



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, 2004

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.)

4400 Main Street  
Kansas City, Missouri 64111  
(Address of principal executive offices, including zip code)

(816) 753-6900  
(Registrant's telephone number, including area code)

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

The number of shares outstanding of the registrant's Common Stock, without par value, at the close of business on February 27, 2004 was 174,970,755 shares.

---

## **TABLE OF CONTENTS**

[CONDENSED CONSOLIDATED BALANCE SHEETS](#)

[CONDENSED CONSOLIDATED INCOME STATEMENTS](#)

[CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS](#)

[NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS](#)

[MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION](#)

[QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK](#)

[CONTROLS AND PROCEDURES](#)

[PART II - OTHER INFORMATION](#)

[SIGNATURES](#)

[Employment Agreement](#)

[Settlement Agreement](#)

[Loan Participation Agreement](#)

[Certification](#)

[Certification](#)

[Certification](#)

[Certification](#)

---

## TABLE OF CONTENTS

	<b>Page</b>
PART I	Financial Information
	Condensed Consolidated Balance Sheets January 31, 2004 and April 30, 2003
	1
	Condensed Consolidated Income Statements Three and Nine Months Ended January 31, 2004 and 2003
	2
	Condensed Consolidated Statements of Cash Flows Nine Months Ended January 31, 2004 and 2003
	3
	Notes to Condensed Consolidated Financial Statements
	4
	Management's Discussion and Analysis of Results of Operations and Financial Condition
	27
	Quantitative and Qualitative Disclosures about Market Risk
	65
	Controls and Procedures
	65
PART II	Other Information
	66
SIGNATURES	73

---

**H&R BLOCK, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**Amounts in thousands, except share amounts**

	January 31, 2004	April 30, 2003
	(Unaudited)	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 671,089	\$ 875,353
Cash and cash equivalents - restricted	606,832	438,242
Marketable securities - trading	70,280	23,859
Receivables from customers, brokers, dealers and clearing organizations, net	645,357	517,037
Receivables, net (note 4)	1,093,051	403,197
Prepaid expenses and other current assets	611,561	489,673
Total current assets	3,698,170	2,747,361
Residual interests in securitizations (note 5)	233,851	264,337
Mortgage servicing rights (note 5)	106,196	99,265
Property and equipment, at cost less accumulated depreciation and amortization of \$550,662 and \$485,608	284,148	288,594
Intangible assets, net (note 6)	340,748	341,865
Goodwill, net (note 6)	948,530	714,215
Other assets	176,544	148,268
Total assets	<u>\$ 5,788,187</u>	<u>\$ 4,603,905</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Commercial paper	\$ 1,411,177	\$ —
Current portion of long-term debt	277,599	55,678
Accounts payable to customers, brokers and dealers	1,126,103	862,694
Accounts payable, accrued expenses and other	398,250	468,933
Accrued salaries, wages and payroll taxes	170,043	210,629
Accrued income taxes	73,419	299,262
Total current liabilities	3,456,591	1,897,196
Long-term debt	551,406	822,302
Other noncurrent liabilities	303,624	220,698
Total liabilities	<u>4,311,621</u>	<u>2,940,196</u>
<b>Stockholders' equity:</b>		
Common stock, no par, stated value \$.01 per share, 500,000,000 shares authorized; 217,945,398 shares issued at January 31, 2004 and April 30, 2003	2,179	2,179
Additional paid-in capital	530,282	496,393
Accumulated other comprehensive income (note 8)	56,591	36,862
Retained earnings	2,240,592	2,221,868
Less cost of 42,409,777 and 38,343,944 shares of common stock in treasury	(1,353,078)	(1,093,593)
Total stockholders' equity	<u>1,476,566</u>	<u>1,663,709</u>
Total liabilities and stockholders' equity	<u>\$ 5,788,187</u>	<u>\$ 4,603,905</u>

*See Notes to Condensed Consolidated Financial Statements*

**H&R BLOCK, INC.**  
**CONDENSED CONSOLIDATED INCOME STATEMENTS**  
**Unaudited, amounts in thousands, except per share amounts**

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2004	2003	2004	2003
<b>Revenues:</b>				
Service revenues	\$591,050	\$510,042	\$1,037,312	\$ 907,015
Gains on sales of mortgage assets, net	168,965	306,364	581,893	602,749
Interest income	117,643	57,230	276,462	228,176
Product sales	51,324	43,312	107,839	74,234
Royalties	44,427	39,026	49,410	43,082
Other	3,748	2,439	9,786	5,919
	<u>977,157</u>	<u>958,413</u>	<u>2,062,702</u>	<u>1,861,175</u>
<b>Operating expenses:</b>				
Employee compensation and benefits	392,835	352,209	873,804	791,692
Occupancy and equipment	94,764	87,349	253,229	223,642
Depreciation and amortization	46,487	42,670	122,497	114,738
Marketing and advertising	67,975	55,331	99,766	85,335
Interest	21,361	24,817	64,457	69,789
Supplies, freight and postage	28,609	33,154	51,350	55,472
Impairment of goodwill	—	—	—	24,000
Other	150,622	142,591	389,991	356,300
	<u>802,653</u>	<u>738,121</u>	<u>1,855,094</u>	<u>1,720,968</u>
Operating income	174,504	220,292	207,608	140,207
Other income, net	1,616	2,642	4,475	4,576
Income before taxes	176,120	222,934	212,083	144,783
Income taxes	69,394	90,621	83,462	59,361
Net income before cumulative effect of change in accounting principle	106,726	132,313	128,621	85,422
Cumulative effect of change in accounting principle for multiple deliverable revenue arrangements, less taxes of \$4,031	—	—	(6,359)	—
Net income	<u>\$106,726</u>	<u>\$132,313</u>	<u>\$ 122,262</u>	<u>\$ 85,422</u>
<b>Basic earnings per share:</b>				
Before change in acctg. principle	\$ .60	\$ .74	\$ .72	\$ .48
Cumulative effect of change in accounting principle	—	—	(.03)	—
Net income	<u>\$ .60</u>	<u>\$ .74</u>	<u>\$ .69</u>	<u>\$ .48</u>
<b>Diluted earnings per share:</b>				
Before change in acctg. principle	\$ .59	\$ .73	\$ .71	\$ .46
Cumulative effect of change in accounting principle	—	—	(.04)	—
Net income	<u>\$ .59</u>	<u>\$ .73</u>	<u>\$ .67</u>	<u>\$ .46</u>

*See Notes to Condensed Consolidated Financial Statements*

**H&R BLOCK, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Unaudited, amounts in thousands**

	Nine Months Ended January 31,	
	2004	2003
<b>Cash flows from operating activities:</b>		
Net income	\$ 122,262	\$ 85,422
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	122,497	114,738
Accretion of residual interests in securitizations	(118,389)	(113,146)
Impairments of residual interests in securitizations	26,048	25,589
Additions to trading securities - residual interests in securitizations	(251,585)	(326,395)
Proceeds from net interest margin transactions, net	197,417	325,642
Realized gain on sale of previously securitized residuals	(17,000)	(130,881)
Additions to mortgage servicing rights	(64,265)	(55,960)
Amortization of mortgage servicing rights	57,334	33,273
Net change in receivable from Trusts	(12,565)	(73,494)
Cumulative effect of change in accounting principle	6,359	—
Impairment of goodwill	—	24,000
Mortgage loans held for sale:		
Originations and purchases	(17,006,283)	(12,640,440)
Sales and principal repayments	16,948,363	12,629,199
Other net changes in working capital, net of acquisitions	(1,011,833)	(264,296)
<b>Net cash used in operating activities</b>	<b>(1,001,640)</b>	<b>(366,749)</b>
<b>Cash flows from investing activities:</b>		
Available-for-sale securities:		
Purchases of available-for-sale securities	(10,495)	(10,577)
Cash received from residual interests in securitizations	127,997	117,522
Cash proceeds from sale of previously securitized residuals	17,000	142,486
Sales of other available-for-sale securities	17,604	9,730
Purchases of property and equipment, net	(81,178)	(95,629)
Payments made for business acquisitions, net of cash acquired	(280,280)	(24,239)
Other, net	11,943	(6,004)
<b>Net cash provided by (used in) investing activities</b>	<b>(197,409)</b>	<b>133,289</b>
<b>Cash flows from financing activities:</b>		
Repayments of commercial paper	(1,022,716)	(9,301,285)
Proceeds from issuance of commercial paper	2,433,893	9,888,088
Proceeds from securitization financing	50,100	—
Repayments of securitization financing	(50,100)	—
Payments on acquisition debt	(50,820)	(52,107)
Dividends paid	(103,538)	(93,645)
Acquisition of treasury shares	(371,242)	(317,608)
Proceeds from issuance of common stock	111,155	112,813
Other, net	(1,947)	(2,023)
<b>Net cash provided by financing activities</b>	<b>994,785</b>	<b>234,233</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(204,264)</b>	<b>773</b>
<b>Cash and cash equivalents at beginning of the period</b>	<b>875,353</b>	<b>436,145</b>
<b>Cash and cash equivalents at end of the period</b>	<b>\$ 671,089</b>	<b>\$ 436,918</b>

*See Notes to Condensed Consolidated Financial Statements*

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

*Unaudited, dollars in thousands, except per share amounts*

### 1. Basis of Presentation

The condensed consolidated balance sheet as of January 31, 2004, the condensed consolidated income statements for the three and nine months ended January 31, 2004 and 2003, and the condensed consolidated statements of cash flows for the nine months ended January 31, 2004 and 2003 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, 2004 and for all periods presented have been made.

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

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's April 30, 2003 Annual Report to Shareholders on Form 10-K.

Operating revenues of the U.S. Tax Operations, Business Services and International Tax Operations 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.

The Company files its Federal and state income tax returns on a calendar year basis. The condensed consolidated income statements reflect the effective tax rates expected to be applicable for the respective full fiscal years.

### 2. Business Combinations

During the nine months ended January 31, 2004, cash payments of \$243,257 were made related to the acquisition of assets and stock in the franchise territories of ten former major franchisees. The preliminary allocation of the purchase price to assets acquired is as follows: property and equipment of \$2,697; goodwill of \$194,883; customer relationships of \$18,167; noncompete agreements of \$17,069; and \$10,441 related to legal reserves for franchise litigation. The customer relationships will be amortized in conjunction with the estimated retention curve over ten years. The noncompete agreements will be amortized on a straight-line basis over three years. The weighted average life of the intangible assets is approximately seven years. Goodwill recognized in these transactions is included in the U.S. Tax Operations segment and all but \$3,901 is deductible for tax purposes. Results related to these ten former major franchise territories have been included in the accompanying condensed consolidated financial statements since the respective dates company-owned operations commenced. See discussion related to



litigation involving major franchisees in note 12 to the condensed consolidated financial statements.

### 3. Earnings Per Share

Basic earnings 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. The computations of basic and diluted earnings per share are as follows:

(in 000s, except per share amounts)	Three months ended January 31,		Nine months ended January 31,	
	2004	2003	2004	2003
Net income before change in accounting principle	\$106,726	\$132,313	\$128,621	\$ 85,422
Basic weighted average common shares	176,732	178,770	177,964	179,620
Dilutive potential shares from stock options and restricted stock	4,251	3,402	3,516	4,757
Convertible preferred stock	1	1	1	1
Dilutive weighted average common shares	180,984	182,173	181,481	184,378
Earnings per share before change in accounting principle:				
Basic	\$ .60	\$ .74	\$ .72	\$ .48
Diluted	.59	.73	.71	.46

Diluted earnings per share excludes the impact of shares of common stock issuable upon the exercise of options to purchase 283 shares and 3.7 million shares of stock for the three and nine months ended January 31, 2004, respectively, as the options' exercise prices were greater than the average market price of the common shares during those periods and therefore, the effect would be antidilutive. Diluted earnings per share for the three and nine months ended January 31, 2003 excludes the impact of 4.7 million shares and 2.1 million shares, respectively, issuable upon the exercise of stock options as they are antidilutive.

The weighted average shares outstanding for the three and nine months ended January 31, 2004 decreased to 176.7 million and 178.0 million, respectively, from 178.8 million and 179.6 million last year, respectively, primarily due to the purchase of treasury shares by the Company. The effect of these purchases was partially offset by the issuance of treasury shares related to the Company's stock-based compensation plans.

During the nine months ended January 31, 2004, the Company issued 3.8 million shares of common stock pursuant to the exercise of stock options, employee stock purchases and awards of restricted shares, in accordance with the Company's stock-based compensation plans. During the nine months ended January 31, 2003, the Company issued 4.4 million shares of common stock

[Table of Contents](#)

pursuant to the exercise of stock options, employee stock purchases and awards of restricted shares.

During the nine months ended January 31, 2004, the Company acquired 7.8 million shares of its common stock at an aggregate cost of \$371,242. During the nine months ended January 31, 2003, the Company acquired 6.6 million shares of its common stock at an aggregate cost of \$317,608.

#### 4. Receivables

Receivables consist of the following:

	January 31, 2004	April 30, 2003
Participation in refund anticipation loans (RALs)	\$ 562,974	\$ 12,871
Business Services accounts receivable	153,322	185,023
Mortgage loans held for sale	152,668	68,518
Receivables for tax related fees	79,287	1,500
Loans to franchisees	46,729	33,341
Royalties from franchisees	39,898	83
Software receivables	25,995	36,810
Other	72,521	87,471
	1,133,394	425,617
Allowance for doubtful accounts	(22,020)	(17,038)
Lower of cost or market adjustment – mortgage loans	(18,323)	(5,382)
	<u>\$1,093,051</u>	<u>\$403,197</u>

#### 5. Mortgage Banking Activities

Activity related to available-for-sale residual interests in securitizations for the nine months ended January 31, 2004 and 2003 and the twelve months ended April 30, 2003 consists of the following:

	Nine Months Ended		Year Ended
	January 31, 2004	January 31, 2003	April 30, 2003
Balance, beginning of period	\$ 264,337	\$ 365,371	\$ 365,371
Additions from NIM transactions	1,604	753	753
Additions from NIM secured financing, held as collateral	40,196	—	—
Termination of NIM trust	(40,196)	—	—
Cash received	(127,997)	(117,522)	(140,795)
Cash received from sale of previously securitized residuals	(17,000)	(142,486)	(142,486)
Accretion	118,389	113,146	145,165
Impairments of fair value	(26,048)	(25,589)	(54,111)
Exercise of call options	(5,875)	—	—
Changes in unrealized holding gains arising during the period, net	26,441	80,680	90,440
Balance, end of period	<u>\$ 233,851</u>	<u>\$ 274,353</u>	<u>\$ 264,337</u>

## Table of Contents

The Company sold \$16,940,590 and \$12,412,587 of mortgage loans in whole loan sales to third-party trusts (Trusts) or other buyers during the nine months ended January 31, 2004 and 2003, respectively, with gains totaling \$590,941 and \$497,457, respectively, recorded on these sales.

Residual interests valued at \$199,021 and \$326,395 were securitized in net interest margin (NIM) transactions during the respective nine-month periods. Net cash proceeds of \$197,417 and \$325,642 were received from the NIM transactions for the nine months ended January 31, 2004 and 2003, respectively. Total net additions to residual interests from NIM transactions for the nine months ended January 31, 2004 and 2003 were \$1,604 and \$753, respectively.

At January 31, 2004, the Company had \$52,564 of residual interests classified as trading securities. These residual interests are included in marketable securities – trading on the condensed consolidated balance sheet. There were no such trading securities recorded as of April 30, 2003.

In the second quarter of fiscal year 2004, the Company completed a NIM transaction with a special purpose entity (SPE) that did not meet the criteria for a qualifying special purpose entity (QSPE) under Statement of Financial Accounting Standards No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” As a result, the SPE was consolidated and the transaction was accounted for as a secured financing (on-balance sheet securitization). During the third quarter, the NIM trust was terminated and the related residual interests were subsequently securitized in a NIM transaction with a QSPE.

Cash flows of \$127,997 and \$117,522 were received from the securitization trusts for the nine months ended January 31, 2004 and 2003, respectively. An additional \$17,000 and \$142,486 was received during the nine months ended January 31, 2004 and 2003, respectively, as a result of the sale of previously securitized residuals. Cash received on residual interests is included in investing activities in the condensed consolidated statements of cash flows.

Residual interests are classified as either available-for-sale (AFS) or trading securities and are therefore reported at fair market value (based on discounted cash flow models). Unrealized holding gains represent the write-up in value of AFS residual interests as a result of actual or projected performance factors that are better than the projected assumptions previously used in the Company’s valuation models, such as interest rates, loan losses or loan prepayments. Trading securities are marked-to-market through the income statement.

Aggregate net unrealized gains on residual interests, which had not yet been accreted into income, totaled \$107,066 at January 31, 2004 and \$98,089 at April 30, 2003. 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.

In connection with securitization transactions, the Company, as servicer, generally has a 10% clean-up call option, whereby the Company, at its discretion, may repurchase the outstanding loans in the securitization once the current value of the loans is 10% or less of their original

[Table of Contents](#)

value. During the nine months ended January 31, 2004, the Company exercised call options on residual interests initially recorded in 1996 and 1999. The outstanding loans were repurchased from the securitization trust, and the proceeds were used to pay off the remaining bondholders. These repurchased loans may be included in future sale transactions. At the time the call options were exercised, the book value of the corresponding residual interests was \$5,875.

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

	Nine Months Ended		Year Ended
	January 31, 2004	January 31, 2003	April 30, 2003
Balance, beginning of period	\$ 99,265	\$ 81,893	\$ 81,893
Additions	64,265	55,960	65,345
Amortization	(57,334)	(33,273)	(47,107)
Impairments of fair value	—	—	(866)
Balance, end of period	<u>\$106,196</u>	<u>\$104,580</u>	<u>\$ 99,265</u>

The key assumptions the Company used to estimate the cash flows and values of residual interests in securitizations initially recorded during the three months ended January 31, 2004 are as follows:

Estimated annual prepayments	35% to 90%
Estimated credit losses	4.72%
Discount rate – residual interests	25% to 28%
Variable returns to third-party beneficial interest holders	LIBOR forward curve at NIM closing date

The following table illustrates key assumptions the Company used to estimate the cash flows and values of residual interests and MSRs held at January 31, 2004:

Estimated annual prepayments	30% to 90%
Estimated credit losses	0.74% to 11.67%
Discount rate – residual interests	18% to 25%
Discount rate – MSRs	12.80%

[Table of Contents](#)

At January 31, 2004, the sensitivities of the current fair value of the residual interests and MSRs to 10% and 20% adverse changes in the above key assumptions are as follows:

	Residential Mortgage Loans			
	Original Residuals	NIM Residuals	Trading Residuals	Servicing Asset
Carrying amount/fair value of residuals	\$14,674	\$219,177	\$52,564	\$106,196
Weighted average life (in years)	2.2	1.9	2.2	1.2
Prepayments (including defaults):				
Adverse 10% - \$ impact on fair value	\$ 657	\$ 5,135	\$ (562)	\$ (19,644)
Adverse 20% - \$ impact on fair value	1,305	9,967	3,272	(38,463)
Credit losses:				
Adverse 10% - \$ impact on fair value	\$ (832)	\$ (28,099)	\$ (1,452)	Not applicable
Adverse 20% - \$ impact on fair value	(1,536)	(52,187)	(2,185)	Not applicable
Discount rate:				
Adverse 10% - \$ impact on fair value	\$ (436)	\$ (4,218)	\$ (846)	\$ (1,516)
Adverse 20% - \$ impact on fair value	(834)	(8,068)	(1,662)	(3,032)
Variable interest rates:				
Adverse 10% - \$ impact on fair value	\$ 54	\$ (9,749)	\$ (2,388)	Not applicable
Adverse 20% - \$ impact on fair value	109	(18,550)	(4,781)	Not applicable

These sensitivities are hypothetical and should be used with caution. 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. It is likely that changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

**6. Intangible Assets and Goodwill**

Intangible assets consist of the following:

	January 31, 2004		April 30, 2003	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
U.S. Tax Operations:				
Customer relationships	\$ 18,167	\$ (2,295)	\$ —	\$ —
Noncompete agreements	17,069	(3,573)	—	—
Business Services:				
Customer relationships	121,588	(53,590)	120,178	(44,192)
Noncompete agreements	27,504	(8,016)	26,909	(6,157)
Trade name – amortizing	1,450	(314)	1,450	(205)
Trade name – non-amortizing	55,637	(4,868)	55,637	(4,868)
Investment Services:				
Customer relationships	293,000	(122,083)	293,000	(100,108)
Corporate Operations:				
Customer relationships	844	(45)	172	(10)
Noncompete agreements	295	(22)	60	(1)
<b>Total intangible assets</b>	<b>\$535,554</b>	<b>\$(194,806)</b>	<b>\$497,406</b>	<b>\$(155,541)</b>

Amortization of intangible assets for the three and nine months ended January 31, 2004 was \$15,286 and \$39,265, respectively. Amortization of intangible assets for the three and nine months ended January 31, 2003 was \$11,085 and \$33,322, respectively. Estimated amortization of intangible assets for fiscal years 2004 through 2008 is \$53,284, \$52,342, \$51,313, \$42,506 and \$40,897, respectively.

Changes in the carrying amount of goodwill for the nine months ended January 31, 2004, consist of the following:

	April 30, 2003	Additions	Other	January 31, 2004
U.S. Tax Operations	\$130,502	\$201,254	\$ —	\$331,756
Mortgage Operations	152,467	—	—	152,467
Business Services	279,650	31,467	—	311,117
Investment Services	145,732	—	—	145,732
International Tax Operations	5,666	849	734	7,249
Corporate Operations	198	11	—	209
<b>Total goodwill</b>	<b>\$714,215</b>	<b>\$233,581</b>	<b>\$734</b>	<b>\$948,530</b>

Preliminary additions to goodwill for U.S. Tax Operations include \$194,883 related to asset and stock acquisitions involving former major franchise territories and other acquisitions of \$6,371. Additions to goodwill for Business Services primarily result from the final contingent payment related to the acquisition of the non-attest assets of McGladrey & Pullen, LLP of \$26,685.

The Company tests goodwill for impairment annually at the beginning of its fourth quarter, or more frequently if events occur that indicate a potential reduction in the fair value of a reporting

unit's net assets below its carrying value. During the nine months ended January 31, 2003, a goodwill impairment charge of \$24,000 was recorded for the Investment Services segment. No such impairment or events indicating potential impairment have been identified within any of the Company's segments during the nine months ended January 31, 2004.

## **7. Derivative Instruments**

The Company, in the normal course of business, enters into commitments with its customers to fund mortgage loans for specified periods of time at "locked-in" interest rates. These financial instruments represent commitments (rate-lock equivalent) to fund loans. The estimated fair value of these rate-lock equivalents is determined based on the difference in the value of the commitments to fund loans between the date of commitment and the date of valuation, taking into consideration the probability of the commitments being exercised and changes in other market conditions. At January 31, 2004 and April 30, 2003, the Company recorded assets totaling \$8,620 and \$12,531, respectively, in prepaid expenses and other current assets on the condensed consolidated balance sheets related to these commitments. See related discussion of Staff Accounting Bulletin No. 105, "Application of Accounting Principles to Loan Commitments," (SAB 105) in note 14.

The Company, in the normal course of business, enters into interest rate caps to mitigate interest rate risk and to enhance the marketability of NIM transactions. As of January 31, 2004 the Company held \$52,564 in residual interests – trading securities. The Company elected not to securitize the residuals in a NIM transaction prior to quarter end. Therefore, an interest rate cap valued at \$9,376 has been included in other assets on the condensed consolidated balance sheet related to these trading residual interests. The interest rate cap will be marked-to-market monthly through the income statement. The net adjustment to trading securities and the interest rate cap in the condensed consolidated income statements was zero for the three and nine months ended January 31, 2004.

The Company entered into an agreement with Household Tax Masters, Inc. (Household) during fiscal year 2003, whereby the Company waived its right to purchase any participation interests in and receive license fees relating to RALs during the period January 1 through April 30, 2003. In consideration for waiving these rights, the Company received a series of payments from Household, subject to certain adjustments based on delinquency rates on RALs made by Household through December 31, 2003. This adjustment provision was accounted for as a derivative and was marked-to-market monthly through December 31, 2003. Accordingly, during the three and nine months ended January 31, 2004, the Company recognized \$988 and \$6,548, respectively, of revenues related to this instrument. The final settlement in accordance with this agreement was received in January 2004. A receivable of \$5,171 was included on the condensed consolidated balance sheet as of April 30, 2003.

## 8. Comprehensive Income

The Company's comprehensive income is comprised of net income, the change in net unrealized gain on marketable securities and foreign currency translation adjustments. The components of comprehensive income for the three and nine months ended January 31, 2004 and 2003 are:

	Three months ended January 31,		Nine months ended January 31,	
	2004	2003	2004	2003
Net income	\$106,726	\$132,313	\$122,262	\$ 85,422
Change in net unrealized gain on marketable securities	(8,356)	(65,585)	5,680	(31,385)
Change in foreign currency translation adjustments	2,319	9,204	14,049	9,975
Comprehensive income	<u>\$100,689</u>	<u>\$ 75,932</u>	<u>\$141,991</u>	<u>\$ 64,012</u>

## 9. Stock-Based Compensation

Prior to fiscal year 2004, the Company accounted for stock-based compensation plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25) as allowed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123). Effective May 1, 2003, the Company adopted the fair value recognition provisions of SFAS 123, under the prospective transition method as described in Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" (SFAS 148). Had compensation cost for all stock-based compensation plan grants been determined in accordance with the fair value accounting method prescribed under SFAS 123, the Company's net income and earnings per share for the three and nine months ended January 31, 2004 and 2003 would have been as follows:



	Three Months Ended January 31,		Nine Months Ended January 31,	
	2004	2003	2004	2003
Net income as reported	\$106,726	\$132,313	\$122,262	\$ 85,422
Add: Stock-based compensation expense included in reported net income, net of related tax effects	4,733	413	7,530	945
Deduct: Total stock-based compensation expense determined under fair value method for all awards, net of related tax effects	(7,132)	(4,455)	(17,763)	(16,669)
Pro forma net income	\$104,327	\$128,271	\$112,029	\$ 69,698
Basic earnings per share:				
As reported	\$ .60	\$ .74	\$ .69	\$ .48
Pro forma	.59	.72	.63	.39
Diluted earnings per share:				
As reported	\$ .59	\$ .73	\$ .67	\$ .46
Pro forma	.58	.71	.62	.38

## 10. Supplemental Cash Flow Information

During the nine months ended January 31, 2004, the Company paid \$245,355 and \$57,458 for income taxes and interest, respectively. During the nine months ended January 31, 2003, the Company paid \$176,168 and \$55,193 for income taxes and interest, respectively.

During the nine months ended January 31, 2004 and 2003, the Company characterized the following as non-cash investing activities:

	Nine months ended January 31,	
	2004	2003
Additions to residual interests	\$ 1,604	\$ 753
Residual interest mark-to-market	24,731	48,631

## 11. Commitments and Contingencies

The Company offers guarantees under its Peace of Mind (POM) program to tax clients whereby the Company will assume the cost of additional tax assessments attributable to tax return preparation error for which the Company is responsible. The Company defers the revenue and direct costs associated with these guarantees, recognizing these amounts over the term of the guarantee based upon historic and actual payment of claims. The related current asset and liability are included in prepaid expenses and other current assets and accounts payable, accrued expenses and other, respectively, on the condensed consolidated balance sheets. The related noncurrent asset and liability are included in other assets and other noncurrent liabilities, respectively, on the condensed consolidated balance sheets. A loss on these POM guarantees

[Table of Contents](#)

would be recognized if the sum of expected costs for services exceeded unearned revenue. Changes in the deferred revenue liability for the nine months ended January 31, 2004 and 2003 and the twelve months ended April 30, 2003 are as follows:

	Nine Months Ended January 31,		Year Ended April 30,
	2004	2003	2003
Balance, beginning of period	\$ 49,280	\$ 44,982	\$ 44,982
Amounts deferred for new guarantees issued	19,098	7,592	28,854
Revenue recognized on previous deferrals	(47,273)	(17,809)	(24,556)
Adjustment resulting from change in accounting principle (note 14)	61,487	—	—
Balance, end of period	<u>\$ 82,592</u>	<u>\$ 34,765</u>	<u>\$ 49,280</u>

Option One Mortgage Corporation provides a guarantee up to a maximum amount equal to approximately 10% of the aggregate principal balance of mortgage loans held by the Trusts (QSPEs) before ultimate disposition of the loans by the Trusts. This guarantee would be called upon in the event adequate proceeds were 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, 2004 and April 30, 2003 was \$2,785,603 and \$2,176,286, respectively. The fair value of mortgage loans held by the Trusts as of January 31, 2004 and April 30, 2003 was approximately \$2,895,000 and \$2,273,000, respectively.

The Company may enter into forward loan sale commitments to be settled at a future date as a part of its interest rate risk management strategy. The Company had commitments to sell loans of approximately \$4,500,000 and \$1,470,000 as of January 31, 2004 and April 30, 2003, respectively.

The Company has entered into whole loan sale agreements with investors in the normal course of business, which include standard representations and warranties customary to the mortgage banking industry. Violations of these representations and warranties may require the Company to repurchase loans previously sold. A liability has been established related to the potential loss on repurchase of loans previously sold of \$21,907 and \$18,859 at January 31, 2004 and April 30, 2003, respectively. This liability is included in accounts payable, accrued expenses and other on the condensed consolidated balance sheets. Repurchased loans are normally sold in subsequent sale transactions.

The Company and its subsidiaries have various contingent purchase price obligations in connection with prior acquisitions. In many cases, contingent payments to be made in connection with these acquisitions are not subject to a stated limit. The Company estimates the potential payments (undiscounted) total approximately \$7,112 and \$52,290 as of January 31, 2004 and April 30, 2003, respectively. The Company's estimate is based on current financial conditions. Should actual results differ materially from the Company's assumptions, the

potential payments will differ from the above estimate. Such payments, if and when paid, would be recorded as additional goodwill.

The Company has contractual commitments to fund certain franchises requesting draws on Franchise Equity Lines of Credit (FELCs). The commitment to fund FELCs as of January 31, 2004 and April 30, 2003 totaled \$61,152 and \$56,070, respectively, with a related receivable balance of \$46,729 and \$33,341, respectively, included on the condensed consolidated balance sheets. The receivable represents the amount drawn on the FELCs as of January 31, 2004 and April 30, 2003.

The Company and its subsidiaries routinely enter into contracts that include embedded indemnifications that have characteristics similar to guarantees. Other guarantees and indemnifications of the Company and its subsidiaries include obligations to protect counter parties 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 the Company's 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 the Company or its subsidiaries and the ultimate liability related to any such claims, if any, is difficult to predict. While management cannot provide assurance the Company and its subsidiaries will ultimately prevail in the event any such claims are asserted, management believes the fair value of these guarantees and indemnifications is not material as of January 31, 2004.

## **12. Litigation Commitments and Contingencies**

In November 2002, the Company and a major franchisee of a subsidiary of the Company, reached an agreement with the plaintiff class in the class action lawsuit entitled *Ronnie and Nancy Haese, et al. v. H&R Block, Inc. et al.*, Case No. CV96-423, in the District Court of Kleberg County, Texas, related to RALs. The settlement provides a five-year package of coupons class members can use to obtain a variety of tax preparation and tax planning services from the Company's subsidiaries. The Company's major franchisee (a co-defendant), which operates more than half of all H&R Block offices in Texas, will share a portion of the total settlement cost. As a result, the Company recorded a liability and pretax expense of \$41,672, during the second quarter of fiscal year 2003, which, at the time, represented the Company's best estimate of its share of the settlement cost for plaintiff class legal fees and expenses, tax products and associated mailing expenses. The Company's share of the settlement is less than the total amount awarded due to amounts recoverable from a co-defendant in the case. The settlement was approved by the court as a part of a final judgment entered on June 24, 2003. No appeals of the judgment and award were filed. The Company paid the award of \$49,900 of attorneys' fees and expenses to class counsel on August 22, 2003. In addition to the liability that has already been recorded and/or paid, the Company will reduce revenues associated with tax preparation services as the coupons are redeemed each year. The settlement coupons were distributed prior to the 2004 tax season.

## Table of Contents

The Company has been involved in a number of putative RAL class action cases since 1990. While the Company has successfully defended many such cases, several cases are still pending and the amounts claimed in some of those cases is very substantial. In order to avoid the uncertainty of litigation and the diversion of resources and personnel resulting from the lawsuits, the Company, the lending bank, and the plaintiffs in the case *Joel E. Zawikowski, et al. v. Beneficial National Bank, H&R Block, Inc., et al.* (renamed *Lynne A. Carnegie, et al. v. H&R Block, Inc., et al.*), Case No. 98-C-2178 in the United States District Court for Northern Illinois, had agreed to a settlement class and a settlement of RAL-related claims on a nationwide basis. Under that settlement, the Company and the lending bank agreed to each pay \$12,500 toward a \$25,000 settlement fund for the benefit of the class members. The settlement was approved by the District Court in February 2001 and the defendants paid the \$25,000 into an escrow fund. Certain class members who had objected to the settlement appealed the order approving the settlement to the Seventh Circuit Court of Appeals. In April 2002, the Court of Appeals reversed the District Court's order approving the settlement and remanded the matter back to the District Court for further consideration of the fairness and adequacy of the proposed settlement by a new District Court judge. In April 2003, the District Court judge declined to approve the \$25,000 settlement, finding that counsel for the settlement plaintiffs had been inadequate representatives of the plaintiff class and failed to sustain their burden of showing that the settlement was fair. The judge appointed new counsel for the plaintiffs in the first quarter of fiscal year 2004 and named their client, Lynne A. Carnegie, as lead plaintiff. The new counsel for the plaintiffs have since filed an amended complaint and a motion for partial summary judgment. The defendants have filed a motion to dismiss, a brief in response to allegations in the plaintiffs' amended complaint relating to class certification, and responses to plaintiffs' motion for partial summary judgment. Rulings on these motions are pending, and extensive discovery is proceeding. The Company recorded a receivable in the amount of its \$12,500 share of the settlement fund in the fourth quarter of fiscal year 2003 and recorded a reserve in such quarter of \$12,500 consistent with the existing settlement authority of the Board of Directors. The defendants requested the release of the escrowed settlement fund and the \$12,500 was received during the second quarter of fiscal year 2004. The Company intends to defend the case and the remaining RAL class action litigation vigorously, but there are no assurances as to their outcome.

The Company and certain of its current and former officers and directors are named defendants in litigation entitled *Paul White, et al. v. H&R Block, et al.*, consolidated Case Numbers 02CV8965, 02CV9661, 02CV9682 and 02CV9830 pending in the United States District Court for the Southern District of New York since the third quarter of fiscal year 2003. The respective named plaintiffs seek to represent a class of shareholders who purchased the Company's stock between November 8, 1997 and November 6, 2002, and allege that the defendants violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by failing to disclose to shareholders various cases in which the Company had been sued regarding the RAL program, by failing to set adequate reserves for those cases, and by failing to disclose the supposed implications of those cases for the future of the RAL program. The four securities law cases were all assigned to the same judge and consolidated for pre-trial matters. A consolidated complaint was filed in March 2003 and the defendants responded by filing a motion to dismiss in April 2003. In response to defendants' motion to dismiss, the plaintiffs informed defendants that they wished further to amend their complaint. Defendants consented to the filing of an amended

## [Table of Contents](#)

complaint as a pleading matter, the plaintiffs filed the amended complaint, and the defendants filed a motion to dismiss it in August 2003. The Company believes the claims in these actions are without merit, and intends to defend them vigorously.

In January 2004, the Company and most of its former major franchisees entered into settlement of the litigation entitled *William R. Smith, Inc., et al. v. H&R Block, Inc., et al.*, Case No. 99-CV-206379, in the Circuit Court of Jackson County, Missouri (previously known as *Armstrong Business Services, Inc., et al. v. H&R Block, Inc., et al.*). In this litigation, the former major franchisees alleged breaches of contract and other matters against the Company and certain subsidiaries. The Company's subsidiary, HRB Royalty, Inc., in turn sought and received a declaration that it could elect not to renew the major franchise agreements upon expiration of their current terms. HRB Royalty subsequently notified the plaintiff major franchisees that it did not intend to renew their major franchise agreements upon expiration. During the nine months ended January 31, 2004, the plaintiffs' major franchise agreements accordingly expired and subsidiaries of the Company acquired and began operating the tax preparation business as company-owned operations in the former major franchise territories. The major franchise agreements required HRB Royalty to pay a "fair and equitable price" to the franchisee for the franchise business. The major franchise agreements provided further such price must be no less than 80% of the franchisee's revenues for the most recent twelve months ended April 30 plus the value of equipment and supplies and certain off-season expenses. Cash payments of \$243,257 were made related to these former major franchises during the nine months ended January 31, 2004.

