

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

- ☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended: April 30, 2003
- ☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from to

Commission File Number: 1-6089

H&R BLOCK, INC.

(Exact name of registrant as specified in its charter)

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

4400 MAIN STREET, KANSAS CITY, MISSOURI 64111

(Address of principal executive offices, including zip code)

(816) 753-6900

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, without par value	New York Stock Exchange Pacific Exchange

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, without par value  
(Title of Class)

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

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

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

The aggregate market value of the registrant's Common Stock (all voting stock) held by non-affiliates of the registrant, computed by reference to the price at which the stock was sold on June 1, 2003, was \$7,350,442,111.

Number of shares of registrant's Common Stock, without par value, outstanding on June 1, 2003: 179,645,081.

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## **Documents Incorporated by Reference**

Certain specified portions of the registrant's annual report to security holders for the fiscal year ended April 30, 2003, are incorporated herein by reference in response to Part I, Item 1, and Part II, Items 5 through Item 8, and certain specified portions of the registrant's definitive proxy statement filed within 120 days after April 30, 2003, are incorporated herein by reference in response to Part III, Items 10 through 12, inclusive.

## **PART I**

### **Item 1. Business.**

#### **General Development of Business**

H&R Block, Inc. (the "Company") is a diversified company with subsidiaries delivering tax services and financial advice, investment and mortgage products and services and business and consulting services. In fiscal year 2003, the Company's tax subsidiaries and their franchisees served 18.8 million taxpayers - more than any tax or accounting firm - through more than 10,600 offices located in the United States, Canada, Australia and the United Kingdom. Another 2.1 million clients utilized the award-winning tax software program, TaxCut<sup>®</sup> from H&R Block (includes federal e-filings only), or the online tax preparation service. H&R Block Mortgage Corporation and Option One Mortgage Corporation offer a full range of home mortgage products and services. RSM McGladrey Business Services, Inc. is a national accounting, tax and consulting firm primarily serving mid-sized businesses. Investment services and securities products are offered through H&R Block Financial Advisors, Inc., member NYSE, SIPC. The Company is not a registered broker-dealer.

The Company is a corporation organized in 1955 under the laws of the State of Missouri. It is the parent corporation in a two-tier holding company structure with H&R Block Group, Inc., a Delaware corporation, as the second-tier holding company and the direct or indirect owner of the operating subsidiaries providing tax and financial products and services to the general public principally in the United States, but also in Canada, Australia and the United Kingdom. The Company's subsidiaries provide tax return preparation, filing and other tax-related products and services, originate, service and sell mortgages, provide investment services, offer personal productivity software, participate in refund anticipation loan products offered by a third-party lending institution (although the Company's subsidiaries did not participate in such products originated during the fiscal year 2003 tax season), and offer accounting, tax and consulting services to business clients.

The H&R Block Mission is "To help our clients achieve their financial objectives by serving as their tax and financial partner." The H&R Block Vision is "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 the enhancement of client experiences with the H&R Block brand through consistent delivery of valuable services and advice. Operating through multiple lines of business allows the Company to meet the changing financial needs of all of its subsidiaries' customers. Developments during fiscal year 2003 within U.S. Tax Operations,

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Mortgage Services, Business Services, Investment Services and International Tax Operations are described in the section below entitled "Description of Business."

On June 11, 2003, the Company's Board of Directors approved the repurchase of 20 million shares of its Common Stock, without par value. Such authorization was in addition to the 15 million-share repurchase authorization in September 2001. Approximately 1.9 million shares remained under the 2001 authorization as of the end of fiscal year 2003. The number of shares purchased under the June 2003 and September 2001 authorizations will depend upon a number of factors including the price of the stock, the ability to maintain progress toward a capital structure that will support a single A rating, availability of excess cash, the ability to maintain liquidity and financial flexibility, securities laws restrictions and other investment opportunities available.

On September 11, 2002, Frank L. Salizzoni retired as Chairman of the Board of the Company and as a director of the Company. The Board of Directors on June 12, 2002 approved a reduction in the size of the Board from ten to nine directors, effective upon Mr. Salizzoni's retirement. On September 11, 2002, the Board of Directors elected Mark A. Ernst Chairman of the Board and appointed Louis W. Smith as Presiding Director of the Board of Directors. Mr. Ernst also continued as President and Chief Executive Officer of the Company.

During the fiscal year ended April 30, 2003, the Company was not involved in any bankruptcy, receivership or similar proceedings or any material reclassifications, mergers or consolidations, and the Company did not acquire or dispose of any material amount of assets during such year.

The information contained in this Form 10-K 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 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, which 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 the Company will achieve or exceed its revenue, earnings, and earnings per share growth goals or expectations for fiscal year 2004 or any other fiscal year; the uncertainty actual fiscal year 2004 financial results will fall within any guidance provided by the Company; 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; the uncertainty of laws, legislation, regulations, supervision and licensing by federal, state and local authorities and self-regulatory organizations and their impact on any proposed or possible transactions and the lines of business in which the Company's subsidiaries are involved; unforeseen compliance

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costs; changes in interest rates; changes in economic, political or regulatory environments; changes in competition and the effects of such changes; changes in management and management strategies; the inability to successfully implement the Company's 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 mortgage 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 any settlements in litigation will ultimately be approved by the courts; the inability of the Company to purchase shares of its Common Stock pursuant to its share repurchase program; 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 ("SEC"). Readers should take these factors and risks 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.

### **Financial Information About Industry Segments**

The information required by Item 101(b) of Regulation S-K relating to financial information about industry segments is contained in the Notes to Consolidated Financial Statements in the Company's annual report to security holders for the fiscal year ended April 30, 2003, and is hereby incorporated by reference.

### **Number of Employees**

The Company itself has no employees. Its direct and indirect wholly owned subsidiaries have approximately 11,200 regular full-time employees. The highest number of persons employed by the subsidiaries during the fiscal year ended April 30, 2003, including seasonal employees, was approximately 118,300.

### **Description of Business**

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

Generally, This operating segment provides to the general public in the United States income tax return preparation services, electronic filing services and other services related to income tax return preparation, participates in refund anticipation loan products offered by a third-party lending institution (although the Company did not participate in such products originated during the fiscal year 2003 tax season), offers a wide range of online tax services including online tax preparation and electronic filing through the web site at [www.hrblock.com](http://www.hrblock.com), and sells to the general public tax return preparation software and other personal productivity computer software. Multi-channel offerings of tax products and services (retail, software, online and combinations of such channels) allow the segment to serve consumers in the manner they choose to be served and to introduce more consumers to the H&R Block brand and the variety of H&R Block services. Additionally, U.S. Tax Operations is also focused on the provision of basic tax and financial advice in association with the provision of tax services to achieve H&R Block's mission and vision. Revenues from

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U.S. Tax Operations constituted approximately 49%, 55% and 54% of the Company's consolidated revenues for fiscal years 2003, 2002 and 2001 respectively.

**Tax Services.** The income tax return preparation and related services business is the original core business of the Company. These services are provided to the public in the United States through a system of offices operated by tax subsidiaries of H&R Block Services, Inc. (collectively referred to as "Tax Services") or by others to whom Tax Services has granted franchises. Tax Services and its franchisees (collectively referred to herein as "H&R Block") provide to the general public income tax return preparation services, electronic filing services, the Peace of Mind program (described below) and other services relating to income tax return preparation. For U.S. returns, H&R Block offers a refund anticipation loan service and an electronic refund advance loan service in conjunction with its electronic filing service. H&R Block also markets its knowledge of how to prepare income tax returns through its income tax training schools.

**Taxpayers Served.** H&R Block served approximately 16,517,000 taxpayers in the United States during fiscal year 2003, compared to 17,148,000 taxpayers served in fiscal year 2002 and 16,883,000 taxpayers served in fiscal year 2001. "Taxpayers served" includes taxpayers for whom H&R Block prepared income tax returns (both online through Professional Tax Service and in H&R Block offices) as well as taxpayers for whom H&R Block provided only electronic filing services.

**Tax Return Preparation.** During fiscal year 2003, H&R Block offices in the United States prepared approximately 16,331,000 individual income tax returns, compared to the preparation of 16,899,000 returns in fiscal year 2002 and 16,442,000 returns in fiscal year 2001. These returns constituted 13.5% of an Internal Revenue Service ("IRS") estimate of total individual income tax returns filed as of April 30, 2003, compared to 14.3% in fiscal year 2002. The following table shows the approximate number of income tax returns prepared at H&R Block offices in the United States during the last five fiscal years:

	Fiscal Year Ended April 30 (in thousands)				
	1999	2000	2001	2002	2003
Returns Prepared	15,761	16,276	16,442	16,899	16,331

During the tax season, most H&R Block offices are open from 9:00 a.m. to 9:00 p.m. weekdays and from 9:00 a.m. to 5:00 p.m. Saturdays and Sundays. Office hours are often extended during peak periods. Most tax preparation business is transacted on a cash basis. The procedures of Tax Services have been developed so that a tax return is prepared on a computer in the presence of the client, in most instances in less than one hour, based on information furnished by the client. Pursuant to the one-stop service offered at company-owned offices, the return is reviewed for accuracy and presented to the client for signature and filing during his or her initial visit to the office.

**Electronic Filing.** Electronic filing reduces the amount of time required for a taxpayer to receive a federal tax refund and provides assurance to the client the

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return, as filed with the IRS, is mathematically accurate. If the client desires, he or she may have his or her refund deposited by the Treasury Department directly into his or her account at a financial institution designated by the client. In fiscal year 2003, H&R Block offered a service to transmit state income tax returns electronically to state tax authorities in 43 states and the District of Columbia and plans to continue to expand this program as more states make this filing alternative available to their taxpayers.

An eligible electronic filing client may also apply for a refund anticipation loan ("RAL") at an H&R Block office. Under the 2003 RAL program, through a contractual arrangement with Household Tax Masters, Inc., Tax Services' electronic filing clients who met certain eligibility criteria were offered the opportunity to apply for loans from Imperial Capital Bank ("Imperial") in amounts based upon the clients' anticipated federal income tax refunds. Income tax return information is simultaneously transmitted by H&R Block to the IRS and the lending bank. Within a few days after the date of filing, a check in the amount of the loan, less the bank's transaction fee and H&R Block's tax return preparation fee (and, where applicable, a systems administration fee or electronic filing fee, and/or other fees for client-selected services), is received by the RAL client. During the 2003 tax season, certain qualifying Tax Services' electronic filing clients were eligible to receive their RAL proceeds, less applicable fees, in approximately one hour after electronic filing under a product known as Instant Money. In order for a RAL to be repaid, the IRS directly deposits the participating client's actual federal income tax refund into a designated account at the lending bank.

H&R Block also offers an electronic refund service called "Refund Anticipation Check" pursuant to which an eligible electronic filing service client's income tax refund is directly deposited into an account at the lending bank (Imperial) within approximately three weeks after the tax return is electronically filed. A check is thereafter issued to the taxpayer in the amount of the refund, less the bank's transaction fee and H&R Block's tax return preparation fee (and, where applicable, a systems administration fee or electronic filing fee, and/or other fees for client-selected services).

H&R Block filed approximately 14,324,000 U.S. tax returns electronically in fiscal year 2003 compared to 14,279,000 in fiscal year 2002 and 13,327,000 in fiscal year 2001. Approximately 4,648,000 RALs were processed and funded in fiscal year 2003 by H&R Block, compared to 4,672,000 in fiscal year 2002 and 4,016,000 in fiscal year 2001. Approximately 1,636,000 Refund Anticipation Checks were processed and funded in fiscal year 2003 by H&R Block, compared to 1,745,000 in fiscal year 2002 and 1,932,000 in fiscal year 2001.

*Block Advantage.* When clients have tax returns prepared by a tax professional, they also receive a Block Advantage report and consultation, which provide free, personalized tax and financial-related information and guidance they can use throughout the year. A summary of the client's tax return is provided in the report. The service helps clients identify opportunities to potentially minimize tax liability, maximize tax refunds, take advantage of new savings created by tax law changes, and, in some cases, take advantage of government and other programs which may be helpful to the client's financial situation.

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

*H&R Block Guarantee and "Peace of Mind" Program.* If an H&R Block tax professional makes an error in the preparation of a client's tax return that results in the assessment of any interest or penalties on additional taxes due, while H&R Block does not assume the liability for the additional taxes (except under its Peace of Mind program described below), it guarantees payment of the interest and penalties under its standard guarantee.

Under the Peace of Mind program, in addition to H&R Block's standard guarantee described above, H&R Block will pay additional taxes owed by the client (for which liability would not ordinarily accrue) resulting from errors attributable to an H&R Block tax professional. The Peace of Mind program has a per client cumulative limit of \$5,000 in additional taxes assessed with respect to the federal, state and local tax returns prepared by H&R Block for the taxable year covered by the program. There is an additional charge for the Peace of Mind program, except at H&R Block Premium offices.

*Easy Pay Program.* Through Imperial Capital Bank and the assistance of H&R Block tax professionals, clients may obtain an Easy Pay loan to pay a balance due shown on a tax return prepared at H&R Block. The service is designed to provide clients additional time needed to obtain the funds necessary to pay their taxes. The loan amount can include the tax return preparation fees and any other fees for client-related services. H&R Block charges a fee for this service. The lender does not charge interest on the loan if paid within 90 days during the same tax year. If the loan is not paid in full by the end of the 90 days, interest accrues from the due date of the tax return. H&R Block processed nearly 38,000 Easy Pay loans in fiscal year 2003.

*Income Tax Courses.* H&R Block offers income tax return preparation courses to the public, which teach taxpayers how to prepare their own income tax returns, as well as to provide H&R Block with a source of trained tax professionals. During the 2003 fiscal year, 254,000 students enrolled in H&R Block's basic and advanced income tax courses in the United States, compared to 202,800 students during fiscal year 2002 and 165,600 students during fiscal year 2001.

*Double Check Challenge.* During the 2003 tax season, H&R Block promoted its Double Check Challenge, encouraging taxpayers to bring previously filed returns, which were not prepared by the Company, to H&R Block for review at no charge. An H&R Block tax professional reviews the returns to determine whether the taxpayer



should file an amended return for a tax refund which otherwise would have been lost due to overlooked credits or deductions, or other reasons.

*Refund Rewards Program.* H&R Block again offered its Refund Rewards program in 2003. The Refund Rewards booklet contains coupons for up to \$4,000 in savings from the program's participating merchants, and is distributed free of charge to clients at participating H&R Block offices. Clients can also enroll in the program at the Refund Rewards web site at [www.refundrewards.com](http://www.refundrewards.com).

*Employer Solutions.* Under an expanded H&R Block Employer Solutions program for fiscal year 2003, employers throughout the United States were able to add H&R Block income tax services to their employee benefits packages and H&R Block was able to attract new, targeted clients. The program features tax products and services to assist a company's employees with preparing and filing tax returns or tax advice.

*Owned and Franchised Offices.* Most H&R Block offices are similar in appearance and usually contain the same type of furniture and equipment, in accordance with the specifications of Tax Services. Freestanding offices are generally located in business and shopping centers of large metropolitan areas and in the central business areas of smaller communities. All offices are open during the tax season. During the balance of the year, only a limited number of offices are open, but H&R Block personnel are also available by telephone to provide service to clients throughout the entire year.

In addition to its regular offices, H&R Block offers tax return preparation services at H&R Block Premium offices in the United States. Appealing to taxpayers with more complex returns, H&R Block Premium stresses the convenience of appointments, year-round tax service from the same tax professional and private office interviews. The number of H&R Block Premium offices in fiscal year 2003 was 427, compared to 446 in fiscal year 2002 and 484 in fiscal year 2001. In fiscal year 2003, the number of H&R Block Premium clients was 504,000 compared to 559,000 for each of fiscal years 2002 and 2001.

In fiscal year 2003, H&R Block also operated 754 offices in department stores in the United States, including 739 offices in Sears stores operated as "H&R Block at Sears." During the 2003 tax season, the Sears' facilities constituted approximately 7.9% percent of the tax office locations of H&R Block. Tax Services is a party to a license agreement with Sears relating to Tax Service's operation in Sears' locations throughout the United States. Such license agreement expires on December 31, 2004, subject to termination rights of both parties for a limited period of time after each tax season. Tax Services believes its relations with Sears to be excellent and both parties to the license arrangement view the operations thereunder to date as satisfactory.

On April 15, 2003, there were 9,301 H&R Block offices in operation in the United States compared to 9,015 offices in operation on April 15, 2002 and 9,072 offices in operation on April 16, 2001. Of the 9,301 offices, 5,279 were owned and operated by Tax Services (compared to 5,017 in fiscal year 2002 and 5,060 in fiscal year 2001) and 4,022 were owned and operated by independent franchisees (compared to 3,998 in fiscal year 2002 and 4,012 in fiscal year 2001). Of such

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franchised offices in fiscal year 2003, 2,705 were operated by franchisees of Tax Services (described below), 828 were operated by major franchisees (described below) and 489 were operated by franchisees of major franchisees.

The Company and its subsidiaries have principally granted two types of franchises – franchises (formerly called “satellite” franchises) and major franchises. Major franchisees entered into agreements with the Company (primarily in the Company’s early years) covering larger cities and counties and providing for the payment of franchise royalties based upon a percentage of gross revenues of their offices. Under the agreements, the Company granted to each franchisee the right to the use of the name “H&R Block” and provided a Policy and Procedure Manual and other supervisory services. Tax Services offers to sell furniture, signs, advertising materials, office equipment and supplies to major franchisees. Each major franchisee selects and trains the employees for its office or offices. Since March 1993, HRB Royalty, Inc., an indirect subsidiary of the Company, has been the franchisor under the major franchise agreements.

Franchises have been granted by Tax Services in smaller localities. A franchisee receives from Tax Services signs, designated equipment, specialized forms, local advertising, initial training, and supervisory services and, consequently, pays Tax Services a higher percentage of his or her gross tax return preparation and related service revenues as a franchise royalty than do major franchisees. Many of the franchises of Tax Services are located in cities with populations of 15,000 or less. Some major franchisees also grant franchises to sub-franchisees in their respective areas.

It has always been the policy of Tax Services to grant tax return preparation franchises to qualified persons without an initial franchise fee; however, the policy of Tax Services is to require a deposit to secure compliance with franchise contracts.

From time to time, Tax Services has acquired the operations of existing franchisees and other tax return preparation businesses, and it will continue to do so if future conditions warrant such acquisitions and satisfactory terms can be negotiated. In fiscal year 2003, Tax Services acquired three franchise offices.

Consistent with the ruling by the Circuit Court of Jackson County, Missouri, in *Armstrong Business Services, Inc., et al. v. H&R Block, Inc., et al.* (See “Franchise Litigation” in Item 3, “Legal Proceedings,” below), that HRB Royalty, Inc. could elect not to renew the major franchise agreements when the current five-year renewal periods end (such ruling being upheld on appeal during fiscal year 2003), HRB Royalty, Inc. placed most of the major franchisees on notice in 2000 that it would not consent to the renewal of their respective major franchise agreements as of the expiration of the current renewal terms. Some of the major franchise agreements terminated on July 1, 2003, others will terminate in September 2003 and still others will terminate in fiscal year 2005. Pursuant to the terms of the major franchise agreements, HRB Royalty, Inc. must pay the major franchisee a “fair and equitable price” for the franchise business upon termination and such price shall be no less than 80% of the franchisee’s revenues for the most recent 12-month period ending April 30, plus the value of equipment and supplies, and certain off-season expenses. HRB Royalty, Inc. may acquire the majority of these businesses during the next several fiscal years, although there is no certainty

all of these businesses ultimately will be acquired or of the timing or ultimate cost of such potential acquisitions due to the related litigation.

E-Commerce Initiatives. The Company's subsidiaries offer a wide range of online services, including online tax preparation, electronic filing of tax returns, mortgage products and brokerage services, through their web site at [www.hrblock.com](http://www.hrblock.com). The web site is organized into three main areas: Taxes, Mortgages and Investments.

In the Taxes area, Block Financial Corporation ("BFC") offers a comprehensive range of tax tools, from tax advice to complete professional tax return preparation and electronic filing. The web site provides users with the ability to prepare their income tax returns online using the Online Tax Program, receive tax tips and tax-related news, review tax planning guides and workbooks and use withholding and refund calculators for tax planning. The Online Tax Program, designed for the do-it-yourself taxpayer, enables such taxpayers with internet access to input their income tax return information securely online in response to a step-by-step interview, and have the program perform all the calculations and complete the appropriate IRS forms. The taxpayer then reviews the return and electronically files the return with the IRS. The fees charged in 2003 for the online preparation and electronic filing of the federal return was \$19.95 before April 1 and \$29.95 on or after April 1. Users could also prepare one state return online for an additional \$9.95.

During the 2003 tax season, BFC participated in the newly formed Free Filing Alliance created by industry participants and the IRS. The Alliance allows qualified lower income tax return filers to obtain online federal tax return preparation and electronic filing services at no charge.

In addition to the Online Tax Program, several other online tax products and services are offered, including Professional Tax Service and Ask a Tax Advisor. A taxpayer choosing Professional Tax Service can provide tax information online and have an H&R Block tax professional prepare and deliver a completed tax return to the taxpayer. The tax professional will contact the taxpayer, if necessary, to complete the interview and address any specific concerns. The \$79.95 base fee for this service in 2003 covered the preparation and electronic filing of the taxpayer's federal income tax return. The Ask a Tax Advisor service allows a taxpayer to obtain customized answers to individual tax questions from an H&R Block tax professional. Ask a Tax Advisor is available via e-mail, live chat, or telephone. A charge of \$19.95 per question was assessed to the taxpayer in fiscal year 2003.

The Taxes area also offers a program called Electronic Refund Advance ("ERA"), a loan product which allows a user to have a refund anticipation loan in an amount up to \$5,000 deposited directly into his or her bank account, usually within two days after the IRS accepts the taxpayer's electronically filed return. ERA is a loan and the lending institution, Imperial, charged a fee ranging from \$29.95 to \$89.95 for each transaction during the 2003 tax season. Household Tax Masters, Inc., servicer of the ERA, paid BFC a license fee from \$7 to \$9 for each approved ERA to compensate BFC for the sublicense of patent rights, the license of trademarks and certain expenses incurred in connection with the making of ERAs.

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The Mortgages area enables users to obtain information about loan products offered by H&R Block Mortgage Corporation, find an H&R Block Mortgage loan specialist, use interactive calculators and tools to estimate the tax implications and benefits of home ownership, refinancing or debt consolidation, determine the best loan type for a borrower's situation, and pre-qualify for a home purchase loan or refinancing.

The Investments area provides online investment services through H&R Block Financial Advisors, Inc. ("HRBFA"), a registered securities broker-dealer. Users may open a variety of accounts, obtain research, create investment plans, execute trades in a variety of securities including stocks, fixed-income products (including bonds, certificates of deposit, and unit investment trusts), and a variety of mutual funds, as well as view the status of their account online. See "Integrated Online Services" under "Investment Services," below.

Software Products. BFC develops and markets the income tax preparation software, TaxCut® from H&R Block, H&R Block DeductionPro™ and markets Kiplinger's Home and Business Attorney and Kiplinger's WILLPower<sup>SM</sup> software products. In 2003, the TaxCut from H&R Block Standard Federal Filing Edition offered a step-by-step tax preparation interview, financial data imports from money management software and other tax preparation software, calculations, completion of the appropriate tax forms, checking for errors, electronic filing (for an additional charge), and a financial planning tool. The TaxCut from H&R Block Deluxe Federal Filing Edition offered in 2003 the same features as the Standard Edition, except electronic filing is available free after a mail-in rebate. It also offered video tax advice from H&R Block and Kiplinger experts, access to IRS publications, Kiplinger Publications' Practical Guide to Your Money, the H&R Block Home Mortgage Advisor and the H&R Block IRA Advisor. The TaxCut from H&R Block Platinum Federal Filing Edition offered in 2003 the following features beyond those offered by the Deluxe Edition: free preparation of one state tax return through a software download or rebate on state tax software purchased at a store, free Kiplinger's Home & Business Attorney or Kiplinger's WILLPower through a limited-time coupon redemption, Capital Gains Assistant, Stock Options Advisor, Business Expense Assistant, Rental Property Assistant, Depreciation Assistant, Portfolio Manager powered by Gainskeeper®, and exclusive customer technical support.

H&R Block DeductionPro helps taxpayers with charitable deductions, providing thousands of valuations for hundreds of household items. It provides a donation report, H&R Block's Guide to Charitable Donations and Tax Planning, access to IRS publications, a donation planner and the ability to import data directly to TaxCut software.

Kiplinger's Home & Business Attorney guides the user through the process of creating a variety of personalized contracts and other legal documents. It provides video explanations and onscreen advice by an attorney, a four-volume legal library, pop-up legal definitions, keyword search and a personal information storage feature. Kiplinger's WILLPower helps the user draft and edit state-specific wills, trusts, living trusts, living wills, powers of attorney, stock powers and other documents. It also includes a memorial planner and executive checklist. Kiplinger's Home & Business Attorney and WILLPower are not intended to be a substitute for the advice of an

attorney and users are encouraged to speak with an attorney before using documents and to consult an attorney before starting any negotiations with others.

Refund Anticipation Loan Participations and 2003 Tax Season Waiver. Since July 1996, BFC has been a party to agreements with Household Tax Masters, Inc. ("Household") and others to participate in RALs provided by a lending bank to H&R Block tax clients. See "Electronic Filing" under "Tax Services" above for a discussion of RALs. The 1996 agreement was amended and restated in January 2003 and again in June 2003. In the 1996 agreement, BFC agreed to purchase an initial 40% participation interest in such RALs, which interest would be increased to nearly 50% in specified circumstances. Beginning in fiscal year 1999, the participation interest was increased to 49.9% in RALs obtained through company-owned offices, and BFC participated in 25% of RALs obtained through major franchise offices. BFC's purchases of the participation interests are financed through short-term borrowings. BFC bears all of the risks associated with its interests in the RALs. Revenue from participations is calculated as the rate of participation multiplied by a fee paid by the borrower to the lending bank. BFC's RAL participation revenue was approximately \$160.0 million in fiscal year 2002 and \$133.7 million in fiscal year 2001.

In January 2003, BFC and H&R Block Services, Inc. entered into an agreement with Household, the servicer of the RALs, whereby BFC waived its right to purchase any participation interests in RALS and H&R Block Services, Inc. waived its right to receive license fees related to RALs during the period January 1 through April 30, 2003. In consideration for waiving such rights, BFC and H&R Block Services, Inc. received a series of payments from Household, subject to certain adjustments based on delinquency rates for the 2003 tax season. Initial payments received totaling \$133.0 million were recognized as revenue over the waiver period. Receipt of any additional payment based on the adjustments, or any adjustment payment to be made to Household based on such adjustments, will occur in January 2004. The waiver agreement covered only the 2003 tax season and the amended and restated agreement pertaining to participation in RALs is scheduled to continue through 2006.

Seasonality of Business. Because most of the clients of Tax Services file their tax returns during the period from January through April of each year, substantially all of Tax Services' revenues from income tax return preparation, related services and franchise royalties are received during this period. As a result, Tax Services generally operates at a loss through the first eight or nine months of its fiscal year. Historically, such losses primarily reflect payroll of year-round personnel, training of tax professionals, rental and furnishing of tax offices, and other costs and expenses relating to preparation for the following tax season.

BFC's income tax return preparation software, online tax service and RAL participation businesses are also seasonal, with the substantial portion of the revenues from these businesses generated during the tax season.

Service Marks and Trademarks. HRB Royalty, Inc., a Delaware corporation, claims ownership of the following service marks and trademark registered on the principal register of the United States Patent and Trademark Office:

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Alguien En Quien Confiar  
Block Mortgage  
Executive (when used in connection with the preparation of income tax returns for others)  
H&R Block in Two Distinct Designs  
H&R Block in a Third Distinct Design (4)  
H&R Block Premium  
H&R Block Rapid Refund and Design  
Rapid Refund H&R Block and Design  
Someone You Can Count On  
The Income Tax People

In addition, HRB Royalty, Inc., claims ownership of the following unregistered service marks and trademarks:

America's Largest Tax Service  
Double Check Challenge  
H&R Block DeductionPro  
H&R Block Just Plain Smart and Design (4)  
Just Plain Smart (5)  
H&R Block Small Business Resources  
Nation's Largest Tax Service  
Refund Rewards  
Smart Solutions  
We know. Do you?

Tax Services and other subsidiaries of the Company have licenses to use the trade names, service marks and trademarks of HRB Royalty, Inc., in the conduct of their businesses.

BFC claims ownership of the following services marks and trademarks registered on the principal register of the United States Patent and Trademark Office:

Audit Buster  
Conductor and Baton Design Conductor  
Conductor and Hand-Held Baton Design  
Fast Lane  
Names&Dates  
Net Wealth and Design  
Netwealth  
Small Business Attorney  
Tax Cut  
Tax Cut and Design  
TaxCut  
The Easy Way to Financial Success  
The Fastest and Easiest Way to Do Your Taxes  
Web  
Webbank  
Webcard  
Webpay

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Willpower  
Your Complete Personal Legal Resource

BFC also claims ownership of the following unregistered service marks and trademarks:

Home Legal Advisor  
Netguard  
Will Power

BFC also claims ownership of the patent "SYSTEM FOR ON-LINE FINANCIAL SERVICES USING DISTRIBUTED OBJECTS" registered as Patent No. 5,706,442 on January 6, 1998, on the principal register of the United States Patent and Trademark Office.

In connection with BFC's sale of its credit card portfolio in January 1999, it granted to Provident National Bank non-exclusive, non-transferable and royalty-free licenses to use the mark "Conductor and Baton Design" for up to two years and the patent "SYSTEM FOR ON-LINE FINANCIAL SERVICES USING DISTRIBUTED OBJECTS" for a period of ten years.

**Competitive Conditions.** The tax return preparation and electronic filing businesses are highly competitive. There are a substantial number of tax return preparation firms and accounting firms offering tax return preparation services. Many tax return preparation firms and many firms not otherwise in the tax return preparation business are involved in providing electronic filing and refund anticipation loan services to the public. Commercial tax return preparers and electronic filers are highly competitive with regard to price, service and reputation for quality. Tax Services believes, in terms of the number of offices and tax returns prepared, it is the largest tax return preparation firm in the United States. Tax Services also believes, in terms of the number of offices and tax returns electronically filed in fiscal year 2003, it is the largest provider of electronic filing services in the United States.

The software and e-commerce businesses are highly competitive and consist of a large number of companies. In the software industry, Intuit, Inc. and Microsoft are dominant suppliers of personal financial software. Intuit, Inc. is also H&R Block's primary competitor in the online tax preparation market. BFC expects increased competition in this area as more competitors enter the online market or existing providers of online tax preparation services consolidate.

**Government Regulation.** The subsidiaries in the U.S. Tax Operations segment seek to determine the applicability of all federal, state, county, municipal, other local and self-regulatory organization statutes, ordinances, rules and regulations (collectively, "Laws") and comply with such Laws applicable to their activities. From time to time in the ordinary course of business, such subsidiaries receive inquiries from governmental and self-regulatory agencies regarding the applicability of Laws to the products and services offered by them. In response to such inquiries, such subsidiaries have agreed to comply with such Laws, convinced the authorities such Laws were not applicable or 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 the past resolution of such inquiries and its ongoing compliance with Laws have not had a material adverse effect on the operations of the subsidiaries in the U.S. Tax Operations segment or the consolidated financial statements of the Company and its subsidiaries. The Company cannot predict what effect the enactment of 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 reporting segments, any particular subsidiary, or the consolidated financial statements of the Company and its subsidiaries.

Several states have enacted, or have considered, legislation regulating commercial tax return preparers. Primary efforts toward the regulation of such preparers have historically been made at the federal level. Federal legislation requires income tax return preparers to, among other things, set forth their signatures and identification numbers on all tax returns prepared by them, and retain for three years all tax returns prepared. Federal laws also subject income tax return preparers to accuracy-related penalties in connection with the preparation of income tax returns. Preparers may be enjoined from further acting as income tax return preparers if the preparers continuously and repeatedly engage in specified misconduct. With certain exceptions, the Internal Revenue Code also prohibits the use or disclosure by income tax return preparers of certain income tax return information without the prior written consent of the taxpayer. In addition, the Gramm-Leach-Bliley Act and Federal Trade Commission regulations adopted thereunder require income tax preparers to adopt and disclose consumer privacy policies, and provide consumers a reasonable opportunity to "opt out" of having personal information disclosed to unaffiliated third parties for marketing purposes. Some states have adopted or proposed more strict "opt-in" requirements in connection with use or disclosure of consumer information.

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

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



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

Many states have statutes requiring the licensing of persons offering contracts of insurance. Tax Services has received from certain state insurance regulators inquiries about its Peace of Mind guarantee program and the applicability of the state insurance statutes. In those states where the inquiries are closed, the regulator's affirmed the position of Tax Services that Peace of Mind guarantee is not a contract of insurance and is therefore not subject to state insurance licensing laws. In the few states where inquiries are pending, the Company believes there are no insurance laws under which the Peace of Mind guarantee constitutes a contract of insurance. There can be no assurances, however, that the product, or other similar products we may offer in the future, could be subject to scrutiny as potential insurance products, and asserted and ultimately held to be subject to various insurance laws and regulations.

Many of H&R Block's income tax courses are regulated and licensed in select states. Failure to obtain a tax school license could affect the Company's revenues and limit its ability to develop interest in tax preparation as a career or obtain qualified tax professionals.

The Company believes the federal, state and local laws and legislation regulating electronic filing, RALs and the facilitation of refund anticipation loans, loan brokers, credit services, credit repair services, insurance products, and proprietary schools have not, and will not in the future have a material adverse effect on the operations of H&R Block. However, the Company cannot predict what the effect may be of the enactment of new statutes or the adoption of new regulations pertaining to these matters.

The repayment of RALs generally depends on IRS direct deposit procedures. The IRS may from time to time change its direct deposit procedures or may determine not to make direct deposits of all or portions of a borrower's federal income tax refund. The failure of the IRS to make direct deposits of refunds may impair the lender's ability to collect a RAL and result in a loss to BFC in connection with its purchases of participation interests in RALs and a loss to Tax Services for tax preparation fees not collected. However, the Company believes federal policies,

procedures and practices relating to direct deposits by the IRS have not had and will not have a material adverse effect on the operations of BFC or Tax Services. However, the Company cannot predict what the effect may be of the enactment of new federal statutes or the adoption of new regulations, policies, procedures or practices relating to direct deposits.

As noted above under "Owned and Franchised Offices," many of the income tax return preparation offices operating in the United States under the name "H&R Block" are operated by franchisees. Certain aspects of the franchisor/franchisee relationship have been the subject of regulation by the Federal Trade Commission and by various states. The extent of such regulation varies, but relates primarily to disclosures to be made in connection with the grant of franchises and limitations on termination by the franchisor under the franchise agreement. To date, no such regulation has materially affected the business of the Company's subsidiaries. However, the Company cannot predict what the effect may be of the enactment of new statutes or adoption of new regulations pertaining to franchising.

From time to time, and especially in election years, the subjects of tax reform, tax simplification, the restructuring of the tax system, a flat tax, a consumption tax, a value-added tax or a national sales tax surface. While each flat tax proposal and most other tax simplification proposals have fallen short of adoption, such issues have received serious attention in recent years. Historically, changes in tax laws have increased H&R Block's business. The immediate result of tax law changes has usually been an increase in complexity. The transition from the current system to a new, untested system is likely to take a number of years and, under most serious tax reform proposals, Americans will still need to file federal and state tax returns. The Company believes clients will still come to H&R Block for convenience, accuracy and answers to tax questions. However, if enacted, the effect of tax reform or simplification legislation on the business of the Company's subsidiaries over time is uncertain, and such legislation could have a material adverse effect on the Company's business, financial position and results of operations.

### **Mortgage Operations**

Generally, Subsidiaries in the Mortgage Operations segment originate prime and non-prime mortgage loans, service non-prime loans, sell mortgage loans and securitize residual interests in the United States. Revenues from the Mortgage Operations segment constituted approximately 32%, 22% and 14% of the Company's consolidated revenues for fiscal years 2003, 2002 and 2001 respectively. Prime mortgages are those that may be offered through government sponsored loan agencies. Non-prime mortgages are those that may not be offered through government-sponsored loan agencies and typically involve borrowers with impaired credit and have substantial equity in the property which will be used to secure the loan. Wholesale mortgage originations are offered by Option One Mortgage Corporation ("Option One") and retail mortgage originations are offered by H&R Block Mortgage Corporation, a wholly owned subsidiary of Option One.

By the end of fiscal year 2003, Option One and H&R Block Mortgage Corporation had five loan origination centers in California, four loan origination centers in Florida, three loan origination centers in each of Illinois and Texas, two

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loan origination centers in each of Arizona, Georgia, New York, Ohio, Rhode Island and Virginia, one loan origination center in each of Colorado, Connecticut, Michigan, Nevada, New Hampshire, New Jersey, North Carolina, Pennsylvania, Washington and Wisconsin, 27 retail financial centers in 18 states and 16 mortgage-only branches in 13 states.

Option One Mortgage Corporation. Option One, based in Irvine, California, has a network of more than 24,000 mortgage brokers in 49 states. During fiscal 2003, Option One sold \$17.2 billion of mortgage loans, compared to \$11.4 billion sold in fiscal 2002 and \$6.0 billion in fiscal 2001.

*Loan Origination.* Option One originated \$13.7 billion in mortgage loans in fiscal year 2003, compared to \$9.5 billion in fiscal year 2002 and \$5.3 billion in fiscal year 2001. The average Option One loan during fiscal year 2003 had a \$146,100 principal balance (compared to \$127,400 in fiscal year 2002 and \$106,200 in fiscal year 2001), and was secured by a first lien on a single-family residence. Wholesale originations represented the substantial majority of Option One's total loan production. Wholesale loan originations involve a broker who assists the borrower in completing the loan application, the gathering of necessary information and identifying a lender which offers a loan product best suited to the borrower's financial needs. Brokers are free to submit an application to one or more non-prime lenders, such as Option One.

Each applicant completes an application, which includes information with respect to the applicant's liabilities, income, credit history, employment history and personal information. Option One requires a credit report on each applicant from a credit reporting company. The report typically contains information relating to such matters as credit history with local and national merchants and lenders, installment debt payments and any record of defaults, bankruptcies, repossessions or judgments. Mortgaged properties that are used to secure mortgage loans are appraised by qualified independent appraisers. Such appraisers inspect and appraise the subject property and verify such property is in acceptable condition. Following such appraisal, the appraiser prepares a report including a market value analysis based on recent sales of comparable homes in the area and, when deemed appropriate, replacement cost analysis based on the current cost of constructing a similar home. Upon receipt of an application from a broker, a credit report and appraisal report, Option One's branch office processes and underwrites the loan. Option One's underwriting guidelines require mortgage loans be underwritten in a standardized procedure that complies with federal and state laws and regulations. The guidelines are primarily intended to assess the value of the mortgaged property, evaluate the adequacy of such property as collateral for the mortgage loan, and assess the creditworthiness of the related borrower. Based upon this assessment, Option One advises the broker whether the loan application meets Option One's underwriting guidelines and product description by issuing a loan approval or denial, and in some cases, issues a "conditional approval," which requires the submission of additional information or clarification. The mortgage loans are generally underwritten with a view toward resale in the secondary market. Option One sells virtually all of its non-prime loan production through whole loan sales to third-party trusts as a part of its off-balance sheet arrangements described below.

