosure regarding certain of our critical accounting policies and should be read in conjunction with the complete critical accounting policies disclosures included in our Annual Report on Form 10-K for the year ended April 30, 2006. For all of our critical accounting policies, we caution that future events rarely develop precisely as forecasted, and estimates routinely require adjustment and may require material adjustment.

Gains on Sales of Mortgage Assets

We sell substantially all of the non-prime mortgage loans we originate to warehouse trusts (the "Trusts") which are qualifying special purpose entities (QSPEs), with servicing rights generally retained. Prime mortgage loans are sold in 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 third-party buyers, including the Trusts) and are based on the difference between net proceeds received (cash proceeds less recourse obligations) and the allocated cost of the assets sold. We determine the allocated cost of assets sold based on the relative fair values of net proceeds (i.e. the loans sold), retained MSRs and the beneficial interest in Trusts, which represents our residual interest in the ultimate expected outcome from the disposition of the loans by the Trusts.

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	\$ 999,000
Cash received	(4,000)
Less recourse obligation	\$ 995,000
Beneficial interest in Trusts	20,000
MSRs	7,000
	\$ 1,022,000

Computation of gain on sale:	
Net proceeds	\$ 995,000
Less allocated cost ($\$995,000 / \$1,022,000 \times \$1,000,000$)	973,581
Recorded gain on sale	\$ 21,419
Recorded beneficial interest in Trusts ($\$20,000 / \$1,022,000 \times \$1,000,000$)	\$ 19,570
Recorded value of MSRs ($\$7,000 / \$1,022,000 \times \$1,000,000$)	\$ 6,849
Recorded liability for recourse obligation	\$ 4,000

-40-

Table of Contents

Variations in the assumptions we use affect the estimated fair values and the reported net gains on sales. Gains on sales of mortgage loans totaled \$333.3 million and \$499.5 million for nine months ended January 31, 2007 and 2006, respectively.

Our recourse obligation relates to potential losses that could be incurred related to the repurchase of sold loans or indemnification of losses as a result of early payment defaults or breaches of other representations and warranties customary to the mortgage banking industry.

The substantial majority of loan repurchases or indemnification for losses occurs within nine months from the date the loans are sold. We estimate the fair value of the recourse liability at the time the loan is sold. Provisions for losses are charged to gain on sale of mortgage loans and credited to the recourse liability, while actual losses are charged to the liability. We evaluate, and adjust if necessary, the fair value of the recourse obligation quarterly based on current information and trends in underlying loan performance. The amount of losses we expect to incur related to the repurchase of sold loans depends primarily on the frequency of early payment defaults, the rate at which defaulted loans subsequently become current on payments (cure rate), the propensity of the buyer of the loans to demand recourse under the loan sale agreement and the severity of loss incurred on loans which have been repurchased. The frequency of early payment defaults, cure rates and loss severity may vary depending on the creditworthiness of the borrower and economic factors such as home price appreciation and interest rates. To the extent actual losses related to repurchase activity are different from our estimates, the fair value of our recourse obligation will increase or decrease.

During the nine months ended January 31, 2007, we experienced higher early payment defaults, resulting in an increase in actual and expected loan repurchase activity. As a result, we recorded total loss provisions of \$251.1 million during the nine months ended January 31, 2007 compared to \$49.5 million in the prior year. Loss provisions recorded in the current year consist of \$130.7 million recorded on loans sold during the current year and \$120.4 million related to loans sold in prior periods. At January 31, 2007, we assumed that substantially all loans that failed to make timely payments according to contractual early payment default provisions will be repurchased, and that 6% of loans will be repurchased from sales that have not yet reached the contractual date upon which repurchases can be determined. Based on historical experience and review of current early payment default, cure rate and loss severity trends, we assumed 10% of all loans we repurchase from whole loan sale transactions will cure with no loss incurred, and of those that do not cure, we assumed an average 17% loss severity for loans on which we hold a first lien position. During the three months ended January 31, 2007, we increased our estimated loss severity for on-balance sheet loans from an average of 17% to 29%. We recorded \$92.8 million in reserves related to loans sold in prior quarters due to higher severity assumptions, higher loss frequency and a decrease in our estimated cure rate.