The *Smith* settlement provides for payment to the franchisees of \$130,096, which is included in the amount above, as additional payment for the value of their former franchise businesses and resolves all other disputes involved in the litigation. The settlement also resolved all issues regarding the first trial involving one of the plaintiffs in the *Smith* litigation held in October 2003, with the settlement payment encompassing payment of the jury verdict in the first trial of \$3,197 for the franchise business and \$921 for plaintiff's claims for damages against the Company. In December 2003, one other "major" franchisee whose franchise agreement did not expire until early 2005 entered into a new franchise agreement with a limited term.

In addition to the aforementioned cases, the Company and its subsidiaries have from time to time been parties to claims and lawsuits arising out of such subsidiaries' business operations, including other claims and lawsuits relating to RALs, and claims and lawsuits concerning the preparation of customers' income tax returns, the electronic filing of income tax returns, the fees charged customers for various services, the Peace of Mind guarantee program associated with income tax return preparation services, relationships with franchisees and contract disputes. Such lawsuits include actions by individual plaintiffs, as well as cases in which plaintiffs seek to represent a class of similarly situated customers. The amounts claimed in these claims and lawsuits are substantial in some instances, and the ultimate liability with respect to such litigation and claims is difficult to predict. The Company's management considers these cases to be ordinary, routine litigation incidental to its business, believes the Company and its subsidiaries have meritorious defenses to each of them and is defending, or intends to defend, them vigorously. While management cannot provide assurance the Company and its subsidiaries will

## [Table of Contents](#)

ultimately prevail in each instance, management believes that amounts, if any, required to be paid by the Company and its subsidiaries in the discharge of liabilities or settlements will not have a material adverse effect on the Company's consolidated results of operations, cash flows or financial position. Regardless of outcome, claims and litigation can adversely affect the Company and its subsidiaries due to defense costs, diversion of management and publicity related to such matters.

It is the Company's policy to accrue for amounts related to legal matters if it is probable that a liability has been incurred and an amount is reasonably estimable. Many of the various legal proceedings are covered in whole, or in part, by insurance.

### 13. Segment Information

Information concerning the Company's operations by reportable operating segment for the three and nine months ended January 31, 2004 and 2003 is as follows:

	Three months ended January 31,		Nine months ended January 31,	
	2004	2003	2004	2003
<b>Revenues:</b>				
U.S. Tax Operations	\$463,646	\$403,571	\$ 551,357	\$ 460,286
Mortgage Operations	331,926	396,980	985,977	921,874
Business Services	112,293	100,741	319,816	293,938
Investment Services	57,753	48,047	167,443	156,737
International Tax Operations	10,849	8,779	35,403	28,388
Corporate Operations	690	295	2,706	(48)
	<u>\$977,157</u>	<u>\$958,413</u>	<u>\$2,062,702</u>	<u>\$1,861,175</u>
<b>Income (loss) from:</b>				
U.S. Tax Operations	\$ 68,236	\$ 34,137	\$ (155,874)	\$ (212,192)
Mortgage Operations	154,476	262,466	502,331	563,071
Business Services	1,955	(4,197)	(7,456)	(12,255)
Investment Services	(12,811)	(31,755)	(41,904)	(92,488)
International Tax Operations	(6,409)	(5,735)	(12,262)	(12,436)
Corporate Operations	(29,327)	(31,982)	(72,752)	(88,917)
Income before taxes	<u>\$176,120</u>	<u>\$222,934</u>	<u>\$ 212,083</u>	<u>\$ 144,783</u>

### 14. New Accounting Pronouncements

#### *SAB 105*

On March 9, 2003, the SEC Staff issued SAB 105. SAB 105 states that, when valuing loan commitments, registrants may not include expected future cash flows related to the associated servicing of the loan and, similarly, may not recognize any other internally developed intangible assets as part of the loan commitment derivative. The guidance in SAB 105 is effective for new loan commitments entered into after March 31, 2004. At January 31, 2004, the Company had recorded assets totaling \$8,620 related to its loan commitments. It is possible that the effect of SAB 105 will be to delay recognition of all, or a portion, of the loan commitment asset, and

## Table of Contents

related gain, until the loans are sold. The Company is in the process of analyzing the effect of SAB 105 and has not yet determined the impact of adoption.

### *SFAS 149*

In April 2003, Statement of Financial Accounting Standards No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" (SFAS 149) was issued. SFAS 149 amends and clarifies the accounting for derivative instruments and incorporates many of the implementation issues cleared as a result of the Derivatives Implementation Group process. The provisions of this standard are effective for contracts entered into or modified after June 30, 2003. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

### *FIN 46*

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). A revision of FIN 46 was issued in December 2003. FIN 46 provides guidance with respect to the consolidation of certain variable interest entities (VIEs) whereby a VIE must be consolidated by its primary beneficiary if the entity does not effectively disperse risks among parties involved. The primary beneficiary is one who absorbs a majority of the expected losses, residual returns, or both as a result of holding variable interests. FIN 46 also requires disclosures for both the primary beneficiary of a VIE and other parties with significant variable interests in the entity.

The provisions of FIN 46 apply immediately to VIEs created after January 31, 2003, and to VIEs in which an enterprise obtains an interest after that date. As revised, application of FIN 46 is required for interests in VIEs commonly referred to as special-purpose entities in financial statements for periods ending after December 15, 2003. Application for interests in all other types of entities is required in financial statement for periods ending after March 15, 2004.

The Mortgage Operations segment has an interest in certain QSPEs it currently does not consolidate, which are exempt from the provisions of FIN 46. Adoption of FIN 46 where application was required during the quarter ended January 31, 2004 did not have a material impact on the Company's consolidated financial statements.

The Company is continuing its evaluation of interests in other potential VIEs, and will continue to monitor additional guidance as provided by the FASB.

### *EITF 00-21*

In August 2003, the Company adopted Emerging Issues Task Force Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" (EITF 00-21). EITF 00-21 requires consideration received in connection with arrangements involving multiple revenue generating activities be measured and allocated to each separate unit of accounting in the arrangement. Revenue recognition is determined separately for each unit of accounting within the arrangement. EITF 00-21 impacts revenue and expense recognition related to tax preparation in the Company's premium tax offices where POM guarantees are included in the price of a completed tax return. Prior to the adoption of EITF 00-21, revenues and expenses related to POM guarantees at

## [Table of Contents](#)

premium offices were recorded in the same period as tax preparation revenues. Beginning May 1, 2003, revenues and direct expenses related to POM guarantees are now initially deferred and recognized over the guarantee period in proportion to POM claims paid. As a result of the adoption of EITF 00-21, the Company recorded a cumulative effect of a change in accounting principle of \$6,359, net of taxes of \$4,031, as of May 1, 2003.

Restated results for the three months ended July 31, 2003 and pro forma results, as if EITF 00-21 had been applied during the three and nine months ended January 31, 2003 are as follows:

	Three months ended July 31, 2003	
	As reported	Restated
Revenues	\$494,843	\$505,690
Income before taxes	17,297	18,829
Net income before cumulative effect of change in accounting principle	10,582	11,519
Cumulative effect of change in accounting principle	—	(6,359)
Net income	\$ 10,582	\$ 5,160
Basic and diluted earnings per share	\$ .06	\$ .03

  

	Three months ended January 31, 2003		Nine months ended January 31, 2003	
	As reported	Pro forma	As reported	Pro forma
Net income	\$132,313	\$132,680	\$85,422	\$88,124
Basic earnings per share	\$ .74	\$ .74	\$ .48	\$ .49
Diluted earnings per share	.73	.73	.46	.48

Revenues recognized during the three and nine months ended January 31, 2004, which were initially recognized in prior periods and recorded as part of the cumulative effect of a change in accounting principle, totaled \$6,206 and \$26,631, respectively.

### **Current Accounting Issues**

#### *Exposure Draft – Amendment of SFAS 140*

The FASB intends to reissue the exposure draft, “Qualifying Special Purpose Entities and Isolation of Transferred Assets, an Amendment of FASB Statement No. 140,” during the first quarter of calendar year 2004. The purpose of the proposal is to provide more specific guidance on the accounting for transfers of financial assets to a QSPE.

Provisions in the first exposure draft, if adopted, may have required the Company to consolidate its current QSPEs (the Trusts) established in its Mortgage Operations segment. As of January 31, 2004, the Trusts had assets and liabilities of \$2,785,603. The provisions of the exposure draft are subject to FASB due process and are subject to change. The Company will continue to monitor



[Table of Contents](#)

the status of the exposure draft, and consider changes, if any, to current structures as a result of the proposed rules.

## 15. 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 October 21, 1997 and April 13, 2000. 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

	Three months ended January 31, 2004				
	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Total revenues	\$ —	\$457,873	\$519,412	\$ (128)	\$977,157
Expenses:					
Compensation & benefits	—	121,229	271,626	(20)	392,835
Occupancy & equipment	—	16,789	77,975	—	94,764
Depreciation & amortization	—	18,785	27,702	—	46,487
Marketing & advertising	—	16,955	51,130	(110)	67,975
Interest	—	10,515	10,846	—	21,361
Supplies, freight & postage	—	5,526	23,083	—	28,609
Other	—	117,725	33,005	(108)	150,622
	—	307,524	495,367	(238)	802,653
Operating income	—	150,349	24,045	110	174,504
Other income, net	176,120	—	1,616	(176,120)	1,616
Income before taxes	176,120	150,349	25,661	(176,010)	176,120
Income taxes	69,394	60,986	8,364	(69,350)	69,394
Net income	\$106,726	\$ 89,363	\$ 17,297	\$(106,660)	\$106,726

**Three months ended January 31, 2003**

	<b>H&amp;R Block, Inc. (Guarantor)</b>	<b>BFC (Issuer)</b>	<b>Other Subsidiaries</b>	<b>Elims</b>	<b>Consolidated H&amp;R Block</b>
Total revenues	\$ —	\$484,901	\$473,597	\$ (85)	\$958,413
Expenses:					
Compensation & benefits	—	105,387	246,785	37	352,209
Occupancy & equipment	—	19,780	67,569	—	87,349
Depreciation & amortization	—	20,490	22,180	—	42,670
Marketing & advertising	—	9,999	45,486	(154)	55,331
Interest	—	13,960	10,857	—	24,817
Supplies, freight & postage	—	8,167	24,987	—	33,154
Other	—	76,035	66,626	(70)	142,591
	—	253,818	484,490	(187)	738,121
Operating income (loss)	—	231,083	(10,893)	102	220,292
Other income, net	222,934	—	2,642	(222,934)	2,642
Income (loss) before taxes (benefit)	222,934	231,083	(8,251)	(222,832)	222,934
Income taxes (benefit)	90,621	93,931	(3,354)	(90,577)	90,621
Net income (loss)	\$132,313	\$137,152	\$ (4,897)	\$ (132,255)	\$132,313

**Nine months ended January 31, 2004**

	<b>H&amp;R Block, Inc. (Guarantor)</b>	<b>BFC (Issuer)</b>	<b>Other Subsidiaries</b>	<b>Elims</b>	<b>Consolidated H&amp;R Block</b>
Total revenues	\$ —	\$1,230,483	\$ 832,451	\$ (232)	\$2,062,702
Expenses:					
Compensation & benefits	—	339,308	534,450	46	873,804
Occupancy & equipment	—	55,586	197,643	—	253,229
Depreciation & amortization	—	54,877	67,620	—	122,497
Marketing & advertising	—	33,396	66,809	(439)	99,766
Interest	—	34,978	29,479	—	64,457
Supplies, freight & postage	—	13,627	37,723	—	51,350
Other	—	279,610	110,659	(278)	389,991
	—	811,382	1,044,383	(671)	1,855,094
Operating income (loss)	—	419,101	(211,932)	439	207,608
Other income, net	212,083	—	4,475	(212,083)	4,475
Income (loss) before taxes (benefit)	212,083	419,101	(207,457)	(211,644)	212,083
Income taxes (benefit)	83,462	170,537	(87,248)	(83,289)	83,462
Net income (loss) before change in accounting	128,621	248,564	(120,209)	(128,355)	128,621
Cumulative effect of change in accounting	(6,359)	—	(6,359)	6,359	(6,359)
Net income (loss)	\$122,262	\$ 248,564	\$ (126,568)	\$ (121,996)	\$ 122,262

## Nine months ended January 31, 2003

	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Total revenues	\$ —	\$ 1,121,858	\$ 739,547	\$ (230)	\$ 1,861,175
Expenses:					
Compensation & benefits	—	294,779	496,553	360	791,692
Occupancy & equipment	—	51,199	172,443	—	223,642
Depreciation & amortization	—	58,027	56,711	—	114,738
Marketing & advertising	—	22,561	63,237	(463)	85,335
Interest	—	47,690	22,099	—	69,789
Supplies, freight & postage	—	16,724	38,748	—	55,472
Impairment of goodwill	—	24,000	—	—	24,000
Other	—	185,195	171,643	(538)	356,300
	—	700,175	1,021,434	(641)	1,720,968
Operating earnings (loss)	—	421,683	(281,887)	411	140,207
Other income, net	144,783	—	4,576	(144,783)	4,576
Earnings (loss) before income taxes (benefit)	144,783	421,683	(277,311)	(144,372)	144,783
Income taxes (benefit)	59,361	180,671	(121,478)	(59,193)	59,361
Net earnings (loss)	\$ 85,422	\$ 241,012	\$ (155,833)	\$ (85,179)	\$ 85,422

## Condensed Consolidating Balance Sheets

## January 31, 2004

	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Cash & cash equivalents	\$ —	\$ 157,737	\$ 513,352	\$ —	\$ 671,089
Cash & cash equivalents - - restricted	—	591,398	15,434	—	606,832
Receivables from customers, brokers and dealers, net	—	645,357	—	—	645,357
Receivables, net	543	801,636	290,872	—	1,093,051
Intangible assets and goodwill, net	—	469,116	820,162	—	1,289,278
Investments in subsidiaries	3,700,167	205	333	(3,700,167)	538
Other assets	(193)	1,085,228	396,182	825	1,482,042
Total assets	\$ 3,700,517	\$ 3,750,677	\$ 2,036,335	\$ (3,699,342)	\$ 5,788,187
Notes payable	\$ —	\$ 1,411,177	\$ —	\$ —	\$ 1,411,177
Accts. payable to customers, brokers and dealers	—	1,126,103	—	—	1,126,103
Long-term debt	—	498,075	53,331	—	551,406
Other liabilities	2	575,153	647,780	—	1,222,935
Net intercompany advances	2,223,949	(981,478)	(1,242,857)	386	—
Stockholders' equity	1,476,566	1,121,647	2,578,081	(3,699,728)	1,476,566
Total liabilities and stockholders' equity	\$ 3,700,517	\$ 3,750,677	\$ 2,036,335	\$ (3,699,342)	\$ 5,788,187

April 30, 2003

	<u>H&amp;R Block, Inc. (Guarantor)</u>	<u>BFC (Issuer)</u>	<u>Other Subsidiaries</u>	<u>Elims</u>	<u>Consolidated H&amp;R Block</u>
Cash & cash equivalents	\$ —	\$ 180,181	\$ 695,172	\$ —	\$ 875,353
Cash & cash equivalents - - restricted	—	420,787	17,455	—	438,242
Receivables from customers, brokers and dealers, net	—	517,037	—	—	517,037
Receivables, net	168	171,612	231,417	—	403,197
Intangible assets and goodwill, net	—	491,091	564,989	—	1,056,080
Investments in subsidiaries	3,546,734	215	1,105	(3,546,734)	1,320
Other assets	(1,321)	1,019,118	293,930	949	1,312,676
Total assets	<u>\$3,545,581</u>	<u>\$2,800,041</u>	<u>\$ 1,804,068</u>	<u>\$(3,545,785)</u>	<u>\$4,603,905</u>
Accts. payable to customers, brokers and dealers	\$ —	\$ 862,694	\$ —	\$ —	\$ 862,694
Long-term debt	—	747,550	74,752	—	822,302
Other liabilities	2,654	360,125	892,457	(36)	1,255,200
Net intercompany advances	1,879,218	(37,776)	(1,841,943)	501	—
Stockholders' equity	<u>1,663,709</u>	<u>867,448</u>	<u>2,678,802</u>	<u>(3,546,250)</u>	<u>1,663,709</u>
Total liabilities and stockholders' equity	<u>\$3,545,581</u>	<u>\$2,800,041</u>	<u>\$ 1,804,068</u>	<u>\$(3,545,785)</u>	<u>\$4,603,905</u>

[Table of Contents](#)

## Condensed Consolidating Statements of Cash Flows

	Nine months ended January 31, 2004				
	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Net cash provided by (used in) operating activities:	\$ 30,336	\$ (630,337)	\$(401,639)	\$ —	\$(1,001,640)
Cash flows from investing:					
Purchase of AFS securities	—	—	(10,495)	—	(10,495)
Cash received on residuals	—	127,997	—	—	127,997
Proceeds from sale of NIM residuals	—	17,000	—	—	17,000
Sales of AFS securities	—	4,165	13,439	—	17,604
Purchase property & equipment	—	(28,037)	(53,141)	—	(81,178)
Payments for business acq.	—	—	(280,280)	—	(280,280)
Net intercompany advances	333,289	—	—	(333,289)	—
Other, net	—	19,309	(7,366)	—	11,943
Net cash provided by (used in) investing activities	333,289	140,434	(337,843)	(333,289)	(197,409)
Cash flows from financing:					
Repayments of notes payable	—	(1,022,716)	—	—	(1,022,716)
Proceeds from notes payable	—	2,433,893	—	—	2,433,893
Repayments of securitization financing	—	(50,100)	—	—	(50,100)
Proceeds from securitization financing	—	50,100	—	—	50,100
Payments on acquisition debt	—	—	(50,820)	—	(50,820)
Dividends paid	(103,538)	—	—	—	(103,538)
Acquisition of treasury shares	(371,242)	—	—	—	(371,242)
Proceeds from issuance of common stock	111,155	—	—	—	111,155
Net intercompany advances	—	(943,718)	610,429	333,289	—
Other, net	—	—	(1,947)	—	(1,947)
Net cash provided by (used in) financing activities	(363,625)	467,459	557,662	333,289	994,785
Net decrease in cash	—	(22,444)	(181,820)	—	(204,264)
Cash - beginning of period	—	180,181	695,172	—	875,353
Cash - end of period	\$ —	\$ 157,737	\$ 513,352	\$ —	\$ 671,089

## Nine months ended January 31, 2003

	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Net cash provided by (used in) operating activities:	\$ 27,060	\$ (21,514)	\$(372,295)	\$ —	\$ (366,749)
Cash flows from investing:					
Purchase of AFS securities	—	(10,577)	—	—	(10,577)
Cash received on residuals	—	117,522	—	—	117,522
Proceeds from sale of NIM residuals	—	142,486	—	—	142,486
Maturities of AFS securities	—	7,730	2,000	—	9,730
Purchase property & equipment	—	(30,149)	(65,480)	—	(95,629)
Payments for business acq.	—	—	(24,239)	—	(24,239)
Net intercompany advances	271,380	—	—	(271,380)	—
Other, net	—	(1,518)	(4,486)	—	(6,004)
Net cash provided by (used in) investing activities	271,380	225,494	(92,205)	(271,380)	133,289
Cash flows from financing:					
Repayments of notes payable	—	(9,301,285)	—	—	(9,301,285)
Proceeds from notes payable	—	9,888,088	—	—	9,888,088
Payments on acquisition debt	—	—	(52,107)	—	(52,107)
Dividends paid	(93,645)	—	—	—	(93,645)
Payments to acquire treasury shares	(317,608)	—	—	—	(317,608)
Proceeds from issuance of common stock	112,813	—	—	—	112,813
Net intercompany advances	—	(812,757)	541,377	271,380	—
Other, net	—	—	(2,023)	—	(2,023)
Net cash provided by (used in) financing activities	(298,440)	(225,954)	487,247	271,380	234,233
Net increase (decrease) in cash	—	(21,974)	22,747	—	773
Cash - beginning of period	—	197,959	238,186	—	436,145
Cash - end of period	\$ —	\$ 175,985	\$ 260,933	\$ —	\$ 436,918

**16. Subsequent Event**

On February 24, 2004, the Company declared a cash dividend of \$.20 per share to shareholders of record as of March 11, 2004, payable on April 1, 2004.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

### RESULTS OF OPERATIONS

H&R Block, Inc. (the Company) is a diversified company with subsidiaries primarily engaged in the business of providing financial services including tax services, investment and mortgage products and services, and accounting and consulting services. For nearly 50 years, the Company has been developing relationships with millions of tax clients and its strategy is to expand on these relationships.

#### **H&R Block's Mission:**

*To help our clients achieve their financial objectives  
by serving as their tax and financial partner.*

#### **H&R Block's Vision:**

*To be the world's leading provider of financial services  
through tax and accounting-based advisory relationships.*

Key to achieving the Company's mission and vision is enhancing client experiences through consistent delivery of valuable services and advice. The Company believes offering advice facilitates a financial partnership and increases client satisfaction and retention. New products and services are continually introduced to bring additional value to the overall experience and allow clients to reach their financial objectives. Operating in multiple lines of business allows the Company to serve the changing financial needs of all its customers. The Company carries out its mission and vision through the following reportable operating segments:

**U.S. Tax Operations:** This segment primarily consists of the Company's income tax preparation businesses. Retail tax offices served 16.5 million taxpayers in fiscal year 2003 - more than any other personal tax services company. Digital tax services also served 2.1 million clients through TaxCut tax preparation software (includes only federal e-filings) and online tax preparation in fiscal year 2003. By offering professional and do-it-yourself tax preparation options, the Company can serve its clients how they choose to be served.

**Mortgage Operations:** This segment is primarily engaged in the origination of non-prime mortgage loans, the sale and securitization of mortgage assets (which includes mortgage loans and residual interests), and the servicing of non-prime loans. A key focus of Mortgage Operations is to optimize cash flows from its operations. The Company believes offering mortgage products to other segments' clients results in added value to the total client experience.

**Business Services:** This segment is engaged in providing accounting, tax, consulting, payroll, employee benefits and capital markets services to business clients and tax, financial and estate planning, wealth management and insurance services to individuals. The Company continues to focus on establishing core service relationships with middle-market clients by adding non-traditional business and personal services to enhance these client relationships. In doing so, the

## [Table of Contents](#)

Company intends to develop Business Services as a leading provider of middle-market professional services.

**Investment Services:** This segment is primarily engaged in offering investment services and securities products. Investment Services also offers these services and products to U.S. Tax and Mortgage Operations clients, bringing additional value to the overall client experience.

**International Tax Operations:** This segment is primarily engaged in providing local tax return preparation, filing and related services in Canada, Australia and the United Kingdom. In addition, International Tax Operations includes Overseas operations, which consists of company-owned and franchise offices preparing tax returns for U.S. citizens living abroad.

The analysis that follows should be read in conjunction with the tables below and the condensed consolidated income statements found on page 2.

### **Consolidated H&R Block, Inc.**

#### *Consolidated H&R Block, Inc. – Three-Month Results*

(in 000s, except per share amounts)	January 31, 2004	January 31, 2003	October 31, 2003
Revenues	\$977,157	\$958,413	\$579,855
Pretax income	176,120	222,934	17,134
Net income	\$106,726	\$132,313	\$ 10,376
Basic earnings per share	\$ .60	\$ .74	\$ .06
Diluted earnings per share	\$ .59	\$ .73	\$ .06

### **Overview**

A summary of the Company's results for the three months ended January 31, 2004 is as follows:

- Net income was \$106.7 million, compared to \$132.3 million in the prior year.
- Revenues grew \$18.7 million, or 2.0%, over the prior year.
- U.S. Tax Operations' revenues increased \$60.1 million, or 14.9%, primarily due to company-owned operations in former major franchise territories, which contributed \$24.3 million, \$10.5 million in additional revenues from the digital tax solutions business, and revenues related to the Company's RAL business, which increased \$6.2 million.
- U.S. Tax Operations' pretax income increased \$34.1 million, or 99.9%, in conjunction with the increased revenues and as a result of a decline of \$8.3 million in legal expenses and effective management of off-season expenses.
- Mortgage Operations' revenues and pretax earnings decreased \$65.1 million and \$108.0 million, respectively, from the prior year and \$19.2 million and \$29.6 million, respectively, from the preceding quarter. The decline from the prior year is due to the gain on sale of NIM residual interests of \$130.9 million recorded in November 2002, compared to a similar gain of only \$17.0 million in the current year.
- Mortgage originations totaled \$5.4 billion, an increase of 18.1% over the prior year and a decrease of 15.6% over the preceding quarter. Execution pricing on sales of mortgage assets



## [Table of Contents](#)

was 4.08% in the current quarter compared to 4.60% in the prior year and 3.87% in the preceding quarter.

- Investment Services' pretax loss improved 59.7% due primarily to increases in production revenues coupled with lower operating expenses.

### *Consolidated H&R Block, Inc. – Nine-Month Results*

<i>(in 000s, except per share amounts)</i>	<b>January 31, 2004</b>	<b>January 31, 2003</b>
Revenues	\$2,062,702	\$1,861,175
Pretax income	212,083	144,783
Net income before change in accounting principle	128,621	85,422
Cumulative effect of change in accounting principle	(6,359)	—
Net income	<u>\$ 122,262</u>	<u>\$ 85,422</u>
Basic earnings per share:		
Before change in accounting principle	<u>\$ .72</u>	<u>\$ .48</u>
Net income	<u>\$ .69</u>	<u>\$ .48</u>
Diluted earnings per share:		
Before change in accounting principle	<u>\$ .71</u>	<u>\$ .46</u>
Net income	<u>\$ .67</u>	<u>\$ .46</u>

### **Overview**

A summary of the Company's results for the nine months ended January 31, 2004 is as follows:

- Net income was \$122.3 million, compared to \$85.4 million in the prior year.
- Revenues grew \$201.5 million, or 10.8%, over the prior year.
- U.S. Tax Operations' revenues increased \$91.1 million, or 19.8%, primarily due to company-owned operations in former major franchise territories, which contributed \$24.9 million, increased Peace of Mind (POM) revenues of \$23.3 million related primarily to the adoption of EITF 00-21, revenues related to RALs, which increased \$11.7 million, and the digital tax solutions business, which increased \$10.8 million.
- Mortgage Operations' revenues increased \$64.1 million and pretax earnings decreased \$60.7 million over the prior year.
- Mortgage originations totaled \$17.0 billion, an increase of 44.3% over the prior year.
- Investment Services' pretax loss improved 54.7% due primarily to the goodwill impairment charge recorded in the prior year and increases in annuitized revenues.

### **U.S. Tax Operations**

This segment is primarily engaged in providing tax return preparation, filing, advice and related services in the United States. Segment revenues include fees earned for tax-related services performed at company-owned tax offices, royalties from franchise offices, sales of tax preparation and other software, fees from online tax preparation, and payments related to refund anticipation loan (RAL) participations.

## [Table of Contents](#)

TaxCut from H&R Block enables do-it-yourself users to prepare their federal and state tax returns easily and accurately. Several versions of the software are available to suit the needs of individual users, including TaxCut Standard, TaxCut Deluxe (includes free state and electronic filing), TaxCut Platinum for more complex returns and TaxCut Home & Business for small business owners. Other personal productivity software packages are also offered, including H&R Block Deduction Pro, WillPower and Home & Business Attorney.

Clients also have the option of online do-it-yourself tax preparation, online professional tax review, online tax advice and online tax preparation through a tax professional (whereby the client completes an online tax organizer and sends it to a tax professional for preparation) through the *hrblock.com* website. The Company also participates in the Free File Alliance, formed in fiscal year 2003. This alliance was created by the tax preparation industry and the Internal Revenue Service (IRS), and allows qualified lower-income filers to prepare and file their federal return online at no charge.

During the nine months ended January 31, 2004, the Company began operating income tax return preparation businesses in the franchise territories previously operated by ten of its former major franchisees. As a result of these operations, the company has 459 company-owned and 277 company-owned franchise offices for the current tax season in these territories. The current year includes the results for company-owned operations in these former franchise territories. These retail offices contributed pretax losses of \$2.3 million and \$8.2 million for the three and nine months ended January 31, 2004, respectively.

The Company has been named as a defendant in a number of lawsuits around the country alleging that the Company's subsidiaries engaged in wrongdoing with respect to the RAL program. In particular, the plaintiffs in these cases have alleged that disclosures in the RAL applications were inadequate, misleading and untimely; that the RAL interest rates were usurious and unconscionable; that the Company suppressed the fact that it would receive part of the finance charges paid by the customer for such loans; and that the Company owes, and breached, a fiduciary duty to its customers in connection with the RAL program. In many of these cases, the plaintiffs seek to proceed on behalf of a class of similarly situated RAL customers, and in certain instances the courts have allowed the cases to proceed as class actions. In other cases, courts have held that plaintiffs must pursue their claims on an individual basis, and may not proceed as a class action. See Legal Proceedings section for additional information.

On November 19, 2002, the Company announced a settlement had been reached in the cases *Ronnie and Nancy Haese, et al. v. H&R Block, Inc., et al.*, Case No. CV96-4213, District Court of Kleberg County, Texas (Haese I) and *Ronnie and Nancy Haese, et al. v. H&R Block, Inc., et al.*, Case No. CV-99-314-D, District Court of Kleberg County, Texas (Haese II), filed originally as one action on July 30, 1996. As a result of that settlement, the Company recorded a liability and pretax expense of \$43.5 million during the 2003 fiscal year.

The Company believes it has strong defenses to the various RAL cases and will vigorously defend its position. Nevertheless, the amounts claimed by the plaintiffs are, in some instances, very substantial, and there can be no assurances as to the ultimate outcome of the pending RAL cases, or as to the impact of the RAL cases on the Company's financial statements.

(in 000s except average fee and offices)	Period January 1 through January 31,	
	2004	2003
<b>Clients served:</b>		
Company-owned offices <sup>(1)</sup>	2,191	2,218
Former major franchise territories <sup>(2)</sup>	168	**
Total company-owned offices	2,359	2,218
Franchise offices <sup>(3)</sup>	1,347	1,340
Former major franchise territories <sup>(2)</sup>	**	157
Total franchise offices	1,347	1,497
Digital tax solutions <sup>(4)</sup>	1,268	1,042
	<u>4,974</u>	<u>4,757</u>
<b>Average fee per client served: <sup>(5)</sup></b>		
Company-owned offices <sup>(1)</sup>	\$141.05	\$129.40
Former major franchise territories <sup>(2)</sup>	130.29	**
Total company-owned offices	140.28	129.40
Franchise offices <sup>(3)</sup>	\$125.71	\$115.59
Former major franchise territories <sup>(2)</sup>	**	119.20
Total franchise offices	125.71	115.97
	<u>\$134.99</u>	<u>\$123.99</u>
<b>Refund anticipation loans (RALs):</b>		
Company-owned offices <sup>(1)</sup>	1,112	1,146
Former major franchise territories <sup>(2)</sup>	81	**
Total company-owned offices	1,193	1,146
Franchise offices <sup>(3)</sup>	713	703
Former major franchise territories <sup>(2)</sup>	**	81
Total franchise offices	713	784
Digital tax solutions <sup>(4)</sup>	20	19
	<u>1,926</u>	<u>1,949</u>
<b>Offices:</b>		
Company-owned offices <sup>(1)</sup>	4,746	4,672
Former major franchise territories <sup>(2)</sup>	459	**
Company-owned shared office locations <sup>(6)</sup>	947	607
Total company-owned offices	6,152	5,279
Franchise offices <sup>(3)</sup>	3,374	3,398
Former major franchise territories <sup>(2)</sup>	**	529
Franchise shared office locations <sup>(6)</sup>	325	95
Total franchise offices	3,699	4,022
	<u>9,851</u>	<u>9,301</u>

<sup>(1)</sup> Excludes company-owned offices in former major franchise territories which commenced operations during fiscal year 2004.

<sup>(2)</sup> Impact of company-owned offices in former major franchise territories which commenced operations during fiscal year 2004.

<sup>(3)</sup> Represents remaining major franchise territories and other franchises.

<sup>(4)</sup> Includes online completed and paid returns and federal software units sold.

<sup>(5)</sup> Calculated as tax preparation and related fees divided by clients served.

<sup>(6)</sup> Shared locations include offices located within Wal-Mart, Sears and other third-party businesses.

## U.S. Tax Operations – Three-Month Results

(in 000s)	January 31, 2004	January 31, 2003	October 31, 2003
Tax preparation and related fees	\$332,138	\$289,540	\$ 12,792
Royalties	43,357	38,211	1,651
RAL participation fees	37,185	37	7
RAL waiver fees	988	31,676	1,446
Software sales	20,995	15,703	933
Online tax services	8,414	3,174	430
Peace of Mind revenue	9,712	9,634	17,658
Other	10,857	15,596	12,272
<b>Total revenues</b>	<b>463,646</b>	<b>403,571</b>	<b>47,189</b>
Compensation and benefits	160,162	151,251	35,927
Occupancy and equipment	61,342	50,180	44,286
Depreciation and amortization	16,324	10,188	10,781
Cost of software sales	9,650	8,511	723
Supplies, freight and postage	11,991	13,454	3,947
Legal	2,096	10,430	11,101
Other	45,398	40,366	27,050
Allocated corporate and shared costs:			
Information technology	24,183	21,896	22,908
Marketing	44,653	39,601	5,634
Finance	4,981	5,532	4,708
Supply	8,235	12,049	4,886
Other	6,395	5,976	6,176
<b>Total expenses</b>	<b>395,410</b>	<b>369,434</b>	<b>178,127</b>
Pretax income (loss)	\$ <u>68,236</u>	\$ <u>34,137</u>	\$ <u>(130,938)</u>

**Three months ended January 31, 2004 compared to January 31, 2003**

U.S. Tax Operations' revenues increased \$60.1 million, or 14.9%, for the three months ended January 31, 2004, compared to the three months ended January 31, 2003.

Tax preparation and related fees increased \$42.6 million, or 14.7%, for the three months ended January 31, 2004. This increase is primarily due to the former major franchise territories now being operated as company-owned, which contributed \$21.9 million in additional tax preparation and related fees. The Company also saw an 8.4% increase in the average fee per client served, which increased to \$140.28 in the current year compared to \$129.40 last year. Average fee per client served is calculated as tax preparation and related fees divided by the number of clients served. Clients served in company-owned offices during the current tax season totaled 2.4 million, up 6.4% from the prior year, due entirely to the former major franchise territories now being operated as company-owned.

The average fee per client served at franchise offices increased by 8.4%, while clients served declined 10.0%. The decline is due to the former major franchise territories being operated as company-owned in fiscal year 2004. These changes, coupled with the re-franchising of certain

## Table of Contents

former major franchise territories at higher royalty rates, resulted in an increase in royalty revenue of 13.5%.

During fiscal year 2003, the Company entered into an agreement with Household Tax Masters, Inc. (Household), whereby the Company waived its right to purchase any participation interests in and receive license fees for RALs during the period January 1 through April 30, 2003. In consideration for waiving these rights the Company received a series of payments from Household in fiscal year 2003, subject to certain adjustments in fiscal year 2004 based on delinquency rates.

Revenues earned during the current quarter in connection with RAL participations totaled \$37.2 million. These revenues are approximately \$5.5 million higher than waiver fees earned during the three months ended January 31, 2003. The Company's RAL participation revenues are also benefiting from the new company-owned operations in former major franchise territories. The Company participates in RALs at a rate of nearly 50% for company-owned offices compared to 25% in major franchise offices.

Revenues from software sales increased \$5.3 million, or 33.7%. A total of 1.6 million software units were sold during the quarter ended January 31, 2004, an increase of 26.0% from the 1.3 million units sold in the prior year. Software units include all software products. Unit growth is due, in part, to marketing strategies, which may be accelerating sales from the fourth quarter into the third quarter. Therefore, unit growth experienced during the third quarter may not be representative of growth expected for the full year.