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*Servicing.* As of the end of fiscal year 2003, Option One serviced 246,463 loans totaling more than \$31.3 billion, compared to 209,594 loans totaling \$23.8 billion in fiscal 2002 and approximately 173,900 loans totaling \$18.2 billion in fiscal 2001. The average servicing portfolio for fiscal year 2003 increased to \$27.7 billion, an increase of 39.4% over the average servicing portfolio of \$19.9 billion for fiscal year 2002. Mortgage servicing involves the processing of mortgage loan payments and associated fees 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 fifty 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 and prepayment penalties. Option One exclusively services non-prime mortgage loans. In addition to servicing loans originated by Option One and H&R Block Mortgage Corporation, Option One also services non-prime loans originated by other lenders. Further, when Option One originated loans are subsequently sold or securitized, as described below under "Financing, Sale and Securitization of Loans," Option One generally retains the right to service the loans. The resulting mortgage servicing rights are assets of Option One recorded at allocated carrying amounts based on relative fair values when the loans are sold. The fair values of mortgage servicing rights are determined based on the present value of estimated future cash flows related to servicing loans. Assumptions used in estimating the value of mortgage servicing rights include discount rates, prepayment speeds (including default), ancillary fee income and other economic factors. Prepayment rates are estimated using Option One's historical experience and third-party market sources. Variations in these assumptions could materially affect the carrying value of the mortgage servicing rights. Mortgage servicing rights are periodically reviewed for impairment by management. If actual prepayment rates prove to be higher than the estimate made by management, impairment of the mortgage servicing rights could occur.

*Financing, Sale and Securitization of Loans.* Substantially all non-prime mortgage loans originated by Option One are sold daily in whole loan sales to qualifying special purpose entities in the form of trusts ("Trusts"), with servicing rights retained. During fiscal year 2003, the Trusts purchased the loans from Option One utilizing three warehouse facilities arranged by Option One, with total commitments of \$4.0 billion. These facilities are subject to various Option One performance triggers, limits and financial covenants, including tangible net worth and leverage ratios. In addition, the three facilities each have cross-default provisions under which a default in one facility also triggers a default under each of the other facilities. One of the three bank commitments was renewed in December 2002, one was renewed in April 2003 and the third was extended for ninety days in July 2003. As a result of the whole loan sales to the Trusts, Option One 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 by the Trusts.

As directed by the trustees, the Trusts either sell the loans directly to third-party investors or pool the loans for a securitization, depending primarily on market conditions. For fiscal year 2003, the disposition of loans by the Trusts was 59% securitizations and 41% whole loan sales, compared to 89% securitizations and 11% whole loan sales in fiscal year 2002. If the Trusts choose to sell the loans, Option One receives cash for its receivable. If the Trusts pool the loans for a securitization, the

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Trusts transfer the loans and the right to receive all payments on the loans to a securitization trust and Option One transfers its receivable to the securitization trust. The securitization trust then issues bonds to third-party investors. The bonds are supported by the cash flows from the pooled loans. At the settlement of each securitization, Option One records the cash received and the estimated fair value of the interest in the mortgage loans retained from the securitization (the residual interests). Additionally, the receivable from the whole loan sale to the Trusts is reversed. The excess of the net cash received and the assets retained by Option One over the carrying value of the loans sold, less transaction costs, equals the net gain on the sale of mortgage loans by Option One.

In addition to retaining an interest in the loans in the form of a residual interest (including overcollateralization accounts and uncertificated interests), Option One usually assumes first risk of loss for credit losses in the loan pool. The residual interests represent the discounted estimated cash flows to be received by Option One in the future. As the cash flows from the underlying loans and market conditions change, the value of Option One's residual interests may also change, resulting in either additional unrealized gains or impairment of the residual interests.

Assumptions used in valuing residual interests include expected losses to be incurred on the portfolio of loans sold over the lives of the loans, estimated collections of prepayment penalty fees, and current and expected interest rate environment, including projected changes in future interest rates and the timing of such changes. Prepayment and loss assumptions used in estimating cash flows are based on evaluations of the actual experience of Option One's servicing portfolio, the characteristics of the applicable portfolio, and the current economic and interest rate environment and its expected impact. Estimated cash flows are discounted at an interest rate which the Company believes an unaffiliated third-party purchaser would require as a rate of return on a financial instrument with a similar risk profile. The estimated fair value of residual interests are evaluated quarterly by updating the actual and expected assumptions in the discounted cash flow models. The updates are based on current information and events and by estimating or validating with third-party experts, if necessary, what a market participant would use in determining the current fair value. Variations in the assumptions could materially affect the estimated fair values, which may require the Company to record impairments or unrealized gains, and could affect the amount of residual interest accretion recorded on a monthly basis.

To accelerate the cash flows from Option One's residual interests, it securitizes a majority of its residual interests in net interest margin ("NIM") transactions. The residual interests are transferred to a trust ("NIM Trust"), which then issues bonds to third-party investors. The NIM Trust is a qualifying special purpose entity. The bond proceeds are returned to Option One as payment for the residual interests. The bonds are secured by the pooled residual interests and are obligations of the NIM Trust. Option One retains a subordinated interest in the NIM Trust and receives cash for its residual interest, generally after the bonds issued to the third-party investors are paid in full.

At the settlement of each NIM transaction, Option One removes the carrying value of the residual interests sold from its consolidated balance sheet and records

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the cash received and the estimated fair value of the portion of the residual interests retained. The excess of the net cash received and assets retained over the carrying value of the residual interests sold, less transaction costs, equals the net gain or loss on the sale of residual interests by Option One.

Residual interests retained from NIM securitizations may also be bundled and sold in a subsequent transaction. In November 2002, Option One completed the sale of NIM residual interests and recorded a gain of \$130.9 million. There is no certainty Option One will sell NIM residuals in the future. The sale of NIM residuals decreases residual accretion income recognized in future periods.

H&R Block Mortgage Corporation. H&R Block Mortgage is a retail mortgage lender for prime, non-prime and government loans and is licensed to conduct business in 50 states. H&R Block Mortgage is an approved seller/servicer for Fannie Mae and Freddie Mac and is HUD authorized to originate and underwrite FHA and VA mortgage loans. In fiscal year 2003, H&R Block Mortgage originated retail mortgage loans from various sales channels, including 43 branch offices in 26 states, and five regional call centers located in Lake Forest, California, Burlington, Massachusetts, Philadelphia, Pennsylvania, Tampa, Florida, and Pleasanton, California. H&R Block Mortgage had 38 branch offices in 16 states in fiscal year 2002, in addition to the three regional call centers. During fiscal year 2003, almost 54% of H&R Block Mortgage's loans were made to clients of H&R Block affiliates.

H&R Block Mortgage originated \$2.9 billion in mortgage loans in fiscal year 2003, compared to \$2.0 billion in loans in fiscal year 2002 and \$1.2 billion in loans in fiscal year 2001. In fiscal year 2003, the firm originated \$1.7 billion in prime loans and \$1.2 billion in non-prime loans.

Prime loans are sold in whole loan sales, servicing released, to third-party buyers. H&R Block Mortgage maintains a strategic alliance with Countrywide Home Loans, Inc. ("Countrywide") to sell 90% of its qualifying prime mortgage loans to Countrywide. The majority of mortgage loans sold to Countrywide are underwritten through an automated system under which H&R Block Mortgage's representations and warranties relating to compliance with Countrywide's underwriting guidelines are assumed by Countrywide. This alliance allows H&R Block Mortgage to achieve improved execution due to price, efficiencies in delivery, and elimination of redundancies in operations. Non-prime mortgage loans are sold by H&R Block Mortgage to Option One.

Service Marks and Trademarks. Option One claims ownership of the following service marks and trademarks registered on the principal register of the United States Patent and Trademark Office:

AppOne  
Backpack  
CorOne and design  
High-way 1  
HouseKeeper  
No Sweat 95!  
Option One and Design

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Option One Mortgage Corporation  
PartnerPlus  
Start Here. Finish Here  
SumOne  
The Big 2

Option One also claims ownership of the following unregistered service marks and trademarks:

Borrower Credit Program  
Borrower Managed Rate Reduction  
Club One and design  
Credit Based Program With No BK Seasoning  
Credit Score Based Program  
Legacy (design)  
Legacy Latitude (design)  
Legacy Plus (design)  
On-Time Advantage and design  
Original Common Sense Non-Score Driven Program  
Right Now. Right On. Right Track!  
Right Track and design

**Competitive Conditions.** Both the prime and non-prime sectors of the residential mortgage loan market are highly competitive. The principal methods of competition are in service, quality and price. There are a substantial number of companies competing in the residential loan market, including mortgage banking companies, commercial banks, savings associations, credit unions and other financial institutions. There are also numerous companies competing in the business of servicing non-prime loans. No one firm is a dominant supplier of prime and non-prime mortgage loans or a dominant servicer of non-prime loans.

**Seasonality of Business.** Residential mortgage volume is subject to seasonal trends, with real estate sales being generally lower in the first quarter of the calendar year, peaking in the spring and summer seasons, and then declining again in November and December. Accordingly, the revenues of the Mortgage Operations reporting segment are generally higher in the peak months, but the seasonal trends do not have a material impact on overall results of the Company.

**Government Regulation.** The subsidiaries in the Mortgage Operations segment seek to determine the applicability of all Laws and comply with such Laws that apply to their activities. From time to time in the ordinary course of business, such subsidiaries receive inquiries from governmental and self-regulatory agencies regarding the applicability of Laws to the products and services offered by them. In response to such inquiries, such subsidiaries have agreed to comply with such Laws, convinced the authorities such Laws were not applicable or 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 the past resolution of such inquiries and its ongoing compliance with Laws have not had a material adverse effect on the operations of the mortgage subsidiaries or the consolidated financial statements of the Company and its subsidiaries. The Company

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cannot predict what effect the enactment of 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 reporting segments, any particular subsidiary, or the consolidated financial statements of the Company and its subsidiaries.

Applicable state laws generally regulate interest rates (other than first mortgage loans which are subject to a federal preemption of all state usury laws) and other charges, require certain disclosures and, unless an exemption is available, require licensing of the originators of certain mortgage loans. In addition, most states have other laws, public policies and general principles of equity relating to the protection of consumers, unfair and deceptive practices, and practices that may apply to the origination, servicing and collection of mortgage loans.

During fiscal years 2001, 2002 and 2003, there was a noticeable increase in state, county and municipal statutes, ordinances and regulations which prohibit or regulate so-called "Predatory Lending" practices. Predatory Lending statutes regulate "High-Cost Loans" which are defined separately by each state, county or municipal statute, regulation or ordinance, but generally include mortgage loans which have interest rates exceeding a specified margin over the Treasury Index for a comparable maturity, or exceed a designated percentage of points and fees. Statutes, ordinances and regulations that regulate High-Cost Loans generally prohibit mortgage lenders from engaging in certain defined practices, or require mortgage lenders to implement certain practices, in connection with any mortgage loans that fit within the definition of a High-Cost Loan. The Company believes that the subsidiaries in Mortgage Operations do not originate loans falling under the definition of High-Cost Loans under any law.

The mortgage subsidiaries of the Company have 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 federally chartered depository institutions, the federal preemption that federally chartered depository institutions enjoy. However, on September 25, 2002, the OTS released a new rule which reduced the scope of the Parity Act preemption and, as a result, the mortgage subsidiaries are no longer able to rely on the Parity Act to preempt state restrictions on prepayment penalties. The effective date of the new rule, originally January 1, 2003, was subsequently extended by the OTS until July 1, 2003 in response to concerns from interested parties about the burdens associated with compliance. The elimination of this federal preemption requires compliance with state restrictions on prepayment penalties. It is expected these restrictions will prohibit the mortgage subsidiaries from charging any prepayment penalties in six states and will restrict the amount or duration of prepayment penalties such subsidiaries may impose in an additional 11 states. This may place the Company's mortgage subsidiaries at a competitive disadvantage relative to financial institutions that will continue to enjoy federal preemption of such state restrictions. Such institutions will be able to 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 which are more attractive than the interest rate and loan fee structures the Company's mortgage subsidiaries are able to offer. It is estimated the net impact to



the Mortgage Operations segment will be a reduction in revenues of approximately \$29.0 million in fiscal year 2004 as a result of the elimination of prepayment penalties.

The mortgage loans purchased, originated and/or serviced by the Company's mortgage subsidiaries are also subject to federal laws and regulations, including, without limitation, the federal Truth-in-Lending Act, as amended, and Regulation Z promulgated thereunder, the Equal Credit Opportunity Act, as amended, and Regulation B promulgated thereunder, the Fair Credit Reporting Act, as amended, the federal Real Estate Settlement Procedures Act, as amended, and Regulation X promulgated thereunder, the Soldiers' and Sailors' Civil Relief Act of 1940, as amended, the Home Mortgage Disclosure Act and Regulation C promulgated thereunder, the federal Fair Housing Act, the Gramm-Leach-Bliley Act and regulations adopted thereunder, and certain other laws and regulations. Under environmental legislation and case law applicable in certain states, it is possible liability for environmental hazards in respect of real property may be imposed on a holder of a mortgage note secured by real property.

### **Business Services**

Generally, The Business Services operating segment, which is conducted primarily through RSM McGladrey, Inc. ("RSM"), a direct subsidiary of RSM McGladrey Business Services, Inc. ("RSMBS"), provides accounting, tax, consulting, payroll, employee benefits and capital market services to business clients, primarily mid-sized companies, and tax, financial planning, estate planning, wealth management and insurance services to individuals in the United States. RSM was formed in August 1999 to acquire substantially all of the non-attest assets of McGladrey & Pullen, LLP ("McGladrey"). Revenues from the Business Services segment constituted approximately 11%, 13% and 13% of the Company's consolidated revenues for fiscal years 2003, 2002 and 2001 respectively.

In addition to providing the aforementioned services to the public, RSM and certain other subsidiaries involved in the Business Services segment provide accounting, payroll, human resources, and other management and administrative services to McGladrey and certain other public accounting firms from which non-attest assets have been acquired. RSM receives a management fee from the public accounting firms, which continue to provide "attest" services, which constitute the practice of public accounting, which H&R Block and its subsidiaries, by regulation, generally cannot provide. See "Management and Administrative Services for McGladrey & Pullen, LLP," below.

RSM McGladrey, Inc. has more than 100 offices in 22 states and offers services in 18 of the top 25 U.S. markets. It provides tax, wealth management and business advice as well as consulting services and planning strategies to mid-sized businesses. RSM McGladrey Retirement Resources ("Retirement Resources") administers retirement plans for some 2,000 companies, mostly mid-sized. Retirement Resources helps clients design the best plan for their needs, and also provides investment advice, year-end compliance, tax reporting and consulting — all related to retirement plans. RSM is also linked with more than 80 independently owned CPA firms in the United States and Puerto Rico through the McGladrey Network. In

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addition, RSM is the U.S. member of RSM International, the sixth largest accounting and consulting organization in the world, with approximately 600 offices in 75 countries.

RSM EquiCo, Inc. is a global investment banking firm specializing in mergers, acquisitions and divestitures for private middle market businesses. It employs about 300 people, is headquartered in Costa Mesa, California, and operates offices in Chicago and London.

MyBenefitSource, Inc. ("MBS") performs a range of client human resources services, including payroll, tax filing, human resources data management, benefits brokerage, and employee eligibility tracking. It is headquartered in Atlanta, Georgia, and has about 120 associates there in addition to sales offices in six states across the country.

PDI Global, Inc. ("PDI") headquartered in Chicago, Illinois, provides marketing communications and visibility programs, tax and financial planning guides, and marketing and management consulting services to accountants, consultants, lawyers, banks, insurers, and other financial service providers.

Management and Administrative Services for McGladrey & Pullen, LLP. McGladrey's attest business (including audit, reviews and other engagements in which the firm issues written opinions evaluating client financial statements) remains in a partnership owned by the McGladrey partners and is, accordingly, an entity separate from RSM and not an affiliate of the Company.

On February 5, 2001, revised SEC auditor independence rules that apply to the accounting firm and its "associated entities" became effective. The SEC staff has advised McGladrey it considers the Company and all of its subsidiaries to be associated entities. Accordingly, any financial interest or business relationship of the Company with a client of McGladrey, which is subject to the SEC's auditor independence rules (an "SEC Audit Client"), will be regarded by the SEC staff as a financial interest or business relationship between McGladrey and the SEC Audit Client. Under the SEC's auditor independence rules, McGladrey and its partners are precluded from holding certain financial interests in and entering into certain business relationships with an SEC Audit Client.

In connection with the evaluation of the regulatory restrictions and environment, the Company and McGladrey have had discussions with the staff of the SEC regarding appropriate disclosure of the policy and procedures implemented by McGladrey, RSM and the Company to safeguard McGladrey's independence and integrity as an audit firm in compliance with applicable regulations and professional responsibilities.

The Company, RSM and McGladrey have enacted certain policies and controls to monitor and prevent violations by them of the SEC's auditor independence rules as interpreted by the SEC staff. These policies and controls include the following:

- The Company has informed the management of each of its business units of the SEC staff's interpretation that certain financial interests and business

relationships with McGladrey SEC Audit Clients are prohibited in as much as they would be deemed to impair McGladrey's independence as an auditor.

- McGladrey's Independence and Relationship Policies and the Code of Professional Conduct promulgated by the American Institute of Certified Public Accountants ("AICPA"), which address auditor independence issues, have been distributed to all of the Company's executive officers and directors.
- McGladrey's Prohibited Securities List, which lists securities of McGladrey's SEC Audit Clients, is distributed to certain officers of the Company and certain subsidiaries on a monthly basis so they can monitor compliance by the applicable business units.
- McGladrey informs the audit committee of each SEC Audit Client, in writing, of the SEC staff's interpretation regarding the attribution to McGladrey, for purposes of McGladrey's auditor independence of the financial interests and business relationships of the Company with SEC Audit Clients.
- McGladrey informs the audit committee of each SEC Audit Client of the SEC staff's interpretation that ownership of the Company's stock by such SEC Audit Client or ownership of more than 5% of the Company's stock by its officers or directors would affect McGladrey's independence as an auditor, and McGladrey obtains representations from each SEC Audit Client that it owns no shares of the Company.
- McGladrey has designated a partner responsible for independence matters who reports directly to its Executive Partner—Assurance Services. The partner responsible for independence matters monitors changes in independence standards promulgated by the AICPA, the Independence Standards Board ("ISB", which has been disbanded) and the SEC. This partner periodically recommends corresponding modifications to McGladrey's Independence and Relationship Policies, which become effective upon the approval of McGladrey's Board of Directors.
- RSM has agreed to comply and cause its employees to comply with the Independence and Relationship policies of McGladrey.
- Employees of RSM and employees of McGladrey are informed of changes to McGladrey's Independence and Relationship Policies and its Prohibited Securities List on a monthly basis via electronic bulletin boards.
- Employees of RSM and partners and employees of McGladrey periodically complete an Independence Compliance Questionnaire, which is reviewed and approved by McGladrey's National Office of Audit & Accounting. All exceptions are reviewed by and approved by McGladrey's partner responsible for independence matters, its Managing Partner and its Board of Directors.
- As mandated by its membership in the SEC Practice Section of the AICPA, McGladrey has implemented independence training programs and programs to test compliance with its Independence and Relationship Policies and the completeness and accuracy of Independence Compliance Questionnaires.
- McGladrey has established consultation procedures for the resolution of all identified exceptions to its policies and AICPA, ISB or SEC independence requirements. The Company and RSM have agreed to cooperate fully with McGladrey in the resolution of all exceptions and the implementation of any remedial actions, including disciplinary actions.

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While the Company and McGladrey believe their policies and controls in place regarding auditor independence are reasonable and adequate to address the matters involved, there can be no assurance (and the SEC staff has indicated it cannot provide any assurance) such policies and controls will positively ensure complete compliance by the Company, RSM and McGladrey with the SEC auditor independence rules as interpreted by the SEC staff. Any noncompliance by the Company, RSM or McGladrey with such rules may impair McGladrey's independence as an auditor of SEC Audit Clients and may adversely affect the ability of McGladrey to attract and retain such clients and perform audits of financial statements filed with the SEC.

Seasonality of Business. Revenues for this segment are seasonal in nature, with peak revenues occurring during January through April.

Service Marks and Trademarks. RSM claims ownership of the following service marks and trademarks registered on the principal register of the United States Patent and Trademark Office:

Business Recovery Planning System  
Business Continuity Planning System

RSM claims ownership of the following unregistered service marks and trademarks:

We Can See It.  
We See It.

FERS Business Services, Inc. ("FERS"), a wholly owned subsidiary of RSM, claims ownership of the following service marks and trademarks registered on the principal register of the United States Patent and Trademark Office:

Benelink  
Pension Resources

MBS claims ownership of the following unregistered service mark and trademark:

MyBenefitSource

PDI claims ownership of the following service marks and trademarks registered on the principal register of the United States Patent and Trademark Office:

CPEC  
PDI Practice Development Institute

PDI claims ownership of the following unregistered service mark and trademark:

Turning Your Firm's Potential Into Profit

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RSM EquiCo, Inc. claims ownership of the following service mark and trademark registered on the principal register of the United States Patent and Trademark Office:

EquiCo

Toback, Inc., a wholly owned subsidiary of RSM, claims ownership of the following service marks and trademarks registered on the principal register of the United States Patent and Trademark Office:

Solutions for Today. Strategies for Tomorrow.  
The Local Firm with a National Reputation

**Competitive Conditions.** The accounting and consulting business is highly competitive. The principal methods of competition are price, service and reputation for quality. There are a substantial number of accounting firms offering similar services at the international, national, regional and local levels.

**Government Regulation.** The subsidiaries in the Business Services segment seek to determine the applicability of all Laws and comply with such Laws applicable to their activities. From time to time in the ordinary course of business, such subsidiaries receive inquiries from governmental and self-regulatory agencies regarding the applicability of Laws to the products and services offered by them. In response to such inquiries, such subsidiaries have agreed to comply with such Laws, convinced the authorities such Laws were not applicable or 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 the past resolution of such inquiries and its ongoing compliance with Laws have not had a material adverse effect on the operations of the Business Services segment subsidiaries or the consolidated financial statements of the Company and its subsidiaries. The Company cannot predict what effect the enactment of 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 reporting segments, any particular subsidiary, or the consolidated financial statements of the Company and its subsidiaries.

Many of the same federal and state regulations relating to tax preparers and the information concerning tax reform discussed above in "Government Regulation" section of "U.S. Tax Operations" apply to the Business Services segment as well, except accountants are not subject to the same prohibition on the use or disclosure of certain income tax return information as the Tax Services tax professionals are. The accounting firms are also subject to state and federal regulations governing accountants, auditors and financial planners. During the past year, numerous legislative and regulatory proposals have been made relating to auditor independence and accounting oversight, among others. Some of these proposals, if adopted, could have an impact on RSM's operations. The Company believes current state and federal regulations and known legislative and regulatory proposals do not and will not have a material adverse effect on the operations of the Company and its subsidiaries, but it cannot predict what the effect of future legislation, regulations and proposals may be.

## Investment Services

Generally, The Investment Services operating segment provides brokerage services and investment planning primarily through H&R Block Financial Advisors, Inc. ("HRBFA"). Revenues from the Investment Services segment constituted approximately 5%, 8% and 16% of the Company's consolidated revenues for fiscal years 2003, 2002 and 2001 respectively. In December 1999, the Company acquired OLDE Financial Corporation ("OLDE Financial"), a Detroit-based financial services holding company that is the parent company of HRBFA.

HRBFA is a registered broker-dealer with the SEC and is a member of the New York Stock Exchange ("NYSE"), other national securities exchanges and the National Association of Securities Dealers, Inc. ("NASD"). HRBFA is one of the largest retail investment firms in the United States offering financial services to retail clients at low commission rates and fees through its network of financial advisors in HRBFA branch offices.

HRBFA, like other brokerage firms, continued to suffer from declining activity by retail investors during the Company's 2003 fiscal year and a corresponding decline in margin balances. Customer trades in fiscal year 2003 totaled approximately 1.2 million, compared to approximately 1.5 million trades in fiscal year 2002 and approximately 2.4 million trades in fiscal year 2001. Average trading volumes fell during fiscal year 2003 by approximately 21% as measured by average trades per day. There were an average of 4,853 trades per day in 2003, compared to averages of 6,123 per day in fiscal 2002 and 9,410 per day in fiscal 2001. Average revenue per trade increased during fiscal year 2003 to \$120.15 from \$106.42 in fiscal year 2002 and \$87.34 in fiscal year 2001. The Investment Services segment had 752,903 active accounts at April 30, 2003, compared to 695,355 active accounts at the end of fiscal year 2002 and 619,846 active accounts at year end in fiscal year 2001. Impacted by market performance, volatility and investor uncertainty, margin balances at HRBFA continued to fall from an average of \$2.4 billion for fiscal year 2001 and an average of \$1.0 billion for fiscal year 2002, to an average of \$577.0 million for fiscal year 2003.

HRBFA Financial Services Offerings. HRBFA is a full service securities broker-dealer providing a full range of financial services to its clients in the United States. Products and services offered to customers include equities, annuities, fixed income products, mutual funds, margin accounts, money market funds with sweep provisions for settlement of customer transactions, checking privileges, account access/review through the internet, online trading, fee-based accounts, IRAs, dividend reinvestment, option accounts, equity research and focus lists, model portfolios, asset allocation strategies, economic commentaries, and other investment tools and information.

During the 2003 tax season, H&R Block tax clients nationwide were again given the opportunity to open an Express IRA through HRBFA as a part of the tax return preparation process. Clients were able to fund an Express IRA by simply using all or part of their tax refund or by writing a personal check for the IRA amount. The Express IRA is invested in an FDIC-insured money market account through Reserve Management Corporation at an insured depository institution paying competitive money market interest rates. Clients funded approximately 126,000 Express IRAs during tax

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season 2003, approximately 130,000 Express IRAs in tax season 2002 and approximately 25,000 Express IRAs in tax season 2001. The Express IRA program was offered in only 14 states in fiscal 2001.

HRBFA offers to account holders a service making it possible for clients to transact all of their investment and banking activities from one convenient, flexible brokerage account with cash management features. The cash management features include no-minimum checking, unlimited check writing, a credit interest program that allows interest to be earned on balances over \$100, a variety of money market fund options, a VISA® Gold ATM/check card with a 1% cash rebate on card purchases and an airline miles program, one consolidated monthly statement and a year-end account summary. HRBFA also offers college savings products – called 529 Plans – through state-sponsored investment programs that allow clients to make tax-free withdrawals for qualified education expenses.

**Dealer Activities.** HRBFA acts as a dealer in fixed income markets including corporate and municipal bonds, various U.S. Government and U.S. Government Agency securities and certificates of deposit.

**Financial Advisors and Their Compensation.** Financial advisors receive compensation in a combination of plans in the form of commissions on HRBFA's revenues from customer transactions, a salary or draw against commissions, a percentage of quarterly fees charged to clients, and/or may have received additional compensation on customer transactions in securities recommended by HRBFA. 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 key initiatives is to build revenues through the addition of experienced financial advisors. During fiscal year 2003, 260 experienced advisors were added. Such additions were offset by attrition of primarily less experienced financial advisors. While revenues are expected to build as a result this initiative, revenues generated by newly recruited advisors have grown slower than anticipated given the current market environment. The retention and recruitment of experienced advisors will continue to be a key initiative in fiscal year 2004.

**Licensed Referral Tax Professional Program.** An initiative for fiscal year 2004 is the Licensed Referral Tax Professional ("LRTP") program. This program encourages a cooperative relationship between Investment Services and U.S. Tax Operations by helping tax preparers become licensed, teaming them with a financial advisor and providing a commission to the LRTP for business referred to Investment Services. As of April 30, 2003, there were 126 LRTPs who generated over \$2.0 million in new customer assets. The Company will continue to increase the number of LRTPs in the coming year.

**Integrated Online Services.** HRBFA provides an online investment center through the Company's web site located at [www.hrblock.com](http://www.hrblock.com). HRBFA provides online users the opportunity to open accounts, obtain research, create investment plans, buy and sell securities, and view the status of their accounts online. The online investment planning service gives HRBFA clients the ability to create and view a personal goal-oriented financial plan while simultaneously receiving advice by telephone from an H&R Block financial advisor who is viewing the same information.

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Clients can create, view or edit a financial plan for many different life-changing events such as retirement, college, a new child or the purchase of a house. After developing a plan, clients have the option to allow an advisor to execute the plan or they can do it themselves at the investment center. Through April 2003, approximately 182,000 accounts had been web enabled, compared to approximately 175,100 accounts through April 2002, and 96,000 accounts through April 2001. In April 2003, more than 11,250 securities transactions were effected online (compared to more than 15,600 securities transactions in April 2002, and 7,000 transactions in April 2001). Additional information regarding online operations is provided under the "E-Commerce Initiatives" in the "U.S. Tax Operations" section, above.

**Advertising and Marketing.** Advertising and marketing play a significant role in the expansion of HRBFA's client base as well as the introduction of new products and services. HRBFA may use a combination of media including newspapers, magazines, the yellow pages, television, and its internet home page to advertise and market its products and services. When an investor contacts HRBFA, the investor receives a package of information including an account application and a brochure containing information on the services and products offered by HRBFA. Additional detailed information is available upon request and can be tailored to match the client's investment preferences.

**Retail Branch Offices.** HRBFA is authorized to do business as a broker-dealer in all 50 states and the District of Columbia. At the end of fiscal year 2003, HRBFA operated approximately 600 offices, substantially unchanged from the prior year, as compared to approximately 525 offices at the end of fiscal year 2001. Some HRBFA offices offer, in addition to financial products and services, tax preparation and mortgage services, year-round to clients. HRBFA believes the existence of branch offices contributes to its growth and client satisfaction. The existence of a branch office generally results in an increase in unsolicited customer transactions in the geographic area near the office. Many clients prefer to conduct business in person in local offices rather than in distant offices or online. Clients may use branch offices to deliver checks and securities.

**Service Marks and Trademarks.** HRBFA claims ownership of the following service marks and trademarks registered on the principal register of the United States Patent and Trademark Office:

Chevron Design  
IRA United  
SmartTrade  
Smartvest  
Smartvestor  
Smartviews  
Smartwire

HRBFA also claims ownership of the following unregistered service marks and trademarks:

H&R Block Wealth Management Account  
H&R Block Financial Advisors Wealth Management Account



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

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

Competition in the online trading business has become similarly intense as recent expansion and customer acceptance of conducting financial transactions online has attracted new brokerage firms to the market. Price competition continues to intensify in online investing as traditional brokerage firms have entered the market and existing competitors have aggressively sought to gain market share.

**Seasonality of Business.** The Investment Services operating segment does not, as a whole, experience significant seasonal fluctuations. However, the securities business is cyclical and directly affected by national and world economic and political conditions, trends in business and finance and changes in the conditions of the securities markets in which HRBFA's clients trade.

**Government Regulation.** The subsidiaries in the Investment Services segment seek to determine the applicability of all Laws and comply with such Laws applicable to their activities. From time to time in the ordinary course of business, such subsidiaries receive inquiries from governmental and self-regulatory agencies regarding the applicability of Laws to the products and services offered by them. In response to such inquiries, such subsidiaries have agreed to comply with such Laws, convinced the authorities such Laws were not applicable or 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 the past resolution of such inquiries and its ongoing compliance with Laws have not had a material adverse effect on the operations of the subsidiaries in the Investment Services segment or the consolidated financial statements of the Company and its

subsidiaries. The Company cannot predict what effect the enactment of 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 reporting segments, any particular subsidiary, or the consolidated financial statements of the Company and its subsidiaries.

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

The Securities and Exchange Commission is the federal agency responsible for the administration of the federal securities laws. HRBFA is a registered broker-dealer. Much of the regulation of broker-dealers has been delegated by the SEC to self-regulatory organizations, principally the Municipal Securities Rulemaking Board, the NASD Regulation, Inc. and the New York Stock Exchange ("NYSE"), which has been designated as HRBFA's primary regulator. These self-regulatory organizations adopt rules (subject to approval by the SEC) which govern the industry and conduct periodic examinations of the operations of HRBFA's brokerage and clearing activities. Securities firms are also subject to regulation by state securities administrators in those states in which they conduct business.

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

HRBFA is required to maintain net capital as defined under Rule 15c3-1 under of the Securities Exchange Act of 1934 and complies with the alternative capital requirement permitted by Rule 15c3-1, which requires net capital be not less than the greater of \$1,000,000 or 2% of combined aggregate debit balances (primarily receivables from customers and other broker-dealers). In computing net capital, various deductions are made from net worth and qualifying subordinated indebtedness. These deductions include the book value of assets not readily convertible into cash and prescribed percentages of securities owned or sold short.

Any failure of HRBFA to maintain the required minimum net capital may subject HRBFA to suspension or revocation of registration or other limitations on the firm's activity by the SEC, and suspension or expulsion by the NYSE, NASD or other regulatory bodies, and ultimately could require the broker-dealer's liquidation. HRBFA could also be prohibited from paying dividends or redeeming stock. HRBFA

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would be prohibited from prepaying or making payments of principal on subordinated indebtedness if its net capital were to become less than the greater of 5% of combined aggregate debit balances or \$1,000,000. Under NYSE Rule 326, HRBFA is required to reduce its business if its net capital is less than 4% of aggregate debit balances and is prohibited from expanding business or redeeming subordinated indebtedness if its net capital is less than 5% of its aggregate debit balances. Net capital rules could limit HRBFA's ability to engage in new activities and expansion, and could restrict the Company's ability to withdraw capital from its brokerage subsidiaries. Such a restriction in turn, could limit the Company's ability to repay or reduce indebtedness (including subordinated debentures of the Company) and pay dividends. Further, a significant operating loss or an extraordinary charge against net capital could adversely affect HRBFA's ability to expand or maintain its current levels of business. At April 30, 2003, HRBFA's net capital of \$95.0 million, which was 17.3% of aggregate debit items, exceeded by \$84.0 million its minimum required net capital of \$11.0 million.

Although HRBFA has always exceeded its minimum net capital requirements, on May 30, 2003 OLDE Financial, its direct parent, contributed \$10.0 million of additional capital to HRBFA.

### **International Tax Operations**

Generally, This operating segment provides the preparation of tax returns, electronic filing and related services to the general public, principally in Canada, Australia and the United Kingdom. Tax preparation of U.S. tax returns and related services are offered by company-owned franchise offices in eight countries. The electronic filing of U.S. income tax returns is offered at offices located in Europe, and the electronic filing of Australian, Canadian and United Kingdom income tax returns is offered at H&R Block offices in Australia, Canada and the United Kingdom, respectively. The segment served 2.3 million taxpayers in each of fiscal years 2003 and 2002.

The returns prepared at 1,334 company-owned and franchised offices in countries outside of the United States in fiscal year 2003 constituted 12.4% of the total returns prepared by H&R Block in the fiscal year (compared to 11.9% in fiscal year 2002 and 12.2% in fiscal year 2001). There were 1,376 company-owned and franchised offices in countries outside the United States in fiscal year 2002.

Canadian Operations. H&R Block Canada, Inc. ("Block Canada") and its franchisees prepared approximately 1,722,000 Canadian regular and discounted returns filed with Revenue Canada in fiscal year 2003, compared to 1,721,000 in fiscal year 2002 and 1,752,000 in fiscal year 2001. Block Canada and its franchisees operated 910 offices in fiscal year 2003, as compared to 955 in fiscal year 2002 and 944 in fiscal year 2001. Of the 910 offices in Canada, 481 were owned and operated by Block Canada and 429 were owned and operated by franchisees. Block Canada operated 131 offices in department stores in Canada in fiscal year 2003, including 79 offices in Sears' facilities. In fiscal years 2002 and 2001, respectively, Block Canada operated 121 and 122 offices in department stores in Canada, including, respectively, 78 and 79 offices in Sears' facilities.

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Block Canada and its franchisees offer a refund discount ("CashBack") program to their customers in Canada. Canadian law specifies the procedures Block Canada must follow in conducting the program. In accordance with current Canadian regulations, if a customer's tax return indicates such customer is entitled to a tax refund, a check is issued by Block Canada to the client for an amount which is equal to the sum of (i) 85% of that portion of the anticipated refund which is less than or equal to \$300 (Canadian) and (ii) 95% of that portion of the refund in excess of \$300 (Canadian). The client assigns to Block Canada the full amount of the tax refund to be issued by Revenue Canada. The refund check is then sent by Revenue Canada directly to Block Canada, which then deposits the refund check into its bank account. In accordance with the law, the discount is deemed to include both the tax return preparation fee and the fee for tax refund discounting. This program is financed by short-term borrowings. In some parts of Canada, CashBack services are offered at offices identified as "H&R Block Express." The number of returns discounted under the CashBack program in fiscal year 2003 was approximately 531,000, compared to 525,000 in fiscal year 2002 and 532,000 in fiscal year 2001.

During fiscal year 2003, Block Canada contracted with Dr. Tax-Ufile CA, Inc. to provide online tax preparation services under the H&R Block brand to Canadian consumers. Users could print and mail their return, or download their return and file electronically.

**Australian Operations.** The number of returns prepared by H&R Block Limited, the Company's indirect subsidiary in Australia, and by franchisees of HRB Royalty, Inc. in Australia, was approximately 505,000 in fiscal year 2003, compared to 489,000 in fiscal year 2002 and 486,000 in fiscal year 2001. The number of offices operated by H&R Block Limited in Australia in fiscal years 2003 and 2002 was 362, compared to 350 offices operated in fiscal year 2001. Of the 362 offices, 263 were owned and operated by H&R Block Limited and 99 were franchised offices.

**United Kingdom Operations.** H&R Block Tax and Financial Services Limited, an indirect subsidiary of the Company, provides tax return preparation services in the United Kingdom. In fiscal years 2003 and 2002, six offices were operated, compared to 23 in fiscal year 2001. The UK business no longer operates under the name "The Tax Team."

**Seasonality of Business.** Revenues in this segment are seasonal in nature with peak revenues occurring during the applicable tax season (January through April in Canada; July through October in Australia; and August through March in the United Kingdom).

**Competitive Conditions.** The tax return preparation business is highly competitive, with a substantial number of firms offering tax preparation services. Commercial tax return preparers are highly competitive with regard to price, service and reputation for quality. Block Canada and H&R Block Limited believe they each operate the largest tax return preparation business in their respective countries. H&R Block Tax and Financial Services Limited believes it is one of the largest providers of tax preparation services in the United Kingdom.