Based on our analysis as of January 31, 2007, we estimated our liability for recourse obligations to be \$44.8 million. The sensitivity of the recourse liability to 10% and 20% adverse changes in loss assumptions is \$4.5 million and \$9.0 million, respectively.

Valuation of MSRs

MSRs are recorded when we sell loans to third-parties with the servicing of those loans retained. At the time of the loan sale, we determine and record on our balance sheet the allocated historical cost of the MSRs attributable to loans sold, as illustrated above. These MSRs are amortized into expense over the estimated life of the underlying loans. MSRs are carried at the lower of cost or market (LOCOM). On a quarterly basis, MSRs are assessed to determine if our carrying value exceeds fair value. Fair value is estimated using a discounted cash flow approach by stratifying the MSRs based on underlying loan characteristics, including the calendar year the loans are sold. To the extent fair value is less than carrying value we record an impairment charge and adjust the carrying value of the MSRs.

A market price of our MSRs is not readily available because non prime MSRs are not actively traded in the marketplace. Therefore, the fair value of our MSRs is estimated using a discounted cash flow approach, using valuation methods and assumptions we believe incorporate assumptions

Table of Contents

used by market participants. Certain of these assumptions are subjective and require a high level of management judgment. MSR valuation assumptions are reviewed and approved by management on a quarterly basis. In determining the assumptions to be used to value MSRs, we review the historical performance of our MSRs, including back-testing of the performance of certain individual assumptions (comparison of actual results to those expected). In addition, we periodically review third-party valuations of certain of our MSRs and peer group MSR valuation surveys to assess the reasonableness of our valuation assumptions and resulting fair value estimates.

Critical assumptions used in our discounted cash flow model include mortgage prepayment speeds, discount rates, costs to service and ancillary income. Variations in our assumptions could materially affect the estimated fair values. Changes to our assumptions are made when current trends and market data indicate that new trends have developed. Certain assumptions, such as ancillary interest income, may change from quarter to quarter as market conditions and projected interest rates change. Other assumptions, such as expected prepayment speeds, discount rates and costs of servicing may change less frequently as they are less sensitive to near-term market conditions.

Prepayment speeds may be affected by economic factors such as home price appreciation, market interest rates, the availability of other credit products to our borrowers and customer payment patterns. Prepayment speeds include the impact of all borrower prepayments including full payoffs, additional principal payments and the impact of loans paid off due to foreclosure liquidations. As market interest rates decline, prepayment speeds will generally increase as customers refinance existing mortgages under more favorable interest rate terms. As prepayment speeds increase, anticipated cash flows will generally decline resulting in a potential reduction, or impairment, to the fair value of the capitalized MSRs. Alternatively, an increase in market interest rates may cause a decrease in prepayment speeds, and an increase in fair value of MSRs. Many of our loans include prepayment penalties during the first two to three years. Prepayment penalties tend to lower prepayment speeds during the early life of our loans, regardless of market interest rate movements, therefore decreasing the sensitivity of expected prepayment speeds to changes in interest rates. Prepayment speeds are estimated based on historical experience and third-party market sources. Changes are made as necessary to ensure such estimates reflect current market conditions specific to our individual MSR stratas.

Discount rates are determined by reviewing market rates used by market participants. These rates may vary based on economic factors such as market perception of risk and changes in the risk-free interest rates. Changes are made as necessary to ensure such estimates reflect current market conditions for MSR assets.

Costs to service includes the cost to process loan payments, make payments to bondholders, collect delinquent accounts and administrative foreclosure activities. Market trends and changes to underlying expenses are evaluated to determine if updates to assumptions are necessary. The economic factors affecting costs to service include unemployment rates, the housing market and the cost of labor. Higher unemployment rates may lead to higher delinquency and foreclosure rates resulting in higher costs to service loans. The housing market, including home price appreciation rates, impacts sale prices for homes in foreclosure and our borrowers' ability to refinance or sell their properties in the event that they can no longer afford their homes, thus impacting delinquencies and foreclosures.