Online revenues increased \$5.2 million, or 165.1%, due to a 102.4% increase in total clients served and a 24.0% increase in the average price per unit over the prior year.

Total expenses for the three months ended January 31, 2004 were up \$26.0 million, or 7.0%, from the prior year. The increase from the prior year is primarily a result of additional occupancy and equipment and compensation and benefits expenses. Occupancy and equipment costs increased \$11.2 million over the prior year due to an increase of 1.6% in the number of company-owned offices under lease, a 6.9% increase in the average rent and new offices related to the former major franchise territories. Compensation and benefits increased \$8.9 million as a result of additional personnel in the former major franchises and \$3.2 million in costs associated with seasonal stock options, which were not expensed in the prior year. Depreciation and amortization expenses increased as a result of \$4.2 million of intangible amortization recorded for the acquisition of assets from former major franchisees, and for additional equipment purchased for new office locations opened during the period. Other expenses increased \$5.0 million, primarily as a result of \$8.3 million in additional bad debt expenses recorded in conjunction with the Company's participation in RALs in the current year. Allocated marketing and information technology costs increased \$5.1 million and \$2.3 million, respectively, as a result of targeted marketing projects and additional technology projects, respectively. These increases were partially offset by a decline in legal expenses of \$8.3 million.

## [Table of Contents](#)

Pretax income of \$68.2 million for the three months ended January 31, 2004, represents a 99.9% improvement over the prior year pretax income of \$34.1 million.

Due to the seasonal nature of this segment's business, operating results for the three months ended January 31, 2004 are not comparable to the three months ended October 31, 2003 and are not indicative of the expected results for the entire fiscal year.

### *U.S. Tax Operations – Nine-Month Results*

(in 000s)	January 31, 2004	January 31, 2003
Tax preparation and related fees	\$ 356,769	\$ 313,918
Royalties	46,044	40,529
RAL waiver fees	6,548	31,727
RAL participation fees	37,192	268
Software sales	22,188	17,134
Online tax services	9,400	3,693
Peace of Mind revenue	47,279	23,960
Other	25,937	29,057
Total revenues	<u>551,357</u>	<u>460,286</u>
Compensation and benefits	223,429	214,462
Occupancy and equipment	145,908	124,611
Depreciation and amortization	34,947	22,713
Cost of software sales	10,624	9,080
Supplies, freight and postage	17,121	19,206
Legal	16,979	58,735
Other	92,830	67,263
Allocated corporate and shared costs:		
Information technology	66,746	56,122
Marketing	53,036	51,402
Finance	13,244	14,500
Supply	15,205	17,634
Other	17,162	16,750
Total expenses	<u>707,231</u>	<u>672,478</u>
Pretax loss	<u>\$(155,874)</u>	<u>\$(212,192)</u>

### **Nine months ended January 31, 2004 compared to January 31, 2003**

U.S. Tax Operations' revenues increased \$91.1 million, or 19.8%, for the nine months ended January 31, 2004, compared to the nine months ended January 31, 2003.

Tax preparation and related fees increased \$42.9 million for the nine months ended January 31, 2004. This increase is primarily due to the former major franchise territories now being operated as company-owned, which contributed \$22.3 million in additional tax preparation and related fees. The Company also saw an 8.4% increase in the average fee per client served, which increased to \$140.28 in the first month of the tax season, compared to \$129.40 last year. Clients served in company-owned offices during the current tax season were 2.4 million, compared to 2.2 million in the prior year.

## Table of Contents

The average fee per client served at franchise offices increased by 8.4%, while clients served declined 10.0%. The decline is due to the former major franchise territories being operated as company-owned in fiscal year 2004. These changes, coupled with the re-franchising of certain former major franchise territories at higher royalty rates, resulted in an increase in royalty revenue of 13.6%.

Revenues earned during the current year in connection with RAL participations totaled \$37.2 million. These revenues are approximately \$5.5 million higher than waiver fees earned during the nine months ended January 31, 2003, primarily as a result of the Company's higher participation rate in company-owned offices, as discussed previously.

During the nine months ended January 31, 2004 the Company recorded revenues of \$6.5 million in conjunction with the RAL waiver agreement with Household based on actual delinquency rates through December 31, 2003.

Software and online revenues increased \$5.1 million and \$5.7 million, respectively, due to significant increases in units sold and the average price per unit, as discussed previously.

POM revenues for the nine months ended January 31, 2004 increased \$23.3 million, or 97.3%, principally due to the adoption of EITF 00-21. Prior to the adoption of EITF 00-21, revenues related to POM guarantees in premium offices were recorded within tax preparation revenues. With the adoption of EITF 00-21, the revenues are deferred and recognized over the guarantee period. The increase over the prior year is a result of the amortization of larger deferred revenue balances established as part of the cumulative effect of change in accounting principle, which increased revenues by \$26.6 million.

Total expenses for the nine months ended January 31, 2004 were \$707.2 million, up \$34.8 million, or 5.2%, from the prior year. The increase from the prior year is primarily a result of additional occupancy and equipment and other expenses. Occupancy and equipment costs increased \$21.3 million over the prior year due to a 4.2% increase in the number of company-owned offices under lease, a 6.0% increase in the average rent and offices related to the former major franchise territories. Other expenses increased \$10.9 million related to the POM program and \$8.3 million for additional bad debt expenses recorded in conjunction with the Company's participation in RALs in the current year. Interest expense increased \$4.2 million as a result of interest accretion related to a legal settlement and commercial paper borrowings used to fund RAL participations. Increases were also seen in depreciation and amortization, which increased as a result of \$5.9 million in intangible amortization from the acquisition of assets from former major franchisees and additional equipment purchased for new office locations opened during the period. Allocated information technology costs increased \$10.6 million as a result of additional technology projects. These increases were partially offset by a decline in legal expenses of \$41.8 million, resulting from the Texas RAL litigation recorded in the prior year.

The pretax loss of \$155.9 million for the nine months ended January 31, 2004, represents a 26.5% improvement over the prior year loss of \$212.2 million.

## **Mortgage Operations**

This segment is primarily engaged in the origination of non-prime mortgage loans, sales and securitizations of mortgage assets and servicing of non-prime loans. Revenues consist of proceeds from sales and securitizations of loans and related assets, accretion on residual interests, loan servicing fees and interest received on loans.

Substantially all non-prime mortgage loans originated are sold daily to qualifying special purpose entities (Trusts). The Company removes the mortgage loans from its balance sheet and records the gain on the sale, cash and a receivable which represents the ultimate expected outcome from the disposition of the loans. The Trusts, as directed by the third-party beneficial interest holders, either sell the loans directly to third-party investors or back to the Company's securitization entity to pool the loans for securitization, depending on market conditions.

In a securitization transaction, the Trusts transfer the loans to a special purpose entity, which is a consolidated subsidiary of the Company, and the Company simultaneously transfers the loans and its receivable, and the right to receive all payments on the loans, to a securitization trust. The securitization trust meets the definition of a qualifying special purpose entity (QSPE) and is therefore not consolidated by the Company. The securitization trust issues bonds, which are supported by cash flows from the pooled loans, to third-party investors. The Company retains an interest in the loans in the form of a residual interest (including overcollateralization (OC) accounts and uncertificated interests) and usually assumes first risk of loss for credit losses in the loan pool. As the cash flows of the underlying loans and market conditions change, the value of the Company's residual interests may also change, resulting in either additional unrealized gains or impairment of the residual interests.

To accelerate cash flows from its residual interests, the Company securitizes the majority of its residual interests in net interest margin (NIM) transactions. In a NIM transaction, residual interests are normally transferred to another QSPE (NIM trust), which then issues bonds to third-party investors.

Proceeds from the bonds are returned to the Company as payment for the residual interests. The bonds are secured by pooled residual interests and are obligations of the NIM trust. The Company retains a subordinated interest in the NIM trust, and receives cash flows on its residual interest generally after the bonds issued to the third-party investors are paid in full. Residual interests retained from NIM securitizations may also be bundled and sold in a subsequent securitization.

Substantially all non-prime loans originated and subsequently sold or securitized are transferred with servicing rights retained. Servicing activities include processing of mortgage loan payments and the administration of mortgage loans, with loan servicing fees received monthly over the life of the mortgage loans. The Company has traditionally received a servicing fee of 50 basis points per annum on the outstanding principal balance of loans sold or securitized, as well as the right to receive certain ancillary income including, but not limited to, late fees. In recent transactions, step-servicing fee structures have been implemented. The purpose of step-servicing is to better match the stream of incoming servicing revenues against the related servicing expenses.



## [Table of Contents](#)

Generally, the cost to service a pool of loans is lower immediately after origination and increases as the related loan pool ages. Recent step-servicing fee structures have typically provided the company with a servicing fee of 30 basis points per annum for the first 10 months of servicing, 40 basis points per annum for the next 20 months of servicing and 65 basis points per annum for the remainder of the servicing term.

Prime mortgage loans are sold in whole loan sales, servicing rights released, to third-party buyers.

Market interest rates have begun to increase after a sustained period of declining rates. In a rising interest rate environment the Company expects its profit margins will narrow from their historically high levels due to less favorable loan execution pricing. Execution pricing on sales of mortgage assets was 4.08% during the three months ended January 31, 2004 compared to 4.60% in the prior year and 3.87% in the preceding quarter. As such, growth in pretax income for the mortgage operations segment is expected to be more moderate or perhaps decline as compared to recent results.

### *Mortgage Operations – Three-Month Statistics*

(dollars in 000s)	January 31, 2004	January 31, 2003	October 31, 2003
Number of loans originated:			
Wholesale (non-prime)	30,678	25,061	36,233
Retail: Prime	1,291	3,560	1,944
Non-prime	3,826	2,284	4,110
Total	35,795	30,905	42,287
Volume of loans originated:			
Wholesale (non-prime)	\$4,732,182	\$3,756,809	\$5,603,118
Retail: Prime	157,438	496,176	247,661
Non-prime	464,926	280,738	492,977
Total	\$5,354,546	\$4,533,723	\$6,343,756
Loan sales	\$5,308,800	\$4,599,255	\$6,330,449
Weighted average FICO score <sup>(2)</sup>	607	606	611
Execution price – Net gain on sale <sup>(1)</sup>	4.08%	4.60%	3.87%
Weighted average interest rate for borrowers <sup>(2)</sup>	7.47%	7.94%	7.51%
Weighted average loan-to-value <sup>(2)</sup>	78.1%	78.6%	78.2%

(1) 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).

(2) Represents non-prime production.

Mortgage Operations – Three-Month Results

(in 000s)	January 31, 2004	January 31, 2003	October 31, 2003
<b>Components of gains on sales:</b>			
Gains on mortgage loans and related assets	\$166,907	\$176,940	\$220,652
Gains on residual interests previously securitized	17,000	130,881	—
Impairment of residual interests	(14,942)	(1,457)	(363)
Total gains on sales	168,965	306,364	220,289
Loan servicing revenue	55,072	43,372	51,659
Accretion income	47,483	20,293	36,843
Interest income	59,838	26,357	41,858
Other	568	594	507
Total revenues	<u>331,926</u>	<u>396,980</u>	<u>351,156</u>
Compensation and benefits	78,841	68,442	77,152
Servicing and processing	32,692	20,331	26,609
Occupancy and equipment	12,030	10,986	12,589
Bad debt	12,633	5,898	12,226
Other	41,254	28,857	38,554
Total expenses	<u>177,450</u>	<u>134,514</u>	<u>167,130</u>
Pretax income	<u>\$154,476</u>	<u>\$262,466</u>	<u>\$184,026</u>

**Three months ended January 31, 2004 compared to January 31, 2003**

Mortgage Operations' revenues decreased \$65.1 million, or 16.4%, for the three months ended January 31, 2004 compared to the prior year. Revenue decreased primarily as a result of the significantly larger sale of previously securitized residual interests recorded in the prior year.

The following table summarizes the key drivers of gains on sales of mortgage loans:

(dollars in 000s)	Three months ended January 31,	
	2004	2003
Number of sales associates <sup>(1)</sup>	2,649	2,163
Total number of applications	59,328	53,927
Closing ratio <sup>(2)</sup>	60.3%	57.3%
Total number of originations	35,795	30,905
Average loan size	\$ 150	\$ 147
Total originations	\$5,354,546	\$4,533,723
Non-prime / prime origination ratio	33.0 : 1	8.1 : 1
Commitments to fund loans	\$2,493,015	\$2,288,002
Loan sales	\$5,308,800	\$4,599,255
Gains on sales of mortgage assets	\$ 183,907	\$ 307,821
Execution price – net gain on sale <sup>(3)</sup>	4.08%	4.60%

<sup>(1)</sup> Includes all direct sales and back office sales support associates.

<sup>(2)</sup> Percentage of loans funded divided by total applications in the period.

<sup>(3)</sup> 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](#)

Gains on sales of mortgage assets decreased \$123.9 million for the three months ended January 31, 2004. The decrease over last year is a result of the \$130.9 million gain on sale of previously securitized residuals recorded in the prior year, partially offset by an increase in loan origination volume and a smaller sale of previously securitized residuals of \$17.0 million in the current quarter. During the third quarter, the Company originated \$5.4 billion in mortgage loans compared to \$4.5 billion last year, an increase of 18.1%. The execution price on mortgage loans originated and sold decreased to 4.08% for the current quarter compared to 4.60% last year, primarily as a result of a decrease in the average interest rates on loans sold during the period.

Impairments of residual interests in securitizations of \$14.9 million were recognized in the current period, compared to \$1.5 million for the three months ended January 31, 2003. The increase is primarily due to a decline in the value of certain older residual based on loan performance.

The following table summarizes the key drivers of loan servicing revenues:

(dollars in 000s)	Three months ended January 31,	
	2004	2003
Number of loans serviced	308,305	232,979
Average servicing portfolio	\$41,224,508	\$26,871,925
Average delinquency rate	6.00%	7.48%
Value of MSR's	\$ 106,196	\$ 104,580

Loan servicing revenues increased \$11.7 million, or 27.0%, compared to the prior year. The increase reflects a higher loan servicing portfolio. The average servicing portfolio for the three-month period ended January 31, 2004 increased \$14.4 billion, or 53.4%, to \$41.2 billion.

Total accretion of residual interests of \$47.5 million for the three months ended January 31, 2004 represents an increase of \$27.2 million from prior year accretion of \$20.3 million. This increase is due to write-ups taken during fiscal years 2003 and 2004.

During the third quarter of fiscal year 2004, the Company's residual interests continued to perform better than expected compared to internal valuation models, primarily due to lower than originally modeled loss and interest rates. The Company recorded pretax mark-to-market write-ups, which increased the fair value of its residual interests \$46.7 million during the quarter. These write-ups were recorded, net of write-downs of \$10.7 million and deferred taxes of \$13.8 million, in other comprehensive income 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. Additionally, sales of previously securitized residual interests would result in decreases to accretion income in future periods.

Interest income increased \$33.5 million, or 127.0%, for the quarter ended January 31, 2004, primarily due to an increase in the average balance on loans held by the Trusts. The average balance increased to \$3.9 billion from \$1.9 billion in the prior year, which was partially offset by

## [Table of Contents](#)

lower interest margin earned. Interest margin is the difference between the rate on the underlying loans and the financing costs of the Trusts. The interest margin decreased to 5.48% for the three months ended January 31, 2004, from 5.72% a year ago.

Total expenses for the three months ended January 31, 2004, increased \$42.9 million, or 31.9%, over the year-ago quarter. This increase is primarily due to \$10.4 million in increased compensation and benefits as a result of a 22.5% increase in sales associates needed to support higher loan production volumes. Servicing and processing expenses increased by \$12.4 million as a result of a higher average servicing portfolio during the three months ended January 31, 2004. Bad debt expense increased \$6.7 million primarily due to more whole loan sales than securitizations in the current year, for which higher reserves are required at the time of sale for estimated repurchases. Whole loan sales accounted for 87% of total loan sales, compared to 25% in the prior year. Other expenses increased by \$12.4 million for the current quarter, primarily due to \$6.2 million in increased retail mortgage direct mail advertising, and \$3.4 million in increased allocated corporate and shared costs. Allocated costs increased as a result of additional insurance costs and the expensing of stock-based compensation.

Pretax income decreased \$108.0 million to \$154.5 million for the three months ended January 31, 2004.

### **Three months ended January 31, 2004 compared to October 31, 2003**

Mortgage Operations' revenues decreased \$19.2 million, or 5.5%, for the three months ended January 31, 2004, compared to the preceding quarter.

The following table summarizes the key drivers of gains on sales of mortgage loans:

(dollars in 000s)	Three months ended	
	January 31, 2004	October 31, 2003
Number of sales associates <sup>(1)</sup>	2,649	2,476
Total number of applications	59,328	72,858
Closing ratio <sup>(2)</sup>	60.3%	58.0%
Total number of originations	35,795	42,287
Average loan size	\$ 150	\$ 150
Total originations	\$5,354,546	\$6,343,756
Non-prime / prime origination ratio	33.0 : 1	24.6 : 1
Commitments to fund loans	\$2,493,015	\$3,244,958
Loan sales	\$5,308,800	\$6,330,449
Gains on sales of mortgage assets	\$ 183,907	\$ 220,652
Execution price – net gain on sale <sup>(3)</sup>	4.08%	3.87%

<sup>(1)</sup> Includes all direct sales and back office sales support associates.

<sup>(2)</sup> Percentage of loans funded divided by total applications in the period.

<sup>(3)</sup> 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).

Gains on sales of mortgage assets decreased \$36.7 million to \$183.9 million for the current quarter. This decrease from the preceding quarter is primarily a result of a 15.6% decrease in

## [Table of Contents](#)

loans originated, partially offset by an increase in execution price on loan sales. The execution price on loan sales for the quarter increased to 4.08% from 3.87% for the three months ended October 31, 2003. The decline in originations is due to fewer funding days in the current quarter and a decrease in loan application volume.

Impairments of residual interests in securitizations of \$14.9 million were recognized during the third quarter, compared to \$0.4 million for the three months ended October 31, 2003. The increase is primarily due to a decline in the value of certain older residuals based on loan performance.

The following table summarizes the key drivers of loan servicing revenues:

(dollars in 000s)	Three months ended	
	January 31, 2004	October 31, 2003
Number of loans serviced	308,305	295,636
Average servicing portfolio	\$41,224,508	\$36,825,033
Average delinquency rate	6.00%	6.28%
Value of MSR's	\$ 106,196	\$ 111,960

Loan servicing revenues increased \$3.4 million, or 6.6%, compared to the second quarter of fiscal year 2004. The increase reflects a higher loan-servicing portfolio. The average servicing portfolio for the three months ended January 31, 2004 increased \$4.4 billion, or 11.9%, to \$41.2 billion.

Accretion of residual interests of \$47.5 million represents an increase of 28.9% from the preceding quarter's accretion of \$36.8 million, primarily due to write-ups taken during the first half of fiscal year 2004.

Interest income increased \$18.0 million, or 43.0%, for the quarter ended January 31, 2004, due to a 21.9% increase in the average balance on loans held by the Trusts and an increase in the interest margin to 5.48% during the three months ended January 31, 2004, from 5.39% in the second quarter.

Total expenses increased \$10.3 million, or 6.2%, primarily due to an increase of \$6.1 million, or 22.9%, in servicing expenses, resulting from the increased servicing portfolio. Other expenses also increased \$2.7 million primarily due to \$3.6 million in additional retail mortgage direct mail advertising.

Pretax income decreased \$29.6 million, or 16.1%, for the three months ended January 31, 2004 compared to the preceding quarter.

[Table of Contents](#)

## Mortgage Operations – Nine-Month Statistics

(dollars in 000s)	January 31, 2004	January 31, 2003
Number of loans originated:		
Wholesale (non-prime)	95,405	67,371
Retail: Prime	7,240	8,548
Non-prime	10,940	7,417
Total	113,585	83,336
Volume of loans originated:		
Wholesale (non-prime)	\$14,740,523	\$ 9,677,763
Retail: Prime	945,424	1,194,685
Non-prime	1,323,236	914,722
Total	\$17,009,183	\$11,787,170
Loan sales:		
Loans originated and sold	\$16,940,590	\$11,778,634
Loans acquired and sold	—	633,953
Total	\$16,940,590	\$12,412,587
Weighted average FICO score <sup>(2)</sup>	608	603
Execution price – Net gain on sale <sup>(1)</sup>		
Loans originated and sold	4.14%	4.75%
Loans acquired and sold	—%	0.18%
Total	4.14%	4.49%
Weighted average interest rate for borrowers <sup>(2)</sup>	7.51%	8.30%
Weighted average loan-to-value <sup>(2)</sup>	78.2%	78.9%

(1) 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).

(2) Represents non-prime production.

Mortgage Operations – Nine-Month Results

(in 000s)	January 31, 2004	January 31, 2003
Components of gains on sales:		
Gains on mortgage loans and related assets	\$590,941	\$497,457
Gains on residual interests previously securitized	17,000	130,881
Impairment of residual interests	(26,048)	(25,589)
Total gains on sales	581,893	602,749
Loan servicing revenue	155,048	123,647
Accretion income	118,389	113,146
Interest income	128,970	80,623
Other	1,677	1,709
Total revenues	985,977	921,874
Compensation and benefits	221,476	183,637
Servicing and processing	84,552	51,958
Occupancy and equipment	36,177	28,924
Bad debt	34,373	15,015
Other	107,068	79,269
Total expenses	483,646	358,803
Pretax income	\$502,331	\$563,071

**Nine months ended January 31, 2004 compared to January 31, 2003**

Mortgage Operations' revenues increased \$64.1 million, or 7.0%, for the nine months ended January 31, 2004 compared to the prior year. Revenue increased primarily as a result of higher interest income, loan servicing revenues and production volumes, partially offset by the significantly larger sale of previously securitized residual interests recorded in the prior year.

The following table summarizes the key drivers of gains on sales of mortgage loans:

(dollars in 000s)	Nine months ended January 31,	
	2004	2003
Number of sales associates <sup>(1)</sup>	2,649	2,163
Total number of applications	194,730	156,588
Closing ratio <sup>(2)</sup>	58.3%	53.2%
Total number of originations	113,585	83,336
Average loan size	\$ 150	\$ 141
Total originations	\$17,009,183	\$11,787,170
Non-prime / prime origination ratio	17.0 : 1	8.9 : 1
Commitments to fund loans	\$ 2,493,015	\$ 2,288,002
Loan sales	\$16,940,590	\$12,412,587
Gains on sales of mortgage assets	\$ 607,941	\$ 628,338
Execution price – net gain on sale <sup>(3)</sup>	4.14%	4.49%

<sup>(1)</sup> Includes all direct sales and back office sales support associates.

<sup>(2)</sup> Percentage of loans funded divided by total applications in the period.

<sup>(3)</sup> 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](#)

Gains on sales of mortgage assets decreased \$20.4 million for the nine months ended January 31, 2004. The decrease over last year is a result of the \$130.9 million gain on sale of previously securitized residuals recorded in the prior year, compared to \$17.0 million in the current year, and a decrease in execution price, partially offset by an increase in loan origination volume. During the current year, the Company originated \$17.0 billion in mortgage loans compared to \$11.8 billion last year, an increase of 44.3%. The execution price on mortgage loans originated and sold decreased to 4.14% for the current period compared to 4.75% last year, primarily as a result of a decrease in the average interest rate during the period.

Impairments of residual interests in securitizations of \$26.0 million were recognized in the nine months ended January 31, 2004, due to a decline in value of older residuals. Impairments of residuals for the nine months ended January 31, 2003 totaled \$25.6 million.

The following table summarizes the key drivers of loan servicing revenues:

(dollars in 000s)	Nine months ended January 31,	
	2004	2003
Number of loans serviced	308,305	232,979
Average servicing portfolio	\$36,907,358	\$26,310,362
Average delinquency rate	6.27%	7.12%
Value of MSRs	\$ 106,196	\$ 104,580

Loan servicing revenues increased \$31.4 million, or 25.4%, this year. The increase reflects a higher loan servicing portfolio. The average servicing portfolio for the nine months ended January 31, 2004 increased \$10.6 billion, or 40.3%, to \$36.9 billion.

Total accretion of residual interests of \$118.4 million for the nine months ended January 31, 2004 represents an increase of \$5.2 million over prior year accretion of \$113.1 million.

The Company recorded pretax mark-to-market write-ups on its residual interests, which increased the fair value \$125.1 million during the period primarily due to lower than originally modeled loss and interest rates. These write-ups were recorded, net of write-downs of \$25.1 million and deferred taxes of \$38.2 million, in other comprehensive income 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. Additionally, sales of previously securitized residual interests would result in decreases to accretion income in future periods.

Interest income increased \$48.3 million, or 60.0%, for the nine months ended January 31, 2004, due to an increase in the average balance on loans held by the Trusts. The average balance increased to \$3.1 billion from \$1.6 billion in the prior year, which was partially offset by lower interest margin earned. The interest margin decreased to 5.46% during the nine months ended January 31, 2004, from 5.99% a year ago.



## Table of Contents

Total expenses for the nine months ended January 31, 2004, increased \$124.8 million, or 34.8% over the year-ago period. This increase is primarily due to a \$37.8 million increase in compensation and benefits as a result of a 22.5% increase in sales associates needed to support higher loan production volumes. Servicing and processing expenses increased by \$32.6 million as a result of a higher average servicing portfolio during the nine months ended January 31, 2004. Occupancy and equipment charges increased \$7.3 million due to nine additional branch offices opened since October 2002, continued expansion of the second servicing center that opened in August 2002 and additional administrative office space. Bad debt expense increased \$19.4 million primarily as a result of a 36.5% increase in loan sales coupled with the increase in whole loan sales compared to securitizations, for which higher reserves are required at the time of sale for estimated repurchases. Whole loan sales accounted for 75% of total loan sales, compared to 35% in the prior year. Other expenses increased by \$27.8 million to \$107.1 million for the current period, primarily due to \$10.6 million in increased marketing expenses and \$9.3 million in increased allocated corporate and shared costs. Allocated costs increased due to higher insurance costs and the expensing of stock-based compensation.

Pretax income decreased \$60.7 million to \$502.3 million for the nine months ended January 31, 2004.

### **Business Services**

This segment is engaged in providing accounting, tax, consulting, payroll, employee benefits and capital markets services to business clients and tax, financial and estate planning, wealth management and insurance services to individuals. Business Services provides accounting, payroll and human resources services to McGladrey & Pullen LLP (M&P) in exchange for a management fee. The Company also has a fully secured commitment to fund M&P's operations on a revolving basis.

A substantial portion of Business Services' revenues are generated by one-time projects or extended services. Improvements in the current business environment have caused clients to begin engaging Business Services in such discretionary projects. While revenues in the Company's consulting services remain weak, profitability is improving through realization of better rates and productivity.

[Table of Contents](#)*Business Services – Three-Month Results*

(in 000s)	January 31, 2004	January 31, 2003	October 31, 2003
Traditional accounting	\$ 55,024	\$ 52,707	\$ 54,441
Business consulting	21,813	22,910	21,174
Capital markets	19,287	8,910	17,870
Other	16,169	16,214	15,539
Total revenues	<u>112,293</u>	<u>100,741</u>	<u>109,024</u>
Compensation and benefits	76,221	65,060	75,397
Occupancy and equipment	5,998	7,110	6,785
Depreciation and amortization	5,607	5,774	5,647
Marketing and advertising	2,127	3,599	1,660
Bad debt expense	744	3,009	1,116
Other	19,641	20,386	21,151
Total expenses	<u>110,338</u>	<u>104,938</u>	<u>111,756</u>
Pretax income (loss)	<u>\$ 1,955</u>	<u>\$ (4,197)</u>	<u>\$ (2,732)</u>

**Three months ended January 31, 2004 compared to January 31, 2003**

Business Services' revenues for the three months ended January 31, 2004 increased \$11.6 million, or 11.5%, from the prior year. This increase was primarily due to a \$10.4 million increase in capital markets revenues, resulting from a 172.1% increase in the number of business valuation projects and capital market transactions. Traditional accounting revenues also increased \$2.3 million due primarily to rate increases.

Total expenses increased \$5.4 million, or 5.2%, for the three months ended January 31, 2004 compared to the prior year. Compensation and benefits costs increased \$11.2 million, primarily as a result of the increased activity in the capital markets business. This increase was partially offset by a decrease of \$2.3 million in bad debt expense and a reduction of \$1.5 million in marketing and advertising.

Pretax income for the three months ended January 31, 2004 was \$2.0 million compared to a loss of \$4.2 million in the prior year.

Due to the seasonal nature of this segment's business, operating results for the three months ended January 31, 2004 are not comparable to the three months ended October 31, 2003 and are not indicative of the expected results for the entire fiscal year.

[Table of Contents](#)*Business Services – Nine-Month Results*

(in 000s)	January 31, 2004	January 31, 2003
Traditional accounting	\$154,561	\$153,824
Business consulting	64,562	66,403
Capital markets	53,787	29,391
Other	46,906	44,320
Total revenues	<u>319,816</u>	<u>293,938</u>
Compensation and benefits	221,903	199,788
Occupancy and equipment	18,849	18,401
Depreciation and amortization	16,750	16,966
Marketing and advertising	5,982	6,864
Bad debt expense	3,221	6,337
Other	60,567	57,837
Total expenses	<u>327,272</u>	<u>306,193</u>
Pretax loss	<u>\$ (7,456)</u>	<u>\$ (12,255)</u>

**Nine months ended January 31, 2004 compared to January 31, 2003**

Business Services' revenues for the nine months ended January 31, 2004 increased \$25.9 million, or 8.8%, from the prior year. This increase was primarily due to a \$24.4 million increase in capital markets revenues, resulting from a 104.5% increase in the number of business valuation projects and capital market transactions. Other revenues also increased \$2.6 million due to improved performance in the outsourcing services line of business. These increases were partially offset by a slight decline in business consulting revenues.

Total expenses increased \$21.1 million, or 6.9%, for the nine months ended January 31, 2004 compared to the prior year. Compensation and benefits costs increased \$22.1 million, primarily as a result of the increased activity in the capital markets business and increased costs in traditional accounting. Additionally, other expenses increased \$2.7 million, primarily due to increased recruiting and insurance costs. These increases were partially offset by a decline of \$3.1 million in bad debt expense resulting from improved billing procedures, which have increased accounts receivable turnover and collections.

The pretax loss for the nine months ended January 31, 2004 was \$7.5 million compared to a loss of \$12.3 million in the prior year.

**Investment Services**

This segment is primarily engaged in offering investment services and securities products through H&R Block Financial Advisors, Inc. (HRBFA), a full-service securities broker-dealer and a registered investment advisor. U.S. Tax Operations clients are also given the opportunity to open an Express IRA through HRBFA as a part of the income tax return preparation process.

Key to the future success of the Investment Services segment is retention of its financial advisors and recruitment of new advisors. One of the Company's major initiatives is to build revenues through the addition of experienced financial advisors. More than 200 new advisors have been

## [Table of Contents](#)

recruited through the third quarter, which was offset by attrition of primarily less experienced advisors. The retention and recruitment of experienced advisors continues to be a focus for fiscal year 2004.

### *Investment Services – Three-Month Statistics*

	<u>January 31, 2004</u>	<u>January 31, 2003</u>	<u>October 31, 2003</u>
Customer trades <sup>(1)</sup>	413,338	306,119	347,828
Customer daily average trades	6,776	4,638	5,351
Average revenue per trade <sup>(2)</sup>	\$ 113.61	\$ 115.57	\$ 116.22
Number of active accounts	741,824	672,247	748,403
Average trades per active account per quarter	0.56	0.46	0.46
Average trades per active account per year (annualized)	2.23	1.83	1.86
Ending balance of assets under administration (billions)	\$ 27.5	\$ 21.0	\$ 25.7
Average assets per active account	\$ 37,122	\$ 31,397	\$ 34,340
Ending margin balances (millions)	\$ 594	\$ 535	\$ 538
Ending customer payables balances (millions)	\$ 1,076	\$ 802	\$ 981
Number of advisors	1,052	1,080	1,010
Included in the numbers above are the following relating to fee-based accounts:			
Customer accounts	5,705	4,338	5,174
Average revenue per account	\$ 2,021	\$ 1,544	\$ 1,897
Ending balance of assets under administration (millions)	\$ 1,342	\$ 706	\$ 1,088
Average assets per active account	\$235,232	\$162,856	\$210,290

*(1) Includes both trades on which commissions are earned (“commissionable trades”) and trades for which no commission is earned (“fee-based trades”). Excludes open-ended mutual fund redemptions.*

*(2) Calculated as total commissions divided by commissionable trades.*

*Investment Services – Three-Month Results*

(in 000s)	January 31, 2004	January 31, 2003	October 31, 2003
Transactional revenue	\$ 26,960	\$ 23,111	\$ 23,162
Annuitized revenue	15,040	9,126	13,689
Production revenue	42,000	32,237	36,851
Other revenue	7,391	6,923	7,795
Non-interest revenue	49,391	39,160	44,646
Margin interest revenue	8,362	8,887	8,057
Less: interest expense	248	945	207
Net interest revenue	8,114	7,942	7,850
Total revenues <sup>(1)</sup>	<u>57,505</u>	<u>47,102</u>	<u>52,496</u>
Commissions	14,160	10,521	10,875
Other variable expenses	814	1,332	1,403
Total variable expenses	14,974	11,853	12,278
Gross profit	42,531	35,249	40,218
Compensation and benefits	23,893	22,110	22,751
Occupancy and equipment	4,480	8,384	6,823
Depreciation and amortization	11,843	14,005	11,046
Other	10,067	17,906	10,223
Allocated corporate and shared costs	5,059	4,599	4,711
Total fixed expenses	<u>55,342</u>	<u>67,004</u>	<u>55,554</u>
Pretax loss	<u>\$(12,811)</u>	<u>\$(31,755)</u>	<u>\$(15,336)</u>

(1) Total revenues, less interest expense.

### Three months ended January 31, 2004 compared to January 31, 2003

Investment Services' revenues, net of interest expense, for the three months ended January 31, 2004 increased \$10.4 million, or 22.1%. The increase is primarily due to higher annuitized revenues, which are based on customer assets rather than transactions.

Transactional revenue, which is based on transaction or trade quantities, increased \$3.8 million, or 16.7%, from the prior year due to a 35.0% increase in trading activity, partially offset by a decline in average revenue per trade. Annuitized revenues increased \$5.9 million, or 64.8%, due to increased sales of annuities and mutual funds.

Margin interest revenue decreased 5.9% from the prior year, which is primarily a result of a decline in interest rates, partially offset by a 10.3% increase in average margin balances. Margin balances have increased from an average of \$515.0 million for the three months ended January 31, 2003 to \$568.3 million in the current period, as the market has begun to recover. Interest expense for the third quarter of fiscal year 2004 declined 73.8% to \$0.2 million compared to \$0.9 million in the third quarter of fiscal year 2003.

Total expenses decreased \$8.5 million, or 10.8%, to \$70.3 million primarily as a result of a decline in consulting fees incurred in the prior year related to the conversion to a new back-office

## [Table of Contents](#)

system. Occupancy and equipment and depreciation and amortization costs declined \$3.9 million and \$2.2 million, respectively, as a result of the consolidation of field offices and the related asset sales. These decreases were partially offset by an increase of \$3.6 million in commissions, related to increased production revenues, and a \$1.8 million increase in compensation and benefits, related to higher bonus accruals due to improved overall performance.

The pretax loss for Investment Services for the third quarter of fiscal year 2004 was \$12.8 million compared to the prior year loss of \$31.8 million.

### **Three months ended January 31, 2004 compared to October 31, 2003**

Investment Services' revenues, net of interest expense, for the three months ended January 31, 2004 increased \$5.0 million, or 9.5%, compared to the preceding quarter.

Production revenue increased \$5.1 million, or 14.0%, primarily due to the increase in customer trades.

Margin interest revenue increased \$0.3 million, or 3.8%, for the quarter ended January 31, 2004, which is primarily a result of higher average margin balances. Margin balances have increased from an average of \$514.4 million for the three months ended October 31, 2003 to \$568.3 million in the current period.