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Government Regulation. The subsidiaries in the International Tax Operations segment seek to determine the applicability of all government and self-regulatory organization statutes, ordinances, rules and regulations in the countries in which they operate (collectively, "Foreign Laws") and comply with such Foreign Laws applicable to their activities. From time to time in the ordinary course of business, such subsidiaries receive inquiries from governmental and self-regulatory agencies regarding the applicability of Foreign Laws to the products and services offered by them. In response to such inquiries, such subsidiaries have agreed to comply with such Foreign Laws, convinced the authorities such Foreign Laws were not applicable or compliance already exists, and/or modified such subsidiaries' activities in the applicable jurisdiction to avoid the application of all or certain parts of such Foreign Laws. The Company's management believes the past resolution of such inquiries and its ongoing compliance with Foreign Laws have not had a material adverse effect on the operations of the subsidiaries in the International Tax Operations segment or the consolidated financial statements of the Company and its subsidiaries. The Company cannot predict what effect the enactment of future Foreign Laws, changes in interpretations of existing Foreign Laws, or the results of future regulator inquiries with respect to the applicability of Foreign Laws may have on the Company's reporting segments, any particular subsidiary, or the consolidated financial statements of the Company and its subsidiaries.

Statutes and regulations relating to income tax return preparers, electronic filing, franchising and other areas affecting the income tax business also exist outside of the United States. In addition, the Canadian government regulates the refund discounting program in Canada, as discussed under "Canadian Operations," above. These laws have not materially affected the International Tax Operations conducted by subsidiaries of the Company.

## **Reports**

The Company makes available, free of charge through its web site at [www.hrblock.com](http://www.hrblock.com), its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission.

The Company has posted on its web site at [www.hrblock.com](http://www.hrblock.com) copies of the following corporate-governance documents: (i) The H&R Block, Inc. Corporate Governance Guidelines, (ii) the H&R Block, Inc. Code of Business Ethics and Conduct, (iii) the H&R Block, Inc. Audit Committee Charter, (iv) the H&R Block, Inc. Governance and Nominating Committee Charter, and (v) the H&R Block, Inc. Compensation Committee Charter. The foregoing corporate-governance documents are also available in print upon the request of any shareholder to the Secretary of the Company.

## Item 2. Properties

The executive offices of the Company, H&R Block Services, Inc., Tax Services, BFC and RSMBS are located at 4400 Main Street, Kansas City, Missouri, in a multi-level building owned by H&R Block Tax Services, Inc. The building was constructed in 1963 and expanded or redesigned in 1965, 1973, 1981, and 1996. In fiscal year 2000, H&R Block Tax Services, Inc. entered into a 20-year lease for a newly constructed building located at 4400 East Blue Parkway, Kansas City, Missouri, which is being utilized by Tax Services and its affiliates as a service center. Most other offices of Tax Services (except those in department stores) are operated in premises held under short-term leases providing fixed monthly rentals, usually with renewal options. The Company's subsidiaries also lease other office space in Kansas City, Missouri.

Option One's executive offices are located in leased offices at 3 Ada, Irvine, California. H&R Block Mortgage is headquartered in leased offices in Lake Forest, California. Option One and H&R Block Mortgage Corporation also lease offices for their loan origination centers and branch office operations throughout the United States.

The executive offices of HRBFA are located in leased offices at 719 Griswold, Detroit, Michigan. Many branch offices of HRBFA are located in facilities owned by various real estate subsidiaries of OLDE Financial and leased primarily to HRBFA. Some branch offices are operated in leased premises.

RSM's executive offices are located in leased offices located at 3600 West 80th Street, Bloomington, Minnesota. Its administrative offices are located in leased offices at 220 North Main Street, Davenport, Iowa. RSM also leases space for the offices in which client services are provided in those states in which it operates.

## Item 3. Legal Proceedings

### RAL Litigation

The Company reported in its current reports on Forms 8-K dated November 1, 2002, November 6, 2002, November 14, 2002, November 15, 2002, November 18, 2002, and June 24, 2003, and its quarterly reports on Form 10-Q for the quarters ended October 31, 2002 and January 31, 2003 certain events and information relating to class action litigation and putative class action litigation involving its subsidiaries' refund anticipation loan program (collectively, "RAL Cases"). The amounts claimed in these lawsuits have been substantial in some instances. The Company has defended numerous class action and putative class action lawsuits filed against it involving the RAL program and a variety of theories asserted by plaintiffs. The amounts claimed in these lawsuits have been substantial in some instances. Of the cases that are no longer pending, the Company has been successful on dispositive motions for dismissal or summary judgment, plaintiffs have voluntarily dismissed the suits after a denial of class certification, or, in some other cases in which classes have not been certified, settlements have been reached with named plaintiffs. Several pending RAL Cases involving statewide classes or putative classes (discussed below) have had preliminary or final trial court approvals of settlements during or following fiscal year 2003. In addition, in April 2003, the United States District Court judge in the *Zawikowski* case (discussed below) declined to approve a settlement that had been pending for several years and that would have settled cases on a nationwide basis (except for some cases carved out of the settlement). 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, or any one of them, and the impact of the RAL Cases on the Company's financial position. The following is updated information regarding the pending RAL 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.*

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*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. The trial court judge in *Haese I* issued a letter on November 6, 2002, indicating that he intended to grant plaintiffs’ motion for partial summary judgment and motion for forfeiture, thereby holding that a fiduciary relationship exists between a tax preparer and its customer and that the company and its franchisee must forfeit fees totaling \$74.9 million to the class of Texas individuals. On November 19, 2002, the Company announced that a settlement 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 \$41.67 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. Through April 30, 2003, the Company recorded an additional liability and pretax expense of \$1.84 million in connection with the settlement, for a total liability and pretax charge of \$43.51 million for the fiscal year. During the fourth quarter 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 ordered that the claims of those class members are dismissed without prejudice of 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 \$49,000,000 on condition that, upon

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payment of the fees to class counsels' trust account, class counsel shall pay \$26 million of the attorneys' fees to the class members pursuant to an approved distribution plan. The Order also ordered 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. If there are any appeals of such final judgment and Order relating to attorneys' fees and expenses, there are no assurances that such final judgment and/or Order relating to attorneys' fees and expenses will ultimately be upheld on appeal.

*Haese II* arose from Plaintiffs' splitting off from *Haese I* claims based upon allegations of usury. In connection with the settlement in *Haese I*, plaintiffs have agreed to take action to obtain the dismissal of *Haese II*.

*Veronica I. Martinez, et al. v. H&R Block, Inc., et al.*, Case No. 02-3629-E in the District Court of Nueces County, Texas. In connection with the settlement in *Haese I*, plaintiffs' counsel has agreed to take action to dismiss this putative class action.

*Joel E. Zawikowski, et al. v. Beneficial National Bank, H&R Block, Inc., Block Financial Corporation, et al.*, renamed *Lynne A. Carnegie, et al. v. Household International, Inc., H&R Block, Inc., et al.*, Case No. 98 C 2178, United States District Court for the Northern District of Illinois, Eastern Division. On remand from the Seventh Circuit Court of Appeals, the District Court held hearings in October and November 2002 with respect to the fairness and adequacy of a proposed settlement. Under that settlement, the Company and the lending bank agreed to each pay \$12.5 million toward a \$25 million settlement fund for the benefit of the class members. The settlement had been approved by the District Court in February 2001 and the defendants had paid the \$25 million 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 had reversed the District Court's order approving the settlement and had 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. On April 15, 2003, the District Court judge declined to approve the \$25 million 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 after the conclusion of fiscal year 2003 and named their client, Lynne 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 motions to dismiss and are seeking the release of the escrowed settlement fund. 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.

*Joyce A. Green, et al. v. H&R Block, Inc., Block Financial Corporation, et al.*, Case No. 97195023, in the Circuit Court for Baltimore City, Maryland. The trial scheduled for



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January 2003 was stayed pending a ruling on the fairness of the settlement in the *Zawikowski* case. No new trial date has been scheduled.

*Sandra J. Basile, et al. v. H&R Block, Inc. et al.*, April Term 1993 Civil Action No. 3246, in the Court of Common Pleas, First Judicial District of Pennsylvania, Philadelphia County. The Company moved to decertify the class in this matter and oral argument on the motion was held in December 2002. The judge took the matter under advisement and a ruling has not yet been made.

*Belinda Peterson, et al. v. H&R Block Tax Services, Inc.*, Case No. 95CH2389, in the Circuit Court of Cook County, Illinois, is a case involving a class of persons who received a RAL in Illinois during a particular two-week period in 1995 and were allegedly improperly advised as to the timing of their receipt of refunds relating to the Earned Income Tax Credit. The court denied defendant's motion to decertify the class in April 2003. A settlement was reached 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. The final settlement agreement was signed and filed with the court following the end of fiscal year 2003 and preliminary approval of the settlement was granted on June 12, 2003.

*Levon and GERAL Mitchell, et al. v. H&R Block and Ruth R. Wren*, Case No. CV-95-2067, in the Circuit Court of Mobile County, Alabama, in which the remaining claim is a breach of fiduciary duty claim relating to the refund anticipation loan program. Class certification was initially denied by the court, such denial was reversed by the Alabama Supreme Court and remanded for further consideration. The court granted plaintiffs' motion for class certification following the end of fiscal year 2003.

*Deadra D. Cummins, et al. v. H&R Block, Inc., et al.*, Case No. 03-C-134 in the Circuit Court of Kanawha County, West Virginia, is a putative class action filed on January 22, 2003, in which plaintiffs allege three different counts of breach of fiduciary duty, breach of West Virginia statute on credit service organizations, breach of contract, unjust enrichment, and unfair or deceptive acts or practices with respect to the RAL program. The class sought to be certified encompasses all West Virginia residents who participated in the "Rapid Refund" program for the past 10 years. The defendants removed the case to federal court, plaintiffs filed a motion to remand the case to state court, and such motion was granted in June 2003.

*Roy Carbajal, et al. v. Household International, H&R Block Tax Services, Inc., et al.*, was filed on January 31, 2000, on behalf of all individuals nationwide (1) who applied for a RAL within one year prior to the date that the case was filed, (2) whose applications were denied, and (3) whose refunds were used by the lending bank to satisfy a prior year RAL debt. This case stems out of the RAL lending banks' practice of cross collection of prior year unpaid RALs, as permitted by the bank's loan agreement. No trial date is presently set.

*Lynne A. Carnegie, et al., v. H&R Block Inc., et al.*, Case No. 96/606129, Supreme Court of the State of New York, County of New York, filed on December 12, 1996,

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includes claims for violations of certain New York lending laws, breach of fiduciary duty, and unfair and deceptive acts and practices. Plaintiff's motion to certify a class was granted by the trial court, but reversed on appeal. The defendants' motion to dismiss was granted as to all but the count alleging unfair and deceptive acts and practices. The dismissal was affirmed on appeal. No trial date is presently set.

The Company has learned that a case entitled *Dennis J. Smith, et al. v. H&R Block, et al.*, was filed as Case No. 3:03CV7181 in the United States District Court for the Northern District of Ohio, Western Division, on April 15, 2003. The complaint alleges RICO violations, fraud, breach of fiduciary duties, negligence, conversion, and violation of Ohio consumer fraud statutes on behalf of a putative class of all those wrongly deprived of all or part of tax refunds under the "Rapid Refund" program. The complaint generally alleges violations of the Fair Debt Collection Practices Act and appears to relate to the cross-collection of prior RAL debt by banks involved in the RAL program or the refund anticipation check program. The Company has not yet been served in this matter.

### **Shareholder Matters**

*Paul White, et al. v. H&R Block, et al.*, *Yuchong Smith, et al. v. H&R Block, Inc., et al.*, *Richard J. Rodney, et al. v. H&R Block, Inc., et al.*, and *Michael F. McCormack, et al. v. H&R Block, Inc., et al.*, Case Numbers 02CV8965, 02CV9661, 02CV9682 and 02CV9830, respectively in the United States District Court for the Southern District of New York, are matters in which the respective named plaintiffs seek to represent a class of shareholders who purchased the Company's stock between November 8, 1997 and November 1, 2002, and allege that the Company and certain of its current and former officers and directors 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 have all been assigned to the same judge and consolidated for pre-trial matters. On January 13, 2003, the judge signed an order relieving the defendants from an obligation to respond to any of the four complaints until after a consolidated complaint was filed. The 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, plaintiffs informed defendants that they desired further to amend their complaint. Defendants consented to the filing of an amended complaint as a pleading matter, and intend to file a motion to dismiss it. The Company believes the claims in these actions are without merit, and intends to defend them vigorously.

*Shareholder Demand.* A shareholder of the Company made a demand in November 2002 through counsel that the Company commence a civil action against the directors of the Company relating to the refund anticipation loan program and the matters that are involved in the *White* and similar cases noted above. The shareholder's demand indicated that a shareholder derivative action will be commenced if the demanded civil action is not commenced. During the third quarter of fiscal year 2003, the shareholder's counsel agreed to relieve the Company and its Board of Directors from any obligation to respond to the demand at this time.

### **Franchise Litigation**

*Armstrong Business Services, Inc., et al. v. H&R Block, Inc., et al.*, Case Number 99-CV-206379, filed April 13, 1999, in the Circuit Court of Jackson County, Missouri, is an action filed by 24 "major" franchisees against the Company and certain of its subsidiaries relating to alleged breaches of contract and other matters. The Company's subsidiary, HRB Royalty, Inc., franchisor under the applicable franchise agreements, filed a counterclaim and subsequently a motion for summary judgment seeking a declaration that HRB Royalty, Inc. could elect not to renew the major franchise agreements when their present five-year terms came to an end. Such motion for summary judgment was granted in March 2001 and the plaintiffs appealed. The Missouri Court of Appeals ruled in favor of HRB Royalty, Inc. on December 24, 2002, holding that the provision in the franchise agreements for automatic renewal will not be held to require the renewal for additional five-year

periods "except upon the mutual assent of the parties." The plaintiff major franchisees' motions to the Missouri Court of Appeals for a rehearing and for transfer to the Missouri Supreme Court were denied in January 2003. In March 2003, the plaintiffs' application to the Missouri Supreme Court for transfer of the case to that court was denied. HRB Royalty, Inc. notified the plaintiff major franchisees in 2000 that it did not intend to renew their franchise agreements at the expiration of the current renewal terms and that the agreements would terminate at that time. The renewal dates vary among franchisees. Pursuant to the franchise agreements, HRB Royalty, Inc. must pay a "fair and equitable price" to the franchisee for franchisee's franchise business upon termination, and such price must be no less than 80% of the franchisee's revenues for the most recent 12 months ended April 30, plus the value of equipment and supplies, and certain off-season expenses. Plaintiffs' claims against the Company and its subsidiaries remain in the trial court. Plaintiffs seek in excess of \$20 million in actual damages, punitive damages, unspecified statutory damages, declaratory, injunctive and other relief, including attorneys' fees under allegations of breach of contract, breach of the covenant of good faith and fair dealing, unfair business practices, state anti-trust violations, breach of fiduciary duty, prima facie tort, violations of various state franchise statutes, fraud and misrepresentation, waiver and estoppel, ambiguity and reformation, relief with respect to a post-termination covenant not to compete in the franchise agreements, and a request for a fair and equitable payment upon nonrenewal of the franchise agreements. The major franchisees allege, among other things, that the sale of TaxCut® income tax return preparation software and online tax services and the purchase of accounting firms encroached on their exclusive franchise territories. The Circuit Court ruled on May 31, 2003 that major franchise agreements with renewal terms scheduled to expire prior to July 1, 2003, will expire on that date, and other major franchise agreements will expire as their renewal terms expire commencing in September 2003. The Court ordered defendants to pay for the franchise businesses as provided in the franchise agreements on the applicable dates of expiration. A trial with respect to two of the plaintiffs is scheduled for September 2003, with trials for the other plaintiffs not yet scheduled. The defendants believe that the allegations against them are without merit and continue to defend the case vigorously. There is no certainty as to the timing and final cost of acquisition as to any franchise business. Management believes that amounts, if any, required to be paid by the Company and its subsidiaries in the discharge of liabilities or settlements relating to plaintiffs' claims in this litigation will not have a material adverse effect on the Company's consolidated results of operations or financial position.

#### **Other Claims and Litigation**

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 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, the Peace of Mind guarantee program associated with income tax return preparation services, losses incurred by customers with respect to their investment accounts, relationships with franchisees, 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

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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 4. Submission of Matters to a Vote of Security Holders.**

No matters were submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the fourth quarter of the fiscal year ended April 30, 2003.

**Item 4a. Executive Officers of the Registrant.**

The names, ages and principal occupations (for the past five years) of the executive officers of the Company, each of whom has been elected to serve at the discretion of the Board of Directors of the Company are as follows:

Name and age	Office(s)
Mark A. Ernst (45)	Chairman of the Board of Directors since September 2002; Chief Executive Officer since January 2001; President of the Company since September 1999; Chief Operating Officer from September 1998 through December 2000; Executive Vice President from September 1998 until September 1999. Member of the Board of Directors since September 1999. See Note 1.
Jeffery W. Yabuki (43)	Chief Operating Officer since April 2002; Executive Vice President since October 2000; President, H&R Block Services, Inc. since October 2000; President, H&R Block International from September 1999 until October 2000. See Note 2.
Jeffrey G. Brandmaier (44)	Senior Vice President and Chief Information Officer since October 2001. See Note 3.
Frank J. Cotroneo (44)	Senior Vice President and Chief Financial Officer since February 2000. See Note 4.
Robert E. Dubrish (51)	President and Chief Executive Officer, Option One Mortgage Corporation, since March 1996.
James H. Ingraham (49)	Senior Vice President and General Counsel since September 2001; Secretary from June 1990 until October 2002; Vice President and General Counsel from July 1999 until September 2001; Vice President, Legal from October 1996 through June 1999.
Brian L. Nygaard (45)	President and Chief Executive Officer, H&R Block Financial Advisors, Inc., since November 2001. See Note 5.

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Name and age	Office(s)
Tammy S. Serati (44)	Senior Vice President, Human Resources since December 2002. See Note 6.
Steven Tait (43)	President, RSM McGladrey Business Services, Inc. (formerly HRB Business Services, Inc.) since April 2003. See Note 7.
Melanie K. Horstmeier (38)	Vice President and Corporate Controller since October 2002. See Note 8.
Linda M. McDougall (50)	Vice President, Communications since July 1999; Assistant Vice President, Communications from November 1995 through June 1999.
Timothy R. Mertz (52)	Vice President, Corporate Tax since October 2000. See Note 9.
Becky S. Shulman (39)	Vice President and Treasurer since September 2001. See Note 10.
Robert A. Weinberger (59)	Vice President, Government Relations, since March 1996.
Bret G. Wilson (44)	Vice President and Secretary since October 2002; Vice President, Corporate Development and Risk Management from October 2000 until October 2002; Vice President, Corporate Planning and Development from September 1999 until October 2000; Vice President, Corporate Development, from December 1997 until September 1999.
Note 1:	Mr. Ernst served as Senior Vice President, Third Party and International Distribution for American Express Company, Minneapolis, Minnesota, from July 1997 until June 1998.
Note 2:	Mr. Yabuki served as President and Chief Executive Officer of American Express Tax & Business Services, Inc., New York, New York, from 1998 to September 1999; and as Vice President, Mergers and Acquisitions, American Express, Minneapolis, Minnesota, from 1996 to 1998.
Note 3:	Mr. Brandmaier was Chief Information Officer for The Money Store, a subsidiary of First Union Bank from 1995 until 2001.
Note 4:	Mr. Cotroneo served as the Chief Financial Officer of MasterCard International, Inc., New York, New York, from 1996 to February 2000.

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- Note 5 Mr. Nygaard was President, ING Advisors Network, ING Group, Atlanta, Georgia, from October 2000 until October 2001; Chief Operating Officer, Advisors Network, ING Advisors Network, from October 1999 until October 2000; and Senior Vice President, Strategic Marketing, ING Advisors Network, from May 1999 until October 1999. He was Vice President, Retail, for Principal Financial Group, Des Moines, Iowa from January 1995 through April 1999.
- Note 6 Ms. Serati was Vice President, Human Resources Corporate Staffs, for Monsanto Agricultural Company, St. Louis, Missouri, from May 2000 through November 2002, and Vice President, Human Resources, Monsanto Nutrition & Consumer Sector, Chicago, Illinois, from January 1997 through April 2000.
- Note 7 Mr. Tait was Executive Vice President, Sales & Client Operations, Gartner, Inc., Stamford, Connecticut, from June 2001 through March 2003, and Senior Vice President, Sales and Operations at Gartner, Inc. from July 2000 until May 2001. He previously served as President and Chief Executive Officer of Xerox Connect, a wholly owned subsidiary of Xerox Corporation, from November 1999 until June 2000, and as Vice President, Xerox Global Services /VP Xerox Offsite Document Management Services, from September 1998 until October 1999.
- Note 8 Ms. Horstmeier was Assistant Vice President and Assistant Controller at Sprint Corporation ("Sprint"), Overland Park, Kansas, from December 2000 until October 2002; Executive Assistant to the Chief Financial Officer of Sprint from September 1999 until December 2000; Director, Capital Asset Accounting at Sprint from October 1998 until September 1999; and Senior Manager, Wholesale Services Group at Sprint from October 1997 until October 1998.
- Note 9 Mr. Mertz was Vice President of Treasury for Payless Cashways, Inc., a full-line building material and finishing products company, Lee's Summit, Missouri, from September 1998 through September 2000. He also served as Director of Taxes and Risk Management for Payless Cashways, Inc. from October 1987 until September 1998.
- Note 10 Ms. Shulman was Chief Investment Officer of U.S. Central Credit Union, Overland Park, Kansas, from September 1998 until August 2001. She served as Vice President, Asset/Liability for U.S. Central Credit Union from May 1997 until September 1998.

## **PART II**

### **Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters.**

The information called for by this item is contained in part in the Company's annual report to security holders for the fiscal year ended April 30, 2003, under the heading "Common Stock Data," and is hereby incorporated by reference. The Company's Common Stock is traded principally on the New York Stock Exchange. The

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Company's Common Stock is also traded on the Pacific Exchange. On June 10, 2003, there were 30,542 shareholders of record of the Company and the closing stock price on the New York Stock Exchange was \$43.14 per share.



**Item 6. Selected Financial Data.**

The information called for by this item is contained in the Company's annual report to security holders for the fiscal year ended April 30, 2003, under the heading "Selected Financial Highlights," and is hereby incorporated by reference.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The information called for by this item is contained in the Company's annual report to security holders for the fiscal year ended April 30, 2003, under the heading "Management's Discussion and Analysis of Results of Operations and Financial Condition," and is hereby incorporated by reference.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

**Generally**

In the operations of its subsidiaries and the reporting of its consolidated financial results, the Company is affected by changes in interest rates, currency exchange rates and equity values. The principal risks of loss arising from adverse changes in market rates and prices to which the Company and its subsidiaries are exposed, and which may be material, relate to:

- interest rates on cash equivalents, available-for-sale securities, residual interests in securitizations, mortgage servicing rights ("MSRs"), mortgage loan origination and purchase commitments, investments in mortgage loans held for sale, debt and margin lending activities, retail trading volumes, other assets, commercial paper issuances;
- foreign exchange rates, generating translation gains and losses; and
- equity prices.

The Company and its subsidiaries have market risk sensitive instruments entered into for "non-trading" and "trading" purposes. The Company's broker-dealer holds marketable fixed-income securities for resale to retail clients.

**Non-trading**

*Interest rates.* The Company's rate-sensitive assets and liabilities are managed at the subsidiary level. The Finance Committee of the Company's Board of Directors approves the Company's policies and procedures utilized to manage the Company's interest rate risk.

The Company has established investment guidelines to help minimize the market risk exposure of its non-residual available-for-sale securities portfolio. These guidelines focus on managing liquidity, preservation of principal, and earnings, which are primarily affected by credit quality and movements in interest rates.

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Approximately 82% of the Company's cash equivalents ("CE") and available-for-sale securities ("AFS"), which includes residual interests, are classified as short term, compared to 61% last year. The CE assets are primarily held for liquidity purposes and are comprised of high quality, short-term investments, including qualified money market funds (taxable and tax-exempt). As of April 30, 2003 and April 30, 2002, the portfolio had a duration of less than 0.1 years with an average credit quality of AAA. With such a short maturity, the portfolio's market value is relatively insensitive to interest rate changes.

The Company's residual interests in securitizations, the majority of AFS, and MSRs are subject to prepayment risk, because a mortgage borrower has the option to prepay a mortgage loan at any time. Prepayment risk tends to increase when interest rates fall due to the benefits of refinancing. The expected income from these residual interests and MSRs is sensitive to movements in interest rates due to this sensitivity to mortgage prepayments. The prepayment risk is partially offset with the collection of prepayment penalties, a feature on the majority of originated loans. In addition, prepayment penalties have the effect of reducing the borrowers propensity to prepay their mortgage during the penalty term.

Residual interests are recorded based on discounted cash flow models utilizing prepayment, interest rate, credit losses and discount rate assumptions. Prepayment and loss assumptions are based on evaluation of the actual experience of the Company's servicing portfolio or on market rates on new portfolios, taking into consideration the current and expected interest rate environment and its expected impact on future prepayment and default rates. At April 30, 2003, the sensitivity of the current fair value of the residual interests to a 10% adverse change in prepayment rates would lower the fair value of the residual interests by \$27.9 million, compared to \$13.1 million at April 30, 2002.

Mortgage servicing rights are recorded based on the present value of estimated future cash flows related to servicing loans utilizing market discount rates and anticipated prepayment speeds. The prepayment speeds are estimated using the Company's historical experience and third party market sources, where applicable. At April 30, 2003, the sensitivity of the current fair value of MSRs to a 10% adverse change in prepayment rates would lower the fair value by \$18.6 million, compared to \$11.3 at April 30, 2002.

Residual assets bear the interest rate risk embedded within the securitization due to an initial fixed-rate period on the loans versus the floating rate funding cost, and the on-going basis risk between the indices of the floating rate assets and liabilities, offset somewhat by interest rate caps sometimes embedded within the securitization. An adverse change in interest rates of 10% would impact the fair value of residuals by \$17.0 million at April 30, 2003, compared to \$35.0 million at April 30, 2002.

The Company originates mortgage loans and sells most non-prime loans the same day the loans are funded to Trusts. As a result of the whole loan sales to the Trusts, the Company removes the mortgage loans from its balance sheet, records the gain on sale, cash and a receivable which represents the ultimate expected outcome from the disposition of the loans by the Trusts. Changes in interest rates and other market factors may result in ultimate disposition of the loans for amounts that vary from this expected outcome. The Trusts, as directed by the Trustees, generally enter into forward loan sales commitments which reduce the variability in the expected outcome from ultimate disposition of the loans. As a result, an adverse change in interest rates of 10% would generally not expose the Company to significant losses relating to changes in the fair value of the receivable from the Trusts.

See note 7 "Mortgage Banking Activities" in the Notes to Consolidated Financial Statements in the Company's annual report to security holders for the fiscal year ended April 30, 2003 for further sensitivity analysis of the other assumptions and detailed explanations of the cash flow models used.

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The Company is exposed to interest rate risk associated with its mortgage loan origination and purchase commitments. These commitments to fund mortgage loans consist of fixed- and adjustable-rate loans, which will be largely sold in the secondary market. The Company had commitments to fund mortgage loans of \$2.6 billion at April 30, 2003 and \$1.7 billion at April 30, 2002, as long as the borrower fulfills the conditions required in the loan commitment. External market forces impact the probability of commitments being exercised, and therefore, total commitments outstanding do not necessarily represent future cash requirements. The risk with some of these commitments to fund mortgage loans is that interest rates might rise between the time the customer locks in the interest rate on the loan and the time the loan is sold. With the remaining commitments, where the borrower has not locked the interest rate on the loan, the same risks exist to the extent that interest rates rise and the Company chooses to not raise the rate on the loan. In some instances, the Company will utilize hedge vehicles or forward loan sale commitments to reduce this interest rate risk. It is the Company's policy to utilize hedge vehicles only for the purpose of offsetting or reducing the risk of loss in earnings associated with a defined or quantified exposure. They are purchased from certain broker-dealer counterparties. If the counterparties do not fulfill their obligations, the Company may be exposed to default risk. As the risk of default depends on the creditworthiness of the counterparty, the Company's policy requires such transactions may be entered into only with counterparties rated A or better (or an equivalent rating) by recognized rating agencies. As a matter of practice, the Company has limited the counterparties to major banks and financial institutions meeting such standards. All interest rate contracts conform to the standard International Swaps and Derivatives Association, Inc. documentation. An adverse change in interest rates of 10% would generally not expose the Company to significant losses related to its commitments, net of any gains or losses on associated hedge positions.

Commercial paper is issued throughout the year primarily to fund seasonal working capital needs, dividend payments and purchases of treasury stock. At April 30, 2003 and April 30, 2002, no commercial paper was outstanding. For fiscal year 2003, the average issuance term was 12 days and average outstandings were \$332 million. This compares with 22 days and \$635 million for fiscal year 2002. The issuance term and average outstandings declined from the prior fiscal year due to the Company's agreement to waive its rights to purchase participation interests in, and receive license fees related to, RALs during the period January 1, 2003 through April 30, 2003. As commercial paper borrowings are seasonal, interest rate risk typically increases through the Company's third fiscal quarter and declines to zero by fiscal year-end. See "Financial Condition" under the heading "Management's Discussion and Analysis of Results of Operations and Financial Condition" in the Company's annual report to security holders for the fiscal year ended April 30, 2003.

At April 30, 2003 and April 30, 2002, there were no hedges outstanding related to long-term debt. The Company's long-term debt at April 30, 2003 and April 30, 2002 consisted primarily of fixed-rate Senior notes; therefore, a change in interest rates would have no impact on consolidated pretax earnings. See note 11, "Long-Term Debt," in the Notes to Consolidated Financial Statements in the Company's annual report to security holders for the fiscal year ended April 30, 2003.

The Company's broker-dealer holds interest bearing receivables from customers, brokers, dealers and clearing organizations, which consist primarily of amounts due on margin transactions and are generally short-term in nature. The Company's broker-dealer funds these short-term assets with short-term variable rate liabilities from customers, brokers and dealers, including stock loan activity. Although there may be differences in the timing of the re-pricing related to these assets and

liabilities, the Company believes it is not significantly exposed to interest rate risk in this area. As a result, any change in interest rates would not materially impact the Company's consolidated pretax earnings.

*Foreign Exchange Rates.* The operation of the Company's subsidiaries in international markets provides exposure to volatile movements in currency exchange rates. The currencies involved are the Canadian dollar, the Australian dollar and the British pound. International Tax Operations constituted approximately 1.1% of the Company's fiscal year 2003 consolidated pretax income, compared to 1.0% in fiscal 2002. As currency exchange rates change, translation of the financial results of International Tax Operations into U.S. dollars does not presently materially affect, and has not historically materially affected, the consolidated financial results of the Company, although such changes do affect the year-to-year comparability of the operating results of the international businesses.

The Company translates revenues and expenses related to its international operations at the average of exchange rates in effect during the period. The sensitivity analysis of fluctuation in foreign currency exchange rates compares the U.S. dollar variance in using the actual exchange rates and using rates, which have been adversely adjusted by 10%. The Company estimates a 10% change in foreign exchange rates by itself would impact reported pretax income from continuing operations by approximately \$1.1 million. Such impact represents approximately 10.5% of the pretax income of International Tax Operations for fiscal year 2003 and approximately .11% of the Company's pretax income for such year. In fiscal 2002, a 10% change in exchange rates would have impacted fiscal 2002 pretax income by approximately \$.8 million or 11.4% of International Tax Operations pretax income and .11% of the Company's pretax income.

*Equity.* The Company has exposure to the equity markets in several ways. The largest exposures are through the Company's Deferred Compensation Plans, which have mismatches in asset and liability amounts and investment choices (both fixed-income and equity), and through equity investments in the captive insurance company. At April 30, 2003, the impact of a 10% market value change in the combined equity assets of the Deferred Compensation Plans and the captive insurance company would be approximately \$8.0 million, assuming no offset for the liabilities, versus \$8.9 million at April 30, 2002.

## **Trading**

The Company's fixed income trading portfolio is affected by changes in market rates/prices. The risk is the loss of income arising from adverse changes in the value of the trading portfolio. The Company's broker-dealer holds the trading portfolio at quoted market prices and such portfolio represents .5% of the Company's total assets at April 30, 2003, compared to .7% at April 30, 2002. The market value of the Company's trading portfolio at 2003 fiscal year end was approximately \$23.9 million, compared to approximately \$28.4 million at 2002 fiscal year end. The impact of a 10% change in the market value of these investments for fiscal year 2003 would be approximately \$2.4 million, or about .2% of consolidated pretax income. The impact

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of such a change for fiscal year 2002 would be \$2.8 million, or about .4% of consolidated pretax income. With respect to its fixed-income securities portfolio, the Company manages its market price risk exposure by limiting concentration risk, maintaining minimum credit quality and limiting inventory to anticipated retail demand and current market conditions.

**Item 8. Financial Statements and Supplementary Data.**

The information called for by this item and listed at Item 15(a) 1 is contained in the Company's annual report to security holders for the fiscal year ended April 30, 2002, and is hereby incorporated by reference.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

The disclosure called for by this Item regarding the change in independent accountants following completion of the audit of the Company's financial statements for the fiscal year ended April 30, 2003 has been previously reported (as such term is defined in Rule 12b-2 for the Securities Exchange Act of 1934, as amended) in the current reports on Form 8-K dated May 12, 2003 and July 14, 2003.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant.**

The information called for by this item with respect to directors of the Company and with respect to compliance with Section 16(a) of the Securities Exchange Act is included under the captions "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance," respectively, in the Company's definitive proxy statement filed pursuant to Regulation 14A not later than 120 days after April 30, 2003, and in Item 4a "Executive Officers of the Registrant" in this report, and is incorporated herein by reference.

The Company has adopted a code of business ethics and conduct that applies to its directors, officers and employees. A copy of the code of business ethics and conduct is available on the Company's web site at [www.hrblock.com](http://www.hrblock.com).

**Item 11. Executive Compensation.**

The information called for by this item is contained in the Company's definitive proxy statement filed pursuant to Regulation 14A not later than 120 days after April 30, 2003, in the sections entitled "Board of Directors' Meetings, Committees and Compensation" and "Compensation of Executive Officers," and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information called for by this item is contained in the Company's definitive proxy statement filed pursuant to Regulation 14A not later than 120 days after April 30, 2003, in the section titled "Election of Directors," in the section titled "Information Regarding Security Holders," and in the section entitled "ITEM 2 ON FORM OF PROXY Approval of an Amendment to the 2003 Long-Term Executive Compensation Plan," and is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions.**

None.

**Item 14. Controls and Procedures.**

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-14 for the Securities Exchange Act of 1934, as amended, (the "Exchange Act") within 90 days of the filing date of this Annual Report on Form 10-K. Based upon their evaluation, the Chief Executive Officer and Chief Financial Officer concluded the Company's disclosure controls and procedures are effective to ensure information required to be disclosed by the Company in the reports filed or submitted by it under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of such evaluation.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.**

(a) 1. Financial Statements

The following consolidated financial statements of H&R Block, Inc. and subsidiaries are incorporated by reference from the Company's annual report to security holders for the fiscal year ended April 30, 2003:

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Consolidated Income Statements	46
Consolidated Balance Sheets	47
Consolidated Statements of Cash Flows	48
Consolidated Statements of Stockholders' Equity	49
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2. Financial Statement Schedules

Report of PricewaterhouseCoopers LLP, Certified Public Accountants on Financial Statement Schedule for H&R Block, Inc.

Schedule II — Valuation and Qualifying Accounts

Schedules not filed herewith are either not applicable, the information is not material or the information is set forth in the financial statements or notes thereto.

- 3. Exhibits
  - 3.1 Restated Articles of Incorporation of H&R Block, Inc., as amended, filed as Exhibit 3.2 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 2001, file number 1-6089, are incorporated herein by reference.
  - 3.2 Certificate of Amendment of Articles of Incorporation effective October 15, 2001, filed as Exhibit 3.1 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 2001, file number 1-6089, is incorporated herein by reference.
  - 3.3 Amended and Restated Bylaws of H&R Block, Inc., as amended, filed as Exhibit 3.1 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 1999, file number 1-6089, are incorporated herein by reference.
  - 4.1 Indenture dated as of October 20, 1997, among H&R Block, Inc., Block Financial Corporation and Bankers Trust Company, as Trustee, filed as Exhibit 4(a) to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 1997, file number 1-6089, is incorporated herein by reference.
  - 4.2 First Supplemental Indenture, dated as of April 18, 2000, among H&R Block, Inc., Block Financial Corporation, Bankers Trust Company and the Bank of New York, filed as Exhibit 4(a) to the Company's current report on Form 8-K dated April 13, 2000, file number 1-6089, is incorporated herein by reference.
  - 4.3 Form of 6¾% Senior Note due 2004 of Block Financial Corporation, filed on October 23, 1997 as Exhibit 2.2 to the Company's current report on Form 8-K, file number 1-6089, is incorporated herein by reference.
  - 4.4 Form of 8½% Senior Note due 2007 of Block Financial Corporation, filed as Exhibit 4(b) to the Company's current report on Form 8-K dated April 13, 2000, file number 1-6089, is incorporated herein by reference.
  - 4.5 Copy of Rights Agreement dated March 25, 1998, between H&R Block, Inc. and ChaseMellon Shareholder Services, L.L.C., filed on July 22, 1998 as Exhibit 1 to the Company's Registration Statement on Form 8-A, file number 1-6089, is incorporated herein by reference.

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- 4.6 Form of Certificate of Designation, Preferences and Rights of Participating Preferred Stock of H&R Block, Inc., filed as Exhibit 4(e) to the Company's annual report on Form 10-K for the fiscal year ended April 30, 1995, file number 1-6089, is incorporated by reference.
- 4.7 Form of Certificate of Amendment of Certificate of Designation, Preferences and Rights of Participating Preferred Stock of H&R Block, Inc., filed as Exhibit 4(j) to the Company's annual report on Form 10-K for the fiscal year ended April 30, 1998, file number 1-6089, is incorporated by reference.
- 4.8 Form of Certificate of Designation, Preferences and Rights of Delayed Convertible Preferred Stock of H&R Block, Inc., filed as Exhibit 4(f) to the Company's annual report on Form 10-K for the fiscal year ended April 30, 1995, file number 1-6089, is incorporated by reference.
- 10.1 The Company's 1993 Long-Term Executive Compensation Plan, as amended and restated as of September 11, 2002, filed as Exhibit 10.1 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 2002, file number 1-6089, is incorporated by reference.
- 10.2 The Company's 2003 Long-Term Executive Compensation Plan, filed as Exhibit 10.2 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 2002, file number 1-6089, is incorporated by reference.
- 10.3 The H&R Block Deferred Compensation Plan for Directors, as Amended and Restated effective July 1, 2002, filed as Exhibit 10.2 to the Company's annual report on Form 10-K for the fiscal year ended April 30, 2002, file number 1-6089, is incorporated by reference.
- 10.4 The H&R Block Deferred Compensation Plan for Executives, as Amended and Restated July 1, 2002, filed as Exhibit 10.3 to the Company's annual report on Form 10-K for the fiscal year ended April 30, 2002, file number 1-6089, is incorporated by reference.
- 10.5 Amendment No. 1 to the H&R Block Deferred Compensation Plan for Executives, as Amended and Restated, effective as of March 12, 2003.
- 10.6 The H&R Block Short-Term Incentive Plan, filed as Exhibit 10.1 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 2000, file number 1-6089, is incorporated herein by reference.