Ancillary fees and income include late charges, non-sufficient funds fees, collection fees and interest earning funds held in deposit. These fees could be impacted by state legislation efforts, customer behavior, fee waiver policies and industry trends.

During the period from May 1, 2005 to the current quarter ended January 31, 2007, assumptions used in valuing MSRs have been updated. The significant changes and their impact, both in dollars and basis points of loans sold during the quarter of initial implementation, are outlined below beginning with the most recent changes.

			(dollars in 000s)
			Quarter
Description	Change	Impact	Implemented
Prepayment rates	Further stratification of prepayment rates	\$4,428 or 8 basis points	January 31, 2007
Ancillary fees	Decreased average number of days of interest collected	(\$3,677) or (5) basis points	July 31, 2006

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related to prepayments

Discount rate	15% to 18%	(\$2,555) or (3) basis points	January 31, 2006
Costs to service	Decreased the number of days of interest paid to investors	\$12,893 or 11 basis points	October 31, 2005

-42-

Table of Contents

During the period ended January 31, 2007 we updated our assumptions related to loan prepayment rates to further stratify by vintage year, loan type, and loans with and without prepayment penalties. We also updated assumptions surrounding investor remittances during the current period. The net impact of the changes outlined above and other less significant changes made during the current quarter was an increase of approximately 4 basis points for MSRs initially recorded in the current quarter. During the period ended July 31, 2006, we updated our assumption related to the average number of days of interest collected on funds received as a result of prepayments (Ancillary fees on the table above). We decreased the average number of days of interest collected following a review of the servicing portfolio data. During the quarter ended January 31, 2006, we increased the discount rate assumption (Discount rate on the table above) used to determine the fair value of MSRs from 15% to 18% as a result of an analysis of third party data including rates used by other market participants. During the quarter ended October 31, 2005, we updated our assumption for number of days of interest paid to investors (Costs to service on the table above) on monthly loan prepayments upon the completion of a review of the historical performance of the servicing portfolio. The cumulative net impact of the changes outlined above and other less significant changes made during the period from January 31, 2006 to January 31, 2007 was an increase of approximately 5 basis points for MSRs initially recorded in the current quarter compared to the prior year quarter.

The changes outlined above are applied not only when we determine the allocated historical cost of MSRs, but are also used in our evaluation of the fair value of the MSR portfolio in conjunction with our impairment review. The changes in assumptions primarily impact the recognition of our initial MSR value through calculation of the gain on sale of mortgage assets. Because MSRs are recorded at LOCOM, we are unable to adjust our MSR portfolio value upward, thus have not recognized the positive impact of the assumption changes on the MSR portfolio as a whole.

MSRs with a book value of \$263.1 million are included in our condensed consolidated balance sheet at January 31, 2007. While changes in any assumption could impact the value of our MSRs, the primary drivers of significant changes to the value of our MSRs are prepayment speeds, discount rates, costs to service and ancillary fees. Below is a table showing the effect of a variation of a particular assumption on the fair value of our MSRs without changing any other assumptions. In reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

Assumption	Impact on Fair Value
Prepayments (including defaults):	
Adverse 10% % impact on fair value	(8%)
Adverse 20% % impact on fair value	(16%)
Discount rate:	
Adverse 10% % impact on fair value	(3%)
Adverse 20% % impact on fair value	(5%)
Ancillary Fees and Income:	
Adverse 10% % impact on fair value	(4%)
Adverse 20% % impact on fair value	(8%)
Costs to service:	
Adverse 10% % impact on fair value	(4%)
Adverse 20% % impact on fair value	(9%)

Table of Contents

FORWARD-LOOKING INFORMATION

In this report, and from time to time throughout the year, we share our expectations for our 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 expressions may identify such forward-looking statements.

RECONCILIATION OF NON-GAAP FINANCIAL INFORMATION

We report our financial results in accordance with generally accepted accounting principles (GAAP). However, we believe certain non-GAAP performance measures and ratios used in managing the business may provide additional meaningful comparisons between current year results and prior periods. Reconciliations to GAAP financial measures are provided below. These non-GAAP financial measures should be viewed in addition to, not as an alternative for, our reported GAAP results.