Total expenses increased \$2.5 million from the preceding quarter, primarily due to a \$3.3 million increase in commission expense resulting from the improvement in production revenues. Compensation and benefits also increased \$1.1 million as a result of higher bonus accruals due to improved overall performance. These increases were partially offset by a decrease of \$2.3 million in occupancy and equipment due to the consolidation of field offices and the related asset sales.

The pretax loss for the Investment Services segment was \$12.8 million, compared to a loss of \$15.3 million in the second quarter of fiscal year 2004.

[Table of Contents](#)*Investment Services – Nine-Month Statistics*

	January 31, 2004	January 31, 2003
Customer trades <sup>(1)</sup>	1,124,219	973,249
Customer daily average trades	5,825	5,043
Average revenue per trade <sup>(2)</sup>	\$ 118.58	\$ 117.95
Number of active accounts	741,824	672,247
Ending balance of assets under administration (billions)	\$ 27.5	\$ 21.0
Average assets per active account	\$ 37,122	\$ 31,397
Ending margin balances (millions)	\$ 594	\$ 535
Ending customer payables balances (millions)	\$ 1,076	\$ 802
Number of advisors	1,052	1,080
Included in the numbers above are the following relating to fee-based accounts:		
Customer accounts	5,705	4,338
Average revenue per account	\$ 1,734	\$ 1,507
Ending balance of assets under administration (millions)	\$ 1,342	\$ 706
Average assets per active account	\$ 235,232	\$162,856

(1) Includes both trades on which commissions are earned (“commissionable trades”) and trades for which no commission is earned (“fee-based trades”). Excludes open-ended mutual fund redemptions.

(2) Calculated as total commissions divided by commissionable trades.

*Investment Services – Nine-Month Results*

(in 000s)	January 31, 2004	January 31, 2003
Transactional revenue	\$ 76,107	\$ 74,976
Annuitized revenue	41,205	26,494
Production revenue	117,312	101,470
Other revenue	25,182	25,426
Non-interest revenue	142,494	126,896
Margin interest revenue	24,949	29,841
Less: interest expense	1,065	4,222
Net interest revenue	23,884	25,619
Total revenues <sup>(1)</sup>	<u>166,378</u>	<u>152,515</u>
Commissions	37,476	31,641
Other variable expenses	3,418	2,711
Total variable expenses	40,894	34,352
Gross profit	125,484	118,163
Compensation and benefits	69,074	69,321
Occupancy and equipment	18,524	21,646
Depreciation and amortization	34,480	39,652
Impairment of goodwill	—	24,000
Other	31,759	45,534
Allocated corporate and shared costs	13,551	10,498
Total fixed expenses	<u>167,388</u>	<u>210,651</u>
Pretax loss	<u>\$ (41,904)</u>	<u>\$ (92,488)</u>

(1) Total revenues, less interest expense.

**Nine months ended January 31, 2004 compared to January 31, 2003**

Investment Services' revenues, net of interest expense, for the nine months ended January 31, 2004 improved \$13.9 million, or 9.1%, compared to prior year. The increase is primarily due to higher annuitized revenue.

Transactional revenue increased \$1.1 million, or 1.5%, from the prior year due to an increase in customer trades. Annuitized revenues increased \$14.7 million, or 55.5%, due to increased sales of annuities and mutual funds. The increases were also due, in part, to the improvement in consumer sentiment surrounding market conditions.

Margin interest revenue declined 16.4% from the prior year, which is primarily a result of lower average margin balances. Margin balances have declined from an average of \$598.7 million for the nine months ended January 31, 2003 to \$528.1 million in the current period. Margin balances, which steadily declined during most of 2003, have steadily increased in the past four months and are now approaching last year's average. Interest expense for the first nine months of fiscal year 2004 declined \$3.2 million, or 74.8%, compared to the prior year.



## [Table of Contents](#)

Total expenses decreased \$36.7 million, or 15.0%, primarily as a result of the \$24.0 million goodwill impairment charge recorded in the prior year. Other expenses decreased \$13.8 million primarily as a result of consulting fees incurred in the prior year related to the conversion to a new back-office system. Depreciation and amortization and occupancy and equipment costs declined by \$5.2 million and \$3.1 million, respectively, as a result of the consolidation of field offices and the related asset sales. Commissions and other variable expenses increased \$6.5 million as a result of higher production revenues.

The pretax loss for Investment Services for the current fiscal year was \$41.9 million compared to the prior year loss of \$92.5 million.

### **International Tax Operations**

This segment is primarily engaged in providing local tax return preparation, filing and related services in Canada, Australia and the United Kingdom. In addition, International Tax Operations includes Overseas operations, which consists of company-owned and franchise offices in eight countries that prepare U.S. tax returns for U.S. citizens living abroad. This segment served 2.3 million taxpayers in fiscal year 2003.

Tax-related service revenues include fees from company-owned tax offices and royalties from franchise offices. The Canadian tax season is from January to April, the Australian tax season is from July to October and the United Kingdom's tax season is from August to March.

Operations in this segment of the Company are transacted in the local currencies of the countries in which it operates, therefore the results can be affected by the translation into U.S. dollars. The weakening of the U.S. dollar during the quarter had the impact of increasing reported revenues, income and losses.

#### *International Tax Operations – Three-Month Results*

<b>(in 000s)</b>	<b>January 31, 2004</b>	<b>January 31, 2003</b>	<b>October 31, 2003</b>
<b>Revenues:</b>			
Canada	\$ 2,690	\$ 2,376	\$ 3,025
Australia	7,446	5,720	15,657
United Kingdom	329	435	305
Overseas	384	248	108
Total revenues	<u>10,849</u>	<u>8,779</u>	<u>19,095</u>
<b>Pretax income (loss):</b>			
Canada	(6,879)	(6,139)	(4,858)
Australia	1,699	1,243	6,297
United Kingdom	(196)	(98)	(196)
Overseas	(102)	(229)	(127)
Allocated corporate and shared costs	(931)	(512)	(561)
Pretax income (loss)	<u>\$ (6,409)</u>	<u>\$ (5,735)</u>	<u>\$ 555</u>

**Three months ended January 31, 2004 compared to January 31, 2003**

International Tax Operations' revenues for the three months ended January 31, 2004 increased \$2.1 million, or 23.6%, compared to the three months ended January 31, 2003. This improvement is primarily due to results in Australia, where tax returns prepared in the current quarter increased 1.1% compared to the prior year and the average charge per return increased 2.7%. Revenues in Canada also improved due to a slight increase in the number of early returns completed.

The pretax loss of \$6.4 million for the quarter ended January 31, 2004, was a decline of \$0.7 million compared to the loss recorded in the third quarter last year. This is due primarily to unfavorable exchange rates in Canada, partially offset by improved performance in the Australian tax season.

Due to the seasonal nature of this segment's business, operating results for the three months ended January 31, 2004 are not comparable to the three months ended October 31, 2003 and are not indicative of the expected results for the entire fiscal year.

*International Tax Operations – Nine-Month Results*

(in 000s)	January 31, 2004	January 31, 2003
<b>Revenues:</b>		
Canada	\$ 9,481	\$ 7,710
Australia	24,226	18,957
United Kingdom	953	1,077
Overseas	743	644
Total revenues	<u>35,403</u>	<u>28,388</u>
<b>Pretax income (loss):</b>		
Canada	(15,432)	(14,629)
Australia	5,986	4,694
United Kingdom	(581)	(429)
Overseas	(307)	(685)
Allocated corporate and shared costs	(1,928)	(1,387)
Pretax loss	<u>\$(12,262)</u>	<u>\$(12,436)</u>

**Nine months ended January 31, 2004 compared to January 31, 2003**

International Tax Operations' revenues for the nine months ended January 31, 2004 increased \$7.0 million, or 24.7%, compared to the nine months ended January 31, 2003. This improvement is primarily due to results in Australia, where tax returns prepared this year increased 3.5% compared to the prior year and the average charge per return increased 1.9%. Canadian revenues also improved, due to a 12.0% increase in tax returns prepared.

The pretax loss of \$12.3 million for the nine months ended January 31, 2004, was basically flat compared to the loss recorded in the prior year. Results in Australia improved due to better performance in the Australian tax season, while Canadian results declined as a result of foreign currency translation.

**Corporate Operations**

This segment consists primarily of corporate support departments, which provide services to the Company's operating segments. These support departments consist of marketing, information technology, facilities, human resources, executive, legal, finance, government relations and corporate communications. These support department costs are largely allocated to the Company's operating segments. The Company's captive insurance, franchise financing subsidiaries and its small business initiative are also included within this segment.

*Corporate Operations – Three-Month Results*

(in 000s)	January 31, 2004	January 31, 2003	October 31, 2003
Operating revenues	\$ 2,332	\$ 1,846	\$ 2,253
Eliminations	(1,642)	(1,551)	(1,565)
<b>Total revenues</b>	<b>690</b>	<b>295</b>	<b>688</b>
Corporate expenses:			
Compensation and benefits	2,828	2,631	930
Interest expense:			
Interest on acquisition debt	17,055	18,014	17,074
Other interest	350	4,283	89
Marketing and advertising	1,615	1,865	(2)
Other	9,314	6,710	2,869
	31,162	33,503	20,960
Support departments:			
Information technology	30,745	24,987	26,738
Marketing	44,513	39,488	5,430
Finance	8,406	7,530	8,835
Stock-based compensation	3,375	—	3,084
Other	19,468	24,741	14,108
	106,507	96,746	58,195
Allocation of corporate and shared costs	(106,593)	(98,163)	(58,021)
Investment income, net	1,059	(191)	2,005
<b>Pretax loss</b>	<b>\$ (29,327)</b>	<b>\$ (31,982)</b>	<b>\$ (18,441)</b>

**Three months ended January 31, 2004 compared to January 31, 2003**

Interest expense on acquisition debt decreased as a result of a \$45.1 million payment on acquisition debt in August 2003 and lower financing costs. Other interest expense declined as a result of more of the cost of borrowing being absorbed by the U.S. Tax Operations segment in conjunction with RAL participations.

Information technology department expenses increased \$5.8 million, or 23.0%, primarily due to an increase in headcount and related facilities. Stock-based compensation expenses increased as a result of the expensing of all stock-based compensation, which began on May 1, 2003. The related expenses reported in this segment do not include seasonal stock options for tax associates, which are charged directly to the segment in which they are employed. During the third quarter,

[Table of Contents](#)

expenses totaling \$3.2 million and \$0.2 million were recorded directly in the U.S. Tax Operations and International Tax Operations segments, respectively, related to the seasonal stock options.

The pretax loss was \$29.3 million, compared with last year's third quarter loss of \$32.0 million.

*Corporate Operations – Nine-Month Results*

(in 000s)	January 31, 2004	January 31, 2003
Operating revenues	\$ 7,313	\$ 4,137
Eliminations	(4,607)	(4,185)
Total revenues	<u>2,706</u>	<u>(48)</u>
Corporate expenses:		
Compensation and benefits	6,827	11,269
Interest expense:		
Interest on acquisition debt	51,801	54,990
Other interest	614	2,728
Marketing and advertising	1,537	2,095
Other	19,028	19,074
	<u>79,807</u>	<u>90,156</u>
Support departments:		
Information technology	80,696	66,266
Marketing	52,607	50,196
Finance	24,140	20,935
Stock-based compensation	7,499	—
Other	43,359	49,054
	<u>208,301</u>	<u>186,451</u>
Allocation of corporate and shared costs	(208,391)	(186,312)
Investment income, net	4,259	1,426
Pretax loss	<u>\$ (72,752)</u>	<u>\$ (88,917)</u>

**Nine months ended January 31, 2004 compared to January 31, 2003**

Operating revenues increased \$2.8 million as a result of a write-down of investments in the prior year.

Compensation and benefits decreased primarily as a result of \$3.5 million of additional expenses related to deferred compensation plans recorded in the prior year. The decrease in interest expense on acquisition debt is attributable to lower financing costs and a \$45.1 million payment on acquisition debt in August 2003. Other interest expense declined as a result of more of the cost of borrowing being absorbed by the U.S. Tax Operations segment in conjunction with RAL participations.

Information technology department expenses increased \$14.4 million, or 21.8%, primarily due to an increase in headcount and related facilities. Stock-based compensation expenses increased as a result of the expensing of all stock-based compensation, which began on May 1, 2003.

The pretax loss was \$72.8 million, compared with last year's loss of \$88.9 million.

**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.

The Company's liquidity needs are met primarily through a combination of operating cash flows, commercial paper (CP) issuance and off-balance sheet financing arrangements.

**OPERATING CASH FLOWS & LIQUIDITY BY SEGMENT**

Operating cash requirements totaled \$1.0 billion and \$366.7 million for the nine months ended January 31, 2004 and 2003, respectively. A condensed consolidating statement of cash flows by segment for the nine months ended January 31, 2004 follows. Generally, interest is not charged on intercompany activities between segments.

(in 000s)	U.S. Tax Operations	Mortgage Operations	Business Services	Investment Services	International Tax Operations	Corporate Operations	Consolidated H&R Block
Cash provided by							
(used in):							
Operations	\$ (808,624)	\$ 39,507	\$ 25,016	\$(52,167)	\$ 2,273	\$ (207,645)	\$(1,001,640)
Investing	(261,486)	130,992	(35,964)	1,705	(3,665)	(28,991)	(197,409)
Financing	—	—	(51,306)	—	(127)	1,046,218	994,785
Net intercompany	1,114,204	(180,411)	70,097	36,650	4,626	(1,045,166)	—

Net intercompany activities are excluded from the investing and financing activities within the segment cash flows. The Company believes that by excluding the intercompany activities, the cash flows by segment more clearly depicts the cash generated and used by each segment. Had the 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.

**U.S. Tax Operations:** U.S. Tax Operations has historically been the largest provider of annual operating cash flows to the Company. This segment generally operates at a loss during the first two quarters of the fiscal year due to off-season costs and preparation activities for the upcoming tax season. The seasonal nature of U.S. Tax Operations generally results in a large positive operating cash flow in the fourth quarter. U.S. Tax Operations had total cash requirements of \$1.1 billion for the nine months ended January 31, 2004, which includes \$243.3 million paid to former major franchisees.

**Mortgage Operations:** This segment primarily generates cash as a result of loan sales and securitizations, NIM transactions, sales of NIM residual interests and as its residual interests mature. Mortgage Operations generated \$39.5 million in cash from operating activities primarily from the sale and securitization of mortgage loans. This segment also generated \$131.0 million in cash from investing activities primarily from cash received on residual interests.

*Gains on sales*

Gains on sales of mortgage loans and related assets totaled \$581.9 million, of which 81% was received as cash. The cash was primarily recorded as operating activities. The percent of gains on sales of mortgage assets received as cash is calculated as follows:

[Table of Contents](#)

(in 000s)	Nine months ended	
	January 31, 2004	January 31, 2003
Cash:		
Gains on whole loans sold by the Trusts	\$ 529,521	\$ 267,499
Gains on loans securitized	81,041	235,690
Gains on sale of previously securitized residuals	17,000	130,881
Loan origination expenses, net	(156,085)	(120,218)
	471,477	513,852
Non-cash:		
Gains on retained mortgage servicing rights	64,265	50,691
Additions (reductions) to balance sheet <sup>(1)</sup>	63,545	(11,605)
Net change in receivable from the Trusts	12,565	73,494
Impairments to fair value of residual interests	(26,048)	(25,589)
Net change in fair value of rate-lock commitments	(3,911)	1,906
	110,416	88,897
Reported gains on sales of mortgage assets	\$ 581,893	\$ 602,749
Percent of gains received as cash	81%	85%

<sup>(1)</sup> Includes residual interests and interest rate caps.

Another important measure of cash generation is the percentage of cash proceeds the Company receives from its capital market transactions. These amounts are also included within the gain on sale of mortgage assets as reconciled below. The percent calculation is as follows:

(in 000s)	Nine months ended	
	January 31, 2004	January 31, 2003
Cash proceeds:		
Gains on whole loans sold by the Trusts	\$ 529,521	\$ 267,499
Gains on loans securitized	81,041	235,690
Gains on sale of previously securitized residuals	17,000	130,881
	627,562	634,070
Non-cash:		
Gains on retained mortgage servicing rights	64,265	50,691
Additions (reductions) to balance sheet <sup>(1)</sup>	63,545	(11,605)
	127,810	39,086
Portion of gain on sale related to capital market transactions	\$ 755,372	\$ 673,156
Other items included in gain on sale:		
Net change in receivable from the Trusts	12,565	73,494
Impairments to fair value of residual interests	(26,048)	(25,589)
Net change in fair value of rate-lock commitments	(3,911)	1,906
Loan origination expenses, net	(156,085)	(120,218)
	(173,479)	(70,407)
Reported gains on sales of mortgage assets	\$ 581,893	\$ 602,749
Percent of cash proceeds from capital market transactions	83%	94%

<sup>(1)</sup> Includes residual interests and interest rate caps.

*Warehouse Funding*

The mortgage segment regularly sells loans as a source of liquidity for its prime and non-prime mortgages. Whole loan sales to the Trusts or other buyers through January 31, 2004 were \$16.9 billion compared with \$12.4 billion for the same period in fiscal year 2003. Additionally, Block Financial Corporation (BFC) provides the mortgage segment a \$150 million line of credit for working capital needs.

In order to finance its prime originations, the Company utilizes a warehouse facility with capacity up to \$50 million, which expires in June 2004. The facility bears interest at one-month LIBOR plus 64 to 175 basis points. As of January 31, 2004, the balance outstanding under this facility was \$0.2 million and is included in accounts payable, accrued expenses and other on the condensed consolidated balance sheets.

Management believes the sources of liquidity available to the Mortgage Operations segment are sufficient for its needs. Risks to the stability of these sources include external events impacting the asset-backed securities market. The liquidity available from the NIM transactions is also subject to external events impacting this market. These external events include, but are not limited to, adverse changes in the perception of the non-prime industry or in the regulation of non-prime lending and, to a lesser degree, reduction in the availability of third parties that provide credit enhancement. Performance of the securitizations will also impact the segment's future participation in these markets. The five off-balance sheet warehouse facilities used by the Trusts, which have a total current capacity of \$7.0 billion, are subject to annual renewal, each at a different time during the year, and any of the above events could lead to difficulty in renewing the lines. These risks are mitigated by the availability of whole loan sales and financing provided by the Company, and to a lesser extent, by staggered renewal dates related to these lines.

**Business Services:** Business Services' funding requirements are largely related to working capital needs. Funding is available from the Company sufficient to cover these needs. This segment generated \$25.0 million in cash from operating activities primarily related to the collections of receivables. Business Services used \$36.0 million in investing activities, primarily as a result of contingent payments on prior acquisitions, and \$51.3 million in financing activities, primarily as a result of payments on acquisition debt.

**Investment Services:** Investment Services used \$52.2 million in cash from operating activities during the quarter, primarily due to the timing of cash deposits that are restricted for the benefit of customers.

Investment Services, through HRBFA, is subject to regulatory requirements intended to ensure the general financial soundness and liquidity of broker-dealers. HRBFA is required to maintain minimum net capital as defined under Rule 15c3-1 of the Securities Exchange Act of 1934 and complies with the alternative capital requirement, which requires a broker-dealer to maintain net capital equal to the greater of \$250 thousand or 2% of the combined aggregate debit balances arising from customer transactions. The net capital rule also provides that equity capital may not be withdrawn or cash dividends paid if resulting net capital would be less than the greater of 5% of combined aggregate debit items or 120% of the minimum required net capital. As of

## [Table of Contents](#)

January 31, 2004, HRBFA's net capital of \$126.3 million, which was 18.4% of aggregate debit items, exceeded its minimum required net capital of \$13.7 million by \$112.6 million. Although HRBFA has always exceeded its minimum net capital requirements, during the nine months ended January 31, 2004 the Company contributed \$32.0 million of additional capital to HRBFA.

To manage short-term liquidity, HRBFA maintains a \$300 million unsecured credit facility with BFC, its indirect corporate parent. As of January 31, 2004 there were no outstanding balances on this facility.

Liquidity needs relating to client trading and margin-borrowing activities are met primarily through cash balances in client brokerage accounts and working capital. Management believes these sources of funds will continue to be the primary sources of liquidity for Investment Services. Stock loans have historically been used as a secondary source of funding and could be used in the future, if warranted.

Securities borrowed and securities loaned transactions are generally reported as collateralized financings. These transactions require the Company to deposit cash and/or collateral with the lender. Securities loaned consist of securities owned by customers, which were purchased on margin. When loaning securities, the Company receives cash collateral approximately equal to the value of the securities loaned. The amount of cash collateral is adjusted, as required, for market fluctuations in the value of the securities loaned. Interest rates paid on the cash collateral fluctuate as short-term interest rates change.

To satisfy the margin deposit requirement of client option transactions with the Options Clearing Corporation (OCC), Investment Services pledges customers' margined securities. Pledged securities as of January 31, 2004 totaled \$68.0 million, an excess of \$25.2 million over the margin requirement.

Management believes the funding sources for Investment 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 customers.

**International Tax Operations:** International Tax Operations provided \$2.3 million in cash from operating activities during the nine months primarily due to higher earnings during the Australian tax season and collections of receivables from Revenue Canada related to its discounted return program.

International Tax Operations are generally self-funded. Cash balances are held in Canada, Australia and the United Kingdom independently in local currencies. H&R Block Canada has a commercial paper program up to \$125 million (Canadian). At January 31, 2004, there was no commercial paper outstanding.



## **CAPITAL RESOURCES**

Cash and cash equivalents – restricted totaled \$606.8 million at January 31, 2004. HRBFA held \$576.4 million of this total segregated in a special reserve account for the exclusive benefit of customers pursuant to Rule 15c3-3 of the Securities Exchange Act of 1934. Restricted cash held by Mortgage Operations totaled \$15.0 million at January 31, 2004 as a result of cash held for outstanding commitments to fund mortgage loans. Restricted cash of \$15.4 million at January 31, 2004 held by Business Services is related to funds held to pay payroll taxes on behalf of its clients.

On September 12, 2001, the Company's Board of Directors authorized the repurchase of 15 million shares of common stock. On June 11, 2003 the Company's Board of Directors approved an authorization to repurchase up to 20 million additional shares of its common stock. During the nine months ended January 31, 2004, the Company purchased 7.8 million shares pursuant to these authorizations at an aggregate price of \$370.0 million, or an average price of \$47.51 per share. There are approximately 14.1 million shares remaining under the June 2003 authorization at January 31, 2004. The Company plans to continue to purchase its shares on the open market in accordance with this authorization, subject to various factors including the price of the stock, the ability to maintain progress toward a capital structure that will support a single A rating, the availability of excess cash, the ability to maintain liquidity and financial flexibility, compliance with securities laws and other investment opportunities available.

## **OFF-BALANCE SHEET FINANCING ARRANGEMENTS**

The Company has commitments to fund mortgage loans in its pipeline of \$2.5 billion at January 31, 2004, subject to contract verification. External market forces impact the probability of loan commitments being closed, and therefore, total commitments outstanding do not necessarily represent future cash requirements. If the loan commitments are exercised, they will be funded through the Company's off-balance sheet arrangements.

For the nine months ended January 31, 2004, the final disposition of loans was 25% securitizations and 75% third-party whole loan sales. For the nine months ended January 31, 2003, the final disposition of loans was 65% securitizations and 35% third-party whole loan sales. The current year shift to whole loan sales is due to the more favorable pricing in the whole loan market. Increased whole loan sale transactions results in gains on loan sales being recorded earlier and cash being received earlier. Whole loan sales also do not add residual interests to the Company's balance sheet, and therefore do not add additional balance sheet risk.

In the third quarter of fiscal year 2004, the warehouse facilities utilized by the Trusts were increased to \$7.0 billion. An additional \$1.0 billion facility was added that expires in November and bears interest at one-month LIBOR plus 50 to 60 basis points. This facility is subject to similar performance triggers, limits and financial covenants as the other facilities. In November 2003, two of the existing \$1.5 billion facilities were increased to \$2.0 billion each.

The Financial Accounting Standards Board (FASB) has decided to reissue its exposure draft, "Qualifying Special Purpose Entities and Isolation of Transferred Assets, an Amendment of

## [Table of Contents](#)

FASB Statement No. 140,” during the first quarter of calendar year 2004. The purpose of the proposal is to provide more specific guidance on the accounting for transfers of financial assets to a QSPE.

Provisions in the first exposure draft, if adopted, may have required the Company to consolidate its current QSPEs (the Trusts) established in its Mortgage Operations segment. As of January 31, 2004, the Trusts had assets and liabilities of \$2.8 billion. The provisions of the exposure draft are subject to FASB due process and are subject to change. The Company will continue to monitor the status of the exposure draft, and consider changes, if any, to current structures as a result of the proposed rules.

There have been no other material changes in the Company’s off-balance sheet financing arrangements from those reported at April 30, 2003 in the Company’s Annual Report on Form 10-K.

### **COMMERCIAL PAPER ISSUANCE**

Borrowings of \$1.4 billion were outstanding at January 31, 2004, with zero outstanding at April 30, 2003.

U.S. commercial paper issuances are supported by an unsecured committed line of credit (CLOC) from a consortium of twenty-four banks. The \$2.0 billion CLOC is subject to annual renewal in August 2004 and has a one-year term-out provision with a maturity date in August 2005. This line is subject to various affirmative and negative covenants. This CLOC includes \$1.5 billion for CP back-up and general corporate purposes and \$500 million for working capital use, general corporate purposes and CP back-up. An additional line of credit of \$500 million was put into place for the period of January 26 to February 25, 2004 to back-up peak commercial paper issuance. This line is subject to various covenants, substantially similar to the primary CLOC. These CLOCs were undrawn at January 31, 2004.

The Canadian issuances are supported by a credit facility provided by one bank in an amount not to exceed \$125 million (Canadian). This line is subject to a minimum net worth covenant. The Canadian CLOC is subject to annual renewal in December 2004. The CLOC was undrawn at January 31, 2004.

There have been no other material changes in the Company’s commercial paper arrangements from those reported at April 30, 2003 in the Company’s Annual Report on Form 10-K.

### **CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS**

In fiscal year 2000, HRB Royalty, Inc. (HRB Royalty), a wholly owned subsidiary of the Company, placed most of its major franchises on notice that it would not be renewing their respective franchise agreements as of the next renewal date. The agreements have expired or were going to expire on varying dates in fiscal years 2004 and 2005. Pursuant to the terms of the applicable franchise agreements, HRB Royalty must pay the major franchisee a “fair and equitable price” for the franchise business and such price shall not be less than eighty percent of

## [Table of Contents](#)

the franchisee's revenues for the most recent twelve months ended April 30, plus the value of equipment and supplies, and certain off-season expenses.

During the nine months ended January 31, 2004, franchise agreements of twelve major franchisees expired and subsidiaries of the Company began operating tax preparation businesses as company-owned operations in the franchise territories of ten former major franchisees. Cash payments of \$243.3 million were made related to the ten former major franchises during the nine months ended January 31, 2004. Of the two other franchisees with expired franchise agreements one franchisee entered into a new franchise agreement with a limited term and the other franchisee continued litigation challenging the post-expiration restrictive covenants and disputing the payment due under the franchise agreement terms.

In August 2003, a subsidiary of the Company entered into a transaction with one of the former major franchisees whose franchise agreements expired in the first quarter, pursuant to which such subsidiary acquired the stock of the franchisee and the franchisee released the Company and its affiliates from any further liability regarding additional payments under the major franchise agreements. A trial relating to one major franchisee was held in October 2003, at the conclusion of which, the jury rendered a verdict and the court entered a judgment requiring the Company to make an additional payment of \$3.2 million for the franchise business. The original payment for the franchise business made in the first quarter of fiscal year 2004 was \$5.0 million.

In December 2003, one additional major franchise whose franchise agreement was scheduled to expire in 2005 entered into a new franchise agreement with a limited term.

On January 8, 2004, the Company reached an agreement to settle pending litigation with nine of its former major franchisees whose franchise agreements expired during the nine months ended January 31, 2004. The Company agreed to pay a total of \$227.0 million as the "fair and equitable price" for the franchise businesses. During the third quarter of fiscal year 2004, the remaining \$130.1 million was paid, which included the trial verdict payments of \$3.2 million and \$0.9 million.

In October 1997, the company issued \$250.0 million of 63/4% Senior Notes under its shelf registration. These Senior Notes are due November 1, 2004 and are included in the current portion of long-term debt in the Company's condensed consolidated balance sheet. The Company plans to refinance these Senior Notes during fiscal year 2005.

There have been no other material changes in the Company's contractual obligations and commercial commitments from those reported at April 30, 2003 in the Company's Annual Report on Form 10-K.

## **REGULATORY ENVIRONMENT**

Certain state laws restrict or prohibit prepayment penalties on mortgage loans, and the Company relied on the federal Alternative Mortgage Transactions Parity Act (Parity Act) and related rules issued in the past by the Office of Thrift Supervision (OTS) to preempt state limitations on prepayment penalties. The Parity Act was enacted to extend to financial institutions, other than

## Table of Contents

federally chartered depository institutions, the federal preemption that federally chartered depository institutions enjoy. However, in September 2002, the OTS released a new rule that reduced the scope of the Parity Act preemption effective July 1, 2003 and, as a result, the Company can no longer rely on the Parity Act to preempt state restrictions on prepayment penalties. The elimination of this federal preemption requires compliance with state restrictions on prepayment penalties. These restrictions prohibit the Company from charging any prepayment penalty in nine states and restrict the amount or duration of prepayment penalties that the Company may impose in an additional eleven states. This places the Company at a competitive disadvantage relative to financial institutions that continue to enjoy federal preemption of such state restrictions. Such institutions can charge prepayment penalties without regard to state restrictions and, as a result, may be able to offer loans with interest rate and loan fee structures that are more attractive than the interest rate and loan fee structures that the Company is able to offer. It is estimated that the net impact to Mortgage Operations will be a reduction in revenues of approximately \$35.0 million in fiscal year 2004 as a result of the elimination of prepayment penalties.

The United States, various state, local, provincial and foreign governments and some self-regulatory organizations have enacted statutes and ordinances, and/or adopted rules and regulations, regulating aspects of the businesses in which the Company's subsidiaries are involved, including, but not limited to, commercial income tax return preparers, income tax courses, the electronic filing of income tax returns, the facilitation of refund anticipation loans, loan originations and assistance in loan originations, mortgage lending, privacy, consumer protection, franchising, sales methods, brokers, broker-dealers and various aspects of securities transactions, financial planners, investment advisors, accountants and the accounting practice. The Company's subsidiaries seek to determine the applicability of such statutes, ordinances, rules and regulations (collectively, Laws) and comply with those Laws that apply to their activities. From time to time in the ordinary course of business, the Company and its subsidiaries receive inquiries from governmental and self-regulatory agencies regarding the applicability of Laws to the products and services offered by the Company's subsidiaries. In response to past inquiries, the Company's subsidiaries have agreed to comply with such Laws, convinced the authorities that such Laws were not applicable or that compliance already exists, and/or modified such subsidiaries' activities in the applicable jurisdiction to avoid the application of all or certain parts of such Laws. The Company's management believes that the past resolution of such inquiries and its ongoing compliance with Laws have not had a material adverse effect on the consolidated financial statements of the Company and its subsidiaries. The Company cannot predict what effect future Laws, changes in interpretations of existing Laws, or the results of future regulator inquiries with respect to the applicability of Laws may have on the Company's subsidiaries, the consolidated financial statements of the Company and its subsidiaries.

### **FORWARD-LOOKING INFORMATION**

The information contained in this Form 10-Q and the exhibits hereto may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such statements are based upon current information, expectations, estimates and projections regarding the Company, the industries and markets in which the Company operates, and management's assumptions and beliefs relating

## [Table of Contents](#)

thereto. Words such as “will,” “plan,” “expect,” “remain,” “intend,” “estimate,” “approximate,” and variations thereof and similar expressions are intended to identify such forward-looking statements. 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 that are difficult to predict. Therefore, actual outcomes and results could materially differ from what is expressed, implied or forecast in such forward-looking statements. Such differences could be caused by a number of factors including, but not limited to, the uncertainty of laws, legislation, regulations, supervision and licensing by Federal, state and local authorities and self-regulatory organizations and their impact on any lines of business in which the Company’s subsidiaries are involved; unforeseen compliance costs; the uncertainty that the Company will achieve or exceed its revenue, income and earnings per share growth goals and expectations for fiscal year 2004; the uncertainty that actual fiscal year 2004 financial results will fall within the guidance provided by the Company; the uncertainty that the growth rate for mortgage originations in the Mortgage Operations segment will equal or exceed the growth rate experienced in fiscal year 2003 or the first three quarters of fiscal year 2004; the uncertainty as to the effect on the consolidated financial statements of the adoption of accounting pronouncements; risks associated with sources of liquidity for each of the lines of business of the Company; changes in interest rates; changes in economic, political or regulatory environments; changes in competition and the effects of such changes; the inability to implement the Company’s strategies; changes in management and management strategies; the Company’s inability to successfully design, create, modify and operate its computer systems and networks; the uncertainty of assumptions utilized to estimate cash flows from residual interests in securitizations and mortgage servicing rights; the uncertainty of assumptions and criteria used in the testing of goodwill and long-lived assets for impairment; litigation involving the Company and its subsidiaries; the uncertainty as to the outcome of any litigation; the uncertainty as to the timing or cost of commencement of operations in former major franchise territories or the fair and equitable price to be paid for any major franchise business; and risks described from time to time in reports and registration statements filed by the Company and its subsidiaries with the Securities and Exchange Commission. Readers should take these factors into account in evaluating any such forward-looking statements. The Company undertakes no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in market risk from those reported at April 30, 2003 in the Company’s Annual Report on Form 10-K.

### **CONTROLS AND PROCEDURES**

Disclosure controls and procedures are controls and other procedures that are designed to ensure information required to be disclosed in reports filed or submitted under the Securities Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure such information is accumulated and communicated to management, including the Chief Executive Officer and Chief

## [Table of Contents](#)

Financial Officer or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosures.

In conjunction with management, including the Chief Executive Officer and Principal Accounting Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on this evaluation, the Chief Executive Officer and Principal Accounting Officer have concluded these controls and procedures are effective. There have been no significant changes in internal controls, or in other factors, which would significantly affect these controls subsequent to the date of evaluation.

## **PART II - OTHER INFORMATION**

### ITEM 1. LEGAL PROCEEDINGS

The information below should be read in conjunction with the information included in note 12 to the Company's condensed consolidated financial statements contained in Part I. The information included in note 12 to the Company's condensed consolidated financial statements contained in Part I is hereby incorporated in this Part II by reference.