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- 10.7 The Company's 1989 Stock Option Plan for Outside Directors, as amended September 12, 2001, filed as Exhibit 10.4 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 2001, file number 1-6089, is incorporated herein by reference.
- 10.8 The H&R Block Stock Plan for Non-Employee Directors, as amended August 1, 2001, filed as Exhibit 10.3 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 2001, file number 1-6089, is incorporated herein by reference.
- 10.9 The H&R Block, Inc. 2000 Employee Stock Purchase Plan, as amended August 1, 2001, filed as Exhibit 10.2 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 2001, file number 1-6089, is incorporated herein by reference.
- 10.10 The H&R Block, Inc. Executive Survivor Plan (as Amended and Restated) filed as Exhibit 10.4 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 2000, file number 1-6089, is incorporated herein by reference.
- 10.11 First Amendment to the H&R Block, Inc. Executive Survivor Plan (as Amended and Restated), filed as Exhibit 10.9 to the Company's annual report on Form 10-K for the fiscal year ended April 30, 2002, file number 1-6089, is incorporated by reference.
- 10.12 Second Amendment to the H&R Block, Inc. Executive Survivor Plan (as Amended and Restated), effective as of March 12, 2003.
- 10.13 Employment Agreement dated July 16, 1998, between the Company and Mark A. Ernst, filed as Exhibit 10(a) to the Company's quarterly report on Form 10-Q for the quarter ended July 31, 1998, file number 1-6089, is incorporated herein by reference.
- 10.14 Amendment to Employment Agreement dated June 30, 2000, between HRB Management, Inc. and Mark A. Ernst, filed as Exhibit 10.1 to the Company's quarterly report on Form 10-Q for the quarter ended July 31, 2000, file number 1-6089, is incorporated herein by reference.
- 10.15 Employment Agreement dated September 7, 1999, between HRB Management, Inc. and Jeffery W. Yabuki, filed as Exhibit 10.4 to the Company's quarterly report on Form 10-Q for the quarter ended January 31, 2000, file number 1-6089, is incorporated herein by reference.
- 10.16 Employment Agreement dated January 26, 2000, between HRB Management, Inc. and Frank J. Cotroneo, filed as Exhibit 10.5 to the Company's quarterly report on Form 10-Q for the quarter

ended January 31, 2000, file number 1-6089, is incorporated herein by reference.

- 10.17 Employment Agreement dated as of October 8, 2001, between HRB Management, Inc. and Jeffrey Brandmaier, filed as Exhibit 10.6 to the Company's quarterly report on Form 10-Q for the quarter ended October 31, 2001, file number 1-6089, is incorporated herein by reference.
- 10.18 Employment Agreement between HRB Management, Inc. and David F. Byers, fully executed as of February 1, 2002, filed as Exhibit 10.1 to the Company's quarterly report on Form 10-Q for the quarter ended January 31, 2002, file number 1-6089, is incorporated herein by reference.
- 10.19 Employment Agreement between Option One Mortgage Corporation and Robert E. Dubrish, executed on February 9, 2002, filed as Exhibit 10.2 to the Company's quarterly report on Form 10-Q for the quarter ended January 31, 2002, file number 1-6089, is incorporated herein by reference.
- 10.20 Employment Agreement dated as of November 5, 2001, between H&R Block Financial Advisors, Inc. and Brian L. Nygaard, filed as Exhibit 10.4 to the Company's quarterly report on Form 10-Q for the quarter ended January 31, 2002, file number 1-6089, is incorporated herein by reference.
- 10.21 Employment Agreement dated as of September 12, 2001 between HRB Management, Inc. and James H. Ingraham, filed as Exhibit 10.3 to the Company's quarterly report on Form 10-Q for the quarter ended January 31, 2002, file number 1-6089, is incorporated herein by reference.
- 10.22 Employment Agreement dated December 2, 2002 between HRB Management, Inc. and Tammy S. Serati, filed as Exhibit 10.4 to the quarterly report on Form 10-Q for the quarter ended January 31, 2003, file number 1-6089, is incorporated herein by reference.
- 10.23 Employment Agreement dated as of April 1, 2003 between HRB Business Services, Inc. and Steven Tait.
- 10.24 Senior Managing Director Agreement dated August 2, 1999, between RSM McGladrey, Inc. and Thomas G. Rotherham, filed as Exhibit 10.23 to the Company's annual report on Form 10-K for the fiscal year ended April 30, 2001, file number 1-6089, is incorporated herein by reference.
- 10.25 Employment Agreement dated as of November 1, 2001, between H&R Block Services, Inc. and Thomas L. Zimmerman, filed as Exhibit 10.6 to the Company's quarterly report on Form 10-Q for

the quarter ended January 31, 2002, file number 1-6089, is incorporated herein by reference.

- 10.26 Amendment to Employment Agreement dated June 18, 2002, between H&R Block Services, Inc. and Thomas L. Zimmerman, filed as Exhibit 10.1 to the quarterly report on Form 10-Q for the quarter ended July 31, 2002, file number 1-6089, is incorporated herein by reference.
- 10.27 Second Amended and Restated Refund Anticipation Loan Operations Agreement dated as of June 9, 2003, between H&R Block Services, Inc., Household Tax Masters, Inc. and Beneficial Franchise Company.
- 10.28 Second Amended and Restated Refund Anticipation Loan Participation Agreement dated as of June 9, 2003, between Block Financial Corporation and Household Tax Masters, Inc.
- 10.29 Agreement of Settlement dated March 31, 2003 by and between H&R Block, Inc., H&R Block and Associates L.P., H&R Block Tax Services, Inc., HRBO, Limited, H&R Block of South Texas, Inc., HRB-Delaware, Inc., H&R Block, Ltd., HRBOI, Ltd., HRBO III, Ltd., HRBOII, Inc., H&R Block of Dallas, Inc., H&R Block of Houston, Ltd., Houston Block, L.C., Block Management, Ltd., and STI-Block, L.C., and Ronnie and Nancy Haese, on behalf of themselves individually and on behalf of the Class as defined in such Agreement.
- 12 Computation of Ratio of Earnings to Fixed Charges for the five years ended April 30, 2003.
- 13 That portion of the annual report to security holders for the fiscal year ended April 30, 2003 which is expressly incorporated by reference in this filing. Portions of such annual report to security holders not expressly incorporated by this reference in this filing are not deemed "filed" with the Commission.
- 21 Subsidiaries of the Company.
- 23 Consent of PricewaterhouseCoopers LLP, Certified Public Accountants.
- 99.1 Certification by Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.2 Certification by Chief Financial Officer 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 Company filed a report on Form 8-K dated April 16, 2003, reporting under Item 5, Other Events and Required FD Disclosure, its issuance that day of a press release relating to refund anticipation loan litigation and other matters relating to such litigation.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

June 11, 2003

By /s/ Mark A. Ernst

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Title
/s/ Mark A. Ernst _____ Mark A. Ernst	Chairman of the Board, President, Chief Executive Officer and Director (principal executive officer)
/s/ G. Kenneth Baum _____ G. Kenneth Baum	Director
/s/ Thomas M. Bloch _____ Thomas M. Bloch	Director
/s/ Donna R. Ecton _____ Donna R. Ecton	Director
/s/ Henry F. Frigon _____ Henry F. Frigon	Director
/s/ Roger W. Hale _____ Roger W. Hale	Director
/s/ Tom D. Seip _____ Tom D. Seip	Director
/s/ Louis W. Smith _____ Louis W. Smith	Director
/s/ Rayford Wilkins, Jr. _____ Rayford Wilkins, Jr.	Director

(Signed as to each on June 11, 2003)

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/s/ Frank J. Cotroneo

Frank J. Cotroneo

Senior Vice President and Chief Financial Officer (principal financial officer)

/s/ Melanie K. Horstmeier

Melanie K. Horstmeier

Vice President and Corporate Controller (principal accounting officer)

(Signed as to each on June 11, 2003)

**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 annual report on Form 10-K 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 officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures 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 as of a date within 90 days prior to the filing date of this report (the "Evaluation Date"); and
  - c) presented in this report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: July 15, 2003

/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, Frank J. Cotroneo, Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K 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 officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures 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 as of a date within 90 days prior to the filing date of this report (the "Evaluation Date"); and
  - c) presented in this report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: July 15, 2003

/s/ Frank J. Cotroneo

\_\_\_\_\_  
Frank J. Cotroneo  
Chief Financial Officer  
H&R Block, Inc.



**Report of Independent Auditors on  
Financial Statement Schedule**

To the Board of Directors of  
H&R Block, Inc.:

Our audits of the consolidated financial statements referred to in our report dated June 10, 2003 appearing in the 2003 Annual Report to Shareholders of H&R Block, Inc. (which report and consolidated financial statements are incorporated by reference in this Annual Report on Form 10-K) also included an audit of the financial statement schedule listed in Item 15(a)(2) of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PricewaterhouseCoopers  
Kansas City, Missouri  
June 10, 2003

**H&R BLOCK, INC.**  
**SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS**  
**YEARS ENDED APRIL 30, 2003, 2002 AND 2001**

Description	Balance at Beginning of Period	Additions		Deductions	Balance at End of Period
		Charged to Costs and Expenses	Charged to Other		
Allowance for Doubtful Accounts - deducted from accounts receivable in the balance sheet					
2003	\$65,842,000	\$49,748,000	—	\$91,649,000	\$23,941,000
2002	\$48,817,000	\$76,804,000	—	\$59,779,000	\$65,842,000
2001	\$50,361,000	\$84,422,000	—	\$85,966,000	\$48,817,000

AMENDMENT NO. 1  
TO THE  
H&R BLOCK DEFERRED COMPENSATION PLAN  
FOR EXECUTIVES, AS AMENDED AND RESTATED

H&R Block, Inc. (the "Company") amended and restated the H&R Block Deferred Compensation Plan for Executives, as Amended and Restated (the "Plan"), effective as of July 1, 2002. Section 9.1 of the Plan provides that the Company, by action by the Company's Board of Directors, may amend the Plan from time to time. The Company hereby exercises that right. This Amendment No. 1 is effective as of March 12, 2003.

AMENDMENT

1. Section 2.1.24 of the Plan is amended by deleting the words "Chief Executive Officer of the Company" and replacing them with the words "Chief Operating Officer of the Company (or the Chief Executive Officer of the Company if there is no Chief Operating Officer of the Company)".

2. Section 2.1.37 of the Plan is amended by deleting the reference to "Section 2.1.37" therein and replacing it a reference to "Section 4.1.2".

3. Section 2.1.38 of the Plan is amended by inserting the words and punctuation "H&R Block Small Business Resources, Inc.," after the words and punctuation "HRB Business Services, Inc.," and before the words "and the majority- owned".

4. Section 6.2.2 of the Plan is amended by deleting the words "fourth Plan Year after the Plan Year during which the election was made" in the fourth sentence thereof and replacing them with the words "second Plan Year after the Plan Year in which any amounts are first credited to the Participant's Account".

5. Except as modified in this Amendment No. 1, the Plan shall remain in full force and effect, including the Company's right to amend or terminate the Plan as set forth in Article 9 of the Plan.

H&R BLOCK, INC.

Dated: March 12, 2003  
Ernst

By: /s/ Mark A.  
-----  
Mark A. Ernst  
President and Chief Executive Officer

EXHIBIT 10.27

AGREEMENT OF SETTLEMENT

This Agreement of Settlement (the "Agreement") is entered into this 31st day of March, 2003, by and between H&R Block, Inc., H&R Block and Associates, L.P., H&R Block Tax Services, Inc., HRBO, Limited (erroneously named as HRBO, Ltd.), H&R Block of South Texas, Inc., HRB-Delaware, Inc., H&R Block, Ltd., HRBOI, Ltd., HRBO III, Ltd., HRBOII, Inc. (erroneously named as HRBOII, Ltd.), H&R Block of Dallas, Inc., H&R Block of Houston, Ltd., Houston Block, L.C., Block Management, Ltd., and STI-Block, L.C. (collectively "H&R Block"), and Ronnie and Nancy Haese (the "Haeses" or "Plaintiffs") on behalf of themselves individually and on behalf of the Class as defined below.

I. DEFINITIONS

1. The "Class" and "Class Members" means all persons who (1) obtained at any time a tax refund anticipation loan ("RAL") through an office operating under the trade name of H&R Block (including franchisee or sub franchisee offices of H&R Block or any H&R Block offices located in Sears stores) in the State of Texas during the period from 1992 through 1996 and (2) did not previously request exclusion from the litigation styled Ronnie and Nancy Haese v. H&R Block, Inc., et al., Cause No. 96-423, in the 105th District Court of

Kleberg County, Texas (hereinafter referred to as the "Action.")

2. "Settlement Administrator" means the entity designated by H&R Block to administer the settlement.

3. "Preliminary Approval Order" means the order to be entered by the Court in the event that the Court grants preliminary approval to this Agreement.

4. "Class Counsel" means Robert C. Hilliard and Hilliard & Munoz, LLP,

Darrell L. Barger and Hartline, Dacus, Barger, Dreyer & Kern, LLP, Edward Carstarphen and Ellis, Carstarphen, Dougherty & Goldenthal, P.C., and Craig Sico and Sico, White & Braugh, who are the attorneys and law firms representing the Haeses and Class Members.

5. "Class Notice" means the notice that attached hereto as Exhibit A.

6. "Class Representatives" means the Haeses.

7. "Court" means the 105th District Court of Kleberg County.

8. "Settled Claims" means any and all actual and potential claims, actions, lawsuits, and causes of action, known or unknown, that Plaintiffs and/or the Class asserted, may assert or could have asserted in the Action, including all claims and potential claims under the laws of Texas or under federal law or any other law arising out of or in any way relating to the tax refund anticipation loans ("RALs") (sometimes erroneously referred to as "Rapid Refunds") obtained by the Class at any time up to and through November 18, 2002, and/or participations in such RALs and/or arising out of or in any way relating to H&R Block's use of the term "Rapid Refund," and/or any sanctions or contempt penalties that have been sought, or could have been sought, against the Released Parties for any acts or omissions, known or unknown, that may have been committed by the Released Parties that might in any way be related to the Action, the Cause 99-314 Action, or the Martinez Action.

9. "Cause 99-314 Action" means the lawsuit defined in Section II, paragraph 1 of the Recitals set forth below.

10. "Martinez Action" means the lawsuit defined in Section II, paragraph 2 of the Recitals set forth below.

11. "Released Parties" means H&R Block, Block Financial Corporation, HRB

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Texas Enterprises, Inc., H&R Block Texas Tax Company, LP, and H&R Block Texas Support Services, LP, and the respective parents, affiliates, subsidiaries, franchisees or sub-franchisees of any of them, all divisions, predecessors, successors, representatives and assignees of any of them, and the present and former officers, directors, employees, shareholders, insurers, underwriters, attorneys and agents of any of them.

8. "Zawikowski Action" means the lawsuit defined in Section II, paragraph 4 of the Recitals set forth below.

9. "Zawikowski Settlement" means the settlement defined in Section II, paragraph 4 of the Recitals set forth below.

## II. RECITALS

14. WHEREAS, (i) in July, 1996, the Haeses filed the Action which was certified as a class action and (ii) in November, 1999, certain claims in the Action were severed into a class action

lawsuit pending in the same Court captioned Ronnie and Nancy Haese, et al. v. H&R Block, Inc., et al., No. CV-99-314-D (hereafter referred to as the "Cause 99-314 Action");

15. WHEREAS, in July, 2002, Veronica I. Martinez filed a class action lawsuit in the 148th Judicial District Court of Nueces County, Texas, captioned Veronica I. Martinez, et al. v. H&R Block, Inc., et al., No. 02-3269-E (hereinafter the "Martinez Action");

16. WHEREAS, all claims in all three cases arise out of the same set of operative facts;

17. WHEREAS, in addition to the aforementioned cases, H&R Block is a defendant in other pending lawsuits in other jurisdictions arising out of the RAL program,

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including an action pending in the United States District Court for the Northern District of Illinois captioned Zawikowski, et al. v. Beneficial National Bank, et al., No. 98-C-2178 ("Zawikowski Action") in which a nationwide settlement is currently pending approval ("Zawikowski Settlement"); but in which H&R Block has moved that the Texas Class Members be excluded.

18. WHEREAS, H&R Block has at all times denied, and continues to deny, that it has committed any wrongful acts or violations of law of any nature whatsoever or that it has any liability to Plaintiffs or the persons they represent;

19. WHEREAS, uncertainty exists as to the potential liability of H&R Block in the Action and as to the nature and amount of relief, if any, to which the Plaintiffs and Class Members may be entitled if liability is imposed on H&R Block;

20. WHEREAS, after extensive arms' length negotiations, the parties hereto now wish to settle the Action, subject to the approval of the Court;

21. WHEREAS, the parties hereto have entered into a Memorandum of Understanding on November 18, 2002;

22. WHEREAS, the Plaintiffs represent the Class and H&R Block agrees not to contest certification of a Class for purposes of effectuating this settlement;

23. WHEREAS, while denying any fault, wrongdoing or liability, H&R Block has agreed that a settlement of the Action on the terms and conditions set forth in this Agreement is desirable solely in order to avoid the further significant burden, expense and inconvenience of protracted litigation, and the distraction and diversion of personnel and resources, and thereby to put to rest this controversy;

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24. WHEREAS, Class Counsel have conducted a thorough study and investigation of the facts and the law relating to the claims asserted in the Action, the Cause 99-314 Action, and the Martinez Action through extensive discovery and independent investigation and have concluded that, taking into account the substantial benefits that Class Members will receive as a result of this settlement and the considerable risks and delays of further litigation, the settlement provided herein is fair, adequate and reasonable and in the best interests of the Class.

THEREFORE, the parties hereto agree to the following terms and conditions:

### III. TERMS AND CONDITIONS

1. The Class Representatives (for themselves and on behalf of the Class), by their attorneys and subject to the approval of the Court pursuant to Texas Rule of Civil Procedure 42(e), hereby settle, release, discharge and dismiss all Settled Claims as against all the Released Parties with prejudice, upon and subject to the terms and conditions specified herein. Each Class Member who has not timely opted out shall covenant and agree that (s)he shall not hereafter assert or continue to assert any claim, suit, demand or cause of action, whether individually or on behalf of a class, based in whole or in part upon any of the Settled Claims against the Released Parties. Such release shall also extend to any sanctions or contempt penalties that have been sought, or could have been sought, against the Released Parties for any acts or omissions, known or unknown, that may have been committed by the Released Parties in the Action, the Cause 99-314 Action, or the Martinez Action.

2. The parties hereto and their counsel agree to take whatever reasonable

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procedural steps may be required to permit the Court to obtain and retain jurisdiction over this settlement.

3. For the benefits and consideration set forth herein and discussed below, the parties hereto will jointly request that the Court's rulings in the Action as to fiduciary duty, breach or the nature of the breach thereof, and for forfeiture of fees reflected in the Court's November 6, 2002, letter be withdrawn. In addition, H&R Block will seek the following orders from the Court: (1) an order granting H&R Block's Motion to Compel Arbitration, which would dismiss the claims of those persons who were a part of the class as defined in the August 28, 1997, class certification order, who obtained a RAL for the first time in 1997 or thereafter; (2) an order granting summary judgment as to HRBO, Limited and HRBO III, Ltd.; and (3) an order granting summary judgment as to the claims of those persons who were part of the class as defined in the August 28, 1997, class certification order, who obtained RALs between 1988 and 1991, based upon the expiration of the applicable statutes of limitation, the non-receipt of license fees paid by H&R Block during that time period, or such other grounds as H&R Block may assert. Such orders being entered and actions taken by the Court shall be conditions subsequent for this settlement, each of which must occur before H&R Block shall have any obligation to make any payment of any of the benefits and/or consideration required herein to the Class or payment of attorneys' fees or expenses to Class Counsel.

4. The parties hereto agree that after Court approval and exhaustion of all appeals, the parties hereto will jointly move for the following: (1) the Cause 99-314 Action shall be decertified and non-suited by the Court, with each party bearing its own costs,

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expenses and attorneys' fees with respect thereto; (2) the Martinez Action shall also be non-suited by the court in the Martinez Action, with each party bearing its own costs, expenses and attorneys' fees with respect thereto; and (3) the mandamus proceeding pending before the Texas Supreme Court under Cause No. 02-1043 shall be dismissed. Such orders being entered and actions taken by the parties hereto, the Court and the court in the Martinez Action shall be conditions subsequent for this settlement, each of which must occur before H&R Block shall have any obligation to make any payment of any of the benefits and/or consideration required herein to the Class or payment of attorneys' fees or expenses to Class Counsel.

5. While final approval of the settlement is pending and while awaiting approval and final exhaustion of all appeals, the parties hereto agree to jointly seek the abatement of all the proceedings identified in the previous paragraph. Such orders being entered and actions taken by the applicable courts shall be conditions

subsequent to this settlement, each of which must occur before H&R Block shall have any obligation to make any payment of any of the benefits and/or consideration required herein to the Class or payment of any attorneys' fees or expenses to Class Counsel.

6. In consideration for the release and dismissal of all Settled Claims, each Class Member shall be entitled to receive - irrespective of how many RALs he or she may have obtained - the following benefits and consideration:

- a. For each tax season over a five-consecutive-year period, a fully transferable and alienable coupon that, upon mailing to the Settlement Administrator, shall entitle the person redeeming such coupons to receive

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a TaxCut(R) Platinum Federal Filing Edition tax preparation software package that currently has a suggested retail price of \$39.95, or an equivalent product of equal value selected by H&R Block. Such redemption shall occur between January 5 and April 15 of the calendar year of the tax season to which the software package applies.

- b. For each tax season over a five-consecutive-year period, a non-transferable and non-alienable coupon that, upon mailing to the Settlement Administrator, along with a receipt evidencing payment, between January 5 and May 15 of the calendar year in which the applicable tax season occurs, shall entitle the Class Member to a \$20 rebate on tax preparation or electronic filing services provided in an H&R Block branded office in the State of Texas; and
- c. For each tax season over a five-consecutive-year period, a fully transferable and alienable coupon that, upon mailing to the Settlement Administrator, shall entitle the person redeeming such coupon to receive a copy of Tax Planning Advisor (of the H&R Block just plain smart Advisor Series of books) that currently has a suggested retail price of \$14.95, or an equivalent product of equal value selected by H&R Block. Such redemption shall occur between January 5 and April 15 of the tax season to which the tax planning book applies.

7. With respect to the foregoing benefits and consideration, the parties hereto

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further agree that:

- a. Assuming final approval of the settlement by the trial court, final exhaustion of all appeals and satisfaction of all conditions subsequent referred to above, the parties hereto anticipate that the benefits and consideration set forth in the preceding paragraph will pertain to the 2004, 2005, 2006, 2007 and 2008 tax seasons. If approval, exhaustion of all appeals and satisfaction of all conditions subsequent referred to above occur within 90 days prior to the beginning of a given tax season or during a given tax season, H&R Block's obligation to provide such benefits and consideration will not

arise until the tax season that immediately follows such given tax season.

- b. For RALs obtained jointly due to the filing of a joint income tax return by a married couple or through other circumstances, such couple or joint interest shall be treated as one Class Member for purposes of the benefits and consideration described above. Such joint filers' rights with respect to those benefits and consideration shall be governed by the applicable property laws pertaining to such marriage or other relationship, and neither H&R Block nor the Settlement Administrator shall have any liability, obligation or responsibility with respect to any disputes arising from any joint interest or common ownership in the benefits provided herein, irrespective of whether such dispute arises from divorce, death or otherwise.

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- c. All coupons provided pursuant to the terms of the settlement and discussed above shall be mailed to each Class Member for whom the parties hereto possess a correct mailing address in one mailing prior to the first applicable tax season in which coupons may be redeemed, as described above. The parties hereto shall be deemed to have a correct mailing address for a Class Member if Class Notice previously mailed was not returned as undeliverable and/or if Class Notice mailed subsequent to entry of a Preliminary Approval Order is not returned as undeliverable and/or a Class Member provides a correct mailing address when requesting a copy of the Class Notice or in response to the class notice. The cost of such mailing of coupons, as well as any other expenses associated with the creation, issuance and redemption of the coupons shall be borne by H&R Block. H&R Block shall have the right to control the timing of such mailing of coupons, although it must occur at some time after April 30 of the year prior to the first applicable tax season, but before December 31.

8. The Final Judgment which will be submitted to the Court for approval of this settlement shall vacate the January 30, 1998 Order of the Court concerning arbitration clauses and contacts with the Class. While the parties hereto are awaiting Court approval, the parties hereto agree to jointly seek the abatement of the January 30, 1998 Order, with such abatement specifically providing that the January 30, 1998 Order shall have no force or effect while the abatement remains in effect and therefore such will not be a basis for any

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sanctions against H&R Block for its conduct while the abatement is in effect. However, any arbitration agreement signed or that may hereafter be signed by Class Members in 1997 and subsequent years will not be enforced against those Class Members with respect to the settled claims applicable to any RAL obtained in calendar years 1992 through 1996, inclusive. If the Court does not approve the settlement, the parties shall jointly request that the Court vacate the abatement. After the abatement has been vacated, the Court's January 30, 1998 Order shall thereafter again become effective (to the extent it remains effective in light of the Judgment and Opinion of the Corpus Christi Court of Appeals and H&R Block v. Haese, 82 S.W.3d 331 (Tex.App. - Corpus Christi, 2000, pet. denied) and subject to the limitation on the amount of any said sanctions set forth in Paragraph 9.



9. If the settlement should ultimately fail due to non-approval by the Court or appellate reversal, the Class and Class Counsel agree that any sanctions sought or asserted against H&R Block for any past conduct - known or unknown - pertaining to or in any way connected with the Action, the Cause 99-314 Action, or the Martinez Action, collectively shall not exceed \$10,000,000 against H&R Block. Should the settlement fail for some reason other than judicial non-approval or reversal, and such failure is not caused by H&R Block, the aforementioned sanctions collectively shall not exceed \$20,000,000 against H&R Block in the Action, the Cause 99-314 Action, or the Martinez Action. Nothing in this paragraph shall be construed as an admission that H&R Block engaged in any sanctionable conduct, which is expressly denied, nor construed as any agreement that any such sanction in any amount should be imposed by any court. Consideration for this provision consists of not only the benefits and consideration set forth herein and discussed above, but also H&R

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Block's request for exclusion of Class Members from the proposed settlement in the Zawikowski Action. Plaintiffs and Class Counsel agree to withdraw their objections to Zawikowski Settlement and to make no objections to such Zawikowski Settlement in the future, provided that if either Plaintiffs and/or Class Counsel or H&R Block is enjoined or otherwise prevented from complying with this settlement by order of any Court or either is ordered by any Court to deposit any of the funds or property to be paid pursuant to the Agreement to any Court, trust, or other third party, then Plaintiffs and Class Counsel may object to the Zawikowski settlement and contest any such injunction or order. This provision shall survive termination or failure of this Agreement or this settlement.

10. While approval of this settlement is being sought, H&R Block agrees to take no action to subject the Class or Class Members to the jurisdiction of any other Federal or State Court. If this settlement is finally approved and all appeals challenging same are exhausted, H&R Block agrees to comply with same even if the Texas Class is not carved out of the Zawikowski Action, provided that neither Plaintiffs and Class Counsel nor H&R Block is enjoined or otherwise prevented from doing so by order of any court, and further provided that H&R Block is not ordered by any court to deposit any of the funds or property to be paid pursuant to this Agreement to any court, trust or other third party. If either Plaintiffs and/or Class Counsel or H&R Block is enjoined or otherwise prevented from complying with this settlement or ordered by any Court to deposit any of the funds or property to be paid pursuant to the Agreement to any Court, trust, or other third party, then Plaintiffs and Class Counsel may contest any such injunction or order.

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11. Unless otherwise agreed by all parties hereto, this Agreement shall be null and void unless finally approved by the Court, and affirmed on appeal if necessary, and unless all conditions subsequent are met. However, an award by the Court, as the same may be affirmed or reduced by an appellate court, of the attorneys' fees and expenses for an amount less than the maximum amounts specified and agreed upon in Article V below, shall not affect any of the other rights and obligations of the parties hereto under the Agreement.

12. It is expressly agreed and understood that the Released Parties deny any fault, wrongdoing, or liability, and that this Agreement does not constitute an admission by any party and may not be admitted in evidence or appended to any pleadings, motions or briefs except in an action brought to enforce the terms hereof or as a defense to any causes of action barred or released by the terms hereof.

13. This Agreement may be executed in separate counterparts.

14. Each of the parties hereto agree to take all steps

necessary, at their own costs, to effectuate the purposes and requirements of this Agreement.

15. This Agreement shall be binding upon and inure to the benefit of the Class, the Released Parties and their respective heirs, administrators, successors and assigns.

16. In determining whether any person is a Class Member, the Settlement Administrator shall be entitled to rely upon the list of persons to whom previous notice was sent in the Action and upon the computer records available to H&R Block from third parties. To the extent that relevant information is not contained therein, the determination may be based upon submission by a Class Member of corroborating documentation such as the customer copy of the RAL application. The Settlement Administrator may employ in its

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discretion reasonable procedures necessary to verify information submitted by claiming Class Members.

17. In the event that the settlement does not become final in accordance with the terms hereof, then this Agreement shall be of no force or effect, except as elsewhere expressly provided herein, and, in any event, the parties hereto agree that this Agreement, whether or not it shall become final, and any and all negotiations, documents and discussions associated with it, shall be without prejudice to the rights of any party, shall not be deemed or construed to be an admission or evidence of any violation of any statute, law or regulation or of any liability or wrongdoing by any of the Released Parties or of the truth of any of the claims or allegations made in the Complaints and/or pleadings in the Action, the Cause 99-314 Action or the Martinez Action or any other pleading, and evidence thereof shall not be discoverable or used directly or indirectly, in any way, in any action or proceeding. If the settlement does not become final in accordance with the terms of this Agreement, H&R Block expressly reserves all its rights, including but not limited to, its rights to compel arbitration and contest class certification in the Action, the Cause 99-314 Action and/or the Martinez Action. If the settlement does not become final in accordance with the terms of this Agreement, Plaintiffs and class members expressly reserve all their rights, including but not limited to, any available sanctions subject to the limitations set forth in paragraph 9, their rights to contest the validity of any arbitration clauses, and their rights to pursue approval of class certification in Cause No. 99-314-D and Cause No. 02-3269-E (Martinez action).

18. This Agreement contains an entire, complete, and integrated statement of each and every term and provision agreed to by and among the parties hereto; it is not subject to

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any condition not provided for herein. This Agreement shall not be modified in any respect except by a writing executed by all the parties hereto. This Agreement supersedes all prior agreements between the parties hereto, including the Memorandum of Understanding dated November 18, 2002.

19. None of the parties hereto shall be considered to be the drafter of this Agreement or any provision hereof for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter hereof.

20. The Class and Class Counsel agree that all public communication regarding the settlement and this Agreement shall be made by H&R Block, except as may be required in court proceedings, or where necessary to protect the integrity of Class Counsel; provided, however, that public communication to protect the integrity of Class Counsel shall not include press releases or any communications to financial

analysts or investment advisors. Any responses to media inquiries shall not disparage H&R Block or their statements and shall only state that the settlement is a compromise of disputed claims. Except as permitted in the previous two sentences, the Class and Class Counsel shall refer any media inquiries to the following representatives of H&R Block: Linda M. McDougall, 816-932-7542, Cyd Slayton, 816-932-8470 or Bob Schneider, 816-932-4835, or such other person(s) as H&R Block shall designate to Class Counsel. Further Class Counsel agree not to provide documents to or otherwise assist any party or anyone representing parties or anyone contemplating such representation in any other RAL-related case now existing or filed at any time in the future, with respect to this settlement or any other aspect of this litigation. The

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Plaintiffs, Class, and Class Counsel shall, upon final and unappealable approval of the settlement, return to H&R Block any and all documents, discovery responses or other information produced or given to the Class and Class Counsel during the course of this litigation.

21. Each of the undersigned attorneys hereby represents and warrants that he or she is authorized to execute this Agreement on behalf of his or her client(s).

#### IV. CLASS NOTICE AND SETTLEMENT FAIRNESS HEARING

1. Upon execution of this Agreement of Settlement, Plaintiffs will file, and H&R Block will not oppose, a Motion for Preliminary Approval of Settlement and for Approval of Class Notice pursuant to Texas Rule of Civil Procedure 42. A copy of the proposed Class Notice is attached hereto as EXHIBIT A.

2. H&R Block shall pay all costs associated with dissemination of the Class Notice and the administration of the settlement.

3. Class Members shall have the right to object to the settlement or the request by Class Counsel for an award of attorneys' fees and expenses by filing written objections with the Court not later than twenty (20) days before the hearing on final approval of the settlement, and serving copies of such papers on all counsel for the parties hereto. Failure to file such timely written objections will preclude a Class Member from objecting at the final approval hearing.

4. Subject to the approval of the Court, Class Notice will also be disseminated to persons who obtained RALs in Texas prior to 1992, by publication, and subsequent to 1996,

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by mail. Any opt-outs of the Action by such persons pursuant to the Class Notice must be in a writing signed by the individual person and not his or her counsel or other representative.

5. Class Counsel shall not solicit the representation of persons who have opted out from the class with respect to any of the Settled Claims that were or could have been raised in the Action, the Cause 99-314 Action or the Martinez Action.

#### V. ATTORNEYS' FEES AND EXPENSES

1. Defendants agree to pay Class Counsel up to \$49,000,000 with respect to attorney's fees that may be awarded by the Court in connection with this settlement, provided that Class Counsel and/or their respective law firms shall not seek or accept an award of more than \$49,000,000 in attorneys fees. Further, in the event the Court awards Class Counsel any recovery of expenses associated with the litigation of the Action, H&R Block agrees to reimburse Class Counsel up to \$900,000 for such expenses incurred prior to execution of this Agreement. Plaintiffs shall provide a reasonable description of such expenses, but H&R Block shall not object to the reasonableness or

necessity of such expenditures. Such fees and expenses shall be subject to Court approval, but in no event shall H&R Block be required to pay more than the amounts stated herein. Such payment shall be made to Class Counsel within 30 days after the Court's order approving the settlement becomes final, and any appeals have been exhausted and all conditions subsequent have been satisfied; provided, however, that any payment by H&R Block shall be made in accordance with a final Court order specifying the division of attorneys fees and expenses among Class Counsel in this case, and shall not be payable by H&R Block until such an

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order specifying divisions has been entered.

2. The Court order awarding attorneys' fees and expenses to Class Counsel shall be in an order which is separate from an order approving the settlement, so that any appeal from the attorneys' fees and expenses to Class Counsel shall not affect the finality of the approval of the settlement.

3. Class Counsel may pay incentive awards to the Plaintiffs out of the aforesaid amounts paid to Class Counsel, in amounts to be approved by the Court.

#### VI. TERMINATION

H&R Block, at its sole discretion, shall have the right but not the obligation to terminate this Agreement if:

1. The Court declines to preliminarily approve the settlement and enter a Preliminary Approval Order except as expressly provided elsewhere in the Agreement; or

2. The conditions subsequent discussed herein are not satisfied; or

3. To the extent any Class Members have opted out of this Class, or may hereafter have the right to opt out of the Class or the Action, H&R Block shall have the option to withdraw from this Settlement if more than one percent (1%) of the persons receiving Class Notice opt out.

Plaintiffs and Class Members, at their sole discretion, shall have the right but not the obligation to terminate this Agreement if the Court declines to preliminarily approve the settlement and enter a Preliminary Approval Order approving all aspects of this Agreement of Settlement, or except as expressly provided in this Agreement.

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Termination by either H&R Block or by Plaintiffs and Class Members pursuant to this Section VI shall mean that all obligations of the parties hereto shall terminate, except as expressly provided herein.

IN WITNESS WHEREOF, the undersigned parties hereto and their attorneys have caused this Agreement to be duly executed on the date first above written.

/s/ Nancy Haese

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Nancy Haese, Plaintiff

/s/ Ronnie Haese

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Ronnie Haese, Plaintiff

HILLIARD & MUNOZ, LLP

By: /s/ Robert C. Hilliard

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Robert C. Hilliard

HARTLINE, DACUS, BARGER,  
DREYER & KERN, L.L.P.

By: /s/ Darrell L. Barger by RCH  
-----

Darrell L. Barger

ELLIS, CARSTARPHEN, DOUGHERTY &  
GOLDENTHAL, P.C.

By: /s/ Edward M. Carstarphen by RCH  
-----

Edward M. Carstarphen

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SICO, WHITE & BRAUGH

By: /s/ Craig M. Sico by RCH  
-----

Craig M. Sico

ATTORNEYS FOR PLAINTIFFS

H&R BLOCK, INC.

By: /s/ Jeffery W. Yabuki  
-----

An Authorized Representative

H&R BLOCK TAX SERVICES, INC.

By: /s/ Jeffery W. Yabuki  
-----

An Authorized Representative

H&R BLOCK AND ASSOCIATES, L.P.

By: /s/ Jeffery W. Yabuki  
-----

An Authorized Representative

HRBO, LIMITED, ERRONEOUSLY NAMED AS  
HRBO, LTD.

By: /s/ Garnett Walker  
-----

An Authorized Representative

HRB-DELAWARE, INC. AS SUCCESSOR IN  
INTEREST TO H&R BLOCK OF SOUTH  
TEXAS, INC.

By: /s/ Garnett Walker  
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An Authorized Representative

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HRB-DELAWARE, INC.

By: /s/ Garnett Walker  
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An Authorized Representative

H&R BLOCK, LTD.

By: /s/ Garnett Walker

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An Authorized Representative  
HRBOI, LTD.

By: /s/ Garnett Walker  
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An Authorized Representative  
HRBO III, LTD.

By: /s/ Garnett Walker  
-----  
An Authorized Representative  
HRBOII, INC., ERRONEOUSLY NAMED AS  
HRBOII, LTD.

By: /s/ Garnett Walker  
-----  
An Authorized Representative  
H&R BLOCK OF DALLAS, INC.

By: /s/ Jeffery W. Yabuki  
-----  
An Authorized Representative  
H&R BLOCK OF HOUSTON, LTD.

By: /s/ Garnett Walker  
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An Authorized Representative  
HOUSTON BLOCK, L.C.

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By: /s/ Garnett Walker  
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An Authorized Representative  
BLOCK MANAGEMENT, LTD.

By: /s/ Garnett Walker  
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An Authorized Representative  
STI-BLOCK, L.C.

By: /s/ Garnett Walker  
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An Authorized Representative

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MEREDITH, DONNELL & ABERNETHY

By: \_\_\_\_\_  
Ben A. Donnell

BRYAN CAVE, LLP.

By: \_\_\_\_\_  
N. Louise Ellingsworth

ATTORNEYS FOR DEFENDANTS

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SECOND AMENDMENT  
TO THE  
H&R BLOCK, INC. EXECUTIVE SURVIVOR PLAN

H&R Block, Inc. (the "Company") adopted the amended and restated H&R Block, Inc. Executive Survivor Plan (the "Plan"), effective as of January 1, 2001. The Company adopted the First Amendment to the Plan effective July 1, 2002. Section 4.1 of the Plan provides that the Company may amend the Plan from time to time. In accordance with the provisions of that Section, effective March 12, 2003, the Plan is amended as follows:

1. The definition of "Affiliate" in Article 1 of the Plan is amended by (A) removing H&R Block Mortgage Corporation, Inc., an Ontario Corporation as an Affiliate, and (B) adding HRB Business Services, Inc. and H&R Block Small Business Resources, Inc. as Affiliates.