-44-

Table of Contents**Banking Ratios**

	(dollars in 000s)	
	Three months ended January 31, 2007	Nine months ended January 31, 2007
Efficiency Ratio:		
Total Consumer Financial Services expenses	\$ 96,552	\$ 262,316
Less: Interest and non-banking expenses	(91,983)	(254,572)
Non-interest banking expenses	\$ 4,569	\$ 7,744
Total Consumer Financial Services revenues	\$ 107,511	\$ 267,888
Less: Non-banking revenues and interest expense	(94,800)	(246,714)
Banking revenue net of interest expense	\$ 12,711	\$ 21,174
	36%	37%
Net Interest Margin (annualized):		
Net banking interest revenue	\$ 6,188	\$ 14,309
Net banking interest revenue (annualized)	\$ 24,752	\$ 19,079
Divided by average assets	\$ 982,633	\$ 682,798
	2.52%	2.79%
Return on Average Assets (annualized):		
Total Consumer Financial Services pretax income	\$ 10,959	\$ 5,572
Less: Non-banking pretax income (loss)	4,505	(15,614)
Pretax banking income	\$ 6,454	\$ 10,042
Pretax banking income (annualized)	\$ 25,816	\$ 13,389
Divided by average assets	\$ 982,633	\$ 682,798
	2.63%	1.96%

Origination Margin

	(dollars in 000s)			
	Three months ended January 31,		Nine months ended January 31,	
	2007	2006	2007	2006
Total expenses	\$ 218,128	\$ 226,072	\$ 633,591	\$ 685,548
Add: Expenses netted against gain on sale revenues	42,288	85,974	135,442	321,177

Less:				
Cost of services	(77,040)	(83,076)	(235,353)	(215,279)
Cost of acquisition	(12,005)	(24,305)	(28,809)	(127,201)
Allocated support departments	(3,883)	(3,581)	(12,034)	(9,799)
Other	(38,874)	(11,291)	(66,819)	(29,891)
	\$ 128,613	\$ 189,793	\$ 426,018	\$ 624,555

Divided by origination volume	\$ 6,260,399	\$ 8,952,487	\$ 21,230,982	\$ 32,460,924
Total cost of origination	2.05%	2.12%	2.01%	1.92%

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The sensitivities of certain financial instruments to changes in interest rates as of January 31, 2007 are presented below. The following table represents hypothetical instantaneous and sustained parallel shifts in interest rates and should not be relied on as an indicator of future expected results.

		(in 000s)					
Carrying Value at January 31, 2007		Basis Point Change					
		-300	-200	-100	+100	+200	+300
Mortgage loans held for investment	\$ 1,069,626	\$ 39,780	\$ 32,367	\$ 21,417	\$ (23,870)	\$ (49,735)	\$ (78,685)
Mortgage loans held for sale	363,016	15,707	10,157	4,916	(4,915)	(9,913)	(14,606)

There have been no other material changes in our market risks from those reported at April 30, 2006 in our Annual Report on Form 10-K.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this Form 10-Q, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures. The controls evaluation was done under the supervision and with the participation of management. Based on this evaluation we have concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this Quarterly Report on Form 10-Q due to a material weakness in internal controls in financial reporting identified related to the valuation of certain residual interests in securitizations. We believe this material weakness has been remediated as of March 12, 2007, and that the remediation is reflected in the information contained in this Form 10-Q.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

RAL LITIGATION

We reported in our annual report on Form 10-K for the year ended April 30, 2006, certain events and information regarding lawsuits throughout the country regarding the RAL Cases. The RAL Cases have involved a variety of legal theories asserted by plaintiffs. These theories include allegations that, among other things, disclosures in the RAL applications were inadequate, misleading and untimely; the RAL interest rates were usurious and unconscionable; we did not disclose that we would receive part of the finance charges paid by the customer for such loans; untrue, misleading or deceptive statements in marketing RALs; breach of state laws on credit service organizations; breach of contract, unjust enrichment, unfair and deceptive acts or practices; violations of the federal Racketeer Influenced and Corrupt Organizations Act; violations of the federal Fair Debt Collection Practices Act and unfair competition regarding debt collection activities; and that we owe, and breached, a fiduciary duty to our customers in connection with the RAL program.