#### *RAL Litigation*

The Company reported in current reports on Forms 8-K, previous quarterly reports on Form 10-Q and in its annual report on Form 10-K for the year ended April 30, 2003, certain events and information relating to class action litigation and putative class action litigation involving its subsidiaries' refund anticipation loan programs (collectively, "RAL Cases"). The Company has successfully defended numerous class action and putative class action lawsuits filed against it involving the RAL program and a variety of legal theories asserted by plaintiffs, although several such cases are still pending. The amounts claimed in these lawsuits have been substantial in some instances. Of the cases that are no longer pending, some were dismissed on the Company's motions for dismissal or summary judgment, some were dismissed voluntarily by the plaintiffs after a denial of class certification, and some were settled. Two RAL Cases involving statewide classes (discussed in note 12 to the condensed consolidated financial statements contained in Part I) had final trial court approvals of settlements during the first nine months of fiscal year 2004 and two other RAL Cases were dismissed in August 2003 in connection with one of those settlements. One new putative class action RAL Case was filed in August 2003. The Company continues to believe it has meritorious defenses to the RAL Cases and intends to defend the remaining RAL Cases vigorously. However, there can be no assurances as to the outcome of the pending RAL Cases individually or in the aggregate, and there can be no assurances regarding the impact of the RAL Cases on the Company's financial position. The following is updated information regarding the pending RAL Cases in which developments occurred during or after the three months ended January 31, 2004:

*Ronnie and Nancy Haese, et al. v. H&R Block Inc., et al.*, Case No. CV96-4213, District Court of Kleberg County, Texas, (*Haese I*) and *Ronnie and Nancy Haese, et al. v. H&R Block Inc., et al.*, Case No. CV-99-314-D, District Court of Kleberg County, Texas (*Haese II*), filed originally as one action on July 30, 1996. On November 19, 2002, the Company announced that a settlement

## Table of Contents

had been reached pursuant to which the Company and its major franchisee will issue coupons to class members that may be redeemed over a five-consecutive-year period following final approval of the settlement and once all appeals have been exhausted. Each class member will receive a packet containing 15 coupons under the settlement. Three coupons will be redeemable each year – one for a \$20 rebate off tax services at Block offices, one that may be redeemed for TaxCut Platinum tax preparation software, and one that may be redeemed for Tax Planning Advisor, a tax planning book. The settlement also provides that defendants will be responsible for the payment of court-approved legal fees up to \$49 million and expenses of class counsel up to \$900,000. As a result of the settlement announcement, the Company recorded a liability and pretax expense of \$41.7 million during the second quarter of fiscal year 2003, which represented, at that time, the Company's best estimate of its share of the settlement cost for plaintiff class attorneys' fees and expenses, tax products and associated mailing expenses. The Company recorded an additional liability and pretax expense of \$1.0 million during the three months ended October 31, 2003, for a total liability and pretax charge of \$47.6 million through July 31, 2003. During the fourth quarter of fiscal year 2003 and prior to the filing of the final settlement agreement with the court and any motions for preliminary approval of the settlement and legal fees and expenses of class counsel, the plaintiffs filed a motion asking the Texas court to direct that \$26 million of awarded class counsel fees be paid to the plaintiff class members. The final settlement agreement was filed with the District Court in March 2003 and preliminary approval of the settlement agreement was granted by the court on March 31, 2003. Notice of the settlement was sent to the class, a hearing on the final approval of the settlement agreement was held on June 24, 2003, and the judge entered a final judgment on June 24, 2003 fully and finally approving the settlement agreement, finding it fair, adequate and reasonable and that it protects the rights of the class, is in the best interests of the settlement class and meets all criteria required by Texas law. As a part of the final judgment, the court also (1) dismissed with prejudice the claims of class members who obtained RALs in Texas during the period from 1992 through 1996; (2) granted defendants' Supplemental Motion for Summary Judgment as to class members who only obtained RALs from 1988 through 1991, and ordered that such defendants take nothing on their claims against the defendants; (3) granted defendants' Motion to Compel Arbitration as to those members of the class who obtained a RAL for the first time from 1997 to 2002, and dismissed the claims of those class members without prejudice as to those members' rights to pursue those claims through binding arbitration; (4) vacated its January 30, 1998 Order pertaining to arbitration clauses and contacts with the class; and (5) withdrew its rulings as to fiduciary duty, breach or the nature of the breach thereof, and for forfeiture as reflected in the Court's November 6, 2002 letter. In a separate Order dated June 24, 2003, the Court found that the awarding of attorneys' and expenses was appropriate and ordered that class counsel and objectors' class counsel be awarded attorneys' fees in the amount of \$49.0 million on condition that, upon payment of the fees to class counsels' trust account, class counsel shall pay \$26.0 million of the attorneys' fees to the class members pursuant to an approved distribution plan. The Order also provided that \$100,000 from the award of attorneys' fees be used to create a cy pres fund pursuant to an approved cy pres plan and specified the manner in which the remaining award of attorneys' fees was to be distributed among the class counsel and objectors' class counsel. There were no appeals of such final judgment and Order relating to attorneys' fees and expenses. The Company paid the award of attorneys' fees and expenses to class counsel on August 22, 2003. In addition to the \$49.9 million liability that has already been recorded and/or

## Table of Contents

paid, the Company will reduce revenues associated with tax preparation services as the coupons are redeemed each year. Coupons were distributed prior to the 2004 tax season.

*Belinda Peterson, et al. v. H&R Block Tax Services, Inc.*, Case No. 95CH2389, in the Circuit Court of Cook County, Illinois. A settlement was reached in April 2003 involving an estimated maximum total amount of \$295,000. As a part of the settlement, class members who submit a claim will receive \$25 in cash, with a guaranteed minimum total payout of \$40,000 and a maximum total payout of \$55,000. Class counsel will receive \$220,000, the named class representative will receive \$5,000, and it is expected that it will cost up to \$15,000 to administer the settlement. Preliminary approval of the settlement was granted on June 12, 2003 and notices of the settlement and claim forms have been sent to the class. The settlement was approved and a judgment entered after a final fairness hearing held in October 2003. The settlement was funded and attorneys' fees were paid in December 2003, and payments were mailed to class members in February 2004.

*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. On April 15, 2003, the District Court judge declined to approve a \$25 million settlement of this matter, finding that counsel for the settlement plaintiffs had been inadequate representatives of the plaintiff class and failed to sustain their burden of showing that the settlement was fair. The judge appointed new counsel for the plaintiffs in May 2003 and named their client, Lynne Carnegie, as lead plaintiff. The new counsel for the plaintiffs filed an amended complaint and a motion for partial summary judgment during the quarter ended July 31, 2003. The defendants filed a motion to dismiss, a brief in response to allegations in the plaintiffs' amended complaint relating to class certification, and responses to plaintiffs' motion for partial summary judgment. Rulings on these motions are pending, and extensive discovery is proceeding. In the fourth quarter of fiscal year 2003, the Company recorded a receivable in the amount of its \$12.5 million share of the settlement fund and recorded a reserve of \$12.5 million consistent with the existing settlement authority of the Board of Directors. The defendants requested the release of the escrowed settlement fund and the Company's \$12.5 million share of such fund was received during the second quarter of fiscal year 2004. The Company intends to defend the case vigorously, but there are no assurances as to its outcome.

*Abby Thomas, et al. v. Beneficial National Bank, H&R Block, Inc., et al.*, Case No. 4:03-CV-00775 GTE in the United States District Court for the Eastern District of Arkansas, Western Division, was originally filed in the Circuit Court for Phillips County, Arkansas on August 12, 2003, and was subsequently removed to federal court. It is a putative class action alleging fraudulent misrepresentation, fraudulent concealment, dual agency, breach of fiduciary duty, violation of Arkansas Deceptive and Unconscionable Trade Practices Law, violation of Arkansas' Secret Payments or Allowance of Rebates and Refunds Law, unjust enrichment, breach of contract and deceit in connection with the RAL program. The complaint requests that the court certify a nationwide class of all persons who obtained a RAL from September 1987 through December 1997, who do not have an arbitration provision in their contract. It also seeks a subclass of class members who are 60 years of age or older, or who are Disabled Persons under



## Table of Contents

Arkansas Statutes section 4-88-201. Plaintiffs seek an unspecified amount of damages, restitution, equitable relief, attorneys' fees, and costs of court. Defendants have moved to dismiss and compel arbitration. Plaintiffs thereafter filed an amended complaint and a motion to remand the case to state court. On December 8, 2003, the federal court denied plaintiffs' motion to remand.

*Deandra D. Cummins, et al. v. H&R Block, Inc., et al.*, Case No. 03-C-134 in the Circuit Court of Kanawha County, West Virginia. Defendants' motions to dismiss and to compel arbitration were heard in part in December 2003 during which the judge discontinued the hearing and ordered the parties to mediation. Mediation occurred in February 2004 during which the parties were unable to reach agreement.

*Sandra J. Basile, et al. v. H&R Block, Inc., et al.*, April Term 1992 Civil Action No. 3246 in the Court of Common Pleas, First Judicial District of Pennsylvania, Philadelphia County. Court ordered mediation occurred in December 2003. The mediation was unsuccessful, and the court decertified the class on December 31, 2003. Plaintiffs have appealed the decertification.

### *Peace of Mind Litigation*

*Lorie J. Marshall, et al. v. H&R Block Tax Services, Inc., et al.*, Civil Action 2002L000004, in the Circuit Court of Madison County, Illinois, is a class action case filed on January 18, 2002, as to which the court granted plaintiffs' first amended motion for class certification on August 27, 2003. Plaintiffs' claims consist of five counts relating to the defendants' Peace of Mind program under which the applicable tax return preparation subsidiary assumes liability for the cost of additional tax assessments attributable to tax return preparation error. The plaintiffs allege that defendants' sale of its Peace of Mind guarantee constitutes statutory fraud by selling insurance without a license, an unfair trade practice, by omission and by "cramming" (i.e., charging customers for the guarantee even though they did not request it and/or did not want it), and constitutes a breach of fiduciary duty. A hearing on the motion to certify both a nationwide plaintiff class and a nationwide defendant class was held on August 14, 2003, and, on August 27, 2003, the court certified the following plaintiff classes: (1) all persons who were charged a separate fee for Peace of Mind by "H&R Block" or a defendant H&R Block class member from January 1, 1997 to final judgment; (2) all persons who reside in certain class states and who were charged a separate fee for Peace of Mind by "H&R Block," or a defendant H&R Block class member, and that was not licensed to sell insurance, from January 1, 1997 to final judgment; and (3) all persons who had an unsolicited charge for Peace of Mind posted to their bills by "H&R Block" or a defendant H&R Block class member from January 1, 1997, to final judgment. Among those excluded from the plaintiff classes are all persons who received the Peace of Mind guarantee through an H&R Block Premium office and all persons who reside in Texas and Alabama. The court also certified a defendant class consisting of any entity with the names "H&R Block" or "HRB" in its name, or otherwise affiliated or associated with H&R Block Tax Services, Inc., and which sold or sells the Peace of Mind product. Defendants filed a motion asking the trial court to certify the class certification issues for interlocutory appeal, which the trial court denied. Discovery is proceeding.

## Table of Contents

There are two other putative class actions pending against the Company in Texas and Alabama that involve the Peace of Mind guarantee. The Texas case is being tried before the same judge that presided over the *Haese* case and involves the same attorneys for the plaintiffs as are involved in the *Marshall* litigation in Illinois and substantially similar allegations. The Alabama case involves allegations of selling insurance without a license in connection with the Peace of Mind program, the erroneous preparation of income tax returns that subjected plaintiffs to audits, failure to provide assistance in responding to auditors' requests, failure to pay the penalties, interest, and additional taxes under Block's standard guarantee and Peace of Mind programs, unjust enrichment, and breach of contract. No classes have been certified in either of these two cases. The Company believes the claims in these Peace of Mind actions are without merit and intends to defend them vigorously. However, there can be no assurances as to the outcome of these pending actions individually or in the aggregate, and there can be no assurances on the impact of these actions on the Company's financial condition.

### *Franchise Litigation*

The Company was a named defendant in litigation entitled *William R. Smith, Inc., et al. v. H&R Block, Inc., et al.*, Case No. 99-CV-206379, pending in the Circuit Court of Jackson County, Missouri (previously known as *Armstrong Business Services, Inc., et al. v. H&R Block, Inc., et al.*). See discussion in note 12 to the condensed consolidated financial statements.

### *Other Claims and Litigation*

As with other broker-dealers that distribute mutual fund shares, H&R Block Financial Advisors, Inc. (HRBFA), a wholly owned indirect subsidiary of the Company, is the subject of an investigation by the National Association of Securities Dealers, Inc. (NASD) into activities characterized as "market timing" and "late trading" of mutual fund shares by HRBFA. The NASD staff has notified HRBFA that on the basis of its investigation it has preliminarily determined to recommend a disciplinary action against HRBFA for violating various federal securities laws and NASD rules in connection with market timing activities that took place primarily in one of HRBFA's offices. The NASD has requested a written statement concerning HRBFA's position on the staff's preliminary determination. HRBFA is cooperating with the NASD and is conducting its own internal investigation. There can be no assurances as to the outcome and resolution of this matter at this time.

As reported in current report on Form 8-K dated December 12, 2003, the United States Securities and Exchange Commission informed outside counsel to the Company on December 11, 2003 that the Commission had issued a Formal Order of Investigation concerning the Company's disclosures, in and before November 2002, regarding RAL litigation to which the Company was and is a party. There can be no assurances as to the outcome and resolution of this matter.

The Company and its subsidiaries have from time to time been party to claims and lawsuits not discussed herein arising out of its business operations, including additional claims and lawsuits concerning RALs and the Peace of Mind guarantee program, and claims and lawsuits concerning the preparation of customers' income tax returns, the electronic filing of customers' tax returns, the fees charged customers for various products and services, losses incurred by customers with

## Table of Contents

respect to their investment accounts, relationships with franchisees, denials of mortgage loans, contested mortgage foreclosures, other aspects of the mortgage business, intellectual property disputes, and contract disputes. Such lawsuits include actions by individual plaintiffs, as well as cases in which plaintiffs seek to represent a class of similarly situated customers. The amounts claimed in these claims and lawsuits are substantial in some instances and the ultimate liability with respect to such litigation and claims is difficult to predict. The Company's management considers these cases to be ordinary, routine litigation incidental to its business, believes and Company and its subsidiaries have meritorious defenses to each of them, and is defending, or intends to defend, them vigorously. While management cannot provide assurance that the Company and its subsidiaries will ultimately prevail in each instance, management believes that amounts, if any, required to be paid by the Company and its subsidiaries in the discharge of liabilities or settlements in these other matters will not have a material adverse effect on the Company's consolidated results of operations or financial position.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

#### a) Exhibits

- 10.1 Employment Agreement dated September 2, 2003 and fully executed on December 20, 2003 between HRB Management, Inc. and Brad C. Iversen.
- 10.2 Settlement Agreement dated January 8, 2004 between (a) Herbert Dicker; HBD, Inc.; Robert Hildorf; RKL, Inc.; Ray Jiruska; HRB, LLC; RLJ Enterprises, Inc.; DFJ Enterprises, Inc.; RRJ Enterprises, Inc.; DEJ Enterprises, Inc.; Moore Business Service, Inc.; T.J. Enterprises, Inc.; Block Mountain West, Inc.; Orr Enterprises Limited Partnership; S.E. Iowa Business Services, Inc.; Taxsavars, Inc.; and JBW Limited Partnership and (b) H&R Block, Inc.; Block Financial Corporation; HRB Royalty, Inc.; H&R Block Tax Services, Inc.; and H&R Block Eastern Tax Services, Inc.
- 10.3 Third Amended and Restated Refund Anticipation Loan Participation Agreement dated as of January 1, 2004, between Block Financial Corporation and Household Tax Masters, Inc.
- 31.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by Principal Accounting 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 Principal Accounting Officer furnished pursuant to 18 U.S.C. 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.

#### b) Reports on Form 8-K

The registrant filed a current report on Form 8-K dated November 26, 2003, reporting under Item 12 thereof its issuance of a press release announcing the results of operations for its second quarter ending October 31, 2003.

## Table of Contents

The registrant filed a current report on Form 8-K dated December 12, 2003, reporting under Item 5 thereof its issuance of a press release announcing the United States Securities & Exchange Commission enforcement staff had issued a Formal Order of Investigation concerning the Company's disclosures, in and before November 2002, about refund anticipation loan litigation to which the Company was and is a party.

The registrant filed a current report on Form 8-K dated January 12, 2004, reporting under Item 5 thereof its issuance of a press release announcing the settlement of the major franchise litigation.

**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.

---

(Registrant)

DATE 3/16/04

BY

/s/ Mark A. Ernst

---

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

DATE 3/16/04

BY

/s/ Melanie K. Coleman

---

Melanie K. Coleman  
Vice President and  
Corporate Controller

## EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT ("Agreement") is entered into as of September 2, 2003, by and between HRB Management, Inc., a Missouri corporation (the "Company"), and Brad C. Iversen ("Executive").

## ARTICLE ONE

## EMPLOYMENT

1.01 - Agreement as to Employment. Effective September 2, 2003 (the "Employment Date"), the Company hereby employs Executive to serve in the capacity set forth in Section 1.02, and Executive hereby accepts such employment by the Company, subject to the terms of this Agreement. The Company reserves the right, in its sole discretion, to change the title of Executive at any time.

## 1.02 - Duties.

(a) Executive is employed by the Company to serve as its Senior Vice President and Chief Marketing Officer as of the Employment Date, and, conditioned on election by the Board of Directors of H&R Block, Inc. ("Block") and as of such election date, the Senior Vice President and Chief Marketing Officer of Block, a Missouri corporation and the indirect parent corporation of the Company, subject to the authority and direction of the Board of Directors of Block and the Executive Vice President and Chief Operating Officer of Block. Subject to the foregoing, Executive will have such authority and responsibility and duties as stated in the job description for the position of Senior Vice President and Chief Marketing Officer, which has been provided to Executive on or before the Employment Date. The Company reserves the right to modify, delete, add, or otherwise change Executive's job responsibilities and job description, in its sole discretion, at any time. Executive will perform such other duties, which may be beyond the scope of the job description, as are assigned to Executive from time to time.

(b) So long as Executive is employed under this Agreement, Executive agrees to devote Executive's full business time and efforts exclusively on behalf of the Company and to competently and diligently discharge Executive's duties hereunder. Executive will not be prohibited from engaging in such personal, charitable, or other nonemployment activities that do not interfere with Executive's full-time employment hereunder and that do not violate the other provisions of this Agreement or the H&R Block, Inc. Code of Business Ethics & Conduct, which Executive acknowledges having read and understood. Executive will comply fully with all reasonable policies of the Company as are from time to time in effect and applicable to Executive's position. Executive understands that the business of H&R Block, Inc. ("Block"), the Company, and/or any other direct or indirect subsidiary of Block (each such other subsidiary an "Affiliate") may be subject to governmental regulation, some of which may require Executive to submit to background investigation as a condition of Block, the Company, and/or Affiliates' participation in certain activities subject to such regulation. If Executive, Block, the Company, or Affiliates are unable to participate, in whole or in part, in any such activity as the result of any action or inaction on the part of Executive, then this Agreement and Executive's employment hereunder may be terminated by the Company

without notice.

1.03 - Compensation.

(a) Base Salary. The Company will pay to Executive a gross salary at an annual rate of \$260,000 ("Base Salary"), payable semimonthly or at any other pay periods as the Company may use for its other executive-level employees. The Base Salary will be reviewed for adjustment no less often than annually during the term of Executive's employment hereunder and, if adjusted, such adjusted amount will become the "Base Salary" for purposes of this Agreement.

(b) Short-Term Incentive Compensation. Executive shall participate in the H&R Block Short-Term Incentive Plan (the "STI Plan") and the discretionary short-term incentive program (the "Discretionary STI Program"). Under the STI Plan and Discretionary STI Program, Executive shall have an aggregate target bonus for fiscal year 2004 of \$130,000 and an opportunity to earn 200% of such target bonus. The payment of the actual award under the STI Plan and Discretionary STI Program shall be based upon such performance criteria which shall be determined by the Compensation Committee of Block. Under the STI Plan and Discretionary STI Program, for the Company's fiscal year 2004 only, Executive's actual incentive compensation shall be prorated based upon the number of months during such year that Executive is actually employed by the Company, provided that Executive must remain employed through April 30, 2004 to receive any payments under the STI Plan and Discretionary STI Program. Such incentive compensation shall be paid to Executive following the completion of fiscal year 2004 when the same is paid to other senior executives of the Company.

(c) Stock Options. Subject to approval by the Compensation Committee of the Board of Directors of Block and Board of Directors of Block itself, Executive shall be granted on the date of such approval a stock option under the H&R Block 2003 Long-Term Executive Compensation Plan, as amended (the "2003 Plan"), to purchase 20,000 shares of Block's common stock at an option price per share equal to its closing price on the New York Stock Exchange on the date of grant, such option to expire on the tenth anniversary of the date of grant; to vest and become exercisable as to one-third (6,666) of the shares covered thereby on the first anniversary of the date of grant, as to an additional one-third (6,667) of such shares on the second anniversary of the date of grant, and as to the remaining one-third (6,667) of the shares on the third anniversary of the date of grant; to be an incentive stock option for the maximum number of shares permitted by Internal Revenue Code Section 422 and the regulations promulgated thereunder; and to otherwise be a nonqualified stock option.

(d) Restricted Stock. Subject to approval by the Compensation Committee of the Board of Directors of Block and Board of Directors of Block itself, Executive shall be awarded promptly after the Employment Date, 2,000 Restricted Shares of Block's common stock under the 2003 Plan. One-third of the 2,000 shares shall vest (i.e., the restrictions on such shares shall terminate), respectively, on each of the first three anniversaries following such employment commencement date (in increments of 666, 667 and 667 whole shares). Prior to the time such Restricted Shares are so vested, (i) such Restricted Shares shall be nontransferable, and (ii) Executive shall be entitled to receive any cash dividends payable with respect to unvested Restricted Shares and vote such unvested Restricted Shares at any

meeting of shareholders of Block.

1.04 - Relocation.

(a) Executive currently resides in Eden Prairie, Minnesota (a suburb of Minneapolis) and is not required to relocate his primary residence to the Greater Kansas City Area during the first 24 months of Executive's employment with the Company. The Company may, in its sole discretion, require Executive to relocate his primary residence to the Greater Kansas City Area any time after the first 24 months of Executive's employment with the Company. If the Company requires Executive to relocate his primary residence to the Greater Kansas City Area, Executive must complete such relocation no later than 12 months after the Company notifies Executive that it is requiring him to relocate.

(b) The Company will reimburse Executive for reasonable packing, shipping, transportation costs and other expenses incurred by Executive in relocating Executive, Executive's family and personal property to the Greater Kansas City Area, in accordance with the H&R Block Executive Relocation Program.

(c) To the extent that Executive incurs taxable income related to any relocation benefits paid pursuant to this Agreement, the Company will pay to Executive such additional amount as is necessary to "gross up" such benefits and cover the anticipated income tax liability resulting from such taxable income.

1.05 - Business Expenses. The Company will promptly pay directly, or reimburse Executive for, all business expenses, to the extent such expenses are paid or incurred by Executive during the term hereof in accordance with the Company's policy in effect from time to time and to the extent such expenses are reasonable and necessary to the conduct by Executive of the Company's business.

1.06 - Fringe Benefits. During the term of Executive's employment hereunder, and subject to the discretionary authority given to the applicable benefit plan administrators, the Company will make available to Executive such insurance, sick leave, deferred compensation, short-term incentive compensation, bonuses, stock options, retirement, vacation, and other like benefits as are approved and provided from time to time to the other executive-level employees of the Company or Affiliates. Executive agrees that from the Employment Date through the end of the Company's fiscal year 2004, Executive will not take more than 13 days of vacation.

1.07 - Termination of Employment.

(a) Without Notice. The Company may, at any time, in its sole discretion, terminate this Agreement and the employment of Executive without notice in the event of:

(i) Executive's misconduct that interferes with or prejudices the proper conduct of the business of Block, the Company or any Affiliate or which may reasonably result in harm to the reputation of Block, the Company and/or any Affiliate; or

(ii) Executive's commission of an act materially and demonstrably



detrimental to the good will of Block or any subsidiary of Block, which act constitutes gross negligence or willful misconduct by Executive in the performance of Executive's material duties to Block or such subsidiary; or

(iii) Executive's commission of any act of dishonesty or breach of trust resulting or intending to result in material personal gain or enrichment of Executive at the expense of Block or any subsidiary of Block; or

(iv) Executive's violation of Section 1.04(a), Article Two or Article Three of this Agreement; or

(v) Executive's conviction of a misdemeanor (involving an act of moral turpitude) or a felony; or

(vi) Executive's disobedience, insubordination or failure to discharge Executive's duties; or

(vii) Executive's suspension by the Internal Revenue Service from participation in the Electronic Filing Program; or

(viii) The inability of Executive, Block, the Company, and/or an Affiliate to participate, in whole or in part, in any activity subject to governmental regulation as the result of any action or inaction on the part of Executive, as described in Section 1.02(b); or

(ix) Executive's death or total and permanent disability. The term "total and permanent disability" will have the meaning ascribed thereto under any long-term disability plan maintained by the Company or Block for executives of the Company.

(b) With Notice. Either party may terminate this Agreement for any reason, or no reason, by providing not less than 45 days' prior written notice of such termination to the other party, and, if such notice is properly given, this Agreement and Executive's employment hereunder will terminate as of the close of business on the 45th day after such notice is deemed to have been given or such later date as is specified in such notice.

(c) Termination Due to a Change of Control.

(i) If Executive terminates Executive's employment under this Agreement during the 180-day period following the date of the occurrence of a "Change of Control" of Block then, upon any such termination of Executive's employment and conditioned on Executive's execution of an agreement with the Company under which Executive releases all known and potential claims against Block, the Company, and Affiliates, the Company will provide Executive with Executive's election (the "Change of Control Election") of the same level of severance compensation and benefits as would be provided under the H&R Block Severance Plan (the "Severance Plan") as the Severance Plan exists either (A) on the date of this Agreement or (B) on Executive's last day of active employment by the Company or any Affiliate (the "Last Day of Employment"), as if Executive had incurred a "Qualifying

Termination" (as such term is defined in the Severance Plan). The Severance Plan as it exists on the date of this Agreement is attached hereto as Exhibit A. Executive must notify the Company in writing within 5 business days after Executive's Last Day of Employment of Executive's Change of Control Election. Severance compensation and benefits provided under this Section 1.07(c) will terminate immediately if Executive violates Sections 3.02, 3.03, or 3.05 of this Agreement or becomes reemployed with the Company or an Affiliate.

(ii) For the purpose of this subsection, a "Change of Control" means:

(A) the acquisition, other than from Block, by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")), of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 35% or more of the then outstanding voting securities of Block entitled to vote generally in the election of directors, but excluding, for this purpose, any such acquisition by Block or any of its subsidiaries, or any employee benefit plan (or related trust) of Block or its subsidiaries, or any corporation with respect to which, following such acquisition, more than 50% of the then outstanding voting securities of such corporation entitled to vote generally in the election of directors is then beneficially owned, directly or indirectly, by all or substantially all of the individuals and entities who were the beneficial owners of the voting securities of Block immediately prior to such acquisition in substantially the same proportion as their ownership, immediately prior to such acquisition, of the then outstanding voting securities of Block entitled to vote generally in the election of directors, as the case may be; or

(B) individuals who, as of the date hereof, constitute the Board of Directors of Block (generally, the "Board," and as of the date hereof, the "Incumbent Board") cease for any reason to constitute at least a majority of the Board, provided that any individual or individuals becoming a director subsequent to the date hereof, whose election, or nomination for election by Block's shareholders, was approved by a vote of at least a majority of the Board (or nominating committee of the Board) will be considered as though such individual were a member or members of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of Block (as such terms are used in Rule 14a-11 of Regulation 14A promulgated under the Exchange Act); or

(C) the completion of a reorganization, merger or consolidation approved by the shareholders of Block, in each case, with respect to which all or substantially all of the individuals and entities who were the respective beneficial owners of the voting securities of Block immediately prior to such reorganization, merger or consolidation do not, following such reorganization, merger or consolidation, beneficially own, directly or indirectly, more than 50% of the then outstanding voting securities entitled to vote generally in the election of directors of the corporation resulting from such reorganization,

merger or consolidation, or a complete liquidation or dissolution of Block, as approved by the shareholders of Block, or the sale or other disposition of all or substantially all of the assets of Block, as approved by the shareholders of Block.

(d) Severance. Executive will receive severance compensation and benefits as would be provided under the Severance Plan, as the same may be amended from time to time, if Executive incurs a "Qualifying Termination," as such term is defined in the Severance Plan (and without regard to whether the termination is with or without notice under this Agreement), and executes an agreement with the Company under which Executive releases all known and potential claims against Block, the Company, and Affiliates. Executive will not be eligible for severance compensation and benefits under this Section 1.07(d) if Executive is terminated for cause, which shall include but not be limited to termination based on the occurrence of any of the events described in Section 1.07(a). Severance compensation and benefits will be Executive's election (the "Severance Election") of the same level of severance compensation and benefits as would be provided under the Severance Plan as such plan exists either (A) on the date of this Agreement or (B) Executive's Last Day of Employment. The Severance Plan as it exists on the date of this Agreement is attached hereto as Exhibit A. Executive must notify the Company in writing within 5 business days after Executive's Last Day of Employment of Executive's Severance Election. Severance compensation and benefits provided under this Section 1.07(d) will terminate immediately if Executive violates Sections 3.02, 3.03, or 3.05 of this Agreement or becomes reemployed with the Company or an Affiliate.

(e) Further Obligations. Upon termination of Executive's employment under this Agreement, neither the Company, Block, nor any Affiliate will have any further obligations under this Agreement and no further payments of Base Salary or other compensation or benefits will be payable by the Company, Block, or any Affiliate to Executive, except (i) as set forth in this Section 1.07, (ii) as required by the express terms of any written benefit plans or written arrangements maintained by the Company or Block and applicable to Executive at the time of such termination of Executive's employment, or (iii) as may be required by law. Any termination of this Agreement, however, will not be effective as to Sections 3.02, 3.03 and 3.05, or any other portions or provisions of this Agreement which, by their express terms, require performance by either party following termination of this Agreement.

## ARTICLE TWO

### CONFIDENTIALITY

2.01 - Background and Relationship of Parties. The parties hereto acknowledge (for all purposes including, without limitation, Articles Two and Three of this Agreement) that Block and its subsidiaries have been and will be engaged in a continuous program of acquisition and development respecting their businesses, present and future, and that, in connection with Executive's employment by the Company, Executive will be expected to have access to all information of value to the Company and Block and that Executive's employment creates a relationship of confidence and trust between Executive and Block with respect to any information applicable to the businesses of Block and its subsidiaries. Executive will possess or have unfettered access to information that has been created,

developed, or acquired by Block and its subsidiaries or otherwise become known to Block and its subsidiaries and which has commercial value in the businesses in which Block and its subsidiaries have been and will be engaged and has not been publicly disclosed by Block. All information described above is hereinafter called "Proprietary Information." By way of illustration, but not limitation, Proprietary Information includes trade secrets, customer lists and information, employee lists and information, developments, systems, designs, software, databases, know-how, marketing plans, product information, business and financial information and plans, strategies, forecasts, new products and services, financial statements, budgets, projections, prices, and acquisition and disposition plans. Proprietary Information does not include any portions of such information which are now or hereafter made public by third parties in a lawful manner or made public by parties hereto without violation of this Agreement.

## 2.02 - Proprietary Information is Property of Block.

(a) All Proprietary Information is the sole property of Block (or the applicable subsidiary of Block) and its assigns, and Block (or the applicable subsidiary of Block) is the sole owner of all patents, copyrights, trademarks, names, and other rights in connection therewith and without regard to whether Block (or any subsidiary of Block) is at any particular time developing or marketing the same. Executive hereby assigns to Block any rights Executive may have or may acquire in such Proprietary Information. At all times during and after Executive's employment with the Company or any Affiliate, Executive will keep in strictest confidence and trust all Proprietary Information and Executive will not use or disclose any Proprietary Information without the written consent of Block, except as may be necessary in the ordinary course of performing duties as an employee of the Company or as may be required by law or the order of any court or governmental authority.

(b) In the event of any termination of Executive's employment hereunder, Executive will promptly deliver to the Company all copies of all documents, notes, drawings, programs, software, specifications, documentation, data, Proprietary Information, and other materials and property of any nature belonging to Block or any subsidiary of Block and obtained during the course of Executive's employment with the Company. In addition, upon such termination, Executive will not remove from the premises of Block or any subsidiary of Block any of the foregoing or any reproduction of any of the foregoing or any Proprietary Information that is embodied in a tangible medium of expression.

## ARTICLE THREE

### NON-HIRING; NON-SOLICITATION; NO CONFLICTS; NON-COMPETITION

3.01 - General. The parties hereto acknowledge that, during the course of Executive's employment by the Company, Executive will have access to information valuable to the Company and Block concerning the employees of Block and its subsidiaries ("Block Employees") and, in addition to Executive's access to such information, Executive may, during (and in the course of) Executive's employment by the Company, develop relationships with such Block Employees whereby information valuable to Block and its subsidiaries concerning the Block Employees was acquired by Executive. Such information includes, without limitation: the identity, skills, and performance levels of the Block Employees, as well as compensation and benefits paid by Block to such Block Employees. Executive agrees

and understands that it is important to protect Block, the Company, Affiliates and their employees, agents, directors, and clients from the unauthorized use and appropriation of Block Employee information, Proprietary Information, and trade secret business information developed, held, or used by Block, the Company, or Affiliates, and to protect Block, the Company, and Affiliates and their employees, agents, directors, and customers Executive agrees to the covenants described in this Article III.

3.02 - Non-Hiring. During the period of Executive's employment hereunder, and for a period of 1 year after Executive's Last Day of Employment, Executive may not directly or indirectly recruit, solicit, or hire any Block Employee or otherwise induce any such Block Employee to leave the employment of Block (or the applicable employer-subsubsidiary of Block) to become an employee of or otherwise be associated with any other party or with Executive or any company or business with which Executive is or may become associated. The running of the 1-year period will be suspended during any period of violation and/or any period of time required to enforce this covenant by litigation or threat of litigation.

3.03 - Non-Solicitation. During the period of Executive's employment hereunder and during the time Executive is receiving payments hereunder, and for 2 years after the later of Executive's Last Day of Employment or cessation of such payments, Executive may not directly or indirectly solicit or enter into any arrangement with any person or entity which is, at the time of the solicitation, a significant customer of the Company or an Affiliate for the purpose of engaging in any business transaction of the nature performed by the Company or such Affiliate, or contemplated to be performed by the Company or such Affiliate, for such customer, provided that this Section 3.03 will only apply to customers for whom Executive personally provided services while employed by the Company or an Affiliate or customers about whom or which Executive acquired material information while employed by the Company or an Affiliate. The running of the 2-year period will be suspended during any period of violation and/or any period of time required to enforce this covenant by litigation or threat of litigation.

3.04 - No Conflicts. Executive represents in good faith that, to the best of Executive's knowledge, the performance by Executive of all the terms of this Agreement will not breach any agreement to which Executive is or was a party and which requires Executive to keep any information in confidence or in trust. Executive has not brought and will not bring to the Company or Block nor will Executive use in the performance of employment responsibilities at the Company any proprietary materials or documents of a former employer that are not generally available to the public, unless Executive has obtained express written authorization from such former employer for their possession and use. Executive has not and will not breach any obligation of confidentiality that Executive may have to former employers and Executive will fulfill all such obligations during Executive's employment with the Company.

3.05 - Non-Competition. During the period of Executive's employment hereunder and during the time Executive is receiving payments hereunder (or if longer, 1 year after Executive's Last Day of Employment), Executive may not engage in, or own or control any interest in (except as a passive investor in less than one percent of the outstanding securities of publicly held companies), or act as an officer, director or employee of, or consultant, advisor or lender to, any firm, corporation, partnership, limited liability company, institution, business, government agency, or entity that engages in any line of

business that is competitive with any Line of Business of Block (as defined below), provided that this Section 3.05 will not apply to Executive if Executive's primary place of employment by the Company or an Affiliate as of the Last Day of Employment is in either the State of California or the State of North Dakota. "Line of Business of Block" means any line of business (including lines of business under evaluation or development) of the Company, as well as any one or more lines of business (including lines of business under evaluation or development) of any Affiliate by which Executive was employed during the two-year period preceding the Last Day of Employment, provided that, "Line of Business of Block" will in all events include, but not be limited to, the income tax return preparation business, and provided further that if Executive's employment was, as of the Last Day of Employment or during the 2-year period immediately prior to the Last Day of Employment, with HRB Management, Inc. or any successor entity thereto, "Line of Business of Block" means any line of business (including lines of business under evaluation or development) of Block and all of its subsidiaries. The running of the 2-year period will be suspended during any period of violation and/or any period of time required to enforce this covenant by litigation or threat of litigation.

3.06 - Reasonableness of Restrictions. Executive and the Company acknowledge that the restrictions contained in this Agreement are reasonable, but should any provisions of any Article of this Agreement be determined to be invalid, illegal, or otherwise unenforceable or unreasonable in scope by any court of competent jurisdiction, the validity, legality, and enforceability of the other provisions of this Agreement will not be affected thereby and the provision found invalid, illegal, or otherwise unenforceable or unreasonable will be considered by the Company and Executive to be amended as to scope of protection, time, or geographic area (or any one of them, as the case may be) in whatever manner is considered reasonable by that court and, as so amended, will be enforced.

#### ARTICLE FOUR

#### MISCELLANEOUS

4.01 - Third-Party Beneficiary. The parties hereto agree that Block is a third-party beneficiary as to the obligations imposed upon Executive under this Agreement and as to the rights and privileges to which the Company is entitled pursuant to this Agreement, and that Block is entitled to all of the rights and privileges associated with such third-party-beneficiary status.