2. The definition of "Eligibility Committee" in Article 1 of the Plan is amended by deleting the words "Chief Executive Officer of the Company" and replacing them with the words "Chief Operating Officer of the Company (or the Chief Executive Officer of the Company if there is no Chief Operating Officer of the Company)".

3. The definition of "Retirement/Retired" in Article 1 of the Plan is amended by deleting the words "the Company or" in both places in the first sentence thereof.

4. Except as modified in this Second Amendment, the Plan shall remain in full force and effect, including the Company's right to amend or terminate the Plan as set forth in Section 4.1 of the Plan.

H&R BLOCK, INC.

Dated: March 12, 2003

By: /s/ Mark A. Ernst

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Mark A. Ernst

President and Chief Executive Officer

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EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT ("Agreement") is entered into as of April 1, 2003, by and between HRB Business Services, Inc., a Delaware corporation (the "Company"), and Steven Tait ("Executive").

ARTICLE ONE  
EMPLOYMENT

1.01 - Agreement as to Employment. Effective April 1, 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 President, subject to the authority and direction of the Board of Directors of the Company and the President and Chief Executive Officer of H&R Block, Inc. ("Block"). Subject to the foregoing, Executive will have such authority and responsibility and duties as are normally associated with the position of President. The Company reserves the right to modify, delete, add, or otherwise change Executive's job responsibilities, in its sole discretion, at any time. Executive will perform such other duties 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 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

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rate of \$400,000 ("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 and the discretionary short-term incentive program beginning with fiscal year 2004. Under such Plan and program, Executive shall have an aggregate target bonus for fiscal year 2004 of \$220,000 and an opportunity to earn 200% of such target bonus. The payment of the actual award under such Plan and program shall be based upon such performance criteria which shall be determined by the Compensation Committee of Block. Executive must remain employed through April 30, 2004 to receive any payments under the Plan and program for fiscal year 2004. 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. As authorized under the H&R Block 1993 Long-Term Executive Compensation Plan, as amended (the "1993 Plan"), Executive shall be granted (i) on the Employment Date a stock option under the 1993 Plan to purchase 50,000 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 (16,666) of the shares covered thereby on the second anniversary of the date of grant, as to an additional one-third (16,667) of such shares on the third anniversary of the date of grant, and as to the remaining one-third (16,667) of the shares on the fourth 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; and (ii) a stock option to purchase 40,000 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 in fiscal year 2004 on which options are granted under the 1993 Plan to all or substantially all other senior executive officers of Block and its subsidiaries, such stock option to have terms and conditions consistent with the terms and conditions of options granted to such other senior executive officers.

(d) Restricted Stock. As authorized under the 1993 Plan, Executive shall be awarded promptly after the Employment Date, 7,500 Restricted Shares of Block's common stock under the 1993 Plan. One-third of the 7,500 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 2,500 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

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unvested Restricted Shares at any meeting of shareholders of Block.

#### 1.04 - Relocation Benefits.

(a) 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.

(b) 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.

#### 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

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Executive at the expense of Block or any subsidiary of Block; or

(iv) Executive's violation of Article Two or 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," or, if Executive does not transfer employment to an Affiliate and remains employed by the Company, a "Change of Control of RSM McGladrey, Inc.," 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

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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); provided, however, (1) Executive will be credited with not less than 12 "Years of Service" (as such term is defined in the Severance Plan) for the purpose of determining severance

compensation under Section 4(a)(i) of the Severance Plan as it exists on the date of this Agreement or the comparable section of the Severance Plan as it exists on Executive's Last Day of Employment, notwithstanding any provision in the Severance Plan to the contrary, (2) Executive will receive an amount equal to Executive's most recent payment under the H&R Block Short-Term Incentive Plan and the discretionary short-term incentive program in lieu of any amount calculated under Section 4(a)(ii) of the Severance Plan as it exists on the date of this Agreement or the comparable section of the Severance Plan as it exists on Executive's Last Day of Employment to be paid out over the "Severance Period" (as such term is defined in the Severance Plan), and (3) any nonvested portion of stock options or Restricted Shares awarded pursuant to Sections 1.03(c)(i) and 1.03(d) of this Agreement shall immediately vest on Executive's Last Day of Employment notwithstanding any provision in the Severance Plan to the contrary. 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 of Block" 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

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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.

(iii) For the purpose of this subsection, a "Change of Control of RSM McGladrey, Inc." means:

(A) the acquisition, other than from RSM McGladrey, Inc. ("RSM"), 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 RSM entitled to vote generally in the election of directors, but excluding, for this purpose, any such acquisition by Block, the Company, or Affiliates, or any employee benefit plan (or related trust) of Block, the Company or Affiliates 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,

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by all or substantially all of the individuals and entities who were the beneficial owners of the voting securities of RSM 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 RSM entitled to vote generally in the election of directors, as the case may be; or

(B) in the event any of RSM's voting securities are available for purchase on a national exchange, individuals who, as of the date hereof, constitute the Board of Directors of RSM (generally, the "RSM Board," and as of the date hereof, the "RSM Incumbent Board") cease for any reason to constitute at least a majority of the RSM Board, provided that any individual or individuals becoming a director subsequent to the date hereof, whose election, or nomination for election by RSM's shareholders, was approved by a vote of at least a majority of the RSM Board (or nominating committee of the RSM Board) will be considered as though such individual were a member or members of the RSM 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 RSM (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 RSM, in each case, with respect to which (1) all or substantially all of the individuals and entities who were the respective beneficial owners of the voting securities of RSM immediately prior to such reorganization, merger or consolidation and (2) affiliates of such individuals and entities 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 RSM, as approved by the shareholders of RSM, or the sale or other disposition of all

or substantially all of the assets of RSM (except for a sale to Block, the Company, or an Affiliate), as approved by the shareholders of RSM.

(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 (except as provided below), and executes an agreement with the Company under which Executive releases all known and potential claims against Block, the Company, and Affiliates; provided, however, "Qualifying Termination" shall include the involuntary termination of Executive resulting from a

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sale of assets or other corporate acquisition or disposition. Such 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; provided, however, (1) Executive will be credited with not less than 12 "Years of Service" (as such term is defined in the Severance Plan) for the purpose of determining severance compensation under Section 4(a)(i) of the Severance Plan as it exists on the date of this Agreement or the comparable section of the Severance Plan as it exists on Executive's Last Day of Employment, notwithstanding any provision in the Severance Plan to the contrary, and (2) all restrictions on any Restricted Shares awarded to Executive, including the Restricted Shares awarded pursuant to Section 1.03(d) of this Agreement, that would have vested in accordance with their terms by reason of lapse of time within 18 months after the Last Day of Employment (absent such termination of employment) shall terminate (and such Restricted Shares shall be fully vested) and any Restricted Shares that would not have vested in accordance with their terms by reason of lapse of time within 18 months after the Last Day of Employment shall be forfeited notwithstanding any provision in the Severance Plan to the contrary. 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,

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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 during the time Executive is receiving payments hereunder (or if longer, 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-subsidiary 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 (or if longer, 1 year after Executive's Last Day of Employment), 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.

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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

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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).

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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: 499 Terracina Way, Naples, FL 34119; and to the Company at: 4400 Main Street, Kansas City, MO 64111, Attn: Corporate Secretary, with a copy to H&R Block, Inc., 4400 Main Street, Kansas City, Missouri 64111, Attn: President; 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: 7/1/2003

/s/ Steven Tait

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Steven Tait

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Accepted and Agreed:

HRB Business Services, Inc.  
a Delaware corporation

By: /s/ James H. Ingraham

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James H. Ingraham, Vice President

Dated: 7/7/03

Approved:

H&R Block, Inc.  
a Missouri corporation

By: /s/ Mark A. Ernst

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Mark A. Ernst  
President and Chief Executive Officer

Dated: 8 July 03

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EXHIBIT A

H&R BLOCK SEVERANCE PLAN  
(AS AMENDED APRIL 15, 2002)

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

(b) "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 seasonal, temporary and inactive employees of a Participating Employer and employees who are customarily employed by a Participating Employer less than 20 hours per week.

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

(d) "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.

(e) "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.

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(f) "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.

(g) "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.

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

(i) "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.

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

(i) the termination of an Employee as a result of 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;

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

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

(iv) the non-renewal of employment contracts.

(k) "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.

(l) "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.

(m) "Severance Period" means the period of time during which a Participant may receive benefits under this Plan. The Severance Period with respect to a

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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(p), unless earlier terminated in accordance with Section 8 of the Plan.

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

(o) "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.

(p) "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:

Number of days since most recent employment anniversary date  
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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

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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. All Employees who incur a Qualifying Termination and sign a Release are 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

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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

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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.

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

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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

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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.

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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)

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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, the applicable Participating Employer will have no liability to pay any amount so attempted to be assigned or transferred.

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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

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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.

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#### 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.

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.

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SECOND AMENDED AND RESTATED  
REFUND ANTICIPATION LOAN  
OPERATIONS AGREEMENT

THIS SECOND AMENDED AND RESTATED REFUND ANTICIPATION LOAN OPERATIONS AGREEMENT dated as of June 9, 2003 (this "Agreement"), is made by and among H & R Block Services, Inc., a Missouri corporation ("Block Services"), on behalf of itself and in regard to its subsidiaries, H & R Block Tax Services, Inc., a Missouri corporation ("Block Tax Services"), HRB Royalty, Inc., a Delaware corporation ("Royalty," and together with Block Services and Block Tax Services, the "Block Companies"); Household Tax Masters Inc., a Delaware corporation ("Tax Masters"), for itself or in its capacity as servicer for the RAL Originator (as such term is defined herein) where appropriate under the circumstances, and Beneficial Franchise Company Inc., a Delaware corporation ("Beneficial Franchise," and together with Tax Masters, the "Household Companies").

RECITALS

A. Block Services is in the income tax preparation business through various offices owned by Block Services or its Affiliates and participating franchisees throughout the United States.

B. Royalty is the owner of certain service marks and trademarks involving Block Companies.

C. In connection with the electronic processing of tax returns, Tax Masters facilitates Refund Anticipation Loans ("RALs") that to date have been made by Imperial Capital Bank ("ICB"), Household Bank, f.s.b ("HB") or its predecessor and Refund Anticipation Checks ("RACs") that to date have been issued by ICB, HB, or its predecessor.

D. Beneficial Franchise is the owner of the entire right, title and interest in and to United States Letters Patent No. 4,890,228 issued on December 26, 1989 and entitled: ELECTRONIC INCOME TAX REFUND EARLY PAYMENT SYSTEM, together with all claims for damage by reason of past infringement by anyone of said Letters Patent, by virtue of an assignment recorded in the U.S. Patent and Trademark office on April 3, 1991 on Reel 5630, Frame 34.

E. Beneficial Franchise is the owner of the entire right, title and interest in and to United States Letters Patent No. 5,193,057 issued on March 9, 1993 and entitled: ELECTRONIC INCOME TAX REFUND EARLY PAYMENT SYSTEM, together with all claims for damage by reason of past infringement by anyone of said Letters Patent, by virtue of an assignment recorded in the U.S. Patent and Trademark Office on April 3, 1991 on Reel 5630, Frame 34.

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F. The Block Companies and the Household Companies are parties to that certain Amended and Restated Refund Anticipation Loan Operations Agreement, dated January 6, 2003 (the "First Amended and Restated RAL Operations Agreement").

G. Tax Masters and ICB are parties to 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 and ICB regarding the RAL Program pursuant to which Tax Masters services loans originated by ICB under the RAL Program. A redacted copy of the Sale and Servicing Agreement and all amendments thereto will be delivered by Tax Masters to Block Services.

H. 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 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 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 originator of RALs and RACs for Tax Periods subsequent to the 2003 Tax Period (the "Block ICB Termination Right").

I. 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 subsequent year, to provide written notice to Tax Masters, Beneficial Franchise and ICB that ICB is not acceptable as the RAL Originator for future Tax Periods, in which event Household Companies agree to substitute a Federally Chartered Financial Institution having sufficient capital to fulfill its anticipated obligations with respect to the RAL Program as the replacement 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.

J. The parties desire to amend and restate the First Amended and Restated RAL Operations Agreement to reflect the continuation of ICB as the RAL Originator and RAC issuer for the 2004 Tax Period, subject to the terms and conditions the First ICB Consent Letter, the Second ICB Consent Letter and this Agreement, and to implement certain changes to the First Amended and Restated RAL Operations Agreement hereinafter set forth.

#### 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 sufficiency and receipt of which

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are hereby acknowledged, Block Companies and Household Companies hereby covenant and agree that the First Amended and Restated RAL Operations Agreement is hereby amended and restated in its entirety with respect to RALs made and RACs issued and other acts and events that occur from and after the effective date hereof by deleting the provisions of Sections 1.1 through 8.21 as the same now appear and by substituting therefor the following Sections 1.1 through 8.21:

#### 1. RIGHTS, DUTIES AND OBLIGATIONS OF BLOCK SERVICES.

1.1 Preparation and Filing of Returns. Block Services shall prepare and file Federal, state and local income tax returns (collectively, the "Returns") for RAL Customers and shall be solely responsible for any liability to the Taxpayer, the Internal Revenue Service ("IRS") and other taxing authorities arising out of its preparation and filing of such Returns. For purposes of this Agreement, in connection with any RACs based on income tax refunds from state taxing authorities, Block Services shall complete any processing and necessary forms to enable the Electronic Filing of such state Returns, where available.

1.2 Marketing of RALs and RACs. Block Services agrees in connection with the operation of the RAL Program: (a) to market RALs and RACs to potential RAL Customers, including conducting marketing research and product development, coordinating the RAL and RAC products with the needs of RAL Customers, and preparing and disseminating marketing and promotional materials; (b) to conduct such advertising; (c) to prepare such forms and other written materials; (d) to equip its company-owned offices with such computer equipment; (e) to develop or acquire such software; (f) to hire and train such personnel; and (g) to incur such expenses in connection with such marketing efforts; in each case as is reasonably necessary in order to market, advertise and disseminate information with respect to the making of RALs and issuance of RACs to RAL Customers.

1.3 RAL Customers. With respect to RAL Customers, Block Services shall obtain certifications from each RAL Customer pursuant to Section 1.4 below. With respect to RAL Customers, Block Services shall also follow all qualifying procedures for RALs as set forth in Schedule 1.3 attached hereto

("Qualifying Procedures") that are being delivered by Tax Masters to Block Services in Tax Masters' capacity as servicer for the RAL Originator after consultation with the RAL Originator. The Initial Credit Criteria and Final Credit Criteria for any year during the term hereof will be delivered to Block Services by Tax Masters in Tax Masters' capacity as servicer for the RAL Originator after consultation with the RAL Originator pursuant to the procedures set forth in Section 6.2 below.

1.4 RAL and RAC Application and Certification Process. Block Services shall obtain information from each Applicant to complete an application for a RAL or an application for a RAC (each such application being hereinafter referred to, interchangeably, as "RAL Application") in a form developed by the RAL Originator and printed by Block Services, which RAL Application shall request from the Applicant certain information specified by Tax Masters as servicer for the RAL Originator after consultation with the RAL Originator. In addition, the RAL Application shall contain an authorization signed by the Applicant to use the Applicant's Return information for the loan application process in accordance with Section 301.7216-3(b) of the U.S. Treasury Department Regulations and shall also include such additional lawful

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consents, if any, as shall allow Tax Masters, or any Affiliate thereof, to make collections on any delinquent RAL as servicer for the RAL Originator and for Tax Masters and its Affiliates to solicit any RAL Customers for present and future loans and related products including, without limitation, deposit, insurance and mortgage loan products, subject to the limitations set forth in Section 7.2 herein. Consents for, and materials used in, the solicitation activities described in the immediately preceding sentence shall not mention the RAL Program, any names, logotypes or marketing slogans related to the RAL Program or any names, logotypes or marketing slogans of Block Services, its subsidiaries or affiliates, without the prior written consent of Block Services. If an Applicant is in the military, a photo identification containing a service identification number may also be supplied and shall satisfy all requirements for acceptable forms of identification for such individual. The RAL Application shall also contain, among other certifications as Tax Masters, as servicer for the RAL Originator after consultation with the RAL Originator, shall reasonably require, a certification signed by the Applicant that he or she: (a) has not previously filed any Return for the applicable Tax Year, does not have any previous tax liabilities, delinquent student loans, or any other delinquent federally guaranteed or sponsored loans, or delinquent child support payments; (b) has not filed a petition (whether voluntary or involuntary) under any federal or state bankruptcy or insolvency laws; and (c) has not filed any power of attorney with the IRS or any state taxing authority and has no power of attorney presently in effect to direct any tax refund to any third party.

1.5 Completion of IRS Form No. 8453. Block Services shall be responsible for the completion of IRS Form 8453, which shall indicate the applicable check routing number designated by the RAL Originator and applicable RAL Originator's client account number consisting of an eight digit prefix followed by the primary social security number of the RAL Customer and the name of the RAL Originator as the financial institution. This form shall be signed by Block Services as Electronic Return Originator (as defined by the IRS) and by the RAL Customer and shall indicate that the account is a "checking" account and that the source is "other". Block Services shall cause the same aforesaid information to be contained in the appropriate data fields as part of the electronically filed Return.

1.6 Customer Copies. Block Services shall ensure that the RAL Customer receives a copy of the signed RAL Application, IRS Form 8453, together with any agreements and other disclosures or documents which Tax Masters as servicer for the RAL Originator may reasonably require. If the IRS Form 8453 needs to be revised, Block Services need not obtain another RAL Application from the Applicant.

1.7 Handling Documents. A copy of the signed RAL Application, the loan agreement completed by the RAL Customer and the loan disclosure statement provided to the RAL Customer shall be stored in each Applicant's client file maintained by Block Services. Further, Block Services shall retain the ability to regenerate a copy of the document notifying an Applicant of the reason the RAL Application was not approved, if applicable, containing also the specific reason marked on the document. Upon Tax Masters' written request, Block Services shall exercise its best efforts to forward such documents to Tax Masters. Those

documents shall be sent to Tax Masters in accordance with the notice provisions contained in this Agreement unless Tax Masters notifies Block Services otherwise in writing. Block Services may dispose of such documents following the expiration of forty-eight (48) months after the preparation or receipt of same.

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1.8 Completion of RAL and RAC Disbursement Checks. Block Services shall have the care and custody of consecutively numbered RAL Originator disbursement checks upon which Block Services, at the direction of Tax Masters as servicer for the RAL Originator, may affix a RAL Originator facsimile signature by way of an imprint of the authorized RAL Originator signatory and which Block Services shall keep secure and safeguard from any loss or misuse. Block Services shall deliver such checks to RAL Customers only in accordance with this Agreement. Such RAL and RAC checks shall be payable only at the RAL Originator. Block Services shall be responsible for loss, alteration or misuse of such checks to the extent set forth in Section 1.12 below.

1.9 Additional Communication Equipment and Lines. An entity appointed by Block Services shall order such communication lines between Columbus, Ohio (or other applicable location), and the Chicago, Illinois metropolitan area, as are determined by such entity to be necessary to support Block Services' projection of its maximum daily RAL and RAC volume, as well as full RAL Application follow-up information, within any one sixteen (16) hour day, using such protocol and process as is mutually agreed upon by Tax Masters as servicer for the RAL Originator and such entity. Such communication lines shall continue in place until such time as the parties hereto shall mutually agree to discontinue the same. If the parties mutually agree to discontinue the aforementioned communication lines at the conclusion of any Tax Period, then the parties agree for each subsequent Tax Period to order and install substantially similar communication lines during the same time periods heretofore mentioned. The cost of such communication lines shall not be borne by Block Services and Tax Masters shall ensure that such costs are paid by the appropriate party. Block Services shall be responsible for, and shall bear the cost of, modems required for such communication lines in Columbus, Ohio (or other applicable location). Tax Masters shall be responsible for, and shall bear the cost of, modems required for such communication lines in the Chicago, Illinois metropolitan area.

1.10 Processing RAL and RAC Requests. Block Services and Tax Masters shall in good faith cooperate regarding the contents of Block Services' Electronic Filing Software and Tax Masters' software in an effort to assure prompt and efficient transmission of data between Block Services, Tax Masters and RAL Originator. Block Services shall extract all RAL and RAC data from its IRS transmission file each time a Return is sent to the IRS in accordance with the Electronic Data Processing Guidelines established by the parties. The Electronic Data Processing Guidelines may be revised upon mutual agreement of the parties from time to time to accommodate any changes to Electronic Data Processing Systems or software no later than July 15th of each year during the term of this Agreement. With respect to a RAL Application which has been designated on behalf of the RAL Originator by Tax Masters' software program as an Instant RAL Application, Block Services shall first forward such RAL Application to Tax Masters, after which Block Services shall electronically transmit the Return, or cause it to be transmitted, to the IRS and then receive positive or negative acknowledgment of the Return's acceptance from the IRS for Electronic Filing, which acknowledgment shall also include, if available, the IRS explanation of the reason the Return was rejected, as described in Chapter 3 of the IRS e-file Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns (Publication 1345, including Rev. Proc. 2000-31), as the same may be amended from time to time ("Notification"). With respect to a RAL Application which has not been designated on behalf of the RAL Originator by Tax Masters' software program as an Instant RAL Application, Block Services shall not forward such RAL Application to Tax Masters without having

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electronically transmitted the Return, or causing it to be transmitted, to the IRS and without having received positive acknowledgement of the Return's acceptance from the IRS for Electronic Filing, which acknowledgment shall also include, if available to the RAL Originator, the Notification. In the event it becomes infeasible to process RAL Applications in the manner specified above in

this Section 1.10 due to circumstances or events beyond the control of the parties hereto, then the parties shall endeavor in good faith to take all reasonable actions necessary to promptly modify the RAL Program in a manner resolving the problems caused by such unfeasibility to process RAL Applications. These modifications may include without limitation, the Final RAL and RAC Fees, the Final Credit Criteria and a reasonable fee to compensate Tax Masters as servicer for the RAL Originator for any additional increase in the cost of funds resulting from a modification of the aforesaid procedures; provided, however, that in all events the parties shall retain their rights to terminate the Agreement in accordance with the procedures hereinafter set forth. Block Services shall be responsible for accurately transmitting to Tax Masters on behalf of Block Offices which use Block Services to transmit such RAL Applications to Tax Masters as servicer for the RAL Originator all material information contained in the RAL Application including without limitation social security numbers ("Information"), as received from the RAL Customer or the Corporate Franchise. Block Services shall notify all Block Offices of the importance of accurate transmission of such Information and shall consult with Tax Masters as servicer for the RAL Originator to develop a system for eliminating, to the extent practicable, errors in such transmission by such Block Offices. Tax Masters shall be responsible for forwarding to the RAL Originator such Information received from Block Services by Tax Masters pursuant to this Section 1.10 as requested by the RAL Originator. Block Services shall pay Tax Masters as servicer for the RAL Originator the amount of any RAL which is not collected by Tax Masters as servicer for the RAL Originator to the extent, and only to the extent, that the failure of Tax Masters as servicer for the RAL Originator to collect such RAL (whether through Direct Deposit or collection from the RAL Customer) is the result of the failure of Block Services to transmit accurately Information as received from the RAL Customer or a Corporate Franchise; provided, however, that Tax Masters as servicer for the RAL Originator must first show that diligent and timely efforts were made to make such collections, such efforts to include an initial contact with the RAL Customer within forty-five (45) days after the clearance of the RAL check by RAL Originator. Such initial contact may consist of the sending of a first collection notice to the RAL Customer and reasonable efforts thereafter to effect collection. All amounts, if any, owed by Block Services under this Section 1.10 shall be paid to Tax Masters as servicer for the RAL Originator in one lump sum within sixty (60) days after Tax Masters verifies that the failure of collection was caused by failure of Block Services to transmit accurately the Information. Block Services shall have no obligation to Tax Masters as servicer for the RAL Originator if the failure of collection is due to either a RAL Customer or a Corporate Franchise giving Block Services inaccurate Information.

1.11 Providing RAL Customer Returns. For collection purposes, Block Services shall provide Tax Masters with a copy of each RAL Customer's electronically filed Returns in the format prescribed by the IRS promptly after the RAL Application is transmitted to Tax Masters, but in no event later than May 30th following such Tax Period. Should interactive processing not be available, such transmission shall only be made after interactive processing is available, or in one batch delivery or transmission not later than May 30 following each Tax Period. In the event Tax Masters needs any RAL Customer's Returns for collection purposes prior to May 30

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following each year's Tax Period, then upon Tax Masters' request, and to the extent practicable, Block Services shall promptly forward such RAL Customer's Returns to Tax Masters.

1.12 Lost RAL or RAC Checks. If a RAL or RAC check disbursed by a Block Office has become lost, or in the case where the RAL Customer has not received the check within fourteen (14) days after such RAL Customer's check is mailed when Tax Masters as servicer for the RAL Originator is mailing the check to a RAL Customer in accordance with Section 8.8, Block Services shall notify Tax Masters as servicer for the RAL Originator to stop payment upon notification from the RAL Customer that the RAL Customer has lost or not received such Check. In either case, Block Services shall directly contact Tax Masters as servicer for the RAL Originator to have a new check issued and obtain from such RAL Customer an indemnifying bond, in a form satisfactory to Tax Masters as servicer for the RAL Originator, holding the RAL Originator free from all costs and expenses or other losses in the event both checks are subsequently presented for payment.

1.13 Compliance with Laws, Rules and Regulations. In connection

with Block Services' preparation of Returns, it shall comply with all applicable laws, rules and regulations, and shall follow all instructions reasonably prescribed by Tax Masters as servicer for the RAL Originator with respect to the preparation and processing of RAL Applications.

1.14 Indemnification. Except as otherwise limited by this Agreement, Royalty, Block Services and Block Tax Services (collectively, the "Block Indemnifying Parties") shall indemnify, hold harmless and reimburse Beneficial Franchise and/or Tax Masters and their respective Affiliates (whichever has incurred the loss) (collectively the "Block Indemnified Parties"), its officers and directors and employees, for all expenses and costs, including without limitation, attorneys' fees, judgments, penalties, payments of other direct expenses and payments in settlement or other disposition of, or in connection with, any claims, disputes, controversies or litigation arising out of Block Services' performance of its duties and responsibilities under this Agreement, including without limitation, liability in connection with the loss, alteration or misuse of disbursement checks or improper completion of disbursement checks, regardless of by whom caused, after delivery of same to Block Services and prior to delivery thereof to the RAL Customer. Notwithstanding any other provision herein, if the Block Indemnifying Parties breach any of their obligations hereunder and any such breach results in a claim for indemnification by the RAL Originator against any Block Indemnified Party, such Block Indemnified Party shall have the right to indemnification from the Block Indemnifying Parties pursuant to the preceding sentence. Block Services may retain attorneys of its own selection to represent it at Block Services' expense. Block Services shall direct the defense of the claim; provided, however, Block Services shall not compromise or settle any such claim or action without prior approval of Tax Masters and Beneficial Franchise, as applicable. If Beneficial Franchise or Tax Masters is named a party to any action or proceeding for which Block Services has a duty of indemnification pursuant to this Section 1.14 Beneficial Franchise and Tax Masters, as applicable, shall have the right to directly defend any such action or proceeding by retaining attorneys of its own selection to represent it at Block Services' expense. Neither Beneficial Franchise nor Tax Masters shall compromise or settle any such claim or action without prior consultation with Block Services.

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## 2. RIGHTS, DUTIES AND OBLIGATIONS OF TAX MASTERS.

2.1 Facilitating RAL Processing. Tax Masters shall act as a facilitator in the processing of RALs between Block Services, Tax Masters and the RAL Originator in accordance with the Electronic Data Processing Guidelines established by the parties.

2.2 Partial Reimbursement of Expenses. On January 2nd or the first business day thereafter of each year, Tax Masters as servicer for the RAL Originator shall reimburse Block Services via a wire transfer for a portion of its out-of-pocket costs and expenses incurred in providing the services described in Section 1.2 hereof in the following agreed upon amounts (the "Expense Reimbursement"):

Tax Period	Expense Reimbursement Amount
-----	-----
2004	\$3,500,000
2005	\$4,250,000
2006	\$5,000,000

2.3 Compliance with Laws, Rules and Regulations. In connection with Tax Masters facilitating the processing of RALs, Tax Masters shall comply with all applicable laws, rules, and regulations.

2.4 Indemnification. Except as otherwise limited by this Agreement and as specifically set forth in Section 1.12 with respect to the care and custody of disbursement checks by Block Services, Tax Masters will indemnify, hold harmless and reimburse Royalty, Block Services, Block Tax Services and/or



Beneficial Franchise or their respective Affiliates (whichever has incurred the loss) (the "Tax Masters Indemnified Parties"), its officers, directors and employees for all expenses and costs, including but not limited to, attorneys' fees, judgments, penalties, payments of other direct expenses and payments in settlement or other disposition of, or in connection with, any claims, disputes, controversies or litigation arising out of any violation of the Federal Truth in Lending Act or Regulation Z of the Federal Reserve Board and other applicable federal and state banking and consumer finance laws and regulations, caused by either Tax Masters or the RAL Originator involving any of the preprinted terms and disclosures set forth on the check to RAL Customers from the RAL Originator, relating to the procedures for applying for or obtaining RALs, relating to cross-collections involving RAL Customers or customers of other financial institutions, relating to the RAL Applications, or the failure of Tax Masters to perform its duties and responsibilities under this Agreement. Tax Masters may retain attorneys of its own selection to represent it at Tax Masters' own expense. Tax Masters shall direct the defense of the claim; provided, however, Tax Masters shall not compromise or settle any claim or action without the prior approval of Block Services, Block Tax Services or Beneficial Franchise as applicable. If Block Services, Block Tax Services or Beneficial Franchise is named a party to any action or proceeding for which Tax Masters has a duty of indemnification pursuant to this Section 2.4, Block Services, Block Tax Services or Beneficial Franchise, as applicable, shall have the right to directly defend any such action or proceeding by retaining attorneys of its own selection to represent it at Tax Masters' expense.

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Provided, however, neither Block Services, Block Tax Services nor Beneficial Franchise shall compromise or settle any such claim or action without prior consultation with Tax Masters. Notwithstanding any other provision herein, in connection with the defense of any such claim, Tax Masters shall have the right to consult with the RAL Originator, including providing any documentation to the RAL Originator that Tax Masters deems reasonably appropriate. All documentation so provided to the RAL Originator shall be subject to the provisions set forth in the agreement between Tax Masters and the RAL Originator with respect to the RAL Originator's right to retain such documentation.

2.5 Cashiers' Checks. Pursuant to the terms of the agreement between Tax Masters and the RAL Originator, all RAL checks, RAC checks, denied RAL and excess checks issued by the RAL Originator will be cashier's checks.

2.6 Review of Marketing and Collection Materials. At Block Services' request, and in all cases where Tax Masters', the RAL Originator's or Beneficial Franchise's name or trade names are used in such materials, Tax Masters as servicer for the RAL Originator shall review, and shall have the right to provide for the RAL Originator to review, the marketing materials in question and shall make reasonable efforts to comment upon such materials within two (2) weeks of receipt thereof. At Tax Masters' request, and in all cases if Block Services' name or trade names are used in the materials, Block Services shall review the marketing materials in question and shall make reasonable efforts to comment upon the same within two (2) weeks of the receipt thereof. If any such marketing materials describe performance of obligations in connection with the RAL Program required by a party other than the party preparing same, such other party's approval of the materials shall be obtained prior to use thereof. Any collection letters developed by Tax Masters shall be in a format reasonably acceptable to Block Services.

2.7 Review of RAL or RAC Checks and Disclosure Statement. Tax Masters shall review the RAL or RAC checks of the RAL Originator and the disclosure statement developed by RAL Originator and shall propose instructions to RAL Originator, concerning the modifications it deems necessary to such checks and disclosure statement in order to comply with the Federal Truth in Lending Act and Regulation Z requirements, as Tax Masters deems necessary after consultation and agreement with the RAL Originator. Tax Masters agrees to provide, at its cost, such instruments (including the RAL and RAC checks of the RAL Originator and envelopes containing Block Services' name on the outside) in accordance with Block Services' specifications and Section 5.2 below, in order that such instruments are compatible with Block Services' processing equipment and standards of trademark usage.

3. RIGHTS, DUTIES AND OBLIGATIONS OF TAX MASTERS AS SERVICER FOR RAL ORIGINATOR.

3.1 Establishment of RAL and RAC Accounts and Making of Loans.

(a) Designation of RAL Originator. Tax Masters has designated ICB as the RAL Originator for the 2004 Tax Period.

(b) Establishment of Accounts. Except as otherwise limited by this Agreement, Tax Masters shall process RAL and RAC Applications for the 2004 Tax Period and

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subsequent Tax Periods during the term of this Agreement as servicer for the RALs and RACs with respect to such Applications received electronically from Block Services by the RAL Originator according to the RAL Originator's Final Credit Criteria, within the same day of the RAL Originator's receipt; provided, however, in either case, such Applications must be received by Tax Masters as servicer for the RAL Originator by 9:00 a.m. Eastern Standard or Daylight Savings Time (as the case may be). On behalf of the RAL Originator, Tax Masters as servicer shall establish an account ("RAL Account") for the RAL Customer and the RAL Originator (and any successor participant in all or any portion of a RAL) shall have the right to offset against the RAL and RAC all sums received from the IRS or state taxing authorities which are deposited in the RAL Account in connection with such RAL Customer's refund up to the amount of the RAL or RAC inclusive of any Final RAL and RAC Fee or other fees or charges. In the event that a RAL Customer is mailed a refund check rather than receiving the refund electronically in the RAL Account, or receives a refund less than the amount anticipated, the RAL Originator shall have the right under the RAL Check Loan Agreement with the RAL Customer to be paid directly by such RAL Customer. Such check may be modified from time to time to comply with regulatory requirements.

(c) Making of Refund Anticipation Loans. Notwithstanding the foregoing, the RAL Originator is not obligated to make a loan to a RAL Customer until such RAL Customer's RAL Application is approved by Tax Masters as servicer for the RAL Originator in accordance with the RAL Originator's Final Credit Criteria. Subject to the Final Credit Criteria and approval of the loans as aforesaid, the RAL Originator has committed to (and Tax Masters shall ensure that all future RAL Originators commit to) make RALs to all customers who make RAL Applications for same at, or whose Returns or RAL Application is processed through, any Block Office. Notwithstanding any other provision of this Agreement to the contrary, Tax Masters as servicer for the RAL Originator shall process such RALs or RACs on terms, and provide a level of services to RAL Customers, which are reasonably competitive with the terms and level of services offered by at least one or more Other RAL Originators (as defined below) to their customers. In establishing such reasonably competitive terms, Tax Masters as servicer for the RAL Originator shall in its good faith judgment design and recommend for approval by the RAL Originator a RAL Program that balances the need for high volumes with adequate fee pricing to generate optimum RAL Program revenues. If Block Services notifies Tax Masters on or after January 1, but on or before October 1 of any Tax Period during the term hereof that the terms pursuant to which the RAL Originator makes loans to RAL Customers, or the level of services provided to RAL Customers, are not reasonably competitive with the terms or level of services being offered or to be offered by at least one or more other RAL originators which make RALs or RACs similar to those contemplated by this Agreement ("Other RAL Originators"), Tax Masters as servicer for the RAL Originator shall recommend to the RAL Originator modifications to the RAL Program, or to the level of services provided to such customers, in a manner which makes such terms and level of services reasonably competitive with the terms and level of services offered by at least one or more Other RAL Originators. Any such modification shall be made effective for the first full Tax Period following such notification. If such notification is given to Tax Masters as servicer for the RAL Originator after October 1 of any Tax Period during the term hereof, then the RAL Originator shall not be required to modify its program as described above, if such modification cannot reasonably be made more promptly, until the commencement of the second full Tax Period which begins after such notification.

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3.2 Deduction of Additional Charges. Tax Masters as servicer for the RAL Originator shall upon receipt of a RAL Customer's check reconciliation record remit on the same banking business day directly by way of an ACH credit

to the appropriate Block Offices' company account the additional fees or charges authorized by the RAL Customer for payment to the Block Office, including without limitation, tax preparation fees. In the event it becomes necessary to process a significant number of RAL Applications resulting in a significant backlog in Tax Masters as servicer for the RAL Originator remitting to the Block Offices the aforesaid fees and charges, then Tax Masters, as servicer for the RAL Originator, shall notify Block Services of the delay and at such time the parties will negotiate in good faith a reasonable fee to compensate Block Services for any additional increase in Block Services' cost of funds resulting from such delay in remitting such fees and charges.

3.3 Replacement RAL and RAC Checks. In connection with Section 1.12 relating to lost checks, Block Services shall issue a RAL Originator replacement check to the RAL or RAC Customer upon receipt from Tax Masters as servicer for the RAL Originator of an electronic approval to issue such check within twenty-four (24) hours after receiving an electronic indication from Block Services that Block Services has in its possession an indemnifying bond executed by the RAL Customer. Such electronic indication shall constitute a conclusive presumption of receipt by Block Services of such indemnifying bond and Block Services shall indemnify and hold Tax Masters and the RAL Originator harmless from any loss in the event such indemnifying bond is lost or has in fact not been obtained.

3.4 Compliance with Laws, Rules and Regulations. In connection with RAL Applications and the procuring, processing and extension of RALs, Tax Masters as servicer for the RAL Originator shall comply with all applicable laws, rules and regulations. In addition, Tax Masters shall enforce the provisions of the agreement between Tax Masters and the RAL Originator requiring the RAL Originator to comply with all applicable laws, rules and regulations.

3.5 RAL Originator Sale and Servicing Agreement. Block Services acknowledges that it has received a redacted copy of the Sale and Servicing Agreement entered into by Tax Masters with ICB. Without the prior written consent of Block Services, such consent not to be unreasonably withheld, conditioned or delayed, Tax Masters hereby agrees not to amend such agreement in any way that (a) modifies or alters the rights of ICB to use (i) Block Services' or any of its Affiliates' tradenames, trademarks and the like or (ii) RAL Customer information other than in its capacity as a RAL Originator, or (b) would materially adversely affect any of the rights of Block Services associated with the RAL Program. Tax Masters shall strictly enforce the provisions of the Sale and Servicing Agreement prohibiting ICB and its Affiliates from soliciting RAL Customers for any other product or service.