The amounts claimed in the RAL Cases have been very substantial in some instances. We have successfully defended against numerous RAL Cases, some of which 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 have been settled, with one settlement resulting in a pretax expense of \$43.5 million in fiscal year 2003 (the Texas RAL Settlement) and other settlements resulting in a combined pretax expense in fiscal year 2006 of \$70.2 million (the 2006 Settlements).

We believe we have meritorious defenses to the remaining RAL Cases and we intend to defend them 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 attorney general actions or 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. This case constitutes one of the 2006 Settlements. On April 19, 2006, we entered into a settlement agreement regarding this case, subject to final court approval. The settlement was approved by the court on August 28, 2006. One objector filed an appeal, which was dismissed on March 1, 2007. Unless a Petition for Certiorari is filed by the objector and granted by the United States Supreme Court, the settlement is final.

Table of Contents

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 Court of Pennsylvania, Philadelphia County, instituted on April 23, 1993. The court decertified the class on December 31, 2003. The Pennsylvania appellate court subsequently reversed the trial court's decertification decision. On September 26, 2006, the Pennsylvania Supreme Court reversed the appellate court's reversal of the trial court's decision to decertify the class. The plaintiff is seeking further review by the appellate court.

Deadra 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. The court approved the settlement of this case on June 8, 2006, and the settlement is now final.

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, 2002, that was granted class certification on August 27, 2003. Plaintiffs' claims consist of five counts relating to the Peace of Mind (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, although plaintiffs have indicated that they plan to seek a trial in July 2007.

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

We believe the claims in the POM actions 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.

EXPRESS IRA LITIGATION

On March 15, 2006, the New York Attorney General filed a lawsuit in the Supreme Court of the State of New York, County of New York (Index No. 06/401110) entitled *The People of New York v. H&R Block, Inc. and H&R Block Financial Advisors, Inc.* The complaint alleged fraudulent business practices, deceptive acts and practices, common law fraud and breach of fiduciary duty with respect to the Express IRA product and sought equitable relief, disgorgement of profits, damages and restitution, civil penalties and punitive damages. On December 1, 2006, the Supreme Court of the State of New York issued a ruling that dismissed the New York Attorney General's lawsuit in its entirety on procedural grounds but granted leave to amend and refile the lawsuit. The amended complaint has been filed and alleges causes of action similar to those claimed in the original complaint and seeks equitable relief, disgorgement of profits, damages and restitution, civil penalties and punitive damages. We intend to defend this case vigorously, but there are no assurances as to its outcome.

Table of Contents

In addition to the New York Attorney General action, a number of civil actions were filed against us concerning the Express IRA matter, the first of which was filed on March 17, 2006. All of the civil actions pending in federal court have been consolidated by the panel for Multi-District Litigation into a single action styled *In re H&R Block, Inc. Express IRA Marketing Litigation* in the United States District Court for the Western District of Missouri. We intend to defend these cases vigorously, but there are no assurances as to their outcome.

SECURITIES AND SHAREHOLDER DERIVATIVE LITIGATION

On March 17, 2006, the first of three putative class actions alleging violations of certain securities laws were filed against the Company and certain of its current and former officers and directors (the "Securities Class Action Cases"). In addition, on April 5, 2006, the first of nine shareholder derivative actions purportedly brought on behalf of the Company (which is named as a nominal defendant) were filed against certain of the Company's current and former directors and officers (the "Derivative Cases"). The Securities Class Action Cases alleged, among other things, deceptive, material and misleading financial statements, failure to prepare financial statements in accordance with generally accepted accounting principles and concealment of the potential for lawsuits stemming from the allegedly fraudulent nature of the Company's operations. The actions seek unspecified damages and equitable relief. The Derivative Cases generally involved allegations of breach of fiduciary duty, abuse of control, gross mismanagement, waste and unjust enrichment pertaining to (i) the Company's restatement of financial results due to errors in determining the Company's state effective income tax rate and (ii) certain of the Company's products and other business activities. On September 20, 2006, the United States District Court for the Western District of Missouri ordered all of the Securities Class Action Cases and the Derivative Cases consolidated into a single action styled *In re H&R Block Securities Litigation*. The court will appoint a lead plaintiff who will then file a consolidated complaint. We intend to defend this litigation vigorously, but there are no assurances as to its outcome.