4.02 - Entire Agreement. This Agreement constitutes the entire agreement and understanding between the Company and Executive concerning the subject matter hereof. No modification, amendment, termination, or waiver of this Agreement will be binding unless in writing and signed by Executive and a duly authorized officer of the Company. Failure of the Company, Block, or Executive to insist upon strict compliance with any of the terms, covenants, or conditions hereof will not be deemed a waiver of such terms, covenants, and conditions.

4.03 - Specific Performance by Executive. The parties hereto acknowledge that money damages alone will not adequately compensate the Company or Block or Executive for breach of any of the covenants and agreements herein and, therefore, in the event of the breach or threatened breach of any such covenant or agreement by either party,

in addition to all other remedies available at law, in equity or otherwise, a wronged party will be entitled to injunctive relief compelling specific performance of (or other compliance with) the terms hereof.

4.04 - Successors and Assigns. This Agreement is binding upon Executive and the heirs, executors, assigns and administrators of Executive or Executive's estate and property and will inure to the benefit of the Company, Block and their successors and assigns. Executive may not assign or transfer to others the obligation to perform Executive's duties hereunder. The Company may assign this Agreement to an Affiliate with the consent of Executive, in which case, after such assignment, the "Company" means the Affiliate to which this Agreement has been assigned.

4.05 - Withholding Taxes. From any payments due hereunder to Executive from the Company, there will be withheld amounts reasonably believed by the Company to be sufficient to satisfy liabilities for federal, state, and local taxes and other charges and customary withholdings. Executive remains primarily liable to such authorities for such taxes and charges to the extent not actually paid by the Company. This Section 4.05 does not affect the Company's obligation to "gross up" any relocation benefits paid to Executive pursuant to Subsection 1.04(b).

4.06 - Indemnification. To the fullest extent permitted by law and Block's Bylaws, the Company hereby indemnifies during and after the period of Executive's employment hereunder Executive from and against all loss, costs, damages, and expenses including, without limitation, legal expenses of counsel selected by the Company to represent the interests of Executive (which expenses the Company will, to the extent so permitted, advance to executive as the same are incurred) arising out of or in connection with the fact that Executive is or was a director, officer, employee, or agent of the Company or Block or serving in such capacity for another corporation at the request of the Company or Block. Notwithstanding the foregoing, the indemnification provided in this Section 4.06 will not apply to any loss, costs, damages, and expenses arising out of or relating in any way to any employment of Executive by any former employer or the termination of any such employment.

4.07 - Right to Offset. To the extent not prohibited by applicable law and in addition to any other remedy, the Company has the right but not the obligation to offset any amount that Executive owes the Company under this Agreement against any amounts due Executive by Block, the Company, or Affiliates.

4.08 - Waiver of Jury Trial. Both parties to this Agreement, and Block, as a third-party beneficiary pursuant to Section 4.01 of this Agreement, waive any and all right to any trial by jury in any action or proceeding directly or indirectly related to this Agreement and Executive's employment hereunder.

4.09 - Notices. All notices required or desired to be given hereunder must be in writing and will be deemed served and delivered if delivered in person or mailed, postage prepaid to Executive at: 15354 Masons Pointe, Eden Prairie, MN 55347; and to the Company at: 4400 Main Street, Kansas City, MO 64111, Attn: President, with a copy to H&R Block, Inc., 4400 Main Street, Kansas City, Missouri 64111, Attn: Corporate Secretary; or to such other address and/or person designated by either party in writing to the other party. Any

notice given by mail will be deemed given as of the date it is so mailed and postmarked or received by a nationally recognized overnight courier for delivery.

4.10 - Counterparts. This Agreement may be signed in counterparts and delivered by facsimile transmission confirmed promptly thereafter by actual delivery of executed counterparts.

Executed as a sealed instrument under, and to be governed by, construed and enforced in accordance with, the laws of the State of Missouri.

EXECUTIVE:

Dated: 9.2.03

/s/ Brad C. Iversen

-----  
Brad C. Iversen

Accepted and Agreed:

HRB Management, Inc.  
a Missouri corporation

By: /s/ Mark A. Ernst

-----  
Mark A. Ernst  
President and Chief Executive Officer

Dated: 20 Dec 03



H&R BLOCK SEVERANCE PLAN  
AMENDED AND RESTATED AUGUST 11, 2003

1. PURPOSE. The H&R Block Severance Plan is a welfare benefit plan established by HRB Management, Inc., an indirect subsidiary of H&R Block, Inc., for the benefit of certain subsidiaries of H&R Block, Inc. in order to provide severance compensation and benefits to certain employees of such subsidiaries whose employment is involuntarily terminated under the conditions set forth herein. This document constitutes both the plan document and the summary plan description required by the Employee Retirement Income Security Act of 1974.

2. DEFINITIONS.

(a) "Cause" means one or more of the following grounds of an Employee's termination of employment with a Participating Employer:

(i) misconduct that interferes with or prejudices the proper conduct of the Company, the Employee's Participating Employer, or any other affiliate of the Company, or which may reasonably result in harm to the reputation of the Company, the Employee's Participating Employer, or any other affiliate of the Company;

(ii) commission of an act of dishonesty or breach of trust resulting or intending to result in material personal gain or enrichment of the Employee at the expense of the Company, the Employee's Participating Employer, or any other affiliate of the Company;

(iii) commission of an act materially and demonstrably detrimental to the good will of the Company, the Employee's Participating Employer, or any other affiliate of the Company, which act constitutes gross negligence or willful misconduct by the Employee in the performance of the Employee's material duties;

(iv) material violations of the policies or procedures of the Employee's Participating Employer, including, but not limited to, the H&R Block Code of Business Ethics & Conduct, except those policies or procedures with respect to which an exception has been granted under authority exercised or delegated by the Participating Employer;

(v) disobedience, insubordination or failure to discharge employment duties;

(vi) conviction of, or entrance of a plea of guilty or no contest, to a misdemeanor (involving an act of moral turpitude) or a felony;

(vii) inability of the Employee, the Company, the Employee's Participating Employer, and/or any other affiliate of the Company to participate, in whole or in part, in any activity subject to governmental regulation as the result of

any action or inaction on the part of the Employee;

(viii) the Employee's death or total and permanent disability. The term "total and permanent disability" will have the meaning ascribed thereto under any long-term disability plan maintained by the Employee's Participating Employer;

(ix) any grounds described as a discharge or other similar term on the Participating Employer's separation review form or other similar document stating the reason for the Employee's termination of employment, including poor performance; or

(x) any other grounds of termination of employment that the Participating Employer deems for cause.

Notwithstanding the definition of Cause above, if an Employee's employment with a Participating Employer is subject to an employment agreement that contains a definition of "cause" for purposes of termination of employment, such definition of "cause" in such employment agreement shall replace the definition of Cause herein for the purpose of determining whether the Employee has incurred a Qualifying Termination, but only with respect to such Employee.

(b) "Company" means H&R Block, Inc.

(c) "Employee" means a regular full-time or part-time, active employee of a Participating Employer whose employment with a Participating Employer is not subject to an employment contract that contains a provision that includes severance benefits. This definition expressly excludes employees of a Participating Employer classified as seasonal, temporary and/or inactive and employees who are customarily employed by a Participating Employer less than 20 hours per week.

(d) "ERISA" means the Employee Retirement Income Security Act of 1974, as amended.

(e) "Hour of Service" means each hour for which an individual was entitled to compensation as a regular full-time or part-time employee from a subsidiary of the Company.

(f) "Line of Business of the Company" with respect to a Participant means any line of business of the Participating Employer by which the Participant was employed as of the Termination Date, as well as any one or more lines of business of any other subsidiary of the Company by which the Participant was employed during the two-year period preceding the Termination Date, provided that, if Participant's employment was, as of the Termination Date or during the two-year period immediately prior to the Termination Date, with HRB Management, Inc. or any successor entity thereto, "Line of Business of the Company" shall mean any lines of business of the Company and all of its subsidiaries.

(g) "Monthly Salary" means -

(i) with respect to an Employee paid on a salary basis, the Employee's current annual salary divided by 12; and

(ii) with respect to an Employee paid on an hourly basis, the Employee's current hourly rate times the number of hours he or she is regularly scheduled to work per week multiplied by 52 and then divided by 12.

(h) "Participant" means an Employee who has incurred a Qualifying Termination and has signed a Release that has not been revoked during any revocation period provided under the Release.

(i) "Participating Employer" means a direct or indirect subsidiary of the Company (i) listed on Schedule A, attached hereto, which may change from time to time to reflect new Participating Employers or withdrawing Participating Employers, and (ii) approved by the Plan Sponsor for participation in the Plan.

(j) "Plan" means the "H&R Block Severance Plan," as stated herein, and as may be amended from time to time.

(k) "Plan Administrator" and "Plan Sponsor" means HRB Management, Inc. The address and telephone number of HRB Management, Inc. is 4400 Main Street, Kansas City, Missouri 64111, (816) 753-6900. The Employer Identification Number assigned to HRB Management, Inc. by the Internal Revenue Service is 43-1632589.

(l) "Qualifying Termination" means the involuntary termination of an Employee, but does not include a termination resulting from:

(i) the elimination of the Employee's position where the Employee was offered another position with a subsidiary of the Company at a comparable salary and benefit level, or where the termination results from a sale of assets or other corporate acquisition or disposition;

(ii) the redefinition of an Employee's position to a lower salary rate or grade;

(iii) the termination of an Employee for Cause; or

(iv) the non-renewal of employment contracts.

(m) "Release" means that agreement signed by and between an Employee who is eligible to participate in the Plan and the Employee's Participating Employer under which the Employee releases all known and potential claims against the Employee's Participating Employer and all of such employer's parents, subsidiaries, and affiliates.

(n) "Release Date" means, with respect to a Release that includes a revocation period, the date immediately following the expiration date of the revocation period in the Release that has been fully executed by both parties. "Release Date" means,

with respect to a Release that does not include a revocation period, the date the Release has been fully executed by both parties.

(o) "Severance Period" means the period of time during which a Participant may receive benefits under this Plan. The Severance Period with respect to a Participant begins on the Termination Date. A Participant's Severance Period will be the shorter of (i) 12 months or (ii) a number of months equal to the whole number of Years of Service determined under Section 2(q), unless earlier terminated in accordance with Section 8 of the Plan.

(p) "Termination Date" means the date the Employee severs employment with a Participating Employer.

(q) "Year of Service" means each period of 12 consecutive months ending on the Employee's employment anniversary date during which the Employee had at least 1,000 Hours of Service. In determining a Participant's Years of Service, the Participant will be credited with a partial Year of Service for his or her final period of employment commencing on his or her most recent employment anniversary date equal to a fraction calculated in accordance with the following formula:

$$\frac{\text{Number of days since most recent employment anniversary date}}{365}$$

Despite an Employee's Years of Service calculated in accordance with the above, an Employee whose pay grade at his or her Participating Employer fits in the following categories at the time of the Qualifying Termination will be credited with no less than the specified Minimum Years of Service and no more than the specified Maximum Years of Service listed in the following table as applicable to such pay grade:

PAY GRADE	MINIMUM YEARS OF SERVICE	MAXIMUM YEARS OF SERVICE
81-89 and 231-235	6	18
65-80, 140-145, 185-190, and 218-230	3	18
57-64, 115-135, 175-180, and 210-217	1	18
48-56, 100-110, 170, and 200-209	1	18

Notwithstanding the above, if an Employee has received credit for Years of Service under this Plan or under any previous plan, program, or agreement for the purpose of receiving severance benefits before a Qualifying Termination, such Years of Service will be disregarded when calculating Years of Service for such Qualifying Termination under the Plan; provided, however, that if such severance benefits were terminated prior to completion because the Employee was rehired by any subsidiary of the Company then the Employee will be re-credited with full Years of Service for which severance benefits were not paid in full or in part because of such termination.

### 3. ELIGIBILITY AND PARTICIPATION.

An Employee who incurs a Qualifying Termination and signs a Release that has not been revoked during any revocation period under the Release is eligible to participate in the Plan. An eligible Employee will become a Participant in the Plan as of the Termination Date.

### 4. SEVERANCE COMPENSATION.

(a) Amount. Subject to Section 8, each Participant will receive during the Severance Period from the applicable Participating Employer aggregate severance compensation equal to:

(i) the Participant's Monthly Salary multiplied by the Participant's Years of Service; plus

(ii) one-twelfth of the Participant's target payout under the Short-Term Incentive Program of the Participating Employer in effect at the time of his or her Termination Date multiplied by the Participant's Years of Service; plus

(iii) an amount to be determined by the Participating Employer at its sole discretion, which amount may be zero.

(b) Timing of Payments. Except as stated in Section 4(c), and subject to Section 8,

(i) the sum of any amounts determined under Sections 4(a)(i) and 4(a)(ii) of the Plan will be paid in semi-monthly or bi-weekly installments (the timing and amount of each installment as determined by the Participating Employer) during the Severance Period beginning after the later of the Termination Date or the Release Date; and

(ii) any amounts determined under Section 4(a)(iii) of the Plan will be paid in one lump sum within 15 days after the later of the Termination Date or the Release Date, unless otherwise agreed in writing by the Participating Employer and Participant or otherwise required by law.

(c) Death. In the event of the Participant's death prior to receiving all payments due under this Section 4, any unpaid severance compensation will be paid (i) in the same manner as are death benefits under the Participant's basic life insurance coverage provided by the Participant's Participating Employer, and (ii) in accordance with the Participant's beneficiary designation under such coverage. If no such coverage exists, or if no beneficiary designation exists under such coverage as of the date of death of the Participant, the severance compensation will be paid to the Participant's estate in one-lump sum.

5. HEALTH AND WELFARE BENEFITS.

(a) Benefits. In addition to the severance compensation provided pursuant to Section 4 of the Plan, a Participant may continue to participate in the following health and welfare benefits provided by his or her Participating Employer during the Severance Period on the same basis as employees of the Participating Employer:

- (i) medical;
- (ii) dental;
- (iii) vision;
- (iv) employee assistance;
- (v) medical expense reimbursement and dependent care expense reimbursement benefits provided under a cafeteria plan;
- (vi) life insurance (basic and supplemental); and
- (vii) accidental death and dismemberment insurance (basic and supplemental).

For the purposes of any of the above-described benefits provided under a Participating Employer's cafeteria plan, a Qualifying Termination constitutes a "change in status" or "life event."

(b) Payment and Expiration. Payment of the Participant's portion of contribution or premiums for such selected benefits will be withheld from any severance compensation payments paid to the Participant under this Plan. The Participating Employer's partial subsidization of such coverages will remain in effect until the earlier of:

- (i) the expiration or earlier termination of the Employee's Severance Period, after which time the Participant may be eligible to elect to continue coverage of those benefits listed above that are provided under group health plans in accordance with his or her rights under Section 4980B of the Internal Revenue Code; or
- (ii) the Participant's attainment of or eligibility to attain health and welfare benefits through another employer after which time the Participant may be eligible to elect to continue coverage of those benefits listed above that are provided under group health plans in accordance with his or her rights under Section 4980B of the Internal Revenue Code.

## 6. STOCK OPTIONS.

(a) Accelerated Vesting. Any portion of any outstanding incentive stock options and nonqualified stock options that would have vested during the 18-month period following the Termination Date had the Participant remained an employee with the Participating Employer during such 18-month period will vest as of the Termination Date. This Section 6(a) applies only to options (i) granted to the Participant under the Company's 1993 Long-Term Executive Compensation Plan, or any successor plan to its 1993 Long-Term Executive Compensation Plan, not less than 6 months prior to his or her Termination Date and (ii) outstanding at the close of business on such Termination Date. The determination of accelerated vesting under this Section 6(a) shall be made as of the Termination Date and shall be based solely on any time-specific vesting schedule included in the applicable stock option agreement without regard to any accelerated vesting provision not related to the Plan in such agreement.

(b) Post-Termination Exercise Period. Subject to the expiration dates and other terms of the applicable stock option agreements, the Participant may elect to have the right to exercise any outstanding incentive stock options and nonqualified stock options granted prior to the Termination Date to the Participant under the Company's 1984 Long-Term Executive Compensation Plan, its 1993 Long-Term Executive Compensation Plan, or any successor plan to its 1993 Long-Term Executive Compensation Plan that are vested as of the Termination Date (or, if later, the Release Date), whether due to the operation of Section 6(a), above, or otherwise, at any time during the Severance Period and, except in the event that the Severance Period terminates pursuant to Section 8(a), for a period up to 3 months after the end of the Severance Period (notwithstanding Section 8). Any such election shall apply to all outstanding incentive stock options and nonqualified stock options, will be irrevocable and must be made in writing and delivered to the Plan Administrator on or before the later of the Termination Date or Release Date. If the Participant fails to make an election, the Participant's right to exercise such options will expire 3 months after the Termination Date.

(c) Stock Option Agreement Amendment. The operation of Sections 6(a) and 6(b), above, are subject to the Participant's execution of an amendment to any affected stock option agreements, if necessary.

7. OUTPLACEMENT SERVICES. In addition to the benefits described above, career transition counseling or outplacement services may be provided upon the Participant's Qualifying Termination. Such outplacement service will be provided at the Participating Employer's sole discretion. Outplacement services are designed to assist employees in their search for new employment and to facilitate a smooth transition between employment with the Participating Employer and employment with another employer. Any outplacement services provided under this Plan will be provided by an outplacement service chosen by the Participating Employer. The Participant is not entitled to any monetary payment in lieu of outplacement services.

8. TERMINATION OF BENEFITS. Any right of a Participant to severance compensation and benefits under the Plan, and all obligations of his or her Participating Employer to pay any unpaid severance compensation or provide benefits under the Plan will terminate as of the day:

(a) The Participant has engaged in any conduct described in Sections 8(a)(i), 8(a)(ii), 8(a)(iii) or 8(a)(iv), below, as the same may be limited pursuant to Section 8(a)(vi).

(i) During the Severance Period, the Participant's engagement in, ownership of, or control of any interest in (except as a passive investor in less than one percent of the outstanding securities of publicly held companies), or acting as an officer, director or employee of, or consultant, advisor or lender to, any firm, corporation, partnership, limited liability company, institution, business, government agency, or entity that engages in any line of business that is competitive with any Line of Business of the Company, provided that this Section 8(a)(i) shall not apply to the Participant if the Participant's primary place of employment by a subsidiary of the Company as of the Termination Date is in either the State of California or the State of North Dakota.

(ii) During the Severance Period, the Participant employs or solicits for employment by any employer other than a subsidiary of the Company any employee of any subsidiary of the Company, or recommends any such employee for employment to any employer (other than a subsidiary of the Company) at which the Participant is or intends to be (A) employed, (B) a member of the Board of Directors, (C) a partner, or (D) providing consulting services.

(iii) During the Severance Period, the Participant directly or indirectly solicits or enters into any arrangement with any person or entity which is, at the time of the solicitation, a significant customer of a subsidiary of the Company for the purpose of engaging in any business transaction of the nature performed by such subsidiary, or contemplated to be performed by such subsidiary, for such customer, provided that this Section 8(a)(iii) shall only apply to customers for whom the Participant personally provided services while employed by a subsidiary of the Company or customers about whom or which the Participant acquired material information while employed by a subsidiary of the Company.

(iv) During the Severance Period, the Participant misappropriates or improperly uses or discloses confidential information of the Company and/or its subsidiaries.



(v) If the Participant engaged in any of the conduct described in Sections 8(a)(i), 8(a)(ii), 8(a)(iii) or 8(a)(iv) during or after Participant's term of employment with a Participating Employer, but prior to the commencement of the Severance Period, and such engagement becomes known to the Participating Employer during the Severance Period, such conduct shall be deemed, for purposes of Sections 8(a)(i), 8(a)(ii), 8(a)(iii) or 8(a)(iv) to have occurred during the Severance Period.

(vi) If the Participant is a party to an employment contract with a Participating Employer that contains a covenant or covenants relating to the Participant's engagement in conduct that is the same as or substantially similar to the conduct described in any of Sections 8(a)(i), 8(a)(ii), 8(a)(iii) or 8(a)(iv), and any specific conduct regulated in such covenant or covenants in such employment contract is more limited in scope geographically or otherwise than the corresponding specific conduct described in any of such Sections 8(a)(i), 8(a)(ii), 8(a)(iii) or 8(a)(iv), then the corresponding specific conduct addressed in the applicable Section 8(a)(i), 8(a)(ii), 8(a)(iii) or 8(a)(iv) shall be limited to the same extent as such conduct is limited in the employment contract and the Participating Employer's rights and remedy with respect to such conduct under this Section 8 shall apply only to such conduct as so limited.

(b) The Participant is rehired by his or her Participating Employer or hired by any other subsidiary of the Company in any position other than a position classified as seasonal by such employer.

9. AMENDMENT AND TERMINATION. The Plan Sponsor reserves the right to amend the Plan or to terminate the Plan and all benefits hereunder in their entirety at any time.

10. ADMINISTRATION OF PLAN. The Plan Administrator has the power and discretion to construe the provisions of the Plan and to determine all questions relating to the eligibility of employees of Participating Employers to become Participants in the Plan, and the amount of benefits to which any Participant may be entitled thereunder in accordance with the Plan. Not in limitation, but in amplification of the foregoing and of the authority conferred upon the Plan Administrator, the Plan Sponsor specifically intends that the Plan Administrator have the greatest permissible discretion to construe the terms of the Plan and to determine all questions concerning eligibility, participation and benefits. Any such decision made by the Plan Administrator will be binding on all Employees, Participants, and beneficiaries, and is intended to be subject to the most deferential standard of judicial review. Such standard of review is not to be affected by any real or alleged conflict of interest on the part of the Plan Administrator. The decision of the Plan Administrator upon all matters within the scope of its authority will be final and binding.

## 11. CLAIMS PROCEDURES.

(a) FILING A CLAIM FOR BENEFITS. Participants are not required to submit claim forms to initiate payment of benefits under this Plan. To make a claim for benefits, individuals other than Participants who believe they are entitled to receive benefits under this Plan and Participants who believe they have been denied certain benefits under the Plan must write to the Plan Administrator. These individuals and such Participants are hereinafter referred to in this Section 11 as "Claimants." Claimants must notify the Plan Administrator if they will be represented by a duly authorized representative with respect to a claim under the Plan.

(b) INITIAL REVIEW OF CLAIMS. The Plan Administrator will evaluate a claim for benefits under the Plan. The Plan Administrator may solicit additional information from the Claimant if necessary to evaluate the claim. If the Plan Administrator denies all or any portion of the claim, the Claimant will receive, within 90 days after the receipt of the written claim, a written notice setting forth:

(i) the specific reason for the denial;

(ii) specific references to pertinent Plan provisions on which the Plan Administrator based its denial;

(iii) a description of any additional material and information needed for the Claimant to perfect his or her claim and an explanation of why the material or information is needed; and

(iv) that any appeal the Claimant wishes to make of the adverse determination must be in writing to the Plan Administrator within 60 days after receipt of the notice of denial of benefits. The notice must advise the Claimant that his or her failure to appeal the action to the Plan Administrator in writing within the 60-day period will render the Plan Administrator's determination final, binding and conclusive. The notice must further advise the Claimant of his or her right to bring a civil action under Section 502(a) of ERISA following the exhaustion of the claims procedures described herein.

(c) APPEAL OF DENIED CLAIM AND FINAL DECISION. If the Claimant should appeal to the Plan Administrator, the Claimant, or his or her duly authorized representative, must submit, in writing, whatever issues and comments the Claimant or his or her duly authorized representative feels are pertinent. The Claimant, or his or her duly authorized representative, may review and request pertinent Plan documents. The Plan Administrator will reexamine all facts related to the appeal and make a final determination as to whether the denial of benefits is justified under the circumstances. The Plan Administrator will advise the Claimant in writing of its decision within 60 days of the Claimant's written request for review, unless special circumstances (such as a hearing) require an extension of time, in which case the Plan Administrator will make a decision as soon as possible, but no later than 120 days after its receipt of a request for review.

12. PLAN FINANCING. The benefits to be provided under the Plan will be paid by the applicable Participating Employer, as incurred, out of the general assets of such Participating Employer.

13. GENERAL INFORMATION. The Plan's records are maintained on a calendar year basis. The Plan Number is 509. The Plan is self-administered and is considered a severance plan.

14. GOVERNING LAW. The Plan is established in the State of Missouri. To the extent federal law does not apply, any questions arising under the Plan will be determined under the laws of the State of Missouri.

15. ENFORCEABILITY; SEVERABILITY. If a court of competent jurisdiction determines that any provision of the Plan is not enforceable, then such provision shall be enforceable to the maximum extent possible under applicable law, as determined by such court. The invalidity or unenforceability of any provision of the Plan, as determined by a court of competent jurisdiction, will not affect the validity or enforceability of any other provision of the Plan and all other provisions will remain in full force and effect.

16. WITHHOLDING OF TAXES. The applicable Participating Employer may withhold from any benefit payable under the Plan all federal, state, city or other taxes as may be required pursuant to any law, governmental regulation or ruling. The Participant shall pay upon demand by the Company or the Participating Employer any taxes required to be withheld or collected by the Company or the Participating Employer upon the exercise by the Participant of a nonqualified stock option granted under the Company's 1984 Long-Term Executive Compensation Plan or its 1993 Long-Term Executive Compensation Plan. If the Participant fails to pay any such taxes associated with such exercise upon demand, the Participating Employer shall have the right, but not the obligation, to offset such taxes against any unpaid severance compensation under this Plan.

17. NOT AN EMPLOYMENT AGREEMENT. Nothing in the Plan gives an Employee any rights (or imposes any obligations) to continued employment by his or her Participating Employer or other subsidiary of the Company, nor does it give such Participating Employer any rights (or impose any obligations) for the continued performance of duties by the Employee for the Participating Employer or any other subsidiary of the Company.

18. NO ASSIGNMENT. The Employee's right to receive payments of severance compensation and benefits under the Plan are not assignable or transferable, whether by pledge, creation of a security interest, or otherwise. In the event of any attempted assignment or transfer contrary to this Section 18, the applicable Participating Employer will have no liability to pay any amount so attempted to be assigned or transferred.

19. SERVICE OF PROCESS. The Secretary of the Plan Administrator is designated as agent for service of legal process. Service of legal process may be made upon the Secretary of the Plan Administrator at:

HRB Management, Inc.  
Attn: Secretary  
4400 Main Street  
Kansas City, Missouri 64111

20. STATEMENT OF ERISA RIGHTS. As a participant in the Plan, you are entitled to certain rights and protections under ERISA, which provides that all Plan Participants are entitled to:

(a) examine without charge, at the Plan Administrator's office, all documents governing the Plan and a copy of the latest annual report (Form 5500 Series) filed by the Plan with the U.S. Department of Labor and available at the Public Disclosure Room of the Pension and Welfare Benefit Administration;

(b) obtain, upon written request to the Plan Administrator, copies of documents governing the operation of the Plan, copies of the latest annual report (Form 5500 Series) and an updated summary plan description. The Plan Administrator may make a reasonable charge for the copies; and

(c) receive a summary of the Plan's annual financial report if required to be filed for the year. The Plan Administrator is required by law to furnish each participant with a copy of this summary annual report if an annual report is required to be filed for the year.

In addition to creating rights for Plan Participants, ERISA imposes duties upon the people who are responsible for the operation of the Plan. The people who operate your Plan, called "fiduciaries" of the Plan, have a duty to do so prudently and in the interest of you and other Plan Participants and beneficiaries. No one, including your Participating Employer or any other person, may fire you or otherwise discriminate against you in any way to prevent you from obtaining a welfare benefit or exercising your rights under ERISA.

If your claim for a welfare benefit is denied or ignored, in whole or in part, you have the right to know why this was done, to obtain copies of documents relating to the decision without charge, and to appeal any denial, all within certain time schedules.

Under ERISA, there are steps you can take to enforce the above rights. For instance, if you request a copy of plan documents or the latest annual report from the Plan and do not receive them within 30 days, you may file suit in a Federal court. In such a case, the court may require the Plan Administrator to provide the materials to you and pay you up to \$110 a day until you receive the materials, unless the materials were not sent because of reasons beyond the control of the Plan Administrator. If you have a claim for benefits that is denied or ignored, in whole or in part, you may file suit in a state or Federal court. If it should happen that you are discriminated against for asserting your rights, you may seek assistance from the U. S. Department of Labor, or you may file suit in a Federal court. The court will decide who should pay court costs and legal fees. If you are successful, the court may order the person you have sued to pay these costs and fees. If you lose, the court may order you to pay these costs and fees, for example, if it finds your claim is frivolous.

If you have any questions about the Plan, you should contact the Plan Administrator. If you have questions about this statement or about your rights under ERISA, or if you need assistance in obtaining documents from the Plan Administrator, you

should contact the nearest office of the Pension and Welfare Benefits Administration, U.S. Department of Labor, listed in your telephone directory or the Division of Technical Assistance and Inquiries, Pension and Welfare Benefits Administration, U.S. Department of Labor, 200 Constitution Avenue N.W., Washington, D.C. 20210. You may also obtain certain publications about your rights and responsibilities under ERISA by calling the publications hotline of the Pension and Welfare Benefits Administration.

IN WITNESS WHEREOF, HRB Management, Inc. adopts this Severance Plan, as amended and restated, effective this 11th day of August, 2003.

HRB MANAGEMENT, INC.

/s/ Mark A, Ernst

-----  
Mark A. Ernst  
President and Chief Executive Officer

SCHEDULE A

PARTICIPATING EMPLOYERS

Block Financial Corporation

Financial Marketing Services, Inc.

Franchise Partner, Inc.

H&R Block Investments, Inc.

H&R Block Services, Inc. and its U.S.-based direct and indirect subsidiaries

HRB Business Services, Inc.

H&R Block Small Business Resources, Inc.

HRB Management, Inc.

HRB Retail Services, Inc.

OLDE Financial Corporation and its U.S.-based direct and indirect subsidiaries,  
which subsidiaries include H&R Block Financial Advisors, Inc.

## SETTLEMENT AGREEMENT

This Settlement Agreement (the "Agreement") is made and entered into effective as of the 8th day of January, 2004 by and among (a) Herbert Dicker; HBD, Inc.; Robert Hildorf; RKL, Inc.; Ray Jiruska; HRB, LLC; RLJ Enterprises, Inc.; DFJ Enterprises, Inc.; RRJ Enterprises, Inc.; DEJ Enterprises, Inc.; Moore Business Service, Inc. ("MBS"); T.J. Enterprises, Inc. ("TJ Enterprises"); Block Mountain West, Inc. ("BMW"); Orr Enterprises Limited Partnership ("Orr"); S.E. Iowa Business Services, Inc. ("S.E. IBS"); Tax Savers, Inc. and JBW Limited Partnership ("JBW") (collectively, the "Plaintiffs"); and (b) H&R Block, Inc.; Block Financial Corporation; HRB Royalty, Inc.; H&R Block Tax Services, Inc. and H&R Block Eastern Tax Services, Inc. (collectively, the "Defendants").

## RECITALS

A. Plaintiffs have asserted various claims against Defendants related to alleged breaches of contract and certain other claims and Defendants have asserted certain counterclaims against Plaintiffs, all as more fully described in the pleadings filed in the lawsuit of Smith, et. al. v. H&R Block, Inc. et. al., Case No. 99CV206379, Cir. Ct. of Jackson County, MO (the "Litigation").

B. On October 29, 2003, judgment (the "JBW Judgment") was entered in the Litigation in favor of JBW in the following amounts: (1) with respect to the fair and equitable payment set forth in paragraph 24 of the applicable major franchise agreements, judgment in the amount of \$3,197,046.00 and (2) with respect to the breach of contract claim arising out of paragraph 2 of the applicable major franchise agreements, judgment in the amount of \$921,973.00.

C. Plaintiffs and Defendants have each filed various post-judgment motions with respect to the JBW Judgment.

D. The parties desire to settle and compromise the Litigation.

## AGREEMENT

In consideration of the respective obligations set forth below, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. Aggregate Payment. HRB Royalty, Inc. or its affiliates ("Block") shall pay the Plaintiffs an aggregate amount of \$130,095,867.84 on or before the close of business on January 23, 2004. The amount set forth in this paragraph reflects and includes all of the components, computations and adjustments, including those as to rent and yellow pages advances by certain franchisees and those as to the JBW Judgment, set forth in the Transcript of Proceedings of Settlement Agreement before the Honorable Jay A. Daugherty, attached hereto as Exhibit C.

2. Method of Payment. The payment of the sum set forth in Section 1 of this Agreement shall be made by Block via wire transfer to the Lathrop & Gage trust account, and the division of that sum among the Plaintiffs will be at the sole discretion of the Plaintiffs. The Plaintiffs have already agreed to that division among themselves, and such amount will be divided by the Plaintiffs and their counsel upon receipt of the sum from Block.

3. Dismissals with Prejudice. Upon receipt by Plaintiffs' counsel of the sum set forth in Section 1 of this Agreement, the parties through their counsel shall file with the Jackson County Circuit Court a stipulation of dismissal with prejudice of their claims and counterclaims in the Litigation in the form attached hereto as Exhibit D. The stipulation of dismissal shall provide that each of the parties shall bear their own respective costs, including but not limited to their attorneys' fees. The parties acknowledge that Block's dismissal of Count I of its counterclaims does not affect the validity or enforceability of a) the Franchisee's covenant not to compete contained in any major franchise agreement or b) any Exhibit B Agreements.



In addition, plaintiffs JBW and Tax savers, Inc. agree to join with Defendants in a stipulation to dismiss with prejudice the case numbered C.A. No. 4-00-CV-00488 WRW, now stayed and administratively closed in the United States District Court for the Eastern District of Arkansas.

4. Satisfaction of Judgment. Upon receipt by Plaintiff's counsel of the payment set forth in Section 1 of this Agreement, JBW, prior to its filing of a dismissal with prejudice of its claims in the Litigation, shall file a satisfaction of the JBW Judgment entered on October 29, 2003. Said satisfaction shall contain a provision stating that all court costs have been satisfied.

5. Non-Competition Agreements. Each person who is an equity owner of any of the Plaintiffs and who was actively working in the business operated under the respective major franchise agreements (as identified by name below, and collectively, the "Equity Owners") shall be subject to the non-competition provisions of his or her respective major franchise agreements by virtue of signing a written agreement in the form attached hereto as Exhibit B. Plaintiffs shall cause all Equity Owners listed below to sign the Exhibit B Agreements and Plaintiffs shall deliver the executed forms to Jennifer Gille Bacon on or before the close of business on Tuesday, January 20, 2004. Notwithstanding anything herein to the contrary, Robert Russell, the son of Beverly Fisher, shall not be subject to this Section 5 and shall not be required to sign an Exhibit B Agreement. The obligations of the individuals who sign an Exhibit B Agreement shall not extend beyond the obligations contained in the underlying major franchise agreements. For example, to the extent the major franchise agreement provides for governance under Missouri law, Missouri law shall also apply to the obligations of the individuals signing the Exhibit B Agreement. The individuals who are the Equity Owners and who shall be required pursuant to this provision to sign the Exhibit B Agreements are as follows:

- a. JBW: James H. Williams, Sr.
- b. Block Mountain West, Inc.: Monte Nelson, David Nelson and Michael Nelson
- c. TJ Enterprises, Inc.: Monte Nelson, David Nelson and Michael Nelson
- d. HRB, L.L.C.: Rodney Jiruska and David Jiruska
- e. Moore Business Service, Inc.: Stephen A. Moore, Jr.
- d. Taxesavers, Inc.: C. Dale Stuart, Jr.
- e. HBD, Inc.: Herbert Dicker
- f. RKL, Inc.: Kurt Hildorf
- g. S.E. Iowa Business Services, Inc.: Beverly Fisher
- h. Orr Enterprises Limited Partnership: Harold Orr

6. Allocation. Block shall prepare an initial proposed allocation for tax purposes of the payment made under this Agreement ("allocation") among the various assets that have been or will be transferred and shall forward the proposed allocation to Plaintiffs' counsel, who will respond with any good faith objections, comments, or proposed changes to that allocation. To the extent there is a dispute regarding the allocation, the parties shall negotiate among themselves in a further good faith effort to resolve any differences. In the event that the parties, despite such good faith negotiations, are unable to agree as to such allocation, they shall submit the dispute regarding such allocation to mediation before the Honorable Jay A. Daugherty. If, despite the efforts of the mediator, the parties are unable to resolve their differences regarding such allocation, each party shall be free to make its own allocation of the various items for tax purposes.