3.6 Indemnification. Except as otherwise limited by this Agreement and except as specifically set forth in Section 1.12 with respect to the care and custody of disbursement checks by Block Services, Tax Masters will indemnify, hold harmless and reimburse Beneficial Franchise, and any of the Block Companies or their respective Affiliates (whichever has incurred the loss), its officers, directors and employees for all direct out-of-pocket expenses and costs, including but not limited to, attorneys' fees, judgments, penalties, payments of other direct expenses and payments in settlement or other disposition of, or in connection with, any claims,

disputes, controversies or litigation arising out of (i) the failure of Tax Masters to perform its duties and responsibilities under this Agreement, or (ii) the failure of the RAL Originator to perform its duties and responsibilities under any agreement between Tax Masters and the RAL Originator relating to the RAL Program. Notwithstanding any other provision herein, if Tax Masters breaches any of its obligations hereunder and any such breach results in a claim for damages by the RAL Originator against any of the Block Companies or their Affiliates, then such Block Company and such Affiliate shall have the right to indemnification from Tax Masters pursuant to the preceding sentence. Tax Masters may retain attorneys of its own selection to represent it at Tax Masters' expense. Tax Masters shall direct the defense of the claim; provided, however, Tax Masters shall not compromise or settle any claim or action without the prior approval of Block Services and Tax Masters. If Block Services, Block Tax Services or Beneficial Franchise is named a party to any action or proceeding for which Tax Masters has a duty of indemnification pursuant to this Section 3.6, Block Services, Block Tax Services or Beneficial Franchise, as applicable, shall have the right to directly defend any such action or proceeding by retaining attorneys of its own selection to represent it at Tax Masters'

expense. Provided, however, neither Block Services nor Block Tax Services nor Beneficial Franchise shall compromise or settle any such claim or action without prior consultation with Tax Masters.

#### 4. RIGHTS, DUTIES AND OBLIGATIONS OF BENEFICIAL FRANCHISE.

4.1 Licenses. Beneficial Franchise hereby grants to Block Services a nonassignable, nonexclusive right and license under U.S. Patent No. 4,890,228 and U.S. Patent No. 5,193,057 ("Patent Rights") to use any data processing system or any method falling within the scope of any claim of the Patent Rights. Beneficial Franchise also grants to Block Services the exclusive right to grant sublicenses to use any data processing system or method falling within the scope of any claim of the Patent Rights to any Person or entity which is involved in the processing of RALs or RACs (whether through Electronic Filing, or the taking, presenting or handling of applications for RALs or RACs) but only to the extent that the RAL or RAC is processed in any manner through an Electronic Filing system majority owned or operated by Block Services or used by any Block Office for a substantial portion of such office's Electronic Filings. Such Person or entity shall hereinafter be referred to as a "Block RAL Processor". Block Services agrees to grant such a sublicense to any Major Franchisee or affiliate of Block Services which uses the RAL Originator to make RALs or RACs to its customers. Any sublicense granted by Block Services shall contain provisions corresponding to those of this Agreement regarding termination of Block Services' Patent Rights and shall not include the right to sublicense to other parties. Beneficial Franchise hereby waives and fully releases Block Services and any Block RAL Processor from any claims for infringement of Patent No. 4,890,228 and Patent No. 5,193,057 arising from RALs or RACs made prior to or during the terms of Block Services' rights under the license granted in this Section.

4.2 Warranties. Beneficial Franchise represents and warrants that it is the owner of Patent Rights and has the right to grant the rights and licenses described herein. BENEFICIAL FRANCHISE MAKES NO WARRANTIES, EXPRESS OR IMPLIED, REGARDING THE SUBJECT MATTER OF THESE LICENSES.

4.3 Indemnification. Except as otherwise limited by this Agreement and as specifically set forth in Section 1.12 with respect to the care and custody of disbursement checks

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by Block Services, Beneficial Franchise will indemnify, hold harmless and reimburse Tax Masters, Royalty and Block Services or their respective Affiliates (whichever has incurred the loss) (the "Beneficial Franchise Indemnified Parties"), its officers, directors and employees for all direct out-of-pocket expenses and costs, including but not limited to, attorneys' fees, judgments, penalties, payments of other direct expenses and payments in settlement or other disposition of, or in connection with, any claims, disputes, controversies or litigation arising out of the failure of Beneficial Franchise to perform its duties and responsibilities under this Agreement or for any claims, disputes, controversies or litigation arising out of or involving Patent Nos. 4,890,228 and 5,193,057. Beneficial Franchise may retain attorneys of its own selection to represent it at Beneficial Franchise's expense. Beneficial Franchise shall direct the defense of the claim; provided, however, Beneficial Franchise shall not compromise or settle any claim or action without the prior approval of Block Services and Tax Masters, as applicable. If Block Services or Tax Masters is named a party to any action or proceeding for which Beneficial Franchise has a duty of indemnification pursuant to this Section 4.3, Block Services or Tax Masters, as applicable, shall have the right to directly defend any such action or proceeding by retaining attorneys of its own selection to represent it at Beneficial Franchise's expense. Neither Block Services nor Tax Masters shall compromise or settle any such claim or action without prior consultation with Beneficial Franchise.

4.4 Expiration of Licenses. Block Services' licenses under Section 4.1 above shall run until the termination of this Agreement in accordance with Sections 6.1 or 6.3, as applicable, except under those circumstances set forth in Section 6.3, pursuant to which the licenses shall survive the termination of this Agreement ("Survival Provisions"). Unless Block Services' licenses survive termination pursuant to the Survival Provisions, termination of Block Services' licenses under the Patent Rights shall terminate any sublicenses granted by Block Services.

5. LICENSE AND SUBLICENSE TO TAX MASTERS OF CERTAIN RIGHTS.

5.1 Sublicense of Rights Under Patent. Block Services hereby grants to Tax Masters (including in its capacity as servicer for the RAL Originator) a nonexclusive and nonassignable right and license under the Patent Rights to use, and the right to sublicense to the RAL Originator to use, any data processing system or any method falling within the scope of any claim of the Patent Rights in connection with the making of RALs and issuing of RACs to any RAL Customer which uses a Block Office for Electronic Filing of a Return.

5.2 License of Trademarks. Royalty hereby grants to Tax Masters (including in its capacity as servicer for the RAL Originator) a nonexclusive and nonassignable right and license to use, and to sublicense to the RAL Originator to use, the name and trade or service mark "H & R Block" and such other trade or service marks that Block Services may from time to time designate for use in connection with its RAL Program (collectively, the "Block Licensed Marks") in connection with the making and processing of RALs and RACs for RAL Customers. Neither Tax Masters nor its Affiliates shall use, nor shall any sublicense by Tax Masters to the RAL Originator permit the RAL Originator to use, the Block Licensed Marks for any purpose except the purposes specifically set forth herein. Any use of the Block Licensed Marks and all goodwill generated thereby shall inure to the benefit of Royalty. All uses of the Block Licensed Marks shall be approved in advance by Royalty and shall be at all times in compliance with any standards which Royalty may impose in writing from time to time regarding such use. All rights

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in and to the Block Licensed Marks which are not specifically granted to Tax Masters shall remain with Royalty. Tax Masters shall cooperate, and shall cause the RAL Originator pursuant to the terms of any sublicense to cooperate, with Royalty in the protection and defense of the Block Licensed Marks and in the prosecution, at Royalty's sole option, of infringers of the Block Licensed Marks. Tax Masters shall not register nor seek to register, and any sublicense by Tax Masters to the RAL Originator shall prohibit the RAL Originator from registering or seeking to register, any trade or service mark, logotype or commercial symbol used by either of them in the exercise of the rights licensed under this Section 5.2 or sublicensed by Block Services to Tax Masters pursuant to the immediately preceding Section 5.1 of this Agreement. Royalty waives and releases Tax Masters, from and against, any and all claims of liability arising in any manner from the use by Tax Masters of the Block Licensed Marks prior to July 19, 1996. The Block Licensed Marks and access granted by Block Services to Tax Masters (including in its capacity as servicer for the RAL Originator) shall terminate upon termination of this Agreement.

5.3 Access to Block Offices. Tax Masters shall, with Block Services' prior written consent, have access to the Block Offices (to the extent it is able to do so with respect to Corporate Franchises) for the purpose of assisting and facilitating the operation of the RAL Program at such Block Offices. Any consent of Block Services shall be in accordance with a procedure mutually agreed upon by Block Services and Tax Masters on or before August 1 of each Tax Year during the term hereof.

5.4 RAC License Fee. Tax Masters as servicer for the RAL Originator shall cause to be paid to Block Services a license fee of \$6.88 for each RAC issued by the RAL Originator pursuant to this Agreement during the 2004 Tax Period and future Tax Periods, except that there shall be no license fee for a RAC for which a RAL Customer has chosen to receive his or her funds by Direct Deposit into his or her IRA or Auto Investor account at an Affiliate of Block Companies. The license fee described in this Section 5.4 (the "RAC License Fee") shall be paid by credit to Block Services' account by ACH credit to the appropriate Block Office's company account.

6. TERM; ANNUAL DETERMINATION OF RAL AND RAC FEES; TERMINATION; EFFECT OF TERMINATION.

6.1 Term of Agreement; Renewal. The term of this Agreement shall commence as of July 19, 1996 and shall expire on June 30, 2006 ("Term"). In the event this Agreement has not been sooner terminated as set forth in Section 6.3 below, the parties agree to review this Agreement prior to each Tax Period with a view toward entering into reasonable, good faith discussions concerning revisions to the relationship represented by the terms hereof, among Block Companies and Household Companies regarding the making of RALs and issuing of

RACs. Such revisions, if any, shall be upon such terms as are mutually agreeable to the parties thereto. If such revisions are not agreed to, this Agreement shall continue on the terms and conditions set forth herein.

## 6.2 Annual Determination of RAL and RAC Fees and Credit Criteria.

(a) Tax Masters as servicer for the RAL Originator, after consultation with the RAL Originator, annually shall make an initial determination of the RAL and RAC fees to be

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paid by each RAL Customer (the "Initial RAL and RAC Fees"). Tax Masters shall provide Block Services with such Initial RAL and RAC Fees no later than August 15 of each year, with the actual final RAL and RAC fees to be established by Tax Masters as servicer for the RAL Originator, after consultation with the RAL Originator, no later than September 15 of each year ("Final RAL and RAC Fees").

(b) Tax Masters as servicer for the RAL Originator, after consultation with the RAL Originator, shall make an initial determination of the RAL credit criteria no later than August 15 of any year during the Term ("Initial Credit Criteria") and, after consultation with the RAL Originator, shall establish final credit criteria ("Final Credit Criteria") together with the Qualifying Procedures on Schedule 1.3 no later than September 15 of such year for the ensuing Tax Period.

(c) Tax Masters as servicer for the RAL Originator, after consultation with the RAL Originator, shall provide to Block Services as Schedule I to this Agreement, the Initial Credit Criteria and the Initial RAL and RAC Fees. Such Schedule may be updated by Tax Masters as servicer for the RAL Originator, after consultation with the RAL Originator, on or before September 15 of each year.

(d) On or before September 15 of each year, Tax Masters as servicer for the RAL Originator, after consultation with the RAL Originator, agrees to provide to Block Services as Schedule 1.3 to this Agreement the Qualifying Procedures, and as Schedule II to this Agreement the Final Credit Criteria and the Final RAL and RAC Fees for the ensuing Tax Period provided, however, that in the event that significant external events or occurrences beyond Tax Masters' control become known to Tax Masters at any time after Tax Masters' determination of the Final Credit Criteria and Final RAL and RAC Fees each year that are likely to affect materially net RAL and RAC revenues of Tax Masters and the RAL Originator for that year, Tax Masters as servicer for the RAL Originator, after consultation with the RAL Originator may, after discussion with Block Services, and upon not less than ten (10) days (or two (2) days during any Tax Period) notice to Block Services promptly modify the RAL Program Final Credit Criteria or Final RAL and RAC Fees but only to an extent which is reasonable under the circumstances, and only until the effect of such event or occurrence ends or until the end of the first Tax Period in which such event or occurrence has or is likely to have the above-described effect.

(e) Notwithstanding any other provision in this Agreement, the RAL Originator, in its exclusive discretion, shall, on advice and recommendation of Tax Masters as servicer for the RAL Originator, establish the Initial RAL and RAC Fees, the Final RAL and RAC Fees, the Initial Credit Criteria and the Final Credit Criteria used by Tax Masters as servicer for the RAL Originator in the RAL Program.

## 6.3 Termination and Cure.

(a) Termination. Any party may at its option terminate this Agreement upon ten (10) days prior written notice to all other parties if (i) any other party is in material default in the performance of any of its obligations or duties under this Agreement and the party in default shall fail to commence cure within such 10-day period or shall fail thereafter diligently to

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prosecute a cure to completion within a reasonable time thereafter, which reasonable time shall be based on the nature of the default and the steps

required to cure, but which in all events shall not exceed forty-five (45) days from the notice of default (or ten (10) days from the notice of default during a Tax Period), provided, however, that in all events any such cure must be accomplished without substantial unreimbursed expense or damage to any other party by reason of the cure; (ii) the IRS and/or state taxing authority withdraws or materially changes the implementing revenue procedures sanctioning RALs or RACs to the substantial detriment of that party; (iii) the operation of the RAL Program or the Electronic Filing program is made infeasible or impractical by (x) legal or regulatory determinations, enactments or interpretations or (y) significant external events or occurrences beyond that party's control provided that the parties shall first mutually endeavor in good faith to employ reasonable efforts to modify the program in a manner resolving the problems caused by such legal, regulatory, or significant external events or occurrences.

In the event that this Agreement is terminated by any party on the basis of clause (i) if the party in default is Block Services, clause (ii) or clause (iii), the non-exclusive license provided to Block Services by Beneficial Franchise shall terminate effective upon the date of termination of this Agreement. If this Agreement is terminated on the basis of clause (i) if Block Services is not the party in default, the license provided by Beneficial Franchise to Block Services under Section 4.1 and the right to sublicense under Section 4.1 shall survive such termination.

(b) Certain Cure. For purposes of Section 6.3(a), if the default with respect to which Block Services gives notice of termination is the failure or inability of RAL Originator to make RALs or RACs as required by this Agreement, then cure shall be accomplished, and no termination of this Agreement shall result to the extent that Tax Masters arranges, subject to Block Companies' rights under the Second ICB Consent Letter, for a substitute performance by another RAL originator or RAC issuer, and such other RAL originator or RAC issuer commences, within the appropriate cure period set forth in Section 6.3(a) (45 days, or 10 days during the Tax Period), to make the RALs and issue RACs which RAL Originator was unable to do. Block Services and Tax Masters as servicer for the RAL Originator shall use their respective best efforts in attempting to arrange for such substitute performance. The provisions of this Section 6.3(b) shall not relieve Tax Masters as servicer for the RAL Originator of its obligations to (i) diligently complete cure under Section 6.3(a) so that RAL Originator can again make RALs and issue RACs notwithstanding substitute performance under this Section 6.3(b) in the interim by an other RAL Originator; and (ii) compensate Block Services for expenses and damages as described in Section 6.3(a). Also, the provisions of this Section 6.3(b) shall not be used by Tax Masters to avoid the provisions of Section 8.5 dealing with assignment of rights and obligations under this Agreement.

6.4 Effect of Termination. After any termination, the RAL and RAC accounts established by the RAL Originator will continue to be the property and responsibility of the RAL Originator which established such RAL and RAC accounts. Termination shall not affect existing obligations.

6.5 Return of Confidential Information. Upon termination of this Agreement, the parties will return to any furnishing party all confidential information received in connection

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with this Agreement and certify in writing to such furnishing party that such receiving party has not retained any copies of such confidential information; provided, notwithstanding any other provision herein, that any information that Tax Masters provides to the RAL Originator in carrying out its obligations under this Agreement that the RAL Originator is required as a regulated institution to retain shall not be subject to the return provisions herein during the period of such legally required retention.

## 7. CONFIDENTIALITY AND PRIVACY OF INFORMATION.

7.1 Proprietary Information. Each of the parties is informed and acknowledges that implementation and operation of the service of offering of RALs and RACs (the "RAL Program") described in this Agreement will involve the use of certain systems, computer programs and/or other data including business information or trade secrets ("Proprietary Information") that are proprietary to the respective parties. Such Proprietary Information shall be identified as "confidential" or "proprietary" by the respective parties. Each party will

retain in confidence all Proprietary Information received in connection with this Agreement and limit access to or disclosure of such Proprietary Information received in connection with this Agreement solely for the purpose of operation of the RAL Program under this Agreement. To this end, the recipient will employ the same degree of care to avoid disclosure of such information that it employs with respect to its own information deemed confidential. Subject to Section 7.4, such obligation of confidentiality shall not extend to any information which is shown to have been known by the receiving party prior to disclosure to it by the other party or parties hereto or generally known to others engaged in the same trade or business as the furnishing party, or that is or shall become part of public knowledge through no act or omission by the receiving party or its directors, officers, employees, professional advisors or other representatives, or that shall have been lawfully received by the receiving party from a third party which the receiving party does not know and has no reason to believe is under any obligation of confidentiality with respect to such information.

## 7.2 Privacy of Information.

(a) Privacy of Customer Information. Notwithstanding anything in this Agreement to the contrary, a party receiving nonpublic personal information (the "Receiving Party") from any party which obtained such nonpublic personal information from a customer or consumer (the "Disclosing Party"), agrees that it will not disclose such nonpublic personal information of customers and consumers of Disclosing Party to non-affiliated third parties or use such nonpublic personal information for any purpose other than satisfying Receiving Party's duties and obligations under this Agreement, unless the consumer or customer has consented to such use or it is otherwise permitted by applicable law, provided that Tax Masters shall have the right to disclose to the RAL Originator information it deems reasonably necessary to carry out its obligations under the RAL Program. Any such use or disclosure by Receiving Party of nonpublic personal information of customers and consumers of the Disclosing Party shall be in compliance with federal and state laws, rules and regulations.

(b) Obligations of Receiving Party to Safeguard Customer Information. In addition to any other obligations of Receiving Party set forth in this Agreement, Receiving Party agrees to implement and maintain safeguards for the nonpublic personal information of

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customers and consumers of Disclosing Party, which shall be consistent with the requirements of 16 CFR 314, as directed by the Disclosing Party, but in no event less than the standard of care Receiving Party uses to protect its own information of similar sensitivity. Receiving Party may permit access and usage of nonpublic personal information of customers and consumers of Disclosing Party to Receiving Party's Affiliates in order to exercise its rights and perform its obligations under this Agreement and any related agreements among the parties (including but not limited to the rights under Section 1.4), provided that Receiving Party shall require that any of its Affiliates that are permitted such access and/or usage agree not to disclose such information to any third party except as otherwise permitted by Section 7.2(a) herein. Receiving Party will allow Disclosing Party to reasonably audit Receiving Party's compliance with its obligations under this Section 7.2. All terms used in this Section shall have the same meanings, where the context permits, as set forth in 16 CFR Parts 313 and Part 314.

7.3 Conduct Prohibited. Notwithstanding anything in this Section 7 to the contrary and notwithstanding any consent from a RAL Customer, Tax Masters and Beneficial Franchise agree that they will not, and Tax Masters shall enforce the obligation of the RAL Originator under the agreement between Tax Masters and the RAL Originator that the RAL Originator and any of its Affiliates not, (a) use Block Services' name (including the H&R Block and the Block Financial Corporation names), or the names of any of Block Services' Return preparers, in any communications with RAL Customers or other Persons except in carrying out RAL Originator's, Tax Masters' and Beneficial Franchise's obligations under this Agreement and the agreement between Tax Masters and the RAL Originator; (b) target or solicit Block Services' RAL Customers for any individual retirement account or similar or alternative retirement account; or (c) use or disclose the fact that a RAL Customer was a customer of Block Services or Block Financial Corporation, without Block Services' prior written consent except as necessary to carry out RAL Originator's, Tax Masters' and Beneficial Franchise's obligations under this Agreement and the agreement between Tax Masters and the RAL Originator.



7.4 Sharing of Return and RAL Application Data. Subject to Section 7.3, Tax Masters may share any data from a RAL Customer's Return and RAL Application with any of its Affiliates and, solely for purposes of carrying out its obligations under this Agreement, to the RAL Originator; provided that it shall obtain appropriate consents for such sharing that are compliant with 26 USC Sections 7216 and regulations promulgated thereunder, and further provided that it complies with the requirements of the Gramm Leach Bliley Act and 16 CFR 313. Tax Masters, upon obtaining appropriate consents from RAL Customers, may share any data from such RAL Customers' Returns and RAL Applications with any of their Affiliates.

7.5 Survival. The obligations of the parties under this Section 7 shall survive the expiration or termination of this Agreement.

## 8. MISCELLANEOUS.

8.1 Offering of RALs and RACs. Block Services, through Block Offices, shall not offer directly or indirectly any RALs or RACs to any of its customers except in connection with a RAL Program offered by or through Tax Masters as servicer for the RAL Originator and Block Services through Block Offices, or Major Franchisees or subfranchisees of Major Franchisees who are participating in the RAL Program. In the event Tax Masters offers a RAL program

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(either directly or through a RAL originator) to subscribers other than Block Services with a RAL or RAC fee less than those offered in Tax Masters' RAL Program with Block Services, Tax Masters shall provide RALs or RACs in conjunction with Tax Masters' RAL Program with Block Services at the same or lower RAL or RAC fees offered in conjunction with such other subscribers.

Block Services agrees that for each Tax Period during this Agreement, except as otherwise agreed by the parties in the Second ICB Consent Letter, RAL Originator will be the RAL originator and RAC issuer for 100% of Block Offices, other than Corporate Franchises. Block Services shall use reasonable good faith efforts to cause Tax Masters to be the facilitator of RALs and RACs for 100% of the Corporate Franchises, but Block Services cannot assure or guarantee that any such Corporate Franchise will use a particular RAL and RAC facilitator.

8.2 Audit Rights of the Parties. Each party agrees that they will each make the applicable files, books and records available to the nationally recognized firm of independent certified public accountants of the other parties as such parties may reasonably request in connection with any of the requirements to be completed or payments to be made under this Agreement. Each party shall furnish to the other parties all such information concerning transactions and services provided by it pursuant to those sections as the requesting parties may reasonably request, and permit the other parties and their authorized representatives reasonable access, during normal business hours, to audit the books and records of such party as they relate to any aspect of those sections. In addition, Tax Masters shall have the right to obtain access to such information for the RAL Originator to the extent necessary to enable the RAL Originator to comply with its obligations under applicable laws and regulations.

8.3 Other Agreements. Each party warrants that its execution of this Agreement does not constitute a violation of any agreement or relationship to which it is a party.

8.4 Use of Name; Agency. Except as otherwise set forth herein, Tax Masters, Beneficial Franchise and Block Companies agree not to use the trade names or service marks of any other party without the other party's express written consent and Tax Masters agrees to enforce the obligation of the RAL Originator under the agreement between Tax Masters and the RAL Originator that the RAL Originator not use the trade names or service marks of Block Services or its Affiliates without Block Services' express written consent. Block Services also agrees not to use the name of the RAL Originator without first obtaining Tax Masters' consent as servicer for the RAL Originator. This Agreement does not establish or create a joint venture among any of the parties to this Agreement or the employees, agents or representatives of the respective parties are not the partners, agents or representatives of each other. Tax Masters and Beneficial Franchise agree to Block Services' use during the term of this

Agreement of the trademark "Because it's your money" in connection with Block Services' tax preparation and RAL Program and other products offered by Block Services from time to time and related advertising; except that with respect to such other non-tax related products of Block Services, if Tax Masters or its Affiliates are using such trademark in connection with products that are comparable to Block Services' (and not part of a joint offering with Block Services), Block Services shall obtain prior approval from Tax Masters or its Affiliates as the case may be for the use of such trademark.

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8.5 Assignment. Except as set forth in Section 6.3(b), any party's rights under this Agreement may not be assigned without the prior written consent of the other parties upon thirty (30) days prior written notice, which consent shall not be unreasonably withheld.

8.6 Litigation. In the event of litigation among the parties with respect to this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees from the losing party or parties, including such fees incurred during any such litigation on appeal.

8.7 Excusable Delays. If the performance of the obligations hereunder of any party to this Agreement is prevented, restricted or interfered with by reason of fire, or other casualty or accident, strikes or labor disputes, war or other violence; any law, order, proclamation, regulation, ordinance, demand, or requirement of any government agency; or any act or condition whatsoever beyond such party's reasonable control (provided, however, that the failure of any computer hardware, software, or communication system maintained by Tax Masters in connection with the RAL Program shall not be "excused" under this Section, to the extent such failure is not caused by or the result of any of the above-mentioned factors or conditions); such party, upon giving prompt notice to the other parties, shall be excused from such performance to the extent of such prevention, restriction or interference; and such non-performance shall not constitute a default under this Agreement, provided, however, that such party shall use reasonable efforts, including, without limitation, the best efforts referred to in Section 6.3(b) to arrange for substitute performance and to avoid or remove such causes of non-performance, and shall continue performance hereunder whenever such causes are removed.

8.8 Contingent Issuing of Checks by RAL Originator. In the event it becomes infeasible due to events or occurrences beyond the parties' control for Block Offices to issue RAL or RAC disbursement checks directly to RAL Customers, then the parties agree that Tax Masters as servicer for the RAL Originator shall issue such checks directly to RAL Customers. If any check is mailed by the RAL Originator, Tax Masters as servicer for the RAL Originator shall mail the check to the RAL Customer within the same day of RAL Originator's receipt of the RAL Customer's RAL Application provided, however, in either case, such RAL Application must be received by the RAL Originator by 9:00 a.m. Eastern Standard or Daylight Savings Time (as the case may be).

8.9 DISCLAIMERS. BLOCK COMPANIES' AND HOUSEHOLD COMPANIES' OBLIGATIONS UNDER THIS AGREEMENT ARE IN LIEU OF ALL WARRANTIES, EXPRESS OR IMPLIED, EXCEPT AS OTHERWISE PROVIDED IN SECTION 1.12 WITH RESPECT TO BLOCK SERVICES' CARE AND CUSTODY OF THE DISBURSEMENT CHECKS, NEITHER BLOCK COMPANIES NOR HOUSEHOLD COMPANIES WILL BE LIABLE FOR INCIDENTAL, SPECIAL, INDIRECT OR CONSEQUENTIAL DAMAGES, LOSS OF PROFITS OR INCOME, LOSS OF USE OR OTHER BENEFITS ARISING OUT OF OR IN CONNECTION WITH THIS AGREEMENT OR THE SERVICES PERFORMED HEREUNDER. PROVIDED, HOWEVER, WITH RESPECT TO BLOCK SERVICES' RESPONSIBILITIES UNDER SECTION 1.12, THE PARTIES AGREE THAT BLOCK SERVICES WILL NOT BE LIABLE FOR INCIDENTAL, SPECIAL, OR INDIRECT DAMAGES BUT WILL BE LIABLE FOR ANY INTEREST CHARGES. It is the responsibility of Block Services to ensure that all of its files are adequately duplicated and documented. Tax Masters will not be responsible for duplicating its files, or for the cost of

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reconstructing data stored on disc files, tapes, memories, etc., lost during the course of performance of its obligations under this Agreement.

8.10 Applicable Law. This Agreement will be governed by and

interpreted in accordance with the laws of the State of Delaware.

8.11 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, addressed to each as follows:

If to Block Companies to: H & R Block Services, Inc.  
4400 Main Street  
Kansas City, Missouri 64111  
Attn: Jeffery W. Yabuki

If to any one or more of  
Household Companies to: Household Tax Masters Inc.  
200 Somerset Corporate Blvd.  
Bridgewater, New Jersey 08807  
Attention: Patrick A. Cozza

Any party may change the address to which it desires notices to be sent by giving the other parties ten (10) days prior notices of any such change.

Any notice shall be deemed given upon its receipt by the party to whom the notice is addressed.

8.12 Other Financial Services. Block Services agrees to consult with Tax Masters regarding financial products and services created by Block Services or Tax Masters or their Affiliates that may be offered through Block Services' company-owned tax offices. In the event Block Services determines to introduce a financial product or service provided by a third party (other than a direct or indirect subsidiary of H&R Block, Inc.) through company-owned tax offices (a "Third-Party Product"), Block Services agrees to consult with Tax Masters regarding such Third-Party Product and negotiate in good faith with Tax Masters (or an Affiliate of Tax Masters) for Tax Masters (or such Affiliate or the RAL Originator designated by Tax Masters) to offer and provide such Third-Party Product through Block Services' company-owned tax offices. Notwithstanding the foregoing sentence, this Section 8.12 shall not apply to any Third-Party Product with respect to which (i) Block Services (or its Affiliates) are conducting discussions within the six (6) month period ending on the date of this Agreement or (ii) a third party approached Block Services or its Affiliates and initiated discussions concerning such Third-Party Product subject to the terms of a confidentiality agreement between Block Services (or its Affiliates) and such third party; provided that, to the extent permitted by any applicable confidentiality agreement (as determined by Block Services (or its Affiliates) in its or their sole discretion), Block Services will consult with Tax Masters (or its Affiliates) regarding such Third-Party Product.

8.13 Severability. If any provision of this Agreement, compensation to Block Services described herein, Final Credit Criteria or Final RAL and RAC Fees charged to customers of

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Block Services, shall for any reason be held to be invalid, illegal or unenforceable, such invalidity shall not otherwise affect the validity of this Agreement or any other provision hereof, and this Agreement shall be interpreted and construed as if such provision, to the extent invalid, had not been contained herein. In such event, the parties shall in good faith endeavor to redesign the RAL Program or the terms hereof in a manner consistent with the intent of this Agreement pursuant to Section 6 hereof.

8.14 Modifications to Agreement. This Agreement supersedes the First Amended and Restated Operations Agreement. Each party represents and warrants that there are no oral understandings between or among them that differ from the terms and conditions of this Agreement. This Agreement may be modified only by a written agreement signed by all of the parties.

8.15 References to RALs. Unless otherwise specified in this Agreement, any general reference to a RAL in this Agreement shall be meant to also refer to an Instant RAL, which is a RAL under which a credit decision is made prior to Block Services receiving positive acknowledgment of the underlying Return's acceptance for Electronic Filing and the Notification from the IRS, and a Classic RAL, which is the name sometimes used for a RAL to distinguish it from an Instant RAL when Instant RALs are offered.

8.16 Instant RALs. Tax Masters, as servicer for the RAL Originator, may offer Instant RALs to certain customers in the 2003 Tax Period. Tax Masters may, however, upon forty-eight (48) hours prior written notice to Block Services, stop offering Instant RALs at any time in its discretion during the 2003 Tax Period. Tax Masters and its Affiliates shall retain ownership of its proprietary rights, including intellectual property rights, in the Instant RAL product.

8.17 File Sharing. Tax Masters as servicer for the RAL Originator shall provide the following files to Block Services for use in the 2003 Tax Period and future Tax Periods:

(a) Guaranteed Loan Offer ("GLO") Processing File. This file is generated from the 2003 GLO file received from Experian. It is coded and incorporated into the TPS software. Block Services is prohibited from accessing and decoding such software, except in response to, and to fulfill, a consumer's request for a RAL. Block Services shall not use this file for any other purpose, including but not limited to marketing its products.

(b) Block Services GLO Marketing File. This file is generated from the 2003 GLO file received from Experian. Block Services may only use this file to inform its customers that they qualify for a pre-approved RAL for the 2003 Tax Period. Block Services shall not use this file for any other purpose, including but not limited to marketing its products.

(c) Advance RAL Processing File. This file is generated from the 2003 GLO file received from Experian. It is coded and incorporated into the TPS software. Block Services is prohibited from accessing and decoding such software, except in response to, and to fulfill, a consumer's request for a RAL. Block Services shall not use this file for any other purpose, including but not limited to marketing its products.

(d) History Processing File. This file is generated from the experiences of the Household Companies. It consists of RAL payment history for the last four (4) years and current

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bad debt. This data is used for scoring a potential Instant RAL customer, is coded, and resides in the Instant RAL decision module incorporated into the TPS software. Block Services is prohibited from accessing and decoding such software, except in response to, and to fulfill, a consumer's request for a RAL. Block Services shall not use this file for any other purpose, including but not limited to marketing its products.

8.18 Representations and Warranties of Block Services. Block Services hereby represents, warrants and covenants that it and its subsidiaries are and shall be the owners of all Block Offices, except for offices of Corporate Franchises through the term of this Agreement. Block Services hereby further represents, warrants and covenants that it will cause its subsidiaries to perform all of the obligations of Block Services required to be performed under this Agreement. Block Services agrees to enforce the terms of any existing agreement with Corporate Franchises relating to the RAL Program.

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

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

8.21 Definitions. Unless otherwise defined herein, capitalized terms shall have the meanings set forth in the Appendix of Defined Terms attached hereto.

8.22 Amendments Effective January 1, 2004. The parties agree that Schedule I and II to this Agreement shall be automatically amended without further action by the parties, effective January 1, 2004, to change the \$5.00

Express IRA/RAC fee and the \$5.00 Tax Cut Tax Preparation Software Channel Express IRA/RAC Fee paid by Block Services on the back-end during the 2003 Tax Period, to a \$2.00 fee to be paid by Block Services on the back-end for each Express IRA/RAC and each Tax Cut Tax Preparation Software Channel Express IRA/RAC established for the 2004, 2005, and 2006 Tax Periods. Notwithstanding any provision of Section 6.2 of this Agreement to the contrary, the amended \$2.00 fee to be paid by Block Services on the back-end for each Express IRA/RAC and each Tax Cut Tax Preparation Software Channel Express IRA/RAC established during the 2004, 2005 and 2006 Tax Periods shall not be subject to further redetermination by the RAL Originator for the 2004, 2005 and 2006 Tax Periods.

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

HOUSEHOLD TAX MASTERS INC.

By: /s/ Patrick A. Cozza  
-----  
Name: Patrick A. Cozza  
Title: President

BENEFICIAL FRANCHISE COMPANY INC.

By: /s/ Patrick A. Cozza  
-----  
Name: Patrick A. Cozza  
Title: Vice President

H & R BLOCK SERVICES, INC.

By: /s/ Jeffery W. Yabuki  
-----  
Name: Jeffery W. Yabuki  
Title: President

H & R BLOCK TAX SERVICES, INC.

By: /s/ Jeffery W. Yabuki  
-----  
Name: Jeffery W. Yabuki  
Title: President

HRB ROYALTY, INC.

By: /s/ Rosalie A. Kenny  
-----  
Name: Rosalie A. Kenny  
Title: President

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#### SCHEDULE I

#### INITIAL CREDIT CRITERIA AND INITIAL RAL AND INITIAL RAC FEE AND INITIAL ACCOUNT ADMINISTRATION FEE FOR TAX PERIOD

January 1, 2003 - June 30, 2003

#### Initial Credit Criteria

1. For a RAL Applicant applying for a RAL, which is defined as a loan in an amount equal to the full amount of such Applicant's anticipated Federal Income Tax Refund ("Refund"), and which RAL is secured by a Refund which may include in part an Earned Income Credit ("EIC"), such RAL Applicant must qualify for approval using RAL Originator credit criteria which includes an IRS debt code indicating no debts or refund delays as well as credit criteria related to any scorecards as applicable.

2. Have a valid Federal Income Tax Return for Tax Year 2002 acceptable by the IRS for Electronic Filing and Direct Deposit with a Federal Tax Refund greater than two-hundred (\$200) dollars and no greater than five thousand (\$5,000) dollars. The maximum RAL amount for Non-EIC applicants is five thousand (\$5,000) dollars inclusive of any fees or charges. The maximum RAL amount for EIC applicants is five thousand (\$5,000) dollars inclusive of any fees or charges. (Applicants showing a Refund greater than \$5,000 shall receive a RAL up to \$5,000 and subsequently will be issued a check for the excess amount.)

3. Be 18 years of age or older or otherwise be eligible under state law to apply for and receive a RAL.

If married filing joint, either applicant (primary or spouse) must meet the minimum requirement.

If state of residence is:

Alabama - applicant must be 19 unless married, then 18.

Nebraska - applicant must be 19 unless married, then no age restriction.

Puerto Rico - applicant must be 21 years old unless they have parental or guardian consent.

4. Comply with the Identification and Qualifying Procedures for a Refund Anticipation Loan through RAL Originator as set forth on Schedule 1.3.

5. Not previously have filed any Federal Income Tax Return for the tax year 2002, not have any tax due and/or tax liens from prior tax years, not owe any delinquent RALs, child support, alimony payments, student loans, V.A. loans or other Federally sponsored loans.

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6. Presently, not have a petition (whether voluntary or involuntary) filed or anticipate filing, under federal bankruptcy laws.

7. Not have a RAL with RAL Originator, or any other RAL originator from a prior year that has been discharged in bankruptcy.

8. Not have paid any estimated tax and/or did not have any amount of the 2001 return applied to the 2002 return.

9. Not be presently making regular payments to the IRS for prior year unpaid taxes.

10. Not have power of attorney that is presently in effect or on file with the IRS to direct the Federal Tax Refund to any third party.

11. Not be a non-resident alien.

12. Not be filing a Federal Income Tax Return for 2002 using a substitute W-2, Form 4852, or any other form of substitute wage and tax documentation, unless the source of the Form 4852 is a Military Leave and Earnings Statement.

13. Not be filing Form 8862, Earned Income Credit Eligibility for 2002, with the Federal Income Tax Return.

14. Not be filing a Federal Income Tax Return for 2002 and be currently incarcerated in a state or federal prison or have income earned while an inmate at a penal institution and are claiming the Earned Income Credit.

15. Not be filing a return if the 2002 income reported is solely from Schedule C or C-EZ (Profit & Loss from Business).

16. If Schedule C is present and EIC claimed, and return is not H & R Block prepared, a RAL application is not permitted unless the taxpayer is a statutory employee and the W-2 indicates statutory employee in Box 15.

17. Not be filing a return that contains a Schedule EIC and the modified adjusted gross income on the Earned Credit Worksheet for Form 1040 is different

from the adjusted gross income reported on Form 1040.

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INITIAL RAL, RAC, AND OTHER BANK PRODUCT FEES

The Initial RAL, RAC, and other bank product Fees established by the RAL Originator for the Tax Period January 1, 2003 - June 30, 2003 shall be as listed below:

2003 INITIAL BANK PRODUCT PRICING  
(As of July 31, 2002)

H&R BLOCK OFFICE CHANNEL  
RAL/IRAL TIERED PRICING -

Loan Amount	RAL Fee	Instant RAL Fee (RAL + \$15.00)
\$200 to \$500	\$30.00	\$45.00
\$501 to \$1000	\$40.00	\$55.00
\$1001 to \$1500	\$60.00	\$75.00
\$1501 to \$2000	\$70.00	\$85.00
\$2001 to \$5000	\$90.00	\$105.00
Maximum Loan Amount \$5000.00		
Earned Income Tax Credit Lending (If qualified capped at \$2,500.00)		
AAF	\$25.00	

RAC -	
Maximum RAC Amount \$5,500.00	\$25.00
EXPRESS IRA/RAC -	
No License Fee/No Participation	\$5.00 (paid by Block Services on back-end)
EXPRESS IRA - RAL/RAC COMBO -	Appropriate RAL Fee based on tier level
BALANCE DUE -	
No License Fee/No Participation	\$0 Transaction Processing Fee for 2003 Tax Season Prime + 13.9% 90 days same as cash 120 days TBD
ARAL -	
No License Fee/No Participation	\$60.00

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ON-LINE TAX PREPARATION (OTP) CHANNEL  
ERA/RAL TIERED PRICING -

Loan Amount	ERA Fee (RAL)
-------------	---------------

\$200 to \$500	\$30.00
-----	-----
\$501 to \$1000	\$40.00
-----	-----
\$1001 to \$1500	\$60.00
-----	-----
\$1501 to \$2000	\$70.00
-----	-----
\$2001 to \$5000	\$90.00
-----	-----
Maximum Loan Amount \$5000.00	
-----	-----
Earned Income Tax Credit Lending (If qualified capped at \$2,500.00)	
-----	-----
AAF	\$25.00
-----	-----

EXPRESS IRA/RAC -  
No license fee/No participation \$5.00 (paid by Block Services on back-end)

EXPRESS IRA - RAL/RAC COMBO - Appropriate RAL Fee

ONLINE RAC -  
Via direct deposit  
Block participates at \$2.76 \$10.00

TAX CUT TAX PREPARATION SOFTWARE CHANNEL  
EXPRESS IRA/RAC -

No license fee/No participation \$5.00 (paid by Block Services on back-end)

No other bank products offered in 2003

PTS CHANNEL

No bank products offered in 2003

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## SCHEDULE II

### FINAL CREDIT CRITERIA AND FINAL RAL AND FINAL RAC FEE AND FINAL ACCOUNT ADMINISTRATION FEE FOR TAX PERIOD

January 1, 2003 - June 30, 2003

#### Final Credit Criteria

1. For a RAL Applicant applying for a RAL, which is defined as a loan in an amount equal to the full amount of such Applicant's anticipated Federal Income Tax Refund ("Refund"), and which RAL is secured by a Refund which may include in part an Earned Income Credit ("EIC"), such RAL Applicant must qualify for approval using RAL Originator credit criteria which includes an IRS debt code indicating no debts or refund delays as well as credit criteria related to any scorecards as applicable.