OTHER CLAIMS AND LITIGATION

As reported previously, the NASD brought charges against HRBFA regarding the sale by HRBFA of Enron debentures in 2001. A hearing for this matter commenced in May 2006, was recessed until October 2006 and is scheduled to continue through August 2007. 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 reporting and listing regulations and whether such strategies were abusive as defined by the IRS. If the IRS were to determine that RSM did not comply with the tax shelter reporting and listing regulations, it might assess fines or penalties against RSM. Moreover, if the IRS were to determine that the tax planning 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. There can be no assurance regarding the outcome of and resolution of this matter.

We have from time to time been party to investigations, claims and lawsuits not discussed herein arising out of our business operations. These investigations, claims and lawsuits include actions by state attorneys general, individual plaintiffs, and 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 investigations, claims and lawsuits pertain to RALs, the electronic filing of customers' income tax returns, the POM guarantee program, and our Express IRA program and other investment products and RSM EquiCo business valuation services. 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.

Table of Contents

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, employment matters and contract disputes. We believe we have meritorious defenses to each of the Other Claims, and we are defending 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 1A. RISK FACTORS

Consumer Financial Services. H&R Block, Inc. is a savings and loan holding company, and HRB Bank is a federal savings bank, which is subject to regulation by the OTS and FDIC. Federal and state laws and regulations govern numerous matters including: changes in the ownership or control of banks and bank holding companies; maintenance of adequate capital and the financial condition of a financial institution; permissible types, amounts and terms of extensions of credit and investments; permissible non-banking activities; the level of reserves against deposits; and restrictions on dividend payments. 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.

Other than the items discussed above, there have been no material changes in our risk factors from those reported at April 30, 2006 in our Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES

A summary of our purchases of H&R Block common stock during the third quarter of fiscal year 2007 is as follows:

		(shares in 000s)		
		Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽²⁾	Maximum Number of Shares that May Be Purchased Under the Plans or Programs ⁽²⁾	
		Average Price Paid per Share	Total Number of Shares Purchased ⁽¹⁾	
November 1	November 30		65	22,352
December 1	December 31		2	22,352
January 1	January 31		19	22,352

- (1) We purchased 86,092 shares in connection with the funding of employee income tax withholding obligations arising upon the exercise of stock options or the lapse of restrictions on

nonvested
shares.

- (2) On June 9, 2004, our Board of Directors approved the repurchase of 15.0 million shares of H&R Block, Inc. common stock. On June 7, 2006, our Board approved an additional authorization to repurchase 20.0 million shares. These authorizations have no expiration date.

ITEM 6. EXHIBITS

- 10.1 Omnibus Amendment and Consent Agreement dated as of December 29, 2006 among Option One Owner Trust 2001-1A, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One Loan Warehouse Corporation, Wells Fargo National Bank, National Association and Greenwich Capital Financial Products, Inc.
- 10.2 Amendment Number Five to Second Amended and Restated Sale and Servicing Agreement dated as of September 7, 2006, among Option One Owner Trust 2001-2, Option One Loan Warehouse Corporation, Option One Mortgage Corporation and Wells Fargo Bank N.A.
- 10.3 Amendment Number Nine to Amended and Restated Indenture dated as of December 15, 2006, among Option One Owner Trust 2001-2 and Wells Fargo Bank, N.A.
- 10.4 Omnibus Amendment and Consent Agreement dated as of December 29, 2006 among Option One Owner Trust 2001-2, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One Loan Warehouse Corporation, Wells Fargo National Bank, National Association and Bank of America N.A.