7. Accounting Firms. Block shall provide a sworn statement by an officer of RSM McGladrey, Inc. ("RSM") in the form attached to this Agreement as Exhibit A. The signed statement shall be delivered to Bernard J. Rhodes on or before the close of business on Tuesday, January 20, 2004. The parties also acknowledge that a de minimis number of tax returns may have been

randomly prepared by RSM McGladrey within the former territories of plaintiffs Orr, Jiruska and S.E. IBS, and agree that less than \$100,000 worth of such returns in any given year will not be deemed to be inconsistent with any representations in Exhibit A.

8. Entire Agreement. This writing memorializes the binding oral agreement reached by the parties on January 8, 2004 as reflected in the Transcript of Proceedings attached hereto as Exhibit C and continues the integration clause contained therein (at pages 22-23) subject to the understanding and agreement that Section 6 and the final two sentences of Section 3 of this writing amend and/or supplement the binding oral agreement ab initio.

9. Severability. In the event any provision of this Agreement shall be rendered illegal, unenforceable, or invalid for any reason, the remainder of the Agreement shall constitute and remain a valid, binding contract imposing legal obligations upon all parties.

10. Deliveries. Plaintiffs will provide Defendants executed originals of the Exhibit B Agreements for each of the Equity Owners. Defendants will provide Plaintiffs an executed original of the statement referenced in Section 7 hereof.

11. Timing of Payment. Subject to Block's receipt of the signed Exhibit B Agreements referenced above, Block shall wire transfer the sums required by this Agreement to Plaintiffs' counsel on or before the close of business on Friday, January 23, 2004. The Tuesday, January 20, 2004, deadline for submission of the signed Exhibit B Agreements shall similarly be the deadline for the submission by Block to Plaintiffs' counsel of the signed statement of the RSM McGladrey officer referenced in Section 7 hereof. In the event Block does not receive all of the above-referenced Exhibit B Agreements by the close of business on Tuesday, January 20, 2004, Block's obligation to wire transfer the sums required by this Agreement shall be delayed until the third business day after the day on which Block receives all such fully executed Exhibit B Agreements.

12. This Agreement may be signed in counterparts.

HBD, INC.

By: \_\_\_\_\_

Printed Name: \_\_\_\_\_

Its: \_\_\_\_\_

-----  
HERBERT DICKER

S.E. IOWA BUSINESS SERVICES, INC.

By: \_\_\_\_\_

Printed Name: \_\_\_\_\_

Its: \_\_\_\_\_

RKL, INC.

By: \_\_\_\_\_

Printed Name: \_\_\_\_\_

Its: \_\_\_\_\_

-----  
ROBERT HILDORF

HRB, LLC

By: \_\_\_\_\_

Printed Name: \_\_\_\_\_

Its: \_\_\_\_\_

RLJ ENTERPRISES, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

DFJ ENTERPRISES, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

RRJ ENTERPRISES, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

DEJ ENTERPRISES, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

-----  
RAY JIRUSKA

T.J. ENTERPRISES, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

MOORE BUSINESS SERVICE, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

BLOCK MOUNTAIN WEST, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

ORR ENTERPRISES LIMITED PARTNERSHIP

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

TAXSAVERS, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

JBW LIMITED PARTNERSHIP

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

H&R BLOCK, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

BLOCK FINANCIAL CORPORATION

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

HRB ROYALTY, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

H&R BLOCK TAX SERVICES, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

H&R BLOCK EASTERN TAX SERVICES, INC.

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Its: \_\_\_\_\_

EXHIBIT A  
RSM AFFIDAVIT

AFFIDAVIT OF

DOUGLAS W. OPHEIM

STATE OF MINNESOTA        )  
                                  ) SS:  
COUNTY OF HENNEPIN        )

BEFORE ME, the undersigned notary public, personally appeared Douglas W. Opheim, who, having been first duly sworn by me, deposes and says that:

1. I am the Chief Financial Officer of RSM McGladrey, Inc.
2. When RSM McGladrey, an H&R Block subsidiary, purchased certain assets from McGladrey and Pullen, LLP, RSM deliberately declined to purchase the tax operations in the franchise territories in which any of H&R Block's major franchisees operated, in order to remain in compliance with their Major Franchise Agreements.
3. Our understanding is that those tax operations were transferred to a subsidiary of a partnership owned by McGladrey & Pullen or some or all of McGladrey & Pullen's partners. Those partners have operated that tax business under the name McGladrey and Pullen Tax Services.
4. The transaction was structured such that no Block affiliate receives any revenue from McGladrey & Pullen's tax preparation services. Therefore, no revenue is received by Block from those services to which the 55% payment set out in Paragraph 2 of the Major Franchise Agreement applied.
5. To the best of my knowledge, neither RSM nor any other affiliate of H&R Block has otherwise received any revenue from tax preparation services performed at any offices in these territories, and RSM has performed no such services at offices in these territories prior to September 21, 2003.
6. The undersigned acknowledges that a de minimis number of tax returns may have been randomly performed by RSM McGladrey within the former Orr and Jiruska territories, and understands that less than \$100,000 worth of such returns in any given year will not be deemed to be inconsistent with any representation herein.
7. Further affiant sayeth naught.

-----  
Douglas W. Opheim



Subscribed and sworn to before me this \_\_\_\_ day of January, 2004.

-----  
Notary Public

My commission expires: -----

EXHIBIT B  
FORM OF NON-COMPETITION AGREEMENT

I agree to be bound personally by the Franchisee's post-termination non-competition provisions of the Major Franchise Agreements identified on Exhibit 1 to this Agreement for the \_\_\_\_\_ franchises. The Franchise Agreements' provisions regarding arbitration shall not apply. The Agreement's provisions regarding applicable laws shall apply.

Dated:

-----

-----

-----  
Printed Name

EXHIBIT D

IN THE CIRCUIT COURT OF JACKSON COUNTY, MISSOURI  
AT KANSAS CITY  
DIVISION 15

Wm. R. Smith, Inc., et al.,        )  
  )  
Plaintiffs,                        )  
  )  
v.                                    )        Case No. 99 CV 206379  
  )  
H&R Block, Inc., et al.,        )  
  )  
Defendants.                         )

STIPULATION FOR DISMISSAL OF ALL CLAIMS AND COUNTERCLAIMS

All remaining plaintiffs in this action, namely Herbert Dicker, HBD, Inc., Robert Hildorf, RKL, Inc., Ray Jiruska, HRB, LLC, RLJ Enterprises, Inc., DFJ Enterprises, Inc., RRJ Enterprises, Inc., DEJ Enterprises, Inc., Moore Business Service, Inc., T.J. Enterprises, Inc., Block Mountain West, Inc., Orr Enterprises Limited Partnership, S.E. Iowa Business Services, Inc., JBW Limited Partnership, and Tax Savers, Inc. (collectively "Plaintiffs"), and all defendants (collectively "Block"), through their respective undersigned counsel, hereby stipulate and agree as follows:

All claims asserted herein by Plaintiffs against Block shall be dismissed with prejudice;

All counterclaims asserted herein by Block against Plaintiffs shall be dismissed with prejudice; and

The parties hereto shall bear their own costs, including attorneys' fees.

-----  
Bernard J. Rhodes  
R. Kent Sellers  
LATHROP & GAGE L.C.  
2345 Grand Boulevard  
Kansas City, MO 64108

W. Michael Garner  
DADY & GARNER, P.A.  
4000 IDS Center  
80 South Eighth Street  
Minneapolis, MN 55402

ATTORNEYS FOR PLAINTIFFS

-----  
R. Lawrence Ward  
Jennifer Gille Bacon  
Karen R. Glickstein  
Shughart, Thomson & Kilroy, P.C.  
120 West 12th Street, Suite 1700  
Kansas City, MO 64105

Peter J. Klarfeld  
Arthur I. Cantor  
WILEY REIN & FIELDING LLP  
1776 K Street, NW  
Washington, DC 20006

ATTORNEYS FOR DEFENDANTS

THIRD AMENDED AND RESTATED  
REFUND ANTICIPATION LOAN  
PARTICIPATION AGREEMENT

THIS THIRD AMENDED AND RESTATED REFUND ANTICIPATION LOAN PARTICIPATION AGREEMENT (this "Agreement"), dated as of January 1, 2004, is made by and among BLOCK FINANCIAL CORPORATION, a Delaware corporation ("BFC"), HOUSEHOLD TAX MASTERS INC., a Delaware corporation ("Tax Masters"), and HOUSEHOLD TAX MASTERS ACQUISITION CORPORATION, a Delaware corporation ("HTMAC").

RECITALS

A. BFC, Tax Masters and Household Bank, f.s.b., a federal savings bank ("HB"), are parties to the Amended and Restated Refund Anticipation Loan Participation Agreement, dated as of January 6, 2003 (the "First Amended and Restated RAL Participation Agreement"), where BFC agreed to purchase from Tax Masters and Tax Masters agreed to sell to BFC a participation interest in refund anticipation loans made to customers of both H&R Block Tax Services, Inc., a Delaware corporation ("Block Tax Services"), and its affiliates and certain franchisees of HRB Royalty, Inc., a Delaware corporation ("Royalty") and their affiliates.

B. HB ceased its operations and in connection therewith, Tax Masters engaged Imperial Capital Bank, a California state-chartered commercial bank ("ICB"), to perform the origination function for Refund Anticipation Loans ("RALs") and issuing function for Refund Anticipation Checks ("RACs") for 2003 and 2004.

C. Tax Masters, HTMAC and ICB entered into an Amended and Restated Sale and Servicing Agreement for RALs and RACs, dated as of January 3, 2003 (the "Sale and Servicing Agreement"), which represents the basic agreement between Tax Masters, HTMAC and ICB regarding the RAL program pursuant to which (i) Tax Masters services the loans originated by ICB under the RAL program, and (ii) HTMAC purchases participation interests in RALs from ICB. Redacted copies of the Sale and Servicing Agreement and all amendments thereto will be delivered by Tax Masters or HTMAC to BFC.

D. H&R Block Services, Inc., a Missouri corporation ("Block Services"), on behalf of itself and its subsidiaries, Block Tax Services, and Royalty (Block Services, Block Tax Services and Royalty are collectively referred to herein as "Block Companies"), Tax Masters and Beneficial Franchise Company, Inc., a Delaware corporation ("Beneficial Franchise") (Tax Masters and Beneficial Franchise are collectively referred to herein as "Household Companies"), and for certain limited purposes, HB, have entered into an Amended and Restated Refund Anticipation Loan Operations Agreement, dated as of January 6, 2003 (the "First Amended and Restated RAL Operations Agreement").

E. Block Companies and Household Companies are parties to a letter agreement, dated November 11, 2002 (the "First ICB Consent Letter"), pursuant to which Block Companies consented to ICB as the RAL originator under the First Amended and Restated RAL

Operations Agreement, subject to the right of Block Companies in their sole discretion, during the ten (10) day period from June 1 through June 10, 2003, to provide written notice to Tax Masters, Beneficial Franchise and ICB that ICB is not acceptable as the RAL originator and RAC issuer for future Tax Periods, in which event Household Companies agree to substitute a financial institution chartered by the Office of Thrift Supervision or the Office of the Comptroller of the Currency (a "Federally Chartered Financial Institution") as the RAL originator and RAC issuer for future Tax Periods (the "Block ICB Termination Right").

F. Block Companies and Household Companies have entered into a Second ICB Consent Letter, dated June 9, 2003 (the "Second ICB Consent Letter"), pursuant to which Block Companies have agreed to refrain from exercising the Block ICB Termination Right for the 2004 Tax Period, on certain terms and conditions, subject to Block Companies' absolute right in their sole discretion during the ten (10) day period from June 1 through June 10 of any year, to provide written notice to Tax Masters, Beneficial Franchise and ICB, that ICB is not acceptable as the RAL originator and RAC issuer for future Tax Periods, in which event Household Companies agree to substitute a Federally Chartered Financial Institution as the RAL Originator and RAC issuer for future Tax Periods, provided that any entity selected by Household Companies (other than an Affiliate of Household Companies that is a Federally Chartered Financial Institution having sufficient capital to fulfill its anticipated obligations with respect to the RAL Program) shall be subject to the consent of Block Companies, which consent shall not be unreasonably withheld.

G. The Block Companies and the Household Companies have entered into a Second Amended and Restated RAL Operations Agreement, dated as of June 9, 2003 (the "Second Amended and Restated RAL Operations Agreement").

H. BFC and Tax Masters are parties to the Second Amended and Restated Refund Anticipation Loan Participation Agreement, dated as of June 9, 2003 (the "Second Amended and Restated RAL Participation Agreement"), which reflected the continuation of ICB as the RAL originator and RAC issuer for the 2004 Tax Period, subject to the terms and conditions of the Second ICB Consent Letter and the Second Amended and Restated RAL Participation Agreement.

I. Pursuant to a Waiver of Rights Under Amended and Restated Refund Anticipation Loan Participation Agreement, dated January 6, 2003, BFC waived its right to purchase Participation Interests with respect to RALs originated from January 1, 2003 to April 30, 2003, therefore, an amendment to the Second Amended and Restated RAL Participation Agreement to reflect the fact that HTMAC (not Tax Masters) is the owner of the Participation Interests being sold to BFC, was not necessary in the past.

J. The parties desire to amend and restate the Second Amended and Restated RAL Participation Agreement as hereinafter set forth to reflect that fact that HTMAC, rather than Tax Masters, is the seller of the Participation Interests to BFC.

## AGREEMENT

NOW, THEREFORE, for and in consideration of the premises and of the agreements of the parties hereto and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, BFC, HTMAC and Tax Masters hereby covenant and agree that the Second Amended and Restated RAL Participation Agreement is hereby amended and restated in its entirety with respect to Participation Interests purchased by BFC and certain other acts and events that occur from and after the effective date hereof, by deleting the provisions of Sections 1.1 through 7.17 as the same now appear and by substituting therefor the following Sections 1.1 through 7.17:

### ARTICLE I DEFINITIONS

Section 1.1. Definitions. As used in this Agreement, the following terms shall have the meaning set forth below:

"Affiliate" of any Person shall mean any other Person controlling, controlled by or under common control with such Person.

"Applicable Percentage" shall mean the percentage set forth for a particular Tax Period in Section 2.5.

"Applicable Tax Period" shall mean any of the ten consecutive Tax Periods commencing with and including the Tax Period beginning January 1, 1997 and ending with and including the Tax Period beginning January 1, 2006.

"BFC" shall mean Block Financial Corporation, a Delaware corporation.

"Block Franchise" shall mean an office owned by a franchisee of Block Services or its subsidiaries that operates under the "H&R Block" name that is open to the public for the preparation of tax returns.

"Block ICB Termination Right" shall have the meaning set forth in Recital E.

"Block Office" shall mean (i) an office owned by Block Services or its subsidiaries that operates under the "H&R Block" name and is open to the public for the preparation of tax returns and (ii) a Corporate Franchise.

"Block Services" shall mean H&R Block Services, Inc., a Missouri corporation.

"Block Tax Services" shall mean H&R Block Tax Services, Inc., a Missouri corporation.

"Business Day" shall mean any day other than a Saturday, a Sunday or a day on which banking institutions in Bridgewater, New Jersey are authorized or obligated by law or executive order to be closed.

"Claim" shall have the meaning set forth in Section 6.2.

"Closing Date" shall mean with respect to a Participation Interest, the date on which such Participation Interest is sold to BFC pursuant to this Agreement.

"Collections" shall mean (i) all finally collected funds received by Tax Masters as servicer for the RAL Originator and applied to Participated Pool RALs, whether such finally collected funds arise from receipt of cash, checks, wire transfers, ATM transfers, exercise of rights of offset or other form of payment, (ii) promissory notes and/or other evidence of indebtedness accepted by Tax Masters as servicer for the RAL Originator from or on behalf of Obligor in payment of Participated Pool RALs (in which case such Collections shall be deemed to be received by the RAL Originator for purposes of this Agreement on the Business Day on which such promissory note or evidence of indebtedness was received by the RAL Originator) and (iii) all fees charged by the RAL Originator to customers of Block Offices for issuing Pool RACs (in which case such Collections shall be deemed to be received by the RAL Originator for purposes of this Agreement on the Business Day on which such RAC is delivered to the customer).

"Corporate Pool RAL" shall have the meaning given such term in the definition of "Pool RAL."

"Corporate Franchise" or "Corporate Franchisee" shall mean a Person authorized directly by Block Services (or an Affiliate of Block Services) pursuant to a corporate franchise agreement to operate a Block Office. Corporate Franchise or Corporate Franchisee does not include a Person authorized by a major franchise agreement between a Major Franchisee and Block Services, or an Affiliate of Block Services, to operate a Block Franchise and to subfranchise others to operate a Block Franchise within a specified territory, or a subfranchisee of a Major Franchisee.

"Defaulted Pool RAL" shall mean each Participated Pool RAL which, in accordance with the RAL Guidelines and Tax Masters' customary and usual servicing procedures for RALs, the RAL Originator has charged off as uncollectible; provided, however, that no Pool RAL originated during any Tax Period shall be classified as a Defaulted Pool RAL prior to January 1 of the following year.

"Eligible RAL" shall mean each Pool RAL:

(a) that was created by the RAL Originator, and is in compliance in all material respects, with the Second Amended and Restated RAL Operations Agreement (or a Major Franchisee RAL Agreement, as the case may be) and the federal Equal Credit Opportunity Act, 15 U.S.C. Sections 1691 et seq.;

(b) (i) as to which any blank preprinted form of disclosure statement supplied by Tax Masters on behalf of the RAL Originator to the tax preparation office at which such Pool RAL was originated for use in connection with the origination of such Pool RAL complied, as to form (subject to proper completion), with the requirements of the federal Truth-in-Lending Act, 15 U.S.C. Sections 1601 et seq. ("TILA") (it being understood that the foregoing shall not be deemed a warranty by Tax Masters that such form has



been properly completed) and (ii) that was created in compliance with the other requirements of TILA; and

(c) as to which, at the time of the sale of the Participation Interest in such Pool RAL to BFC, HTMAC had good and marketable title thereto free and clear of all Liens arising under or through HTMAC or any of its Affiliates.

"ERA Operations Agreement" shall mean the ERA Operations Agreement as in effect from time to time between BFC, Royalty, Tax Masters and Beneficial Franchise.

"Excluded RAL" shall have the meaning set forth in Section 5.2.

"Federally Chartered Financial Institution" shall have the meaning set forth in Recital E.

"First Amended and Restated RAL Participation Agreement" shall have the meaning set forth in Recital A.

"First ICB Consent Letter " shall have the meaning set forth in Recital E.

"Governmental Authority" shall mean the United States of America, any state or other political subdivision thereof and any entity exercising executive, legislative judicial, regulatory or administrative functions pertaining to government.

"HB" shall mean Household Bank, f.s.b., a federal savings bank.

"HTMAC" shall mean Household Tax Masters Acquisition Corporation, a Delaware corporation.

"ICB" shall mean Imperial Capital Bank, a California state chartered commercial bank.

"Ineligible RAL" shall have the meaning set forth in Section 4.4(c).

"Lien" shall mean any pledge, hypothecation, assignment, encumbrance, security interest, lien (statutory or other) or other security agreement of any kind or nature whatsoever, including (without limitation) any conditional sale or other title retention agreement having substantially the same economic effect as any of the foregoing.

"Major Franchisee" shall mean, subject to the terms of Section 7.17 hereof, the Person authorized by a major franchise agreement with Block Services, or with an Affiliate of Block Services, to operate a Block Office and to subfranchise others to operate Block Office within a specified territory.

"Major Franchisee Pool RAL" shall have the meaning given such term in the definition of "Pool RAL."

"Major Franchisee RAL Agreement" shall mean an agreement from time to time between Tax Masters and/or any one or more Affiliates of Tax Masters and a Major Franchisee pursuant to which RALs are made to customers of Block Offices of such Major Franchisee or its subfranchisees, as the same may be amended, modified or supplemented from time to time.

"No Fee RAL" shall mean any RAL for which no RAL fee is charged to a customer.

"Notifying Party" shall have the meaning set forth in Section 5.2.

"Obligor" shall mean, with respect to any RAL, the Person or Persons obligated to make payments to the RAL Originator, or an Affiliate of the RAL Originator, with respect to such RAL.

"Originator Party" shall mean any Person or entity through whom Pool RALs or Pool RACs are made or serviced, and any other Person or entity that prepares or arranges for the preparation of a tax return for a Pool RAL or Pool RAC customer, or that files, makes or transmits or assists or arranges for the filing, making or transmission of any such tax return, refund request or Pool RAL or Pool RAC request, or that acts as a network or service bureau in connection with any of the foregoing, or that owns, distributes, licenses or otherwise has an interest in any software or other intellectual property used in connection with any of the foregoing or in any trademark, service mark or brand name under which Pool RALs or Pool RACs are promoted.

"Participated Pool RAL" shall mean any Pool RAL in which a Participation Interest has been sold to BFC pursuant to Section 2.1 and has not been reassigned to HTMAC or repurchased by HTMAC pursuant to this Agreement.

"Participation Interest" shall have the meaning set forth in Section 2.1.

"Person" shall mean any legal person, including any individual, corporation, partnership, joint venture, association, joint-stock company, trust, unincorporated organization, governmental entity or other entity of similar nature.

"Pool RAC" shall mean any RAC issued by the RAL Originator through a Block Office owned by Block Services, a Corporate Franchise, a Major Franchisee, a subfranchisee of a Major Franchisee or any Affiliate of any of the foregoing.

"Pool RAL" shall mean (a) any RAL made by the RAL Originator through a Block Office owned by Block Services, a Corporate Franchise or either of their Affiliates, pursuant to or under color of (i) the Second Amended and Restated RAL Operations Agreement or (ii) a referral to the RAL Originator by Block Services, such Corporate Franchise or such Affiliates pursuant to a contractual electronic filing arrangement with any other Person and (b) any electronic refund advance ("ERA") made by the RAL Originator originated through On-Line Tax Preparation ("OTP") software pursuant to the ERA Operations Agreement (a RAL or ERA described in subclause (a) or (b) may hereinafter be referred to as a "Corporate Pool RAL") and (c) any RAL made during any Tax Period by a Major Franchisee or a subfranchisee of a Major Franchisee, pursuant to or under color of (i) a Major Franchisee RAL Agreement or (ii) a

referral to the RAL Originator by a Major Franchisee, or a subfranchisee or such Major Franchisee, of an Obligor whose federal income tax return was filed electronically by such Major Franchisee, or subfranchisee of such Major Franchisee, pursuant to a contractual electronic filing arrangement between such Major Franchisee or subfranchisee and any other Person (a RAL described in this subclause (c) may hereinafter be referred to as a "Major Franchisee Pool RAL"). Notwithstanding the foregoing, "Pool RAL", "Corporate Pool RAL", and "Major Franchisee Pool RAL", shall not include any RAL for which no RAL fee is charged to a customer (a "No Fee RAL").

"Principal Amount" of a RAL, shall mean:

(a) the aggregate amount paid or payable by the RAL Originator to or for the account of an Obligor in connection with a RAL, and shall in any event include (i) the amount of any check properly issued or authorized to be issued by the RAL Originator to the order of any such Obligor, and (ii) any amounts paid or payable by the RAL Originator for the account of Obligor to any Originator Party, the Internal Revenue Service or any other Person (whether or not the RAL Originator has a right, contingent or otherwise, to withhold or retain any portion of such amount). The "Principal Amount" of a RAL shall not include any financing fee or refund account fee payable by such Obligor to the RAL Originator for such RAL. Each of the foregoing elements of a RAL shall be deemed to be made for purposes of this Agreement on the Business Day on which the RAL check clears the bank account used by the RAL Originator for the disbursement of RALs and such fact has been recorded in the computer files the RAL Originator uses for administering RALs; and

(b) shall also include any payment made at any time by the RAL Originator with respect to any lost, altered or stopped check issued by or on behalf of the RAL Originator in connection with a RAL described in paragraph (a) (the "Underlying RAL"), as well as any payment by the RAL Originator with respect to any lost, altered or stopped replacement check. Payments on any RAL described in this paragraph (b) shall be deemed to be made for purposes of this Agreement on the Business Day when the replacement RAL check clears the bank account used by the RAL Originator for the disbursement of RALs and such fact has been recorded in the computer files the RAL Originator uses for administering RALs.

"Purchase Price" shall mean the purchase price for a Participation Interest to be paid by BFC to HTMAC as calculated pursuant to Section 2.3.

"RAC" means a check issued by the RAL Originator and delivered to a taxpayer pursuant to a Refund Anticipation Check Service.

"RAL" shall mean any refund anticipation loan from time to time made by the RAL Originator.

"RAL Guidelines" shall mean the RAL Originator's policies and procedures from time to time relating to the operation of its refund anticipation loan business, including (without limitation) the policies and procedures for determining the credit worthiness of refund

anticipation loan customers, the extension of credit to refund anticipation loan customers and relating to the collection and charge off of refund anticipation loans.

"RAL Originator" shall mean the insured depository institution engaged by Tax Masters (subject to the Block Companies' rights under the Letter Agreement and the Second ICB Consent Letter) to serve as the originator under the RAL Program.

"RAL Participation Agreement" shall have the meaning set forth in Recital D.

"RAL Program" shall have the meaning assigned to it in the Second Amended and Restated RAL Operations Agreement.

"Reassignment Amount" shall have the meaning set forth in Section 4.3.

"Reassignment Date" shall have the meaning set forth in Section 4.3.

"Refund Anticipation Check Service" shall mean a service pursuant to which a check in the amount of a taxpayer's federal income tax refund, less the sum of (a) fees charged for the making of the check, (b) tax preparation fees and (c) other properly withheld amounts, is delivered to a taxpayer on account of a direct deposit refund (other than in connection with a RAL made in advance of receipt of the related refund). "Refund Anticipation Check Service" includes the delivery of a direct deposit refund check to a taxpayer in connection with such taxpayer's denied RAL application.

"Repurchase Value" of a Participated Pool RAL at any time shall mean the Principal Amount of such Participated Pool RAL, less any Collections received with respect to such Participated Pool RAL.

"Sale and Servicing Agreement " shall have the meaning set forth in Recital C.

"Second Amended and Restated RAL Operations Agreement" shall have the meaning set forth in Recital G.

"Second Amended and Restated RAL Participation Agreement" shall have the meaning set forth in Recital H.

"Second ICB Consent Letter" shall have the meaning set forth in Recital F.

"Tax Period" for any year shall mean the period from and including January 1 of such year to and including August 15 of such year.

"Tax Masters" shall mean Household Tax Masters, Inc., a Delaware corporation.

"UCC" shall mean the Uniform Commercial Code, as amended from time to time, as in effect in any specified jurisdiction.

"Underlying RAL" shall have the meaning given that term in paragraph (b) of the definition of "Principal Amount".

Section 1.2. Other Definitional Provisions. Unless the context of this Agreement otherwise clearly requires, references to the plural include the singular, the singular the plural and the part the plural. The words "hereof," "herein" and "hereunder" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement; and Section and subsection references contained in this Agreement are references to Sections and subsections in this Agreement unless otherwise specified.

ARTICLE II  
PURCHASE AND SALE OF INTERESTS IN POOL RALS

Section 2.1. Purchase and Sale of Participation Interests in Pool RALS.

(a) Purchase and Sale. Subject to the conditions set forth in this Agreement, HTMAC agrees to sell to BFC, and BFC agrees to purchase from HTMAC, from time to time, on a "checks cleared" basis, an undivided ownership interest in, and in an amount equal to the Applicable Percentage of, all of HTMAC's right, title and interest in and to each Pool RAL hereafter created, including all monies due or to become due with respect thereto and all Collections pertaining thereto and other proceeds (as defined in the UCC as in effect in the State of Delaware) thereof (a "Participation Interest"). Subject to the conditions set forth herein BFC agrees to pay for, purchase and accept all Participation Interests from time to time as provided herein. Except for the representations and warranties expressly made by HTMAC and Tax Masters in this Agreement, Participation Interests (and acquisition thereof by BFC) shall be without recourse to HTMAC. Tax Masters and HTMAC represent and warrant to BFC that the Pool RALS were originated in compliance with the Final Credit Criteria and Final RAL and RAC Fees (as defined in the Second Amended and Restated RAL Operations Agreement) and applicable law, excluding, however, any failure to comply which results from (i) any misrepresentation or omission to state a material fact by a RAL Customer, or (ii) action or inaction by any Block Office, Major Franchisee or subfranchisee of a Major Franchisee to perform its explicit obligations under this Agreement, or a corporate franchise agreement between Block Services and a Corporate Franchise, a Major Franchisee RAL Agreement, or a subfranchisee agreement relating to the RAL Program between a Major Franchisee and a subfranchisee, as applicable (except for any action or inaction by such entities due to changes to the RAL Program required by the RAL Originator or Tax Masters outside of the deadlines set forth in this Agreement for any such changes).

(b) Conveyance of Participation Interest. The conveyance by HTMAC to BFC of a Participation Interest in a Pool RAL shall be deemed to occur at the time when HTMAC receives full payment from BFC of the Purchase Price in respect to such Participation Interest corresponding to such Participated Pool RAL and all other Participated Pool RALS of HTMAC arising on the same day. Upon such conveyance, BFC shall be the owner, to the extent of the Applicable Percentage, of a Participation Interest in such Pool RAL. The parties intend that if and to the extent that any conveyance of a Participation Interest in a Pool RAL is not deemed a sale of a Participation Interest, HTMAC shall be deemed to have granted to BFC a security interest in the Participation Interest that was purportedly conveyed and that this

Agreement shall constitute a security agreement under applicable law. HTMAC agrees to authorize the filing of financing and continuation statements as BFC may from time to time reasonably request with respect to Participation Interests hereafter created or arising.

(c) True Sale and Nonconsolidation Opinions. Upon BFC's request, Tax Masters and HTMAC agree to use all commercially reasonable efforts to obtain for BFC (i) a "true sale" opinion of counsel to Tax Masters and HTMAC with respect to the sale by HTMAC and the purchase by BFC of the Participation Interests in the Pool RALs, and (ii) a "nonconsolidation" opinion of counsel to Tax Masters and HTMAC with respect to HTMAC and any other subsidiary of Tax Masters that owns the Participation Interests prior to such sale and purchase, in both cases in form and substance typically employed in off-balance sheet financing or sale transactions generally; provided, however, that in connection with such efforts (A) neither Tax Masters nor HTMAC shall be obligated to restructure the terms of any agreement relating to the RAL Program, or any aspect of the RAL Program itself, in any way that adversely affects the economic interests of Tax Masters, HTMAC or their Affiliates, and (B) the failure of Tax Masters and HTMAC to obtain such opinions (after making commercially reasonable efforts to do so) shall not constitute a breach of any of Tax Masters' or HTMAC's obligations under this Agreement and shall in no event give rise to any liability on the part of Tax Masters, HTMAC or any of their Affiliates. With respect to such opinions and the RAL Program for a particular Tax Year, (1) BFC shall use all commercially reasonable efforts to request such opinions as soon as reasonably possible during the immediately preceding calendar year, and in any event, no later than September 1st of such preceding calendar year absent major structural changes to the RAL Program made or proposed by Tax Masters or HTMAC, (2) BFC shall use all commercially reasonable efforts to identify the entity, if any, with whom it intends to effectuate any financing or sale transaction, and the proposed structure of such financing or sale transaction, as soon as reasonably possible during the immediately preceding calendar year, and in any event, no later than September 1st of such preceding calendar year absent major structural changes to the RAL Program made or proposed by Tax Masters or HTMAC, and (3) BFC, HTMAC and Tax Masters shall cooperate and use all commercially reasonable efforts to complete all changes to the RAL Program, if any, and the legal documents and agreements reflecting such changes, if any, as soon as reasonably possible during the immediately preceding calendar year, and in any event no later than October 15th of such preceding calendar year absent major structural changes to the RAL Program made or proposed by BFC, HTMAC or Tax Masters. BFC shall be solely responsible for all legal fees of the parties associated with any opinion undertaken pursuant to this Section 2.1(c). In connection with any request by BFC for an opinion pursuant to this Section 2.1(c) for a particular Tax Year, Tax Masters and HTMAC shall, upon reasonable request by BFC, provide to BFC copies of all material operative agreements executed by Tax Masters, HTMAC or their Affiliates relating to the origination of RALs by the RAL Originator, or the sale and servicing of HTMAC's retained interest in the Pool RALs, for such Tax Year, as well as all material operative agreements executed by Tax Masters, HTMAC or their Affiliates relating to the financing or sale of such retained interest for such Tax Year, in each case only to the extent (i) such agreements are reasonably necessary to be reviewed by BFC in connection with the opinions contemplated by this Section 2.1(c), and (ii) the terms of such agreements permit disclosure to third parties; provided, however, that neither Tax

Masters nor HTMAC shall add any provision to any such agreement that unreasonably prohibits disclosure to BFC, its accountants or counsel engaged in connection with the issuance of any opinion pursuant to this Section 2.1(c), or the entity, if any, engaged by BFC to effectuate any financing or sale transaction. BFC hereby agrees to hold all such agreements in strict confidence and not provide any copies or disclose any terms therein to any party other than its accountants, its counsel and the entity, if any, with whom BFC proposes to effectuate any financing or sale transaction; provided, however, that, notwithstanding any other provision in this Agreement, if such entity or an Affiliate of such entity is deemed by Tax Masters to be a competitor of Tax Masters in the making or servicing of RALs, then the disclosure of such agreements to such entity may be restricted by Tax Masters to the extent deemed necessary by Tax Masters, in its sole discretion, to protect its business interests and trade secrets. To the extent that the terms and conditions of this Section 2.1(c) are inconsistent with the terms and conditions of the Second ICB Consent Letter, the terms and conditions of the Second ICB Consent Letter shall control.

Section 2.2. Payment. Each Business Day, not later than 9:00 a.m., New Jersey time, Tax Masters as servicer for the RAL Originator shall give notice to BFC (which notice may be by telephone, e-mail or facsimile) of the number and Principal Amount of Pool RALs made by the RAL Originator and in which HTMAC has purchased a Participation Interest on the preceding Business Day (it being understood that, for such purpose, a Pool RAL shall be deemed to be made at the time set forth in the definition of "Principal Amount" in this Agreement), together with the Purchase Price for the Participation Interest corresponding to such Pool RALs. Not later than 4:00 p.m., New Jersey time, on such Business Day, BFC shall pay to HTMAC the full amount of such Purchase Price. Such payment shall be made to HTMAC at such domestic account designated by HTMAC by notice to BFC from time to time, in United States dollars and in funds immediately available at such office at such time, without setoff, withholding, counterclaim or other deduction of any nature whatsoever.

Section 2.3. Purchase Price. The Purchase Price for a Participation Interest shall be equal to the sum, for each Pool RAL corresponding to such Participation Interest, of the product of (i) the Applicable Percentage applicable to such Pool RAL, times (ii) the Principal Amount of such Pool RAL (the aggregate amount referred to in this Section being referred to as the "Purchase Price" with respect to such Participation Interest).

Section 2.4. Float Adjustment. Tax Masters shall pay to BFC an amount equal to the product of \$.50 times the number of Pool RACs (other than Pool RACs issued through a Major Franchisee or a subfranchisee of a Major Franchisee) issued during the Tax Period. Such amount shall be due and payable by Tax Masters by wire transfer not later than thirty (30) days after the last day that RACs are offered for such Tax Period.

Section 2.5. Applicable Percentages. The Applicable Percentage for Corporate Pool RALs shall be 40%; provided, however, the Applicable Percentage for Corporate Pool RALs shall be 49.999999% for each Tax Period during which Tax Masters (or any of its Affiliates) is the exclusive facilitator of a Refund Anticipation Check Service to customers of Block Offices owned by Block Services, Corporate Franchisees and any of Block Services' Affiliates. The Applicable Percentage for a Major Franchisee Pool RAL shall be 25%.