2. Have a valid Federal Income Tax Return for Tax Year 2002 acceptable by the IRS for Electronic Filing and Direct Deposit with a Federal Tax Refund greater than two-hundred (\$200) dollars and no greater than five thousand (\$5,000) dollars. The maximum RAL amount for Non-EIC applicants is five thousand (\$5,000) dollars inclusive of any fees or charges. The maximum RAL amount for EIC applicants is five thousand (\$5,000) dollars inclusive of any



fees or charges. (Applicants showing a Refund greater than \$5,000 shall receive a RAL up to \$5,000 and subsequently will be issued a check for the excess amount.)

3. Be 18 years of age or older or otherwise be eligible under state law to apply for and receive a RAL.

If married filing joint, either applicant (primary or spouse) must meet the minimum requirement.

If state of residence is:

Alabama - applicant must be 19 unless married, then 18.

Nebraska - applicant must be 19 unless married, then no age restriction.

Puerto Rico - applicant must be 21 years old unless they have parental or guardian consent.

4. Comply with the Identification and Qualifying Procedures for a Refund Anticipation Loan through the RAL Originator as set forth on Schedule 1.3.

5. Not previously have filed any Federal Income Tax Return for the tax year 2002, not have any tax due and/or tax liens from prior tax years, not owe any delinquent RALs, child support, alimony payments, student loans, V.A. loans or other Federally sponsored loans.

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6. Presently, not have a petition (whether voluntary or involuntary) filed or anticipate filing, under federal bankruptcy laws.

7. Not have a RAL with the RAL Originator, or any other RAL originator from a prior year that has been discharged in bankruptcy.

8. Not have paid any estimated tax and/or did not have any amount of the 2001 return applied to the 2002 return.

9. Not be presently making regular payments to the IRS for prior year unpaid taxes.

10. Not have power of attorney that is presently in effect or on file with the IRS to direct the Federal Tax Refund to any third party.

11. Not be a non-resident alien.

12. Not be filing a Federal Income Tax Return for 2002 using a substitute W-2, Form 4852, or any other form of substitute wage and tax documentation, unless the source of the Form 4852 is a Military Leave and Earnings Statement.

13. Not be filing Form 8379 (Injured Spouse Claim and Allocation) with the 2002 Federal Income Tax Return.

14. Not be filing Form 8862, Earned Income Credit Eligibility for 2002, with the Federal Income Tax Return.

15. Not be filing a Federal Income Tax Return for 2002 and be currently incarcerated in a state or federal prison or have income earned while an inmate at a penal institution and are claiming the Earned Income Credit.

16. Not be filing a return if the 2002 income reported is solely from Schedule C or C-EZ (Profit & Loss from Business).

17. If Schedule C is present and EIC claimed and return is not H & R Block prepared, a RAL application is not permitted unless the taxpayer is a statutory employee and the W-2 indicates statutory employee in Box 15.

18. Not be filing Form 1310 (Statement of Person Claiming Refund Due Deceased Taxpayer) with the 2002 Federal Income Tax Return or filing a

## FINAL RAL, RAC, AND OTHER BANK PRODUCT FEES

The Final RAL, RAC, and other bank product Fees established by the RAL Originator for the Tax Period January 1, 2003 - June 30, 2003 are listed below:

H&R BLOCK OFFICE CHANNEL  
RAL/IRAL TIERED PRICING -

## 2003 RAL

Refund/RAL Tier		RAL COST	
	Refund Account Fee	Finance Charge	RAL Total
\$200 - \$500	\$24.95	\$ 5.00	\$29.95
\$501 - \$1,000	\$24.95	\$15.00	\$39.95
\$1,001 - \$1,500	\$24.95	\$35.00	\$59.95
\$1,501 - \$2,000	\$24.95	\$45.00	\$69.95
\$2,001 - \$5,000	\$24.95	\$65.00	\$89.95
Maximum Loan Amount of \$5,000			
Earned Income Tax Credit Lending to \$5,000 if qualified (some EIC customers will be capped at \$2,500 as in tax season 2002)			
RAC Fee	\$24.95	--	--
Denied RAL (AAF)	\$24.95	--	--

## 2003 Full IRAL

Refund Tier		Full IRAL Cost		
	Refund Acct. Fee	IRAL Fee	Finance Charge	Total
\$200 - \$500	\$24.95	\$15.00	\$ 5.00	\$ 44.95
\$501 - \$1,000	\$24.95	\$15.00	\$15.00	\$ 54.95
\$1,001 - \$1,500	\$24.95	\$15.00	\$35.00	\$ 74.95
\$1,501 - \$2,000	\$24.95	\$15.00	\$45.00	\$ 84.95
\$2,001 - \$5,000	\$24.95	\$15.00	\$65.00	\$104.95

## 2003 Partial \$750 IRAL with Subsequent RAL

Refund Tier		Partial \$750 IRAL Cost (Day 1)		RAL Cost (Day 2)	IRAL + RAL Total
	Refund Acct. Fee	IRAL Fee	Finance Charge	Partial IRAL Total	Finance Charge
\$200 - \$500*	\$24.95	\$15.00	\$5.00	\$44.95	--
\$501 - \$1,000	\$24.95	\$15.00	\$5.00	\$44.95	\$10.00
\$1,001 - \$1,500	\$24.95	\$15.00	\$5.00	\$44.95	\$30.00

\$1,501 - \$2,000	\$24.95	\$15.00	\$5.00	\$44.95	\$40.00	\$84.95
\$2,001 - \$5,000	\$24.95	\$15.00	\$5.00	\$44.95	\$60.00	\$104.95

\* This is a Full IRAL since partial IRALs are for \$750.00

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#### 2003 Partial \$750 IRAL with Subsequent Denied RAL

Refund Tier	Partial \$750 IRAL Cost (Day 1)			Denied RAL Cost	IRAL + Denied RAL Total
	Refund Acct. Fee	IRAL Fee	Finance Charge	Partial IRAL Total	Finance Charge
\$200 - \$500*	\$24.95	\$15.00	\$5.00	\$44.95	--
\$501 - \$1,000	\$24.95	\$15.00	\$5.00	\$44.95	\$0
\$1,001 - \$1,500	\$24.95	\$15.00	\$5.00	\$44.95	\$0
\$1,501 - \$2,000	\$24.95	\$15.00	\$5.00	\$44.95	\$0
\$2,001 - \$5,000	\$24.95	\$15.00	\$5.00	\$44.95	\$0

\* This is a Full IRAL since partial IRALs are for \$750.00

RAC -  
Maximum RAC Amount \$9,999.99 \$24.95  
(Maximum RAC first check amount of \$5,500)

EXPRESS IRA/RAC -  
No License Fee/No Participation \$5.00 (paid by Block Services on back-end)

EXPRESS IRA-RAL/RAC - COMBO -  
Appropriate RAL Fee based on tier level

BALANCE DUE -  
No License Fee/No Participation \$0 Transaction Processing Fee for 2003 Tax Season  
Prime + 13.9%  
90 days same-as-cash  
120 days same-as-cash for 2002 tax year  
extension filers only

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Discount RAL Tests for 2003 (2002 TY) - Pricing test as follows:

Test Markets and Client DRAL fees:

Minneapolis - St. Paul, MN - \$39.95  
Columbia, SC - \$39.95  
Charleston, SC - \$39.95  
Greenville, NC - \$39.95

Youngstown, OH - fee as follows to DRAL clients:

Refund Tier	Total DRAL Cost
-----	-----

\$ 200 - \$500	\$29.95
\$ 501 - \$1,000	\$39.95
\$1,001 - \$5,000	\$49.95

IRALs in all markets will be charged an additional \$15.00.

Other:

- A RAL constitutes a customer. A partial IRAL followed by a classic RAL for the balance will not be considered two RALs.

ON-LINE TAX PREPARATION (OTP) CHANNEL  
ERA/RAL PRICING

#### 2003 RAL

Refund/RAL Tier	RAL Cost		
	Refund Account Fee	Finance Charge	RAL TOTAL
\$200 - \$500	\$10.00	\$19.95	\$29.95
\$501 - \$1,000	\$10.00	\$29.95	\$39.95
\$1,001 - \$1,500	\$10.00	\$49.95	\$59.95
\$1,501 - \$2,000	\$10.00	\$59.95	\$69.95
\$2,001 - \$5,000	\$10.00	\$79.95	\$89.95
Maximum Loan Amount of \$5,000			
Earned Income Tax Credit Lending to \$5,000 if qualified (some EIC customers will be capped at \$2,500 as in tax season 2002)			
Denied RAL (AAF) (Block license fee of \$2.76)	\$10.00	--	--

EXPRESS IRA/RAC - No license fee/No participation	\$5.00 (paid by Block Services on back-end)
EXPRESS IRA - RAL/RAC COMBO -	Appropriate RAL fee

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ON LINE RAC - Via direct deposit Block license fee of \$2.76	\$10.00
--	---------

TAX CUT TAX PREPARATION SOFTWARE CHANNEL  
EXPRESS IRA/RAC -

No license fee/No participation	\$5.00 (paid by Block Services on back-end)
---------------------------------	---

No other bank products offered in 2003

PTS CHANNEL  
No bank products offered in 2003

## SCHEDULE 1.3

IDENTIFICATION AND QUALIFYING PROCEDURES FOR A  
REFUND ANTICIPATION LOAN  
THROUGH THE RAL ORIGINATOR

A. NEW CUSTOMER. (An applicant who has not received a RAL Originator Pre-approved Loan Offer.)

Applicant must have two forms of valid identification, one must be a picture and at least one must be from Group A.

B. PRE-APPROVED CUSTOMERS

One acceptable form of identification must be obtained. If Resident Alien ID is presented, proof of qualifying child's residence for EIC is not required.

GROUP A -----	GROUP B -----
IRS Mailing label (within last 10 years)	Copy of Form 8453 or E-File Authentication (within last 10 years) Authorization signed by Electronic Return Originator
IRS Telefile Tax Record	
*Military ID	Copy of Prior Year Return (within last 10 years) including 1040 PC.
*City/State/County Issued ID	
	Prior Client on File
Driver's License	
	Check Cashing ID
*Employee ID	
	Current Pay Stub
*Food Stamp ID	
	Department Store/Gas Credit Card
*Indian Tribal Card	
	Motor Vehicle Registration
Major Credit Card (Visa, MC, Amex, Discover, Optima)	*School ID
	Social Security Card
**Resident Alien ID	
	Union Membership ID
*State Welfare ID	
	Voter Registration Card
*U.S. Passport	
	IRS ITIN or ATIN Letter
Consular Card	
	*Must be a picture ID.

Only one ID issued in the current year is acceptable and IDs marked as duplicate are not allowed.

**\*\*Resident alien taxpayers claiming EIC must provide proof of qualifying child's minimum six month residence in the USA. Such proof, in order of preference, must be a school registration or ID card for the child, a report card, a school health or attendance record, doctor bills for the child, a utility bill in the parent's name, the birth certificate of the child showing birth in the USA or other document establishing residence of the child in the USA.**

#### PHONE CONTACT

If the telephone number for the primary taxpayer's residence is not available, a telephone number where the primary taxpayer can be reached is required.

A work telephone number is required for each taxpayer that is employed.

#### EARNED INCOME CREDIT

Schedule EIC must meet all IRS specifications and pass all IRS reject criteria.

#### APPENDIX OF DEFINED TERMS

"ACH" means the Automated Clearing House System commonly used for electronic payment transactions.

"AFFILIATE" of any Person means any other Person controlling, controlled by or under common control with such Person. RAL Originator shall not be deemed an Affiliate of Tax Masters.

"AGREEMENT" means this Second Amended and Restated Refund Anticipation Loan Operations Agreement and all amendments hereof and supplements hereto.

"APPLICANT" means a Person who has filed a RAL Application during the current Tax Period.

"BENEFICIAL FRANCHISE" means Beneficial Franchise Company Inc., a Delaware corporation.

"BENEFICIAL FRANCHISE INDEMNIFIED PARTIES" shall have the meaning set forth in Section 4.3 of this Agreement.

"BLOCK COMPANIES" means, collectively, Block Services, Block Tax Services and Royalty.

"BLOCK FRANCHISE" means 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 Returns.

"BLOCK ICB TERMINATION RIGHT" shall have the meaning set forth in Recital H of this Agreement.

"BLOCK INDEMNIFIED PARTIES" shall have the meaning set forth in Section 1.14 of this Agreement.

"BLOCK INDEMNIFYING PARTIES" shall have the meaning set forth in Section 1.14 of this Agreement.

"BLOCK LICENSED MARKS" shall have the meaning set forth in Section 5.2 of this Agreement.

"BLOCK OFFICE" means (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 Returns and (ii) a Corporate Franchise.

"BLOCK RAL PROCESSOR" shall have the meaning set forth in

Section 4.1 of this Agreement.

#### Appendix-1

"BLOCK SERVICES" means H & R Block Services, Inc., a Missouri corporation, and its subsidiaries.

"BLOCK TAX SERVICES" means H & R Block Tax Services, Inc., a Missouri corporation.

"BUSINESS DAY" means any day other than a Saturday, Sunday or a day on which banking institutions are authorized or obligated by law or executive order to be closed.

"CLASSIC RAL" shall have the meaning set forth in Section 8.15 of this Agreement.

"CORPORATE FRANCHISE" means a Person authorized by Block Services (or an Affiliate of Block Services) pursuant to a corporate franchise agreement to operate a Block Franchise. "Corporate Franchise" does not include a Person authorized by a Major Franchise Agreement with Block Services (or an Affiliate of Block Services) to operate a Block Franchise and subfranchise others to operate a Block Franchise within a specified territory, or a subfranchisee of a Major Franchisee.

"DIRECT DEPOSIT" means the deposit of a Taxpayer's refund by the IRS directly into a bank account designated by a Taxpayer on his or her Return.

"DISCLOSING PARTY" shall have the meaning set forth in Section 7.2(a) of this Agreement.

"ELECTRONIC FILING" means the filing of a Return with the IRS, or the applicable state taxing authority, by Block Services via its Electronic Filing Software.

"ELECTRONIC FILING SOFTWARE" means the proprietary software owned by Block Services, which is used to electronically file Returns with the IRS.

"ELECTRONIC DATA PROCESSING GUIDELINES" means the guidelines established by the parties hereto related to the process of filing Returns.

"ELECTRONIC DATA PROCESSING SYSTEMS" means those electronic systems used to either electronically file Returns with the IRS or to facilitate the origination of RALs or the issuance of RACs.

"EXPENSE REIMBURSEMENT" shall have the meaning set forth in Section 2.2 of this Agreement.

"FEDERALLY CHARTERED FINANCIAL INSTITUTION" shall have the meaning set forth in Recital H of this Agreement.

"FINAL CREDIT CRITERIA" shall have the meaning set forth in Section 6.2(b) of this Agreement.

#### Appendix-2

"FINAL RAL AND RAC FEES" shall have the meaning set forth in Section 6.2(a) of this Agreement.

"FIRST AMENDED AND RESTATED RAL OPERATIONS AGREEMENT" shall have the meaning set forth in Recital F of this Agreement.

"FIRST ICB CONSENT LETTER" means the letter agreement, dated November 11, 2002, by and among Block Companies and Household Companies.

"GOVERNMENT AGENCY" means any federal, state, municipal, foreign or other governmental department, authority, commission, board, court, administrative agency bureau, body or instrumentality.

"GLO" shall have the meaning set forth in the heading of Section 8.17(a) of this Agreement

"HB" has the meaning set forth in Recital C.

"HOUSEHOLD COMPANIES" means, collectively, Tax Masters and Beneficial Franchise.

"ICB" has the meaning set forth in Recital C.

"INFORMATION" shall have the meaning set forth in Section 1.10 of this Agreement.

"INITIAL CREDIT CRITERIA" shall have the meaning set forth in Section 6.2(b) of this Agreement.

"INITIAL RAL AND RAC FEES" shall have the meaning set forth in Section 6.2(a) of this Agreement.

"INSTANT RAL APPLICATION" means the application completed by a RAL Applicant to obtain an Instant RAL from the RAL Originator that must contain, among those other things as the RAL Originator shall reasonably require, a certification signed by the RAL Applicant that he or she: (a) has not previously filed any Return for the applicable Tax Year, does not have any previous tax liabilities, delinquent student loans, or any other delinquent federally guaranteed or sponsored loans, or delinquent child support payments; (b) has not filed a petition (whether voluntary or involuntary) under any federal or state bankruptcy or insolvency laws; and (c) has not filed any powers of attorney with the IRS or any state taxing authority and has no power of attorney presently in effect to direct any tax return to any third party.

"INSTANT RAL" means a RAL of which a credit decision is made prior to Block Services receiving both (i) positive acknowledgement of the underlying Tax Return's acceptance for Electronic Filing and (ii) the Notification from the IRS.

"IRS" shall have the meaning set forth in Section 1.1 of this Agreement.

#### Appendix-3

"MAJOR FRANCHISEE" means a Person authorized by a Major Franchise Agreement with 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.

"NOTIFICATION" shall have the meaning set forth in Section 1.10 of this Agreement.

"OTHER RAL ORIGINATORS" shall have the meaning set forth in Section 3.1(c) of this Agreement.

"PATENT RIGHTS" shall have the meaning set forth in Section 4.1 of this Agreement.

"PERSON" means any legal person, including any individual, corporation, partnership, joint venture, association, joint-stock company, trust, unincorporated organizations, Governmental Entity or other entity of similar nature.

"PROPRIETARY INFORMATION" shall have the meaning set forth in Section 7.1 of this Agreement.

"QUALIFYING PROCEDURES" shall have the meaning set forth in Section 1.3 of this Agreement.

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

"RAC LICENSE FEE" shall have the meaning set forth in Section 5.4 of this Agreement.



"RAL" or "REFUND ANTICIPATION LOAN" means a loan to a Taxpayer secured by such Taxpayer's federal income tax refund.

"RAL ACCOUNT" shall mean an account established by the RAL Originator for each RAL Customer.

"RAL APPLICATION" shall have the meaning set forth in Section 1.4 of this Agreement.

"RAL CUSTOMERS" shall mean individuals or entities that apply for RALs or RACs under the program through Block Services (or its subsidiaries), Corporate Franchises, and Major Franchisees and subfranchisees of Major Franchisees that have elected to participate in the RAL Program.

"RAL OPERATIONS AGREEMENT" shall mean this Second Amended and Restated Refund Anticipation Loan Agreement, dated June 9, 2003.

"RAL ORIGINATOR" means the insured depository institution engaged by Tax Masters to serve as originator under the RAL Program.

#### Appendix-4

"RAL PROGRAM" has the meaning set forth in Section 7.1 of this Agreement.

"RECEIVING PARTY" shall have the meaning set forth in Section 7.2(a) of this Agreement.

"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.

"RETURNS" shall have the meaning set forth in Section 1.1 of this Agreement.

"ROYALTY" means HRB Royalty, Inc., a Delaware corporation.

"SALE AND SERVICING AGREEMENT" has the meaning set forth in Recital H of this Agreement.

"SECOND ICB CONSENT LETTER " shall have the meaning set forth in Recital I of this Agreement.

"SURVIVAL PROVISIONS" shall have the meaning set forth in Section 4.4 of this Agreement.

"TAX MASTERS" means Household Tax Masters Inc., a Delaware corporation.

"TAX MASTERS INDEMNIFIED PARTIES" shall have the meaning set forth in Section 2.4 of this Agreement.

"TAX PERIOD" means January 1 through June 30 of a year in which individuals typically pay income taxes for income earned in the Tax Year.

"TAX YEAR" means the period beginning on January 1 of the year immediately prior to the current Tax Period and ending on December 31 of the year immediately prior to the current Tax Period.

"TAXPAYER" means a Block Services customer for any of its services. It refers to both to individual taxpayers filing individual Tax Returns and to joint taxpayers filing joint Tax Returns.

"TERM" shall have the meaning set forth in Section 6.1 of this Agreement.

"THIRD-PARTY PRODUCT" shall have the meaning set forth in Section 8.12 of this Agreement.



SECOND AMENDED AND RESTATED  
REFUND ANTICIPATION LOAN  
PARTICIPATION AGREEMENT

THIS SECOND AMENDED AND RESTATED REFUND ANTICIPATION LOAN PARTICIPATION AGREEMENT (this "Agreement"), dated as of June 9, 2003, is made by and among BLOCK FINANCIAL CORPORATION, a Delaware corporation ("BFC"), and HOUSEHOLD TAX MASTERS INC., a Delaware corporation ("Tax Masters").

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 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 and ICB regarding the RAL program pursuant to which Tax Masters services the loans originated by ICB under the RAL program. Redacted copies of the Sale and Servicing Agreement and all amendments thereto will be delivered by Tax Masters 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. The parties desire to amend and restate the First Amended and Restated RAL Participation Agreement to reflect 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 this Agreement, and to implement certain other changes to the First Amended and Restated RAL Participation Agreement as hereinafter set forth.

#### 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 and Tax Masters hereby covenant and agree that the First 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:

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"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).

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"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, Tax Masters had good and marketable title thereto free and clear of all Liens arising under or through Tax Masters or any of its Affiliates.

"ERA Operations Agreement" shall mean the ERA Operations Agreement to be entered into between BFC, Royalty, Tax Masters and Beneficial Franchise effective January 1, 2002.

"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.

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"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.

"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

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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 Tax Masters or repurchased by Tax Masters 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

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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 Tax Masters 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"

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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 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, Tax Masters agrees to sell to BFC, and BFC agrees to purchase from Tax Masters, 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 Tax Masters' 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 Tax Masters in this Agreement,

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Participation Interests (and acquisition thereof by BFC) shall be without recourse to Tax Masters. Tax Masters represents and warrants 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 Franchisee, 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 Tax Masters to BFC of a Participation Interest in a Pool RAL shall be deemed to occur at the time when Tax Masters 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 Tax Masters 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, Tax Masters 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. Tax Masters 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 agrees to use all commercially reasonable efforts to obtain for BFC (i) a "true sale" opinion of counsel to Tax Masters with respect to the sale by Tax Masters and the purchase by BFC of the Participation Interests in the Pool RALs, and (ii) a "nonconsolidation" opinion of counsel to Tax Masters with respect to Tax Masters and any 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) Tax Masters shall not 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 or its Affiliates, and (B) the failure of Tax Masters to obtain such opinions (after making commercially reasonable efforts to do so) shall not constitute a breach of any of Tax Masters' obligations under this Agreement and shall in no event give rise to any liability on the part of Tax Masters or any of its 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

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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, (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, and (3) BFC 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 either BFC 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 shall, upon reasonable request by BFC, provide to BFC copies of all material operative agreements executed by Tax Masters or its Affiliates relating to the origination of RALs by the RAL Originator, or the sale and servicing of Tax Masters' retained interest in the Pool RALs, for such Tax Year, as well as all material operative agreements executed by Tax Masters or its 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 Tax Masters shall not 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 Tax Masters 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.

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Not later than 4:00 p.m., New Jersey time, on such Business Day, BFC shall pay to Tax Masters the full amount of such Purchase Price. Such payment shall be made to Tax Masters at such domestic account designated by Tax Masters 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 RALs (other than Pool RALs 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 RALs 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 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 Tax Masters 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

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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 Tax Masters' 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

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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 and Tax Masters to the effect that such firm has made a study and evaluation of the RAL Originator'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 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 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.

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#### ARTICLE IV REPRESENTATIONS AND WARRANTIES

Section 4.1. General Representations and Warranties of Tax Masters. Tax Masters hereby represents and warrants 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. Tax Masters 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 Tax Masters by all necessary corporate action on its part and this Agreement will remain, from the time of its execution, an official record of Tax Masters.

(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 is a party or by which it or any of its 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 Tax Masters Relating to the Participated Pool RALs. Tax Masters hereby represents and warrants 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 Tax Masters to BFC on such Closing Date constitutes either (i) a valid sale, transfer,

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assignment, set over and conveyance to BFC of all right, title and interest of Tax Masters 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 Tax Masters or any of its Affiliates, or (ii) if it is ultimately determined by a court of competent jurisdiction that a sale from Tax Masters 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 Tax Masters 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, Tax Masters 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 Tax Masters nor any Person claiming through or under Tax Masters shall have any claim to or interest in such Participation Interest, except for the interest of Tax Masters 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 Tax Masters direct Tax Masters 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 Tax Masters 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, Tax Masters 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 Tax Masters, 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 Tax Masters 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 Tax Masters, 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 Tax Masters to BFC, BFC has not sold, transferred or encumbered any such Participated Pool RALs or interest therein), as shall reasonably be requested by Tax Masters to vest in Tax Masters, 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 Tax Masters' obligation to repurchase a Participation Interest pursuant to this Section 4.3 shall apply only to a

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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 Tax Masters of such breach or event, BFC may by notice then given in writing to Tax Masters direct Tax Masters 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 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 no 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 of any such event, BFC may by notice then given in writing to Tax Masters direct Tax Masters 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.

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(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"), Tax Masters 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 Tax Masters, 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 Tax Masters, without recourse, representation or warranty (except for the warranty that since the date of conveyance by Tax Masters 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 Tax Masters 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 Tax Masters 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 Tax Masters 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 Tax Masters 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 Tax Masters;

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

(c) by Tax Masters, 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, (ii) there is an order or decree restraining, enjoining, prohibiting, invalidating or otherwise preventing the transactions contemplated by this Agreement or Tax Masters' performance of any of its material obligations under this

Agreement, (iii) there shall be pending, or any Governmental Authority shall have notified Tax Masters of its intention to institute, any action, suit or proceeding against Tax Masters to restrain, enjoin, prohibit, invalidate or otherwise prevent the transactions contemplated by this Agreement or Tax Masters' performance of any of its material obligations under this Agreement, (iv) any Participated Pool RAL, or any purchase or sale of a Participation Interest in a Participated Pool RAL, or Tax Masters' performance of any of its material obligations under this Agreement would be illegal, and there are no reasonable steps that Tax Masters 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 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 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 under any bankruptcy or insolvency law; or

(e) by BFC, if as of any September 15, any representation or warranty of Tax Masters 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 or BFC shall exercise a right of termination provided above by written notice to the other party. Upon such termination, all obligations of Tax Masters 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 Tax Masters 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.

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Section 5.2. Right to Exclude Certain RALs. If, from time to time, BFC 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

##### Section 6.1. Certain Rights of Tax Masters.

(a) Rescission. If any payment received or application of funds made by Tax Masters on account of any Participated Pool RAL shall be rescinded or otherwise shall be required (or if Tax Masters 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 at any time, BFC, promptly upon notice from Tax Masters, shall pay to Tax Masters 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 Tax Masters 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 Tax Masters.

Section 6.2. Indemnification. Immediately upon Tax Masters' demand therefor, BFC shall reimburse and indemnify Tax Masters 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, 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 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 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

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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 Tax Masters 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 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 of an express obligation of Tax Masters under this Agreement, or (vi) any Claim attributable to the gross negligence or willful misconduct of Tax Masters. 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, Tax Masters shall have the right to indemnification from BFC to the extent Tax Masters 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 or any of its 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 is indemnified by any third party (including, without limitation, Block Tax Services or any other Originator Party). Tax Masters shall remit to BFC the Applicable Percentage of any amount received by Tax Masters as indemnification from a third party to the extent such indemnification pertains to a Claim for which BFC previously indemnified Tax Masters 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

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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 Tax Masters 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 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, Tax Masters has made no representation or warranty, express or implied, to BFC and no act by Tax Masters heretofore or hereafter taken shall be deemed to constitute any representation or warranty by Tax Masters 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: Patrick A. Cozza

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 or

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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 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. Tax Masters 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, by Persons acting on behalf of by Tax Masters or at Tax Masters' 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.

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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 and BFC.

Section 7.13. Tax Masters Not a Tax Preparer. Nothing in this Agreement or the Second Amended and Restated RAL Operations Agreement shall be construed to imply that Tax Masters 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 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 arising from any claim, allegation or assertion that Tax Masters is or may be in any way responsible for the preparation, filing or contents of any such tax return, or that Tax Masters, by virtue of its participation in the transactions contemplated by this Agreement, is engaged in an activity that subjects Tax Masters 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 First Amended and Restated RAL Participation Agreement arising out of events occurring prior to the effective date of this Agreement, and the provisions of the First 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 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 acknowledges 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.

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IN WITNESS WHEREOF, the parties hereto have caused this Second 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: /s/Becky S. Shulman

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Name: Becky S. shulman

Title: Vice President & Treasurer

HOUSEHOLD TAX MASTERS INC.

By: /s/ Patrick A. Cozza

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Name: Patrick A. Cozza

Title: President

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## AGREEMENT OF SETTLEMENT - HAESE

This Agreement of Settlement (the "Agreement") is entered into this 31st day of March, 2003, by and between H&R Block, Inc., H&R Block and Associates, L.P., H&R Block Tax Services, Inc., HRBO, Limited (erroneously named as HRBO, Ltd.), H&R Block of South Texas, Inc., HRB-Delaware, Inc., H&R Block, Ltd., HRBOI, Ltd., HRBO III, Ltd., HRBOII, Inc. (erroneously named as HRBOII, Ltd.), H&R Block of Dallas, Inc., H&R Block of Houston, Ltd., Houston Block, L.C., Block Management, Ltd., and STI-Block, L.C. (collectively "H&R Block"), and Ronnie and Nancy Haese (the "Haeses" or "Plaintiffs") on behalf of themselves individually and on behalf of the Class as defined below.

## I. DEFINITIONS

1. The "Class" and "Class Members" means all persons who (1) obtained at any time a tax refund anticipation loan ("RAL") through an office operating under the trade name of H&R Block (including franchisee or sub franchisee offices of H&R Block or any H&R Block offices located in Sears stores) in the State of Texas during the period from 1992 through 1996 and (2) did not previously request exclusion from the litigation styled Ronnie and Nancy Haese v. H&R Block, Inc., et al., Cause No. 96-423, in the 105th District Court of Kleberg County, Texas (hereinafter referred to as the "Action.")

2. "Settlement Administrator" means the entity designated by H&R Block to administer the settlement.

3. "Preliminary Approval Order" means the order to be entered by the Court in the event that the Court grants preliminary approval to this Agreement.

4. "Class Counsel" means Robert C. Hilliard and Hilliard & Munoz, LLP,

Darrell L. Barger and Hartline, Dacus, Barger, Dreyer & Kern, LLP, Edward Carstarphen and Ellis, Carstarphen, Dougherty & Goldenthal, P.C., and Craig Sico and Sico, White & Braugh, who are the attorneys and law firms representing the Haeses and Class Members.

5. "Class Notice" means the notice that attached hereto as Exhibit A.

6. "Class Representatives" means the Haeses.

7. "Court" means the 105th District Court of Kleberg County.

8. "Settled Claims" means any and all actual and potential claims, actions, lawsuits, and causes of action, known or unknown, that Plaintiffs and/or the Class asserted, may assert or could have asserted in the Action, including all claims and potential claims under the laws of Texas or under federal law or any other law arising out of or in any way relating to the tax refund anticipation loans ("RALs") (sometimes erroneously referred to as "Rapid Refunds") obtained by the Class at any time up to and through November 18, 2002, and/or participations in such RALs and/or arising out of or in any way relating to H&R Block's use of the term "Rapid Refund," and/or any sanctions or contempt penalties that have been sought, or could have been sought, against the Released Parties for any acts or omissions, known or unknown, that may have been committed by the Released Parties that might in any way be related to the Action, the Cause 99-314 Action, or the Martinez Action.

9. "Cause 99-314 Action" means the lawsuit defined in Section II, paragraph 1 of the Recitals set forth below.

10. "Martinez Action" means the lawsuit defined in Section II, paragraph 2 of the Recitals set forth below.

11. "Released Parties" means H&R Block, Block Financial Corporation, HRB

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Texas Enterprises, Inc., H&R Block Texas Tax Company, LP, and H&R Block Texas Support Services, LP, and the respective parents, affiliates, subsidiaries, franchisees or sub-franchisees of any of them, all divisions, predecessors, successors, representatives and assignees of any of them, and the present and former officers, directors, employees, shareholders, insurers, underwriters, attorneys and agents of any of them.

12. "Zawikowski Action" means the lawsuit defined in Section II, paragraph 4 of the Recitals set forth below.

13. "Zawikowski Settlement" means the settlement defined in Section II, paragraph 4 of the Recitals set forth below.

## II. RECITALS

14. WHEREAS, (i) in July, 1996, the Haeses filed the Action which was certified as a class action and (ii) in November, 1999, certain claims in the Action were severed into a class action lawsuit pending in the same Court captioned Ronnie and Nancy Haese, et al. v. H&R Block, Inc., et al., No. CV-99-314-D (hereafter referred to as the "Cause 99-314 Action");

15. WHEREAS, in July, 2002, Veronica I. Martinez filed a class action lawsuit in the 148th Judicial District Court of Nueces County, Texas, captioned Veronica I. Martinez, et al. v. H&R Block, Inc., et al., No. 02-3269-E (hereinafter the "Martinez Action");

16. WHEREAS, all claims in all three cases arise out of the same set of operative facts;

17. WHEREAS, in addition to the aforementioned cases, H&R Block is a defendant in other pending lawsuits in other jurisdictions arising out of the RAL program,

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including an action pending in the United States District Court for the Northern District of Illinois captioned Zawikowski, et al. v. Beneficial National Bank, et al., No. 98-C-2178 ("Zawikowski Action") in which a nationwide settlement is currently pending approval ("Zawikowski Settlement"); but in which H&R Block has moved that the Texas Class Members be excluded.

18. WHEREAS, H&R Block has at all times denied, and continues to deny, that it has committed any wrongful acts or violations of law of any nature whatsoever or that it has any liability to Plaintiffs or the persons they represent;

19. WHEREAS, uncertainty exists as to the potential liability of H&R Block in the Action and as to the nature and amount of relief, if any, to which the Plaintiffs and Class Members may be entitled if liability is imposed on H&R Block;

20. WHEREAS, after extensive arms' length negotiations, the parties hereto now wish to settle the Action, subject to the approval of the Court;

21. WHEREAS, the parties hereto have entered into a Memorandum of Understanding on November 18, 2002;

22. WHEREAS, the Plaintiffs represent the Class and H&R Block agrees not to contest certification of a Class for purposes of effectuating this settlement;

23. WHEREAS, while denying any fault, wrongdoing or

liability, H&R Block has agreed that a settlement of the Action on the terms and conditions set forth in this Agreement is desirable solely in order to avoid the further significant burden, expense and inconvenience of protracted litigation, and the distraction and diversion of personnel and resources, and thereby to put to rest this controversy;

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24. WHEREAS, Class Counsel have conducted a thorough study and investigation of the facts and the law relating to the claims asserted in the Action, the Cause 99-314 Action, and the Martinez Action through extensive discovery and independent investigation and have concluded that, taking into account the substantial benefits that Class Members will receive as a result of this settlement and the considerable risks and delays of further litigation, the settlement provided herein is fair, adequate and reasonable and in the best interests of the Class.

THEREFORE, the parties hereto agree to the following terms and conditions:

### III. TERMS AND CONDITIONS

1. The Class Representatives (for themselves and on behalf of the Class), by their attorneys and subject to the approval of the Court pursuant to Texas Rule of Civil Procedure 42(e), hereby settle, release, discharge and dismiss all Settled Claims as against all the Released Parties with prejudice, upon and subject to the terms and conditions specified herein. Each Class Member who has not timely opted out shall covenant and agree that (s)he shall not hereafter assert or continue to assert any claim, suit, demand or cause of action, whether individually or on behalf of a class, based in whole or in part upon any of the Settled Claims against the Released Parties. Such release shall also extend to any sanctions or contempt penalties that have been sought, or could have been sought, against the Released Parties for any acts or omissions, known or unknown, that may have been committed by the Released Parties in the Action, the Cause 99-314 Action, or the Martinez Action.

2. The parties hereto and their counsel agree to take whatever reasonable

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procedural steps may be required to permit the Court to obtain and retain jurisdiction over this settlement.

3. For the benefits and consideration set forth herein and discussed below, the parties hereto will jointly request that the Court's rulings in the Action as to fiduciary duty, breach or the nature of the breach thereof, and for forfeiture of fees reflected in the Court's November 6, 2002, letter be withdrawn. In addition, H&R Block will seek the following orders from the Court: (1) an order granting H&R Block's Motion to Compel Arbitration, which would dismiss the claims of those persons who were a part of the class as defined in the August 28, 1997, class certification order, who obtained a RAL for the first time in 1997 or thereafter; (2) an order granting summary judgment as to HRBO, Limited and HRBO III, Ltd.; and (3) an order granting summary judgment as to the claims of those persons who were part of the class as defined in the August 28, 1997, class certification order, who obtained RALs between 1988 and 1991, based upon the expiration of the applicable statutes of limitation, the non-receipt of license fees paid by H&R Block during that time period, or such other grounds as H&R Block may assert. Such orders being entered and actions taken by the Court shall be conditions subsequent for this settlement, each of which must occur before H&R Block shall have any obligation to make any payment of any of the benefits and/or consideration required herein to the Class or payment of attorneys' fees or expenses to Class Counsel.



4. The parties hereto agree that after Court approval and exhaustion of all appeals, the parties hereto will jointly move for the following: (1) the Cause 99-314 Action shall be decertified and non-suited by the Court, with each party bearing its own costs,

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expenses and attorneys' fees with respect thereto; (2) the Martinez Action shall also be non-suited by the court in the Martinez Action, with each party bearing its own costs, expenses and attorneys' fees with respect thereto; and (3) the mandamus proceeding pending before the Texas Supreme Court under Cause No. 02-1043 shall be dismissed. Such orders being entered and actions taken by the parties hereto, the Court and the court in the Martinez Action shall be conditions subsequent for this settlement, each of which must occur before H&R Block shall have any obligation to make any payment of any of the benefits and/or consideration required herein to the Class or payment of attorneys' fees or expenses to Class Counsel.