-49-

Table of Contents

- 10.5 Waiver and Amendment dated January 24, 2007, among Option One Owner Trust 2001-2, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One Loan Warehouse Corporation, Well Fargo Bank, National Association and Bank of America, N.A.
- 10.6 Second Amended and Restated Sale and Servicing Agreement dated as of January 19, 2007, among Option One Mortgage Corporation, Option One Owner Trust 2002-3 and Wells Fargo Bank N.A.
- 10.7 Second Amended and Restated Note Purchase Agreement dated as of January 19, 2007, among Option One Loan Warehouse Corporation, Option One Owner Trust 2002-3 and UBS Real Estate Securities, Inc.
- 10.8 Indenture dated as of January 19, 2007 between Option One Owner Trust 2002-3 and Wells Fargo Bank, N.A.
- 10.9 Omnibus Amendment and Consent Agreement dated as of December 29, 2006 among Option One Owner Trust 2003-4, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One Loan Warehouse Corporation, Wells Fargo National Bank, National Association, Falcon Asset Securitization Company LLC, Park Avenue Receivables Company LLC and JPMorgan Chase Bank N.A.
- 10.10 Waiver dated January 24, 2007, among Option One Owner Trust 2003-4, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One Loan Warehouse Corporation, Wells Fargo Bank, National Association, Falcon Asset Securitization Company LLC, Park Avenue Receivables Company LLC and JPMorgan Chase Bank N.A.
- 10.11 Amendment Number Two to Amended and Restated Sale and Servicing Agreement dated as of November 10, 2006, among Option One Owner Trust 2003-5, Option One Loan Warehouse Corporation, Option One Mortgage Corporation and Wells Fargo Bank, N.A.
- 10.12 Amendment Number Two to Note Purchase Agreement dated as of November 10, 2006, among Option One Owner Trust 2003-5, Option One Loan Warehouse Corporation and Citigroup Global Markets Realty Corp.
- 10.13 Omnibus Amendment and Consent Agreement dated as of December 29, 2006 among Option One Owner Trust 2003-5, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One Loan Warehouse Corporation, Wells Fargo National Bank, National Association and Citigroup Global Markets Realty Corp.
- 10.14 Omnibus Amendment dated as of January 1, 2007, among Option One Owner Trust 2003-5, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One Loan Warehouse Corporation, Wells Fargo Bank, National Association and Citigroup Global Markets Realty Corp.
- 10.15 Omnibus Amendment Number Four dated as of July 12, 2006, among Option One Owner Trust 2005-6, Option One Loan Warehouse Corporation, Option One Mortgage Corporation, Wells Fargo Bank, N.A. and Lehman Brothers Bank.
- 10.16 Omnibus Amendment and Consent Agreement dated as of December 29, 2006, among Option One Owner Trust 2005-6, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One Loan Warehouse Corporation, Wells Fargo Bank, National Association and Lehman Brothers Bank.
- 10.17 Omnibus Amendment and Consent Agreement dated as of December 29, 2006, among Option One Owner Trust 2005-7, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One

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Loan Warehouse Corporation, Wells Fargo National Bank, National Association, HSBC Bank USA, N.A., Bryant Park Funding LLC and HSBC Securities (USA) Inc.

10.18 Omnibus Amendment and Consent Agreement dated as of December 29, 2006, among Option One Owner Trust 2005-8, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One Loan Warehouse Corporation, Wells Fargo National Bank, National Association and Merrill Lynch Bank USA.

10.19 Omnibus Amendment and Consent Agreement dated as of December 29, 2006, among Option One Owner Trust 2005-9, Option One Mortgage Corporation, Option One Mortgage Capital

-50-

Table of Contents

Corporation, Option One Loan Warehouse Corporation, Wells Fargo National Bank, National Association, DB Structured Products, Inc., Gemini Securitization Corp., LLC, Aspen Funding Corp. and Newport Funding Corp.