Notwithstanding the foregoing provisions of this Section 2.5, any Applicable Percentage (a) for a particular Tax Period may be such lesser percentage as specified by BFC by giving written notice to Tax Masters and HTMAC on or before September 1 immediately prior to such Tax Period (it being understood that (i) such lesser percentage shall pertain only to the particular Tax Period for which such notice is given and (ii) if no such notice is given for a particular Tax Period, the Applicable Percentages shall be the percentages as set forth in this Section 2.5), or (b) for any portion of a particular Tax Period shall be reduced to zero if BFC has exceeded its internal funding limit (it being understood that (i) the reduction of the percentage to zero shall only be in effect during the periods of time BFC has exceeded its internal funding limit and (ii) for the periods of time BFC has not exceeded its internal funding limit, the Applicable Percentages shall be the percentages as set forth in this Section 2.5).

ARTICLE III  
SERVICING, ADMINISTRATION AND COLLECTION OF POOL RALS

Section 3.1. Servicing and Administration of Participated Pool RALS. Tax Masters as servicer for the RAL Originator shall underwrite, service and administer the Participated Pool RALS and shall collect payments due under the Participated Pool RALS in accordance with its customary and usual servicing procedures for servicing RALS made by the RAL Originator through Block Offices or Major Franchisees or subfranchisees of Major Franchisees and in accordance with the RAL Guidelines, and in which HTMAC has purchased a Participation Interest. Tax Masters as servicer for the RAL Originator shall, subject to the terms of this Section 3.1, have full power and authority, acting alone or through any party properly designated by it hereunder, to do any and all things in connection with such servicing and administration that it may deem necessary or desirable. Without limiting the generality of the foregoing, Tax Masters as servicer for the RAL Originator is hereby authorized and empowered to execute and deliver, on behalf of BFC, any and all instruments of satisfaction or cancellation, or of partial or full release or discharge, and all other comparable instruments, with respect to the Participated Pool RALS and, after the delinquency of any Participated Pool RAL and to the extent permitted under and in compliance with applicable law and regulations, to commence enforcement proceedings with respect to such Participated Pool RALS. In addition, without limiting the generality of the foregoing, Tax Masters as servicer for the RAL Originator is hereby authorized and empowered, in the ordinary course of collecting any Defaulted Pool RAL, to sell or transfer such Defaulted Pool RAL free and clear of any interest of BFC (proceeds of such sale or transfer being treated as Collections for purposes of Section 3.2). BFC shall furnish Tax Masters with any documents necessary or appropriate to enable Tax Masters to carry out its servicing and administrative duties hereunder. Tax Masters shall not be obligated to use servicing procedures, offices, employees or accounts for servicing the Participated Pool RALS that are separate from the procedures, offices, employees and accounts used by Tax Masters in connection with servicing other refund anticipation loans.

Section 3.2. Collections. On each Business Day not later than 4:00 p.m., New Jersey time, Tax Masters as servicer for the RAL Originator shall distribute the Applicable Percentage in all Collections (except those payments received from the Internal Revenue Service ("IRS") in the normal processing of refunds designated for direct deposit) with respect to each Participated Pool RAL received by Tax Masters as servicer for the RAL Originator (or any of its



Affiliates) on the preceding Business Day (less collection fees payable by BFC to Tax Masters or its Affiliates pursuant to Section 3.4). Such distribution shall be made to BFC at such domestic account designated by BFC by notice to Tax Masters from time to time, in United States dollars and in funds immediately available at such office at such time, without setoff, withholding, counterclaim or other deduction of any nature whatsoever and regardless of the form of Collection received by Tax Masters as servicer for the RAL Originator (or any of its Affiliates). Funds received from the IRS as part of the normal processing of refunds designated for direct deposit will be distributed to BFC in the manner provided herein on the day that RAL Originator receives such funds in its designated account(s) at the applicable United States Federal Reserve Bank; provided, that one day's interest shall be deducted by Tax Masters as servicer for the RAL Originator from each such payment in order to reflect the fact that the fundings of Participated Pool RALs are on a one-day delayed basis. For the purpose of the above-referenced interest deduction, interest shall be calculated on the basis of a 365 day year (or a 366 day year in a leap year) at the 30 day dealer placed commercial paper rate as published in the Money Rates section of the Wall Street Journal for the previous Business Day.

### Section 3.3. Reports; Records for BFC.

(a) Daily Reports. On each Business Day during an Applicable Tax Period, Tax Masters as servicer for the RAL Originator shall prepare and forward to BFC a report setting forth (i) the aggregate amount of Collections processed by Tax Masters as servicer for the RAL Originator (or any of its Affiliates) with respect to Participated Pool RALs on the preceding Business Day and BFC's share thereof, (ii) the number of, and aggregate outstanding amount of, Participated Pool RALs as of the close of business on the preceding Business Day and BFC's share thereof, and (iii) the number of Pool RACs made by the RAL Originator on the preceding Business Day and BFC's share of RAC fees pertaining thereto. Tax Masters as servicer for the RAL Originator shall at all times maintain its computer files with respect to Pool RACs and Participated Pool RALs in such a manner so that Pool RACs and Participated Pool RALs may be specifically identified.

(b) Monthly Reports. On the 8th day of each calendar month, or if such day is not a Business Day, the immediately preceding Business Day, Tax Masters as servicer for the RAL Originator shall forward to BFC a report setting forth (i) the aggregate amount of Collections processed with respect to Participated Pool RALs during the preceding calendar month and BFC's share thereof, (ii) the aggregate amount of Participated Pool RALs outstanding as of the end of the last day of the preceding calendar month and BFC's share thereof, (iii) an aging of Participated Pool RALs outstanding as of the end of the last day of the preceding calendar month, (iv) the aggregate Defaulted Pool RALs as of the end of the last day of the preceding calendar month and BFC's share thereof, (v) the number of Pool RACs made during the preceding calendar month and BFC's share of Collections pertaining thereto, and (vi) the aggregate Participated Pool RALs that are not Defaulted Pool RALs but with respect to which payment has not been received within 30 days after such Participated Pool RALs were made by the RAL Originator and a participation interest therein was purchased by BFC, and BFC's share thereof. Such report shall be accompanied by an officer's certificate, stating that to the best of such officer's knowledge such report is complete and accurate.

(c) Independent Accountants' Reports. BFC may cause a firm of nationally recognized independent accountants (who may also render services to Tax Masters) to furnish, at the expense of BFC, a report to BFC, HTMAC and Tax Masters to the effect that such firm has made a study and evaluation of the RAL Originator's, HTMAC's and Tax Masters' internal accounting controls relative to the making of Pool RACs and servicing of Participated Pool RALs under this Agreement, and that, on the basis of such study and evaluation, such firm is of the opinion (assuming the accuracy of any reports generated by the RAL Originator's, HTMAC's and Tax Masters' third party agents) that the systems of internal accounting controls in effect on the date set forth in such report relating to making of Pool RALs by the RAL Originator and servicing procedures performed by Tax Masters as servicer for the RAL Originator pursuant to the terms of this Agreement, taken as a whole, were sufficient for the prevention and detection of errors for such exceptions, errors or irregularities as such firm shall believe to be immaterial to the financial statements of the RAL Originator, HTMAC and Tax Masters and such other exceptions, errors or irregularities as shall be set forth in such report.

Section 3.4. Collection Fee for Defaulted Pool RALs. BFC shall pay to Tax Masters as servicer for the RAL Originator a collection fee in an amount equal to the Applicable Percentage with respect to a Defaulted Pool RAL, times 25% of the Principal Amount of each Defaulted Pool RAL collected by collection offices of Tax Masters as servicer for the RAL Originator or any of its Affiliates. Such fee shall be paid in the form of a deduction from Collections remitted to Tax Masters (or an Affiliate of Tax Masters) pursuant to Section 3.2 pertaining to such Participated Pool RAL.

#### ARTICLE IV REPRESENTATIONS AND WARRANTIES

Section 4.1. General Representations and Warranties of Tax Masters and HTMAC. Tax Masters and HTMAC hereby represent and warrant to BFC as of the date hereof (which representations and warranties shall survive any purchase and sale of Participation Interests pursuant to this Agreement):

(a) Organization and Good Standing. ICB is a commercial bank duly organized and validly existing under the laws of the State of California, has its principal banking office located in the State of California and has a bank branch located and authorized to conduct banking operations in the State of Nevada. ICB has full corporate power and authority to own its properties and conduct its business as such properties are presently owned and such business is presently conducted, and to execute, deliver and perform its obligations under this Agreement. Each of Tax Masters and HTMAC is a corporation duly organized and validly existing under the laws of the State of Delaware and has full corporate power and authority to own its properties and conduct its business as such properties are presently owned and such business is presently conducted, and to execute, deliver and perform its obligations under this Agreement.

(b) Due Authorization. The execution and delivery of this Agreement and the consummation of the transactions provided for in this Agreement have been duly authorized by each of HTMAC and Tax Masters by all necessary corporate action on

their part and this Agreement will remain, from the time of its execution, an official record of Tax Masters and HTMAC.

(c) No Conflict. The execution and delivery of this Agreement, the performance of the transactions contemplated by this Agreement and the fulfillment of the terms hereof will not conflict with, result in any breach of the material terms and provisions of, or constitute (with or without notice or lapse of time or both) a material default under, any indenture, contract, agreement mortgage, deed of trust, or other instrument to which Tax Masters or HTMAC is a party or by which it or any of their properties are bound.

(d) ICB's Deposit Accounts. Deposits in ICB's deposit accounts are insured to the limits provided by law by the Bank Insurance Fund administered by the Federal Deposit Insurance Corporation.

Section 4.2. Representations and Warranties of HTMAC Relating to the Participated Pool RALs. Tax Masters and HTMAC hereby represent and warrant to BFC as of each Closing Date (which representations and warranties shall survive any purchase and sale of Participation Interests pursuant to this Agreement):

(a) Eligible RAL. Each Participated Pool RAL is an Eligible RAL as of the Closing Date relating to the Participation Interest sold to BFC with respect to such Participated Pool RAL.

(b) Sale and Ownership; Title. Each sale of a Participation Interest by HTMAC to BFC on such Closing Date constitutes either (i) a valid sale, transfer, assignment, set over and conveyance to BFC of all right, title and interest of HTMAC in and to such Participation Interest (and the Applicable Percentage in the underlying Pool RALs), free and clear of any Lien of any Person claiming through or under HTMAC or any of its Affiliates, or (ii) if it is ultimately determined by a court of competent jurisdiction that a sale from HTMAC to BFC did not occur, then a grant of a security interest (as defined in the UCC as in effect in the applicable state) by HTMAC to BFC in each Participation Interest purportedly conveyed pursuant to such sale. On each Closing Date, immediately prior to any such sale of (or grant of a security interest in) a Participation Interest, HTMAC will be the sole legal and beneficial owner of, and will have marketable title to, the Participation Interest in the underlying Pool RALs, free and clear of any Lien, claim or encumbrance (other than the interests of BFC contemplated by this Agreement). Neither HTMAC nor any Person claiming through or under HTMAC shall have any claim to or interest in such Participation Interest, except for the interest of HTMAC therein as a "debtor" (specifically, as seller of payment intangibles) for purposes of Article 9 of the UCC.

Section 4.3. Remedy For Breach of Representations and Warranties. In the event of a breach of any of the representations and warranties set forth in Section 4.1, BFC may by notice then given in writing to HTMAC direct HTMAC to accept reassignment of the Participation Interests within 30 days of such notice (or within such longer period as may be specified in such notice but in no event later than 120 days), and HTMAC shall be obligated to

accept reassignment of the Participation Interests on a date specified by BFC (the "Reassignment Date") occurring within such applicable period on the terms and conditions set forth below; provided, however, that no such reassignment shall be required to be made if, at any time during such applicable period, the representations and warranties contained in Section 4.1 shall then be true and correct in all material respects. In connection with such reassignment, HTMAC shall remit to BFC on the Reassignment Date an amount equal to the aggregate of the respective Applicable Percentages of the Repurchase Values of each Participated Pool RAL (the "Reassignment Amount"). Such remittance shall be made to BFC at such domestic account designated by BFC by notice to HTMAC, in United States dollars and in funds immediately available at such office at such time, without setoff, withholding, counterclaim or other deduction of any nature whatsoever. Except as provided in Section 5.1, the obligation of HTMAC to purchase the Participation Interests in accordance with this Section 4.3 shall constitute the sole remedy respecting any breach of the representations and warranties set forth in Section 4.1 available to BFC.

On the date on which the Reassignment Amount has been paid to BFC, the Participation Interests in the uncollected Participated Pool RALs, all monies due or to become due with respect thereto and all proceeds thereof shall be released to HTMAC, or its designee or assignee, and BFC shall execute and deliver such instruments of transfer or assignment, in each case without recourse, representation or warranty (except only for the warranty that since the date of sale by HTMAC to BFC, BFC has not sold, transferred or encumbered any such Participated Pool RALs or interest therein), as shall reasonably be requested by HTMAC to vest in HTMAC, or its designee or assignee, all right, title and interest of BFC in and to the Participation Interests in the uncollected Participated Pool RALs, all monies due or to become due with respect thereto and all proceeds thereof. BFC's right to resell and HTMAC's obligation to repurchase a Participation Interest pursuant to this Section 4.3 shall apply only to a Participation Interest that is adversely affected by or impaired as a result of a breach of a representation or warranty.

#### Section 4.4. Transfer of Ineligible RALs.

(a) Repurchase. In the event of a breach with respect to a Participated Pool RAL of any representations and warranties set forth in Section 4.2(b)(i), or in the event that a Participated Pool RAL is not an Eligible RAL as a result of the failure to satisfy the conditions set forth in clause (c) of the definition of Eligible RAL, and as a result of such breach of event such Participated Pool RAL is charged off as uncollectible or BFC's rights in, to or under the Participation Interest therein are materially impaired, then, upon the earlier to occur of the discovery by BFC of such breach or event, or receipt by BFC of written notice from HTMAC of such breach or event, BFC may by notice then given in writing to HTMAC direct HTMAC to repurchase the Participation Interest in each such Participated Pool RAL within 30 days of such notice (or within such longer period as may be specified in such notice but in no event later than 120 days) on a date specified by BFC occurring within such applicable period on the terms and conditions set forth in Section 4.4(c).

(b) Repurchase After Cure Period. In the event of a breach of any of the representations and warranties set forth in Sections 4.2 and 2.1(a), or in the event that a

Participated Pool RAL is not an Eligible RAL as a result of the failure to satisfy the conditions set forth in the definition of Eligible RAL or Pool RAL (contingent on that failure not being caused by (i) any misrepresentation or omission to state a material fact by a RAL Customer, or (ii) action or inaction of any Block Office, Major Franchisee, or subfranchisee of a Major Franchisee to perform its explicit obligations under this Agreement, or a corporate franchise agreement between Block Services and a Corporate Franchise a Major Franchisee RAL Agreement, or a subfranchisee agreement relating to the RAL Program between a Major Franchisee and a subfranchisee, as applicable (except for any action or inaction by such entities due to changes to the RAL Program required by the RAL Originator, HTMAC or Tax Masters outside of the deadlines set forth in this Agreement for any such changes), other than a breach or event as set forth in Section 4.4(a), and as a result of such breach any Participated Pool RAL becomes a Defaulted Pool RAL or BFC's rights in, to or under the Participated Pool RAL or its proceeds are materially impaired, then, upon the expiration of 60 days (or such longer period as may be agreed to by BFC, but in not event later than 120 days) from the earlier to occur of the discovery of any such event by BFC or receipt by BFC of written notice from Tax Masters or HTMAC of any such event, BFC may by notice then given in writing to Tax Masters and HTMAC direct HTMAC to repurchase the Participation Interest in each such Participated Pool RAL within 30 days of such notice (or within such longer period as may be specified in such notice but in no event later than 120 days) on the terms and conditions set forth in Section 4.4(c); provided, however, that no such repurchase shall be required to be made if, on any day prior to such repurchase, such representations and warranties with respect to such Participated Pool RAL shall then be true and correct in all material respects as if such Participated Pool RAL had been created on such day.

(c) Procedures for Repurchase. When the provisions of Sections 4.4(a) or 4.4(b) require repurchase of a Participation Interest in a Participated Pool RAL (such Participated Pool RAL being hereinafter referred to as an "Ineligible RAL"), HTMAC shall accept reassignment of such Participation by remitting to BFC an amount equal to the Applicable Percentage of the Repurchase Value of the Ineligible RAL as of the date of such repurchase. Such remittance shall be made to BFC at such domestic account designated by BFC by notice to HTMAC, in United States dollars and in funds immediately available at such office at such time, without setoff, withholding, counterclaim or other deduction of any nature whatsoever. Upon such remittance, BFC shall automatically and without further action be deemed to transfer, assign, set over and otherwise convey to HTMAC, without recourse, representation or warranty (except for the warranty that since the date of conveyance by HTMAC to BFC, BFC has not sold, transferred or encumbered any such Participation Interest), all right, title and interest of BFC in and to such Participation Interest. BFC shall execute such documents and instruments of transfer or assignment and take other actions as shall reasonably be requested by HTMAC to evidence the conveyance of such Participation Interest in the Ineligible RALs, all monies due or to become due with respect thereto and all proceeds thereof pursuant to this Section 4.4(c). The obligation of HTMAC to repurchase Participation Interests in Ineligible RALs in accordance with this Section 4.4(c) shall constitute the sole remedy respecting any breach of the representations and warranties set forth in Section 4.2 available to BFC.

(d) Impairment. For the purposes of Sections 4.4(a) and (b) above, proceeds of a Participated Pool RAL shall not be deemed to be impaired hereunder solely because such proceeds are held by HTMAC for more than the applicable period under Section 9-315(d) of the UCC as in effect in the State of Delaware.

ARTICLE V  
TERM

Section 5.1. Termination of Purchase and Sale Obligations. The obligations of HTMAC to sell Participation Interests in Pool RALs pursuant to Section 2.1 that are RALs described in paragraph (a) of the definition of "Principal Amount" in this Agreement and the obligations of BFC to purchase Participation Interests in such Pool RALs pursuant to Section 2.1, may be terminated:

(a) by the mutual written agreement of BFC and HTMAC;

(b) by either party, if the Second Amended and Restated RAL Operations Agreement has been terminated;

(c) by Tax Masters or HTMAC, if (i) there is a failure by BFC to perform or observe any material term, covenant or agreement contained in this Agreement, and any such failure shall remain unremedied for 10 days after written notice of such failure shall have been given to BFC by Tax Masters or HTMAC, (ii) there is an order or decree restraining, enjoining, prohibiting, invalidating or otherwise preventing the transactions contemplated by this Agreement or Tax Masters's or HTMAC's performance of any of their material obligations under this Agreement, (iii) there shall be pending, or any Governmental Authority shall have notified Tax Masters or HTMAC of its intention to institute, any action, suit or proceeding against Tax Masters or HTMAC to restrain, enjoin, prohibit, invalidate or otherwise prevent the transactions contemplated by this Agreement or Tax Masters's or HTMAC's performance of any of their material obligations under this Agreement, (iv) any Participated Pool RAL or purchase or sale of a Participation Interest in a Participated Pool RAL, or Tax Masters's or HTMAC's performance of any of their material obligations under this Agreement, would be illegal, and there are no reasonable steps that Tax Masters or HTMAC could take to prevent such illegality; or (v) there is a dissolution, termination of existence, insolvency, appointment of a receiver of any part of the property of, or assignment for the benefit of creditors by, or the commencement of any proceeding by or against BFC under any bankruptcy or insolvency law;

(d) by BFC, if (i) there is a failure by Tax Masters or HTMAC to perform or observe any material term, covenant or agreement contained in this Agreement and any such failure shall remain unremedied for 10 days after written notice of such failure shall have been given to Tax Masters and HTMAC by BFC, (ii) there is an order or decree restraining, enjoining, prohibiting, invalidating or otherwise preventing BFC's performance of any of its material obligations hereunder, (iii) there shall be pending, or any Governmental Authority shall have notified BFC of its intention to institute, any action, suit or proceeding against BFC to restrain, enjoin, prohibit, invalidate or otherwise

prevent BFC's performance of any of its material obligations hereunder, (iv) BFC's performance of any of its material obligations hereunder would be illegal and there are no reasonable steps that BFC could take to prevent such illegality, or (v) there is a dissolution, termination of existence, insolvency, appointment of a receiver of any part of the property of, or assignment for the benefit of creditors by, or the commencement of any proceeding by or against Tax Masters or HTMAC under any bankruptcy or insolvency law; or

(e) by BFC, if as of any September 15, any representation or warranty of Tax Masters or HTMAC set forth in Section 4.1 would not be true, if repeated as of such date; provided that BFC gives notice of such termination not later than the September 30 next following such September 15.

Tax Masters, HTMAC or BFC shall exercise a right of termination provided above by written notice to the other party. Upon such termination, all obligations of HTMAC to sell Participation Interests in Pool RALs pursuant to Section 2.1 that are RALs described in paragraph (a) of the definition of "Principal Amount" in this Agreement and all obligations of BFC to purchase Participation Interests in such Pool RALs pursuant to Section 2.1 shall automatically cease and BFC shall have no further obligation to purchase additional Participation Interests corresponding to such Participated Pool RALs. Termination pursuant to this Section shall not otherwise affect the rights or obligations of the parties hereto under this Agreement. Without limitation, such termination shall not affect the obligations of HTMAC to sell Participation Interests pursuant to Section 2.1 with respect to Pool RALs that are RALs described in paragraph (b) of the definition of "Principal Amount" in this Agreement to the extent that the Underlying RAL is itself a Participated Pool RAL with respect to which a Participation Interest was sold to BFC prior to such termination, and shall not affect the obligation of BFC to purchase a Participation Interest with respect to such Pool RAL pursuant to Section 2.1.

Section 5.2. Right to Exclude Certain RALs. If, from time to time, BFC, HTMAC or Tax Masters believes in good faith that any specified RALs (of the type described in paragraph (a) of the definition of "Principal Amount" in this Agreement) that otherwise would constitute Pool RALs may violate or conflict with any requirement of law in any jurisdiction, such party (the "Notifying Party") may give notice to the other parties of such fact, specifying the applicable jurisdictions, and specifying such further actions on the part of BFC, Block Tax Services, the RAL Originator or other Persons, if any, as would in the opinion of the Notifying Party prevent such violation or conflict. Unless such steps have been taken within seven days after receipt of such notice, then, effective from and after such seventh day such RALs made after such day in such specified jurisdiction shall not constitute Pool RALs (such RALs being hereinafter referred to as "Excluded RALs"). If such steps subsequently are taken, and the other party gives notice to the Notifying Party of such fact, then the Notifying Party, shall, as promptly as practicable after such notice, by further notice to such other party, revoke its earlier designation of such RALs as Excluded RALs, and RALs of the specified type made after the date of such revocation shall not constitute Excluded RALs (and hence shall constitute Pool RALs).

ARTICLE VI  
CERTAIN RIGHTS OF TAX MASTERS AND HTMAC

Section 6.1. Certain Rights of Tax Masters and HTMAC.

(a) Rescission. If any payment received or application of funds made by Tax Masters or HTMAC on account of any Participated Pool RAL shall be rescinded or otherwise shall be required (or if Tax Masters or HTMAC believes in good faith that such payment or application of funds is or may be required) to be returned or paid over by Tax Masters or HTMAC at any time, BFC, promptly upon notice from Tax Masters or HTMAC, shall pay to HTMAC an amount equal to the Applicable Percentage of the amount so rescinded or returned or paid over, together with the Applicable Percentage of any interest or penalties payable with respect thereto.

(b) Payover. If BFC receives any payment or makes any application on account of its Participation Interest in any Participated Pool RAL, BFC shall promptly pay over to HTMAC the amount in excess of the Applicable Percentage of the amount so received or applied and until so paid over, the same shall be held by BFC in trust for HTMAC.

Section 6.2. Indemnification. Immediately upon Tax Masters' or HTMAC's demand therefor, BFC shall reimburse and indemnify Tax Masters and HTMAC for and against the Applicable Percentage share of any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses and disbursements of every kind and nature whatsoever that may be imposed upon, incurred by or asserted against Tax Masters or HTMAC, acting pursuant hereto, or in any way relating to or arising out of this Agreement or any Participated Pool RAL or the origination or servicing thereof, or any action taken or omitted by Tax Masters or HTMAC under this Agreement or any Participated Pool RAL, including, without limitation, any amounts payable by Tax Masters pursuant to the Second Amended and Restated RAL Operations Agreement (pursuant to indemnification provisions thereof or otherwise), and any amounts that Tax Masters or HTMAC shall be required to pay or repay to any statutory representative of any Obligor or Originator Party or to creditors of any such Obligor or Originator Party acting as such statutory representative (all of the foregoing being referred to collectively as "Claims"); provided, however, that BFC shall not be liable under this Section 6.2 for its Applicable Percentage of (i) any obligation of HTMAC to repurchase Participation Interests in accordance with Sections 4.3 and 4.4, (ii) any out-of-pocket expenses of Tax Masters on account of origination of ordinary and routine servicing of Participated Pool RALs, to the extent duplicative of amounts as to which BFC has paid its Applicable Percentage share pursuant to Article II, (iii) attorneys' fees and related litigation expenses incurred by Tax Masters or HTMAC with respect to Claims (it being understood that each party shall be responsible for its own attorneys' fees and related litigation expenses with respect to Claims), (iv) any Claim attributable to a Participated Pool RAL failing to be an Eligible RAL, (v) any Claim attributable to a breach by Tax Masters or HTMAC of an express obligation of Tax Masters or HTMAC under this Agreement, or (vi) any Claim attributable to the gross negligence or willful misconduct of Tax Masters or HTMAC. Notwithstanding any other provision herein, if BFC breaches any of its obligations hereunder and any such breach results in a claim for indemnification by the RAL Originator against Tax Masters or HTMAC, Tax Masters and



HTMAC shall have the right to indemnification from BFC to the extent Tax Masters or HTMAC is required to indemnify the RAL Originator.

Nothing in this Section 6.2 shall be construed to make BFC liable for (i) any portion of any liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses and disbursements imposed upon, incurred by or asserted against Tax Masters, HTMAC or any of their Affiliates relating solely to or arising solely from any RAL other than a Participated Pool RAL or a RAC other than a Pool RAC or (ii) any Claim with respect to which Tax Masters or HTMAC is indemnified by any third party (including, without limitation, Block Tax Services or any other Originator Party). Tax Masters or HTMAC shall remit to BFC the Applicable Percentage of any amount received by Tax Masters or HTMAC as indemnification from a third party to the extent such indemnification pertains to a Claim for which BFC previously indemnified Tax Masters or HTMAC pursuant to this Section 6.2.

If different Applicable Percentages apply to Pool RALs with respect to which a Claim arises, then (A) to the extent the Claim is identifiable to a particular Pool RAL or to Pool RALs made in a particular Tax Period, the Applicable Percentage applicable to BFC's indemnification obligation with respect to such Claim shall be equal to the Applicable Percentage applicable to such particular Pool RAL or to such Tax Period, as the case may be and (B) otherwise, the Applicable Percentage applicable to BFC's indemnification obligation with respect to such Claim shall be a weighted average of the Applicable Percentages applicable to the Pool RALs or the Tax Period with respect to which such Claim arose.

Section 6.3. Survival. The obligations of BFC under this Article VI shall survive any termination under Section 5.1 and all other events and conditions whatever. If and to the extent that any obligation of BFC under this Article VI is unenforceable for any reason, BFC agrees to make the maximum contribution to the payment and satisfaction of such obligation which is permitted under applicable law.

#### ARTICLE VII MISCELLANEOUS

Section 7.1. Customer Lists. To the extent permitted by applicable law, Tax Masters as servicer for the RAL Originator agrees to provide to BFC, or any Affiliate of BFC during the term of this Agreement, within a reasonable time after BFC's (or such Affiliate's) request but not more than twice during any calendar year, a list of all persons (and, their full mailing addresses) to whom the RAL Originator made and HTMAC purchased Pool RALs or Pool RACs during the most recently ended Tax Period. Such list shall be provided in electronic form and, to the extent reasonably practicable, in a form typical of mailing lists purchased in the open market. Neither BFC nor its Affiliates shall use, or permit the use of, such list for purposes of soliciting customers for credit related products. BFC and such Affiliates shall take appropriate action by agreement with third parties having access to such list to prohibit such third parties from using such list for purposes of soliciting customers for credit related products. Tax Masters or HTMAC shall be designated a third-party beneficiary in any such agreement for purposes of enforcing such restricted use of such list.

Section 7.2. Independent Evaluation. BFC expressly acknowledges (i) that, except as provided in Sections 2.1(a), 4.1 and 4.2, neither Tax Masters nor HTMAC has any representation or warranty, express or implied, to BFC and no act by Tax Masters or HTMAC heretofore or hereafter taken shall be deemed to constitute any representation or warranty by Tax Masters or HTMAC to BFC; and (ii) that, in connection with its entry into and its performance of its obligations under this Agreement, BFC has made and shall continue to make its own independent investigation of the economic and legal risks associated with the making of RALs and purchase of Participation Interests.

Section 7.3. Notices. All notices required or permitted to be given under this Agreement shall be in writing and shall be given by registered or certified mail, return receipt requested, or by nationally recognized overnight courier, addressed as follows:

If to BFC, to:

Block Financial Corporation  
4400 Main Street  
Kansas City, Missouri 64111  
Attention: Jeffery A. Yabuki

If to Tax Masters, to:

Household Tax Masters Inc.  
200 Somerset Corporate Blvd.  
Bridgewater, New Jersey 08807  
Attention: Paul Creatura

If to HTMAC, to:

Household Tax Masters Acquisition Corporation  
200 Somerset Corporate Blvd.  
Bridgewater, New Jersey 08807  
Attention: Paul Creatura

Any party may change the address to which it desires notices to be sent by giving the other parties ten (10) days prior notice of any such change. Any notices shall be deemed given upon its receipt by the party to whom the notice is addressed.

Section 7.4. Modification; No Waiver. This Agreement shall not be modified or amended except by an instrument in writing signed by or on behalf of the parties hereto. No waiver of any breach of, or failure to perform or observe, any material term, covenant or agreement contained in this Agreement shall constitute or be construed as a waiver by BFC, HTMAC or Tax Masters of any subsequent breach or failure or of any breach of or failure with respect to any of the other provisions of this Agreement.

Section 7.5. Prior Understandings. This Agreement supersedes all prior oral understandings between the parties hereto relating to the transactions provided herein.

Section 7.6. Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the laws of Delaware, without regard to choice of law rules thereof.

Section 7.7. Counterparts. This Agreement may be executed in as many counterparts as may be deemed necessary and convenient, and by the different parties hereto in separate counterparts, each of which, when so executed, shall be deemed to be an original, but all such counterparts together shall constitute one and the same instrument.

Section 7.8. Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of BFC, HTMAC and Tax Masters and their representative successors and assigns and shall not be assigned by either party hereto without the prior written consent of the other parties hereto, which consent shall not unreasonably be withheld, conditioned or delayed, and any purported assignment without such consent shall be void.

Section 7.9. Securitizations. Each of Tax Masters and HTMAC will use its reasonable efforts to assist BFC with respect to the negotiation and execution of all instruments and documents and to take all actions that are reasonably necessary, or as BFC may reasonably request, in order to facilitate the sale by BFC of the Participation Interests acquired by BFC pursuant to this Agreement and the assignment by BFC of BFC's rights under this Agreement to an Affiliate of BFC, and the resale of such Participation Interests and the reassignment of such rights by the Affiliate to one or more liquidity providers. Notwithstanding such assignment of its rights, BFC shall remain liable to perform all of its covenants and obligations under this Agreement. To the extent the terms and conditions of this Section 7.9 are inconsistent with the terms and conditions of the Second ICB Consent Letter, the terms and conditions of the Second ICB Consent Letter shall control.

Section 7.10. Headings. The Article, Section and any other headings in this Agreement are for convenience of reference only and shall not be deemed to alter or affect the meaning or interpretation of any of the provisions hereof.

Section 7.11. Confidentiality. Without limitation of any other obligations of confidentiality contained in this Agreement, the Second Amended and Restated RAL Operations Agreement or otherwise arising (but subject to the provisions of Section 7.1), all information, materials and documents heretofore or hereafter furnished to BFC (or to its officers, directors, agents, representatives or advisors) by Tax Masters or HTMAC, by Persons acting on behalf of Tax Masters or HTMAC or at Tax Masters' or HTMAC's direction, or otherwise in connection with this Agreement, either orally, in writing or by inspection, regarding the Obligors, any RAL, any RAC, this Agreement or the Second Amended and Restated RAL Operations Agreement shall be deemed confidential and, except to the extent required by law, shall be kept in strict confidence under appropriate safeguards by BFC and its officers, directors, agents, representatives and advisors.

Section 7.12. Not a Joint Venture. Neither this Agreement nor the transactions contemplated by this Agreement shall be deemed to give rise to a partnership or joint venture between Tax Masters, HTMAC and BFC.

Section 7.13. HTMAC and Tax Masters Not Tax Preparers. Nothing in this Agreement or the Second Amended and Restated RAL Operations Agreement shall be construed to imply that Tax Masters or HTMAC at any time is in any way responsible for the preparation, filing or contents of any tax return of any Obligor under a Pool RAL, and BFC shall indemnify Tax Masters and HTMAC from and against all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses and disbursements of every kind and nature whatsoever which may be imposed upon, incurred by or asserted against Tax Masters or HTMAC arising from any claim, allegation or assertion that Tax Masters or HTMAC is or may be in any way responsible for the preparation, filing or contents of any such tax return, or that Tax Masters or HTMAC, by virtue of its participation in the transactions contemplated by this Agreement, is engaged in an activity that subjects Tax Masters or HTMAC to any penalty on account of the negotiation of any tax refund check in violation of the Internal Revenue Code of 1986, as amended.

Section 7.14. Events Prior to Amendment. The parties affirm that they are responsible for performing all of their agreements, duties and obligations under the Second Amended and Restated RAL Participation Agreement arising out of events occurring prior to the effective date of this Agreement, and the provisions of the Second Amended and Restated RAL Participation Agreement shall survive and continue to define the rights and obligations of the parties with respect to such prior events.

Section 7.15. Financial Privacy. Tax Masters, HTMAC and BFC agree to comply with the financial privacy provisions of Section 7.2 of the Second Amended and Restated RAL Operations Agreement.

Section 7.16. Effective Date. The effective date of this Agreement shall be the date first written above.

Section 7.17. Acquisition of Major Franchisees. Tax Masters and HTMAC acknowledge that Block Services and its Affiliates are in the process of repurchasing the major franchise agreements from certain of the Major Franchisees. The parties hereto expressly agree that, for purposes of this Agreement, (a) any Major Franchisee that is acquired by Block Services or an Affiliate of Block Services shall thereafter be considered a Block Office and shall cease to be considered a Major Franchisee, and (b) any Major Franchisee whose major franchise agreement is terminated and who enters into a corporate franchise agreement shall thereafter be treated as a Corporate Franchisee and shall cease to be treated as a Major Franchisee.

IN WITNESS WHEREOF, the parties hereto have caused this Third Amended and Restated Refund Anticipation Loan Participation Agreement to be executed by their respective officers thereunto duly authorized as of the date set forth above.

BLOCK FINANCIAL CORPORATION

By: -----  
Name:  
Title:

HOUSEHOLD TAX MASTERS INC.

By: -----  
Name:  
Title:

HOUSEHOLD TAX MASTERS ACQUISITION CORPORATION

By: -----  
Name:  
Title:

CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Mark A. Ernst, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of H&R Block, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2004

/s/ Mark A. Ernst

-----  
Mark A. Ernst  
Chief Executive Officer  
H&R Block, Inc.

CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Melanie K. Coleman, Principal Accounting Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of H&R Block, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2004

/s/ Melanie K. Coleman

-----  
Melanie K. Coleman  
Principal Accounting Officer  
H&R Block, Inc.

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of H&R Block, Inc. (the "Company") on Form 10-Q for the period ending January 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark A. Ernst, Chief Executive Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Mark A. Ernst

-----  
Mark A. Ernst  
Chief Executive Officer  
H&R Block, Inc.  
March 16, 2004



CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of H&R Block, Inc. (the "Company") on Form 10-Q for the period ending January 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Melanie K. Coleman, Principal Accounting Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Melanie K. Coleman  
-----  
Melanie K. Coleman  
Principal Accounting Officer  
H&R Block, Inc.  
March 16, 2004