5. While final approval of the settlement is pending and while awaiting approval and final exhaustion of all appeals, the parties hereto agree to jointly seek the abatement of all the proceedings identified in the previous paragraph. Such orders being entered and actions taken by the applicable courts shall be conditions subsequent to this settlement, each of which must occur before H&R Block shall have any obligation to make any payment of any of the benefits and/or consideration required herein to the Class or payment of any attorneys' fees or expenses to Class Counsel.

6. In consideration for the release and dismissal of all Settled Claims, each Class Member shall be entitled to receive - irrespective of how many RALs he or she may have obtained - the following benefits and consideration:

- a. For each tax season over a five-consecutive-year period, a fully transferable and alienable coupon that, upon mailing to the Settlement Administrator, shall entitle the person redeeming such coupons to receive

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a TaxCut(R) Platinum Federal Filing Edition tax preparation software package that currently has a suggested retail price of \$39.95, or an equivalent product of equal value selected by H&R Block. Such redemption shall occur between January 5 and April 15 of the calendar year of the tax season to which the software package applies.

- b. For each tax season over a five-consecutive-year period, a non-transferable and non-alienable coupon that, upon mailing to the Settlement Administrator, along with a receipt evidencing payment, between January 5 and May 15 of the calendar year in which the applicable tax season occurs, shall entitle the Class Member to a \$20 rebate on tax preparation or electronic filing services provided in an H&R Block branded office in the State of Texas; and

- c. For each tax season over a five-consecutive-year period, a fully transferable and alienable coupon that, upon mailing to the Settlement Administrator, shall entitle the person redeeming such coupon to receive a copy of Tax Planning Advisor (of the H&R Block just plain smart Advisor Series of books) that currently has a suggested retail price of \$14.95, or an equivalent product of equal value selected by H&R

Block. Such redemption shall occur between January 5 and April 15 of the tax season to which the tax planning book applies.

7. With respect to the foregoing benefits and consideration, the parties hereto

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further agree that:

- a. Assuming final approval of the settlement by the trial court, final exhaustion of all appeals and satisfaction of all conditions subsequent referred to above, the parties hereto anticipate that the benefits and consideration set forth in the preceding paragraph will pertain to the 2004, 2005, 2006, 2007 and 2008 tax seasons. If approval, exhaustion of all appeals and satisfaction of all conditions subsequent referred to above occur within 90 days prior to the beginning of a given tax season or during a given tax season, H&R Block's obligation to provide such benefits and consideration will not arise until the tax season that immediately follows such given tax season.
- b. For RALs obtained jointly due to the filing of a joint income tax return by a married couple or through other circumstances, such couple or joint interest shall be treated as one Class Member for purposes of the benefits and consideration described above. Such joint filers' rights with respect to those benefits and consideration shall be governed by the applicable property laws pertaining to such marriage or other relationship, and neither H&R Block nor the Settlement Administrator shall have any liability, obligation or responsibility with respect to any disputes arising from any joint interest or common ownership in the benefits provided herein, irrespective of whether such dispute arises from divorce, death or otherwise.

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- c. All coupons provided pursuant to the terms of the settlement and discussed above shall be mailed to each Class Member for whom the parties hereto possess a correct mailing address in one mailing prior to the first applicable tax season in which coupons may be redeemed, as described above. The parties hereto shall be deemed to have a correct mailing address for a Class Member if Class Notice previously mailed was not returned as undeliverable and/or if Class Notice mailed subsequent to entry of a Preliminary Approval Order is not returned as undeliverable and/or a Class Member provides a correct mailing address when requesting a copy of the Class Notice or in response to the class notice. The cost of such mailing of coupons, as well as any other expenses associated with the creation, issuance and redemption of the coupons shall be borne by H&R Block. H&R Block shall have the right to control the timing of such mailing of coupons, although it must occur at some time after April 30 of the year prior to the first applicable tax season, but before December 31.

8. The Final Judgment which will be submitted to the

Court for approval of this settlement shall vacate the January 30, 1998 Order of the Court concerning arbitration clauses and contacts with the Class. While the parties hereto are awaiting Court approval, the parties hereto agree to jointly seek the abatement of the January 30, 1998 Order, with such abatement specifically providing that the January 30, 1998 Order shall have no force or effect while the abatement remains in effect and therefore such will not be a basis for any

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sanctions against H&R Block for its conduct while the abatement is in effect. However, any arbitration agreement signed or that may hereafter be signed by Class Members in 1997 and subsequent years will not be enforced against those Class Members with respect to the settled claims applicable to any RAL obtained in calendar years 1992 through 1996, inclusive. If the Court does not approve the settlement, the parties shall jointly request that the Court vacate the abatement. After the abatement has been vacated, the Court's January 30, 1998 Order shall thereafter again become effective (to the extent it remains effective in light of the Judgment and Opinion of the Corpus Christi Court of Appeals and H&R Block v. Haese, 82 S.W.3d 331 (Tex.App. - Corpus Christi, 2000, pet. denied) and subject to the limitation on the amount of any said sanctions set forth in Paragraph 9.

9. If the settlement should ultimately fail due to non-approval by the Court or appellate reversal, the Class and Class Counsel agree that any sanctions sought or asserted against H&R Block for any past conduct - known or unknown - pertaining to or in any way connected with the Action, the Cause 99-314 Action, or the Martinez Action, collectively shall not exceed \$10,000,000 against H&R Block. Should the settlement fail for some reason other than judicial non-approval or reversal, and such failure is not caused by H&R Block, the aforementioned sanctions collectively shall not exceed \$20,000,000 against H&R Block in the Action, the Cause 99-314 Action, or the Martinez Action. Nothing in this paragraph shall be construed as an admission that H&R Block engaged in any sanctionable conduct, which is expressly denied, nor construed as any agreement that any such sanction in any amount should be imposed by any court. Consideration for this provision consists of not only the benefits and consideration set forth herein and discussed above, but also H&R

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Block's request for exclusion of Class Members from the proposed settlement in the Zawikowski Action. Plaintiffs and Class Counsel agree to withdraw their objections to Zawikowski Settlement and to make no objections to such Zawikowski Settlement in the future, provided that if either Plaintiffs and/or Class Counsel or H&R Block is enjoined or otherwise prevented from complying with this settlement by order of any Court or either is ordered by any Court to deposit any of the funds or property to be paid pursuant to the Agreement to any Court, trust, or other third party, then Plaintiffs and Class Counsel may object to the Zawikowski settlement and contest any such injunction or order. This provision shall survive termination or failure of this Agreement or this settlement.

10. While approval of this settlement is being sought, H&R Block agrees to take no action to subject the Class or Class Members to the jurisdiction of any other Federal or State Court. If this settlement is finally approved and all appeals challenging same are exhausted, H&R Block agrees to comply with same even if the Texas Class is not carved out of the Zawikowski Action, provided that neither Plaintiffs and Class Counsel nor H&R Block is enjoined or otherwise prevented from doing so by order of any court, and further provided that H&R Block is not ordered by any court to deposit any of the funds or property to be paid pursuant to this Agreement to any court, trust or other third party. If either Plaintiffs and/or Class Counsel or H&R Block is enjoined or otherwise prevented from complying with this settlement or ordered by any Court to deposit any of the funds or property to be paid pursuant to the Agreement to any Court, trust, or other third party, then Plaintiffs and Class Counsel may contest any

such injunction or order.

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11. Unless otherwise agreed by all parties hereto, this Agreement shall be null and void unless finally approved by the Court, and affirmed on appeal if necessary, and unless all conditions subsequent are met. However, an award by the Court, as the same may be affirmed or reduced by an appellate court, of the attorneys' fees and expenses for an amount less than the maximum amounts specified and agreed upon in Article V below, shall not affect any of the other rights and obligations of the parties hereto under the Agreement.

12. It is expressly agreed and understood that the Released Parties deny any fault, wrongdoing, or liability, and that this Agreement does not constitute an admission by any party and may not be admitted in evidence or appended to any pleadings, motions or briefs except in an action brought to enforce the terms hereof or as a defense to any causes of action barred or released by the terms hereof.

13. This Agreement may be executed in separate counterparts.

14. Each of the parties hereto agree to take all steps necessary, at their own costs, to effectuate the purposes and requirements of this Agreement.

15. This Agreement shall be binding upon and inure to the benefit of the Class, the Released Parties and their respective heirs, administrators, successors and assigns.

16. In determining whether any person is a Class Member, the Settlement Administrator shall be entitled to rely upon the list of persons to whom previous notice was sent in the Action and upon the computer records available to H&R Block from third parties. To the extent that relevant information is not contained therein, the determination may be based upon submission by a Class Member of corroborating documentation such as the customer copy of the RAL application. The Settlement Administrator may employ in its

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discretion reasonable procedures necessary to verify information submitted by claiming Class Members.

17. In the event that the settlement does not become final in accordance with the terms hereof, then this Agreement shall be of no force or effect, except as elsewhere expressly provided herein, and, in any event, the parties hereto agree that this Agreement, whether or not it shall become final, and any and all negotiations, documents and discussions associated with it, shall be without prejudice to the rights of any party, shall not be deemed or construed to be an admission or evidence of any violation of any statute, law or regulation or of any liability or wrongdoing by any of the Released Parties or of the truth of any of the claims or allegations made in the Complaints and/or pleadings in the Action, the Cause 99-314 Action or the Martinez Action or any other pleading, and evidence thereof shall not be discoverable or used directly or indirectly, in any way, in any action or proceeding. If the settlement does not become final in accordance with the terms of this Agreement, H&R Block expressly reserves all its rights, including but not limited to, its rights to compel arbitration and contest class certification in the Action, the Cause 99-314 Action and/or the Martinez Action. If the settlement does not become final in accordance with the terms of this Agreement, Plaintiffs and class members expressly reserve all their rights, including but not limited to, any available sanctions subject to the limitations set forth in paragraph 9, their rights to contest the validity of any arbitration clauses, and their rights to pursue approval of class certification in Cause No. 99-314-D and Cause No. 02-3269-E (Martinez action).

18. This Agreement contains an entire, complete, and integrated statement of each and every term and provision agreed to by and among the parties hereto; it is not subject to

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any condition not provided for herein. This Agreement shall not be modified in any respect except by a writing executed by all the parties hereto. This Agreement supersedes all prior agreements between the parties hereto, including the Memorandum of Understanding dated November 18, 2002.

19. None of the parties hereto shall be considered to be the drafter of this Agreement or any provision hereof for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter hereof.

20. The Class and Class Counsel agree that all public communication regarding the settlement and this Agreement shall be made by H&R Block, except as may be required in court proceedings, or where necessary to protect the integrity of Class Counsel; provided, however, that public communication to protect the integrity of Class Counsel shall not include press releases or any communications to financial analysts or investment advisors. Any responses to media inquiries shall not disparage H&R Block or their statements and shall only state that the settlement is a compromise of disputed claims. Except as permitted in the previous two sentences, the Class and Class Counsel shall refer any media inquiries to the following representatives of H&R Block: Linda M. McDougall, 816-932-7542, Cyd Slayton, 816-932-8470 or Bob Schneider, 816-932-4835, or such other person(s) as H&R Block shall designate to Class Counsel. Further Class Counsel agree not to provide documents to or otherwise assist any party or anyone representing parties or anyone contemplating such representation in any other RAL-related case now existing or filed at any time in the future, with respect to this settlement or any other aspect of this litigation. The

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Plaintiffs, Class, and Class Counsel shall, upon final and unappealable approval of the settlement, return to H&R Block any and all documents, discovery responses or other information produced or given to the Class and Class Counsel during the course of this litigation.

21. Each of the undersigned attorneys hereby represents and warrants that he or she is authorized to execute this Agreement on behalf of his or her client(s).

#### IV. CLASS NOTICE AND SETTLEMENT FAIRNESS HEARING

1. Upon execution of this Agreement of Settlement, Plaintiffs will file, and H&R Block will not oppose, a Motion for Preliminary Approval of Settlement and for Approval of Class Notice pursuant to Texas Rule of Civil Procedure 42. A copy of the proposed Class Notice is attached hereto as EXHIBIT A.

2. H&R Block shall pay all costs associated with dissemination of the Class Notice and the administration of the settlement.

3. Class Members shall have the right to object to the settlement or the request by Class Counsel for an award of attorneys' fees and expenses by filing written objections with the Court not later than twenty (20) days before the hearing on final approval of the settlement, and serving copies of such papers on all counsel for the parties hereto. Failure to file such timely written objections will preclude a Class Member from objecting at the final approval hearing.

4. Subject to the approval of the Court, Class Notice will also be disseminated to persons who obtained RALs in Texas prior to 1992, by publication, and subsequent to 1996,

by mail. Any opt-outs of the Action by such persons pursuant to the Class Notice must be in a writing signed by the individual person and not his or her counsel or other representative.

5. Class Counsel shall not solicit the representation of persons who have opted out from the class with respect to any of the Settled Claims that were or could have been raised in the Action, the Cause 99-314 Action or the Martinez Action.

#### V. ATTORNEYS' FEES AND EXPENSES

1. Defendants agree to pay Class Counsel up to \$49,000,000 with respect to attorney's fees that may be awarded by the Court in connection with this settlement, provided that Class Counsel and/or their respective law firms shall not seek or accept an award of more than \$49,000,000 in attorneys fees. Further, in the event the Court awards Class Counsel any recovery of expenses associated with the litigation of the Action, H&R Block agrees to reimburse Class Counsel up to \$900,000 for such expenses incurred prior to execution of this Agreement. Plaintiffs shall provide a reasonable description of such expenses, but H&R Block shall not object to the reasonableness or necessity of such expenditures. Such fees and expenses shall be subject to Court approval, but in no event shall H&R Block be required to pay more than the amounts stated herein. Such payment shall be made to Class Counsel within 30 days after the Court's order approving the settlement becomes final, and any appeals have been exhausted and all conditions subsequent have been satisfied; provided, however, that any payment by H&R Block shall be made in accordance with a final Court order specifying the division of attorneys fees and expenses among Class Counsel in this case, and shall not be payable by H&R Block until such an

order specifying divisions has been entered.

2. The Court order awarding attorneys' fees and expenses to Class Counsel shall be in an order which is separate from an order approving the settlement, so that any appeal from the attorneys' fees and expenses to Class Counsel shall not affect the finality of the approval of the settlement.

3. Class Counsel may pay incentive awards to the Plaintiffs out of the aforesaid amounts paid to Class Counsel, in amounts to be approved by the Court.

#### VI. TERMINATION

H&R Block, at its sole discretion, shall have the right but not the obligation to terminate this Agreement if:

1. The Court declines to preliminarily approve the settlement and enter a Preliminary Approval Order except as expressly provided elsewhere in the Agreement; or

2. The conditions subsequent discussed herein are not satisfied; or

3. To the extent any Class Members have opted out of this Class, or may hereafter have the right to opt out of the Class or the Action, H&R Block shall have the option to withdraw from this Settlement if more than one percent (1%) of the persons receiving Class Notice opt out.

Plaintiffs and Class Members, at their sole discretion, shall have the right but not the obligation to terminate this Agreement if the Court declines to preliminarily approve the settlement and enter a Preliminary Approval Order approving all aspects of this Agreement of

Settlement, or except as expressly provided in this Agreement.

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Termination by either H&R Block or by Plaintiffs and Class Members pursuant to this Section VI shall mean that all obligations of the parties hereto shall terminate, except as expressly provided herein.

IN WITNESS WHEREOF, the undersigned parties hereto and their attorneys have caused this Agreement to be duly executed on the date first above written.

/s/ Nancy Haese

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Nancy Haese, Plaintiff

/s/ Ronnie Haese

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Ronnie Haese, Plaintiff

HILLIARD & MUNOZ, LLP

By: /s/ Robert C. Hilliard

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Robert C. Hilliard

HARTLINE, DACUS, BARGER,  
DREYER & KERN, L.L.P.

By: /s/ Darrell L. Barger by RCH

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Darrell L. Barger

ELLIS, CARSTARPHEN, DOUGHERTY &  
GOLDENTHAL, P.C.

By: /s/ Edward M. Carstarphen by RCH

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Edward M. Carstarphen

SICO, WHITE & BRAUGH

By: /s/ Craig M. Sico by RCH

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Craig M. Sico

ATTORNEYS FOR PLAINTIFFS

H&R BLOCK, INC.

By: /s/ Jeffery W. Yabuki

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An Authorized Representative

H&R BLOCK TAX SERVICES, INC.

By: /s/ Jeffery W. Yabuki

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An Authorized Representative

H&R BLOCK AND ASSOCIATES, L.P.

By: /s/ Jeffery W. Yabuki

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An Authorized Representative

HRBO, LIMITED, ERRONEOUSLY NAMED AS

HRBO, LTD.

By: /s/ Garnett Walker  
-----  
An Authorized Representative

HRB-DELAWARE, INC. AS SUCCESSOR IN INTEREST  
TO H&R BLOCK OF SOUTH TEXAS, INC.

By: /s/ Garnett Walker  
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An Authorized Representative

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HRB-DELAWARE, INC.

By: /s/ Garnett Walker  
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An Authorized Representative

H&R BLOCK, LTD.

By: /s/ Garnett Walker  
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An Authorized Representative

HRBOI, LTD.

By: /s/ Garnett Walker  
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An Authorized Representative

HRBO III, LTD.

By: /s/ Garnett Walker  
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An Authorized Representative

HRBOII, INC., ERRONEOUSLY NAMED AS HRBOII, LTD.

By: /s/ Garnett Walker  
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An Authorized Representative

H&R BLOCK OF DALLAS, INC.

By: /s/ Jeffery W. Yabuki  
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An Authorized Representative

H&R BLOCK OF HOUSTON, LTD.

By: /s/ Garnett Walker  
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An Authorized Representative

HOUSTON BLOCK, L.C.

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By: /s/ Garnett Walker  
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An Authorized Representative

BLOCK MANAGEMENT, LTD.

By: /s/ Garnett Walker  
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An Authorized Representative



STI-BLOCK, L.C.

By: /s/ Garnett Walker

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An Authorized Representative

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MEREDITH, DONNELL & ABERNETHY

By: \_\_\_\_\_  
Ben A. Donnell

BRYAN CAVE, LLP.

By: \_\_\_\_\_  
N. Louise Ellingsworth

ATTORNEYS FOR DEFENDANTS

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H&R BLOCK, INC.  
 COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES  
 (AMOUNTS IN THOUSANDS)

	2003	2002	2001	2000	1999
	-----	-----	-----	-----	-----
Pretax income from continuing operations (a)	\$ 987,077	\$ 716,840	\$ 473,078	\$ 412,266	\$ 383,541
	=====	=====	=====	=====	=====
FIXED CHARGES:					
Interest expense	92,644	116,141	242,551	155,027	69,338
Interest portion of net rent expense (b)	70,574	63,458	59,268	52,263	39,206
	-----	-----	-----	-----	-----
Total fixed charges	163,218	179,599	301,819	207,290	108,544
	-----	-----	-----	-----	-----
Earnings before income taxes and fixed charges	\$1,150,295	\$ 896,439	\$ 774,897	\$ 619,556	\$ 492,085
	=====	=====	=====	=====	=====
Ratio of earnings to fixed charges	7.0	5.0	2.6	3.0	4.5
	=====	=====	=====	=====	=====

- (a) Pretax income from continuing operations is shown with the Credit Card Segment as Discontinued Operations for all years presented.
- (b) One-third of net rent expense is the portion deemed representative of the interest factor.

## 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 try to bring additional value to the overall experience and allow clients to reach their financial objectives. Operating in multiple lines of business allows H&R Block 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 and 17.1 million taxpayers in fiscal years 2003 and 2002, respectively — more than any other personal tax services company. This segment also served 2.1 million and 1.5 million clients through TaxCut® (includes only federal e-filings) and online tax preparation in fiscal years 2003 and 2002, respectively. 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. This segment sold \$17.2 billion and \$11.4 billion in loans and recognized 89% and 86% of the gain on sale in cash during fiscal years 2003 and 2002, respectively.

**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 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 consolidated income statements.

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

Year Ended April 30	2003	2002	2001
<i>(in 000s, except per share amounts)</i>			
<b>REVENUES:</b>			
U.S. Tax Operations	\$ 1,859,993	\$ 1,830,752	\$ 1,622,636
Mortgage Operations	1,200,409	734,890	415,802
Business Services	434,140	416,926	386,168
Investment Services	200,794	250,685	472,425
International Tax Operations	85,082	78,710	78,469
Corporate Operations	(651)	5,773	5,837
	<u>\$ 3,779,767</u>	<u>\$ 3,317,736</u>	<u>\$ 2,981,337</u>
<b>INCOME (LOSS):</b>			
U.S. Tax Operations	\$ 547,078	\$ 533,468	\$ 434,067
Mortgage Operations	693,950	339,388	137,992
Business Services	(14,118)	22,716	15,953
Investment Services	(128,292)	(54,862)	9,298
International Tax Operations	10,464	7,093	6,024
Corporate Operations	(122,005)	(130,963)	(130,256)

Income before taxes	<b>987,077</b>	716,840	473,078
Income taxes	<b>407,013</b>	282,435	196,330
Net income before change in accounting principle	<b>580,064</b>	434,405	276,748
Cumulative effect of change in accounting principle	—	—	4,414
Net income	<b>\$ 580,064</b>	<b>\$ 434,405</b>	<b>\$ 281,162</b>
Basic earnings per share	<b>\$ 3.23</b>	<b>\$ 2.38</b>	<b>\$ 1.53</b>
Diluted earnings per share	<b>3.15</b>	<b>2.31</b>	<b>1.52</b>

## OVERVIEW

A summary of the Company's fiscal 2003 financial results is as follows:

- Net earnings were \$3.15 per diluted share, an increase of 36.4% over fiscal year 2002.
- Revenues grew 13.9% over the prior year, primarily due to growth in the Mortgage Operations segment.
- Clients served in company-owned retail tax offices declined 4.3%, while the average fee per client served increased 6.8%.
- U.S. Tax Operations' operating margin improved 30 basis points, from 29.1% to 29.4%.
- Software and online revenues increased 27% compared to fiscal year 2002.
- Mortgage originations totaled \$16.6 billion for the year as a result of increases in the sales force, in average loan size, in loan applications and an increase in the closing ratio.
- Gains on sales of mortgage assets reached \$775 million, including \$131 million realized on the sale of net interest margin ("NIM") residual interests.
- The Investment Services segment reported a loss of \$128 million as a result of continued low investor confidence and declining market conditions.

## U.S. TAX OPERATIONS

This segment is primarily engaged in providing tax return preparation, filing 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.

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. During the fiscal 2003 tax season, the Company participated in the newly formed Free File Alliance. This alliance was created by the industry and the Internal Revenue Service ("IRS"), and allows qualified lower-income filers to prepare and file their federal return online at no charge.

In addition to tax preparation services, U.S. Tax Operations includes the following product offerings:

- RALs are offered to tax clients by a designated bank through a contractual relationship with Household Tax Masters, Inc. ("Household").
- The Peace of Mind ("POM") program is offered as a separately priced guarantee to tax clients, whereby the Company will assume the cost, subject to certain limits, of additional tax assessments attributable to tax return preparation errors.
- "EasyPay" revolving loans are offered by Household's designated bank to those clients whose tax returns reflect a balance due to the IRS through a contractual relationship with Household. The loan has "same as cash" terms for 90 days. Unlike RAL products, the Company does not have a right to purchase a participation interest in these loans.
- Individual retirement accounts ("Express IRAs"), invested in FDIC-insured money market accounts, are offered to tax clients as a tax savings strategy and as a retirement savings tool.
- All retail office, software and online tax clients also have the opportunity to receive a free financial plan through H&R Block Financial Advisors, Inc.

## U.S. Tax Operations — Operating Statistics

Year Ended April 30	2003	2002 <sup>(1)</sup>	2001 <sup>(1)</sup>
<i>(in 000s, except average fee and offices)</i>			
Tax returns prepared:			
Company-owned offices	9,995	10,431	10,275
Franchise offices	6,336	6,468	6,167
	<b>16,331</b>	<b>16,899</b>	<b>16,442</b>
Clients served:			
Company-owned offices	10,058	10,513	10,425
Franchise offices	6,459	6,635	6,458
E-commerce:			
Software <sup>(2)</sup>	1,244	1,017	989
Online <sup>(3)</sup>	895	455	275
	<b>18,656</b>	<b>18,620</b>	<b>18,147</b>
Tax returns filed electronically:			
Company-owned offices	8,936	9,057	8,635
Franchise offices	5,388	5,222	4,693
E-commerce:			
Software <sup>(2)</sup>	1,244	1,017	989
Online <sup>(3)</sup>	812	344	207
	<b>16,380</b>	<b>15,640</b>	<b>14,524</b>
Average fee per client served: <sup>(7)</sup>			
Company-owned offices	\$ 138.41	\$ 129.61	\$ 118.19
Franchise offices	118.40	109.51	101.11
	<b>\$ 130.59</b>	<b>\$ 121.83</b>	<b>\$ 111.65</b>

Refund anticipation loans: <sup>(4)</sup>			
Company-owned offices	2,778	2,855	2,476
Franchise offices	1,795	1,773	1,501
E-commerce:			
Software	—	11	20
Online	75	33	19
	<u>4,648</u>	<u>4,672</u>	<u>4,016</u>
Software units sold:			
TaxCut-Retail <sup>(5)</sup>	1,773	1,631	1,556
Other <sup>(6)</sup>	1,636	1,411	1,296
	<u>3,409</u>	<u>3,042</u>	<u>2,852</u>
Offices:			
Company-owned	5,279	5,017	5,060
Franchise	4,022	3,998	4,012
	<u>9,301</u>	<u>9,015</u>	<u>9,072</u>

(1) Company-owned and franchise numbers for fiscal years 2002 and 2001 have not been restated for franchise acquisitions during fiscal year 2003. See the Company's data as disclosed in its volume press releases for restated tax season numbers.

(2) Includes federal e-filings for software clients.

(3) Includes a) online completed and paid federal returns, and b) state returns only when no payment was made for a federal return.

(4) Data is for tax season (January 1 — April 30) only.

(5) Includes TaxCut federal units only, as reported by The NPD Group, Inc., an independent retail volume reporting agency.

(6) Includes TaxCut State, Deduction Pro, WillPower and Legal Advisor software sales.

(7) Calculated as tax preparation and filing fees divided by the number of clients served.

## U.S. Tax Operations — Financial Results

Year Ended April 30	2003	2002	2001
<i>(in 000s)</i>			
Tax preparation and related fees	\$ 1,378,058	\$ 1,364,673	\$ 1,237,622
Royalties	163,519	154,780	140,146
RAL waiver fees	138,242	—	—
RAL participation fees	874	159,965	133,710
Software sales	61,355	54,301	44,138
Online tax services	26,290	14,606	6,793
Other	91,655	82,427	60,227
<b>Total revenues</b>	<b>1,859,993</b>	<b>1,830,752</b>	<b>1,622,636</b>
Compensation and benefits	577,545	598,355	561,962
Occupancy and equipment	207,366	186,998	172,572
Depreciation and amortization	39,456	39,871	55,346
Cost of software sales	19,072	19,425	17,549
Bad debt	17,358	38,235	55,391
Supplies, freight and postage	39,579	35,989	32,520
Texas litigation reserve	41,672	—	—
Legal	28,111	7,641	4,641
Other	104,781	137,884	116,837
Allocated corporate and shared costs:			
Marketing	90,142	99,560	60,333
Information technology	77,285	77,230	60,384
Finance	22,367	13,270	14,445
Supply	19,724	19,508	13,131
Other	28,457	23,318	23,458
<b>Total expenses</b>	<b>1,312,915</b>	<b>1,297,284</b>	<b>1,188,569</b>
<b>Pretax income</b>	<b>\$ 547,078</b>	<b>\$ 533,468</b>	<b>\$ 434,067</b>

### Fiscal 2003 compared to fiscal 2002

U.S. Tax Operations' revenues increased \$29.2 million, or 1.6%, to \$1.9 billion for fiscal year 2003.

Tax preparation and related fees increased \$13.4 million, or 1.0%, for fiscal year 2003, compared to fiscal year 2002. This increase is due to a 6.8% increase in the average fee per client served, partially offset by a 4.2% decrease in tax returns prepared. The average fee per client served increased to \$138.41 in fiscal year 2003. The increase in the average fee per client served is primarily due to an increase in the complexity of returns prepared.

Tax returns prepared in company-owned offices during the current year decreased 436 thousand, or 4.2%, compared to the prior year. The decline in tax returns prepared is driven primarily by the impact of the sustained weak economy. U.S. Tax Operations' core client base has traditionally been lower income clients. Due to the weak economy, a larger portion of these clients did not return in fiscal 2003 as they did not file a tax return with the IRS. Additionally, due to the absence of substantive tax law changes, the marketing programs failed to attract as much new business as in the previous year.

The average fee per client at franchise offices increased 8.1%, while tax returns prepared declined 2.0%, resulting in an increase in royalty revenue of \$8.7 million, or 5.6%. The Company has begun the process of acquiring the business of up to thirteen of its major franchises as their respective franchise agreements expire over the next two years. While any major franchise acquisitions are not expected to increase the number of overall clients served under the H&R Block brand, the Company's pretax earnings are expected to increase as these operations are incorporated with company-owned offices and their royalties are replaced with direct revenues and expenses.

During fiscal year 2003, the Company entered into an agreement with 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, subject to certain adjustments based on delinquency rates. Initial payments received totaling \$133.0 million were recognized as revenue over the waiver period. An additional payment is expected to be received in January 2004, based on the final delinquency rates for the 2003 tax season. At April 30, 2003 the Company recognized additional revenues of \$5.2 million based on actual delinquency rates through April 30, 2003. The waiver agreement with Household is a one-year agreement and does not affect the Company's ability to participate in RALs in the future.

A total of 3.4 million software units were sold during fiscal year 2003, an increase of 12.1% compared to unit sales of 3.0 million in 2002. Revenues from software sales of \$61.4 million in fiscal year 2003 increased 13.0% as a result of the higher sales volume. This increase was partially offset by increases in the number of rebates offered and customer rebate redemption rates.

Online tax preparation revenues increased 80.0% primarily as a result of the 96.7% increase in clients served. Increases in software and online unit sales have an especially beneficial impact to the Company's earnings, as these operations have primarily fixed costs and relatively low variable costs.

Other revenues for the year increased \$9.2 million, or 11.2%, over 2002, principally due to an increase of \$5.8 million in supply sales to franchises and an increase of \$3.3 million in revenues recognized under the POM guarantee program.



Total expenses for fiscal year 2003 were up \$15.6 million, or 1.2%, from 2002. These increased expenses were primarily attributable to a litigation reserve of \$41.7 million recorded during the second quarter of fiscal year 2003 relating to Texas RAL litigation. In November 2002, the Company reached an agreement with the plaintiff class in a Texas class action lawsuit related to RALs. The settlement provides a five-year package of coupons class members can use for a variety of tax preparation and tax planning services from the Company. The reserve of \$41.7 million represents plaintiff class legal fees and expenses, tax products and associated mailing expenses. The Company will recognize the cost of the tax preparation rebate coupons as they are redeemed. Other legal costs increased \$20.5 million due to various legal proceedings, including those discussed further in note 20 to the consolidated financial statements.

Occupancy and equipment costs increased \$20.4 million due primarily to a 5.2% increase in the number of offices under lease and increases in related utility and other support charges. Allocated finance expenses increased \$9.1 million, or 68.6%, primarily due to increased insurance costs. These increases were partially offset by a \$20.8 million decrease in compensation and benefits. This decrease was due to better management of support staff wages, a decline in payroll taxes related to seasonal stock option exercises and changes in the tax preparer compensation plan. Bad debt expense declined \$20.9 million as a result of collections of RAL receivables, which were written off in prior years, and the elimination of bad debt expense associated with RAL participations. Other expenses decreased \$33.1 million from 2002 primarily due to reduced servicing expenses associated with prior year RAL participations.

Pretax income for fiscal year 2003 increased \$13.6 million, or 2.6%, over 2002. The segment's operating margin improved thirty basis points to 29.4% in fiscal year 2003.

#### **Fiscal 2002 compared to fiscal 2001**

U.S. Tax Operations' revenues increased \$208.1 million, or 12.8%, for fiscal year 2002 compared to fiscal year 2001.

Tax preparation and related fees increased 10.3% to \$1.4 billion during fiscal year 2002. This increase is primarily attributable to a 1.5% increase in returns prepared in company-owned offices combined with a 9.7% increase in the average fee on those returns. The average fee benefited from the first time inclusion of a federal rebate credit form, increased usage of the child tax credit form and other overall increases in client complexity.

Royalties from franchises increased 10.4% due to a 4.9% increase in tax returns prepared during fiscal year 2002, and an 8.3% increase in the average fee in franchise offices.

Revenues from RAL participation increased \$26.3 million, or 19.6%, compared to the previous year. This increase is attributable to a 16.6% increase in the number of RALs in which the Company participated to 4.7 million, and a 2.6% increase in pricing. The increased price was driven by an increase in the average refund amount and favorable changes in the product mix resulting in a gross revenue per RAL of \$33.67, up 2.8% over fiscal year 2001. Prior to January 1, 2003, the Company purchased participation interests in RALs (49.9% for RALs facilitated at company-owned offices and franchise offices and 25.0% for RALs facilitated in major franchise offices). Revenue from participation was calculated as the Company's percentage participation multiplied by a fee paid by the customer to Household.

Software revenues increased 23.0% over the previous year to \$54.3 million. The increase is primarily due to an increase in the number of units sold and an increase in electronic filings and related charges. Units sold increased 6.7%, from 2.9 million to 3.0 million units.

Online tax preparation revenues improved \$7.8 million over fiscal year 2001 due to the increase in clients served.

Revenues from the POM guarantee program increased \$10.9 million due to the increase in the number of guarantees sold compared to 2001.

Total expenses increased \$108.7 million, or 9.1%, during the year ended April 30, 2002. This increase is due to a 35.6% increase in allocated corporate and shared costs primarily related to marketing and technology development, which increased \$39.2 million and \$16.8 million, respectively. The higher marketing costs are due to increased advertising initiatives in fiscal year 2002. In addition, compensation and benefits and occupancy and equipment costs increased as a direct result of the increase in revenues. Offsetting these increases was lower bad debt expense associated with RAL participation, which declined \$15.2 million due to a more favorable collection rate in fiscal year 2002. In addition, depreciation and amortization expense decreased 28.0% primarily due to the cessation of goodwill amortization beginning May 1, 2001, related to the adoption of new accounting standards, and certain assets becoming fully depreciated at the end of fiscal year 2001.

Pretax income for fiscal year 2002 increased 22.9%, compared to fiscal year 2001. The segment's operating margin improved to 29.1% in fiscal year 2002, compared to 26.8% in fiscal year 2001.

## 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 by the Trusts. The Trusts, as directed by the Trustees, either sell the loans directly to third-party investors or pool the loans for securitization, depending on market conditions. In a securitization transaction, the Trusts transfer the loans, and the right to receive all payments on the loans, to a securitization trust and the Company transfers its receivable. The securitization trust meets the definition of a qualifying special purpose entity ("QSPE"). The securitization trust issues bonds, which are supported by the 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 the cash flows from its residual interests, the Company securitizes the majority of its residual interests in NIM transactions. In a NIM transaction, the residual interests are transferred to another QSPE ("NIM trust"), which then issues bonds to third-party investors. The proceeds from the bonds are returned to the Company as payment for the residual interests. The bonds are secured by the 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 and prepayment penalties.

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

### Mortgage Operations — Operating Statistics

Year Ended April 30	2003	2002	2001
<i>(dollars in 000s)</i>			
Number of loans originated:			
Wholesale (non-prime)	93,497	74,208	49,805
Retail: Prime	12,361	7,935	3,861
Non-prime	9,983	7,190	6,393
Total	115,841	89,333	60,059
Volume of loans originated:			
Wholesale (non-prime)	\$ 13,659,243	\$ 9,457,331	\$ 5,289,715
Retail: Prime	1,697,815	1,179,137	822,579
Non-prime	1,220,563	816,705	412,607
Total	\$ 16,577,621	\$ 11,453,173	\$ 6,524,901
Loan sales:			
Loans originated and sold	\$ 16,591,821	\$ 11,440,190	\$ 6,009,544
Loans acquired and sold	633,953	—	—
Total	\$ 17,225,774	\$ 11,440,190	\$ 6,009,544
Weighted-average FICO score <sup>(1)</sup>	604	600	586
Execution price -			
Net gain on sale: <sup>(1), (2)</sup>			
Loans originated and sold	4.63%	4.30%	3.71%
Loans acquired and sold	0.18%	—	—
Total	4.46%	4.30%	3.71%
Weighted-average coupon rate for borrowers <sup>(1)</sup>	8.15%	9.09%	10.40%
Weighted-average loan-to-value <sup>(1)</sup>	78.7%	78.6%	77.9%

<sup>(1)</sup> Represents non-prime production.

(2) *Defined as total premium received divided by total balance of loans delivered (excluding mortgage servicing rights).*

## Mortgage Operations — Financial Results

Year Ended April 30	2003	2002	2001
<i>(in 000s)</i>			
Components of gains on sales:			
Gains on sales of mortgage assets:			
Mortgage loans and related assets	\$ 698,571	\$ 487,945	\$254,256
NIM residuals	130,881	—	—
Impairment of residual interests	(54,111)	(30,987)	(9,467)
Total gains on sales	775,341	456,958	244,789
Loan servicing	168,351	147,162	110,222
Accretion	145,165	50,583	21,824
Interest	108,715	77,277	35,693
Other	2,837	2,910	3,274
Total revenues	1,200,409	734,890	415,802
Compensation and benefits	255,846	181,630	128,683
Servicing and processing	74,774	86,146	34,620
Occupancy and equipment	42,626	30,700	23,683
Bad debt	21,364	25,442	16,153
Other	111,849	71,584	74,671
Total expenses	506,459	395,502	277,810
Pretax income	\$ 693,950	\$ 339,388	\$137,992

### Fiscal 2003 compared to fiscal 2002

Mortgage Operations' revenues increased \$465.5 million, or 63.3%, compared to the prior year. This increase was primarily a result of increased production volumes and related sales execution pricing, gains on sales of NIM residuals and accretion on residual interests.

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

Year Ended April 30	2003	2002
<i>(dollars in 000s)</i>		
Number of sales associates	2,228	1,809
Total number of applications	216,492	174,049
Closing ratio <sup>(1)</sup>	53.5%	50.3%
Total number of originations	115,841	89,333
Average loan size	\$ 143	\$ 128
Total originations	\$ 16,577,621	\$ 11,453,173
Non-prime / prime ratio	8.8 : 1	8.7 : 1
Commitments to fund loans	\$ 2,614,500	\$ 1,726,620
Loan sales	\$ 17,225,774	\$ 11,440,190
Gains on sales	\$ 698,571	\$ 487,945
Execution price — net gain on sale <sup>(2)</sup>	4.46%	4.30%

(1) Percentage of loans funded divided by total applications.

(2) Defined as total premium received divided by total balance of loans delivered (excluding mortgage