- 10.20 Supplemental Indenture No. 2 dated as of January 16, 2007, between Option One Owner Trust 2005-9 and Wells Fargo Bank, N.A.
- 10.21 Amendment Number One to Sale and Servicing Agreement dated as of January 16, 2007, among Option One Owner Trust 2005-9, Option One Loan Warehouse Corporation, Option One Mortgage Corporation and Wells Fargo Bank, N.A.
- 10.22 Sale and Servicing Agreement dated as of January 1, 2007, among Option One Loan Warehouse Corporation, Option One Mortgage Corporation, Option One Mortgage Capital Corporation, Option One Owner Trust 2007-5A and Wells Fargo Bank, N.A.
- 10.23 Note Purchase Agreement dated as of January 1, 2007, among Option One Loan Warehouse Corporation, Option One Owner Trust 2007-5A and Citigroup Global Markets Realty Corp.
- 10.24 Indenture dated as of January 1, 2007, between Option One Owner Trust 2007-5A and Wells Fargo Bank, N.A.
- 10.25 Joinder and First Amendment to Program Contracts dated as of November 10, 2006, among HSBC Bank USA, National Association; HSBC Trust Company (Delaware), N.A.; HSBC Taxpayer Financial Services Inc.; Beneficial Franchise Company Inc.; Household Tax Masters Acquisition Corporation; H&R Block Services, Inc.; H&R Block Tax Services, Inc.; H&R Block Enterprises, Inc.; H&R Block Eastern Enterprises, Inc.; H&R Block Digital Solutions, LLC; H&R Block and Associates, L.P.; HRB Royalty, Inc.; HSBC Finance Corporation; H&R Block, Inc.; and Block Financial Corporation.*
- 10.26 Second Amendment to Program Contracts dated as of November 13, 2006, among HSBC Bank USA, National Association; HSBC Trust Company (Delaware), N.A.; HSBC Taxpayer Financial Services Inc.; Beneficial Franchise Company Inc.; H&R Block Services, Inc.; H&R Block Tax Services, Inc.; H&R Block Enterprises, Inc.; H&R Block Eastern Enterprises, Inc.; H&R Block Digital Solutions, LLC; H&R Block and Associates, L.P.; HRB Royalty, Inc.; HSBC Finance Corporation; and H&R Block, Inc.*
- 10.27 First Amended and Restated HSBC Refund Anticipation Loan and IMA Participation Agreement dated as of November 13, 2006 among Block Financial Corporation; HSBC Bank USA, National Association; HSBC Trust Company (Delaware), National Association; and HSBC Taxpayer Financial Services, Inc.*
- 10.28 First Amended and Restated HSBC Settlement Products Servicing Agreement dated as of November 13, 2006, among HSBC Bank USA, National Association; HSBC Taxpayer Financial Services, Inc.; HSBC Trust Company (Delaware), N.A.; and Block Financial Corporation.*
- 10.29 Credit and Guarantee Agreement dated January 2, 2007, among Block Financial Corporation, H&R Block, Inc. and HSBC Finance Corporation.*
- 10.30 First Amendment dated as of November 28, 2006 to Five-Year Credit and Guarantee Agreement among Block Financial Corporation, H&R Block, Inc., JPMorgan Chase Bank and various financial institutions.
- 10.31

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First Amendment dated as of November 28, 2006 to Amended and Restated Five-Year Credit and Guarantee Agreement among Block Financial Corporation, H&R Block, Inc., JPMorgan Chase Bank and various financial institutions.

- 10.32 Separation and Release Agreement between HRB Management, Inc. and Nicholas J. Spaeth.**
- 31.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification by Chief Executive Officer furnished pursuant to 18 U.S.C. 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by Chief Financial Officer furnished pursuant to 18 U.S.C. 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.

* Confidential Information has been omitted from this exhibit and filed separately with the Commission pursuant to a confidential treatment request under Rule 24b-2.

** Indicates management contract, compensatory plan or arrangement.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

H&R BLOCK, INC.

Mark A. Ernst
Chairman of the Board, President
and Chief Executive Officer
March 14, 2007

William L. Trubeck
Executive Vice President and
Chief Financial Officer
March 14, 2007

Jeffrey E. Nachbor
Senior Vice President and
Corporate Controller
March 14, 2007

-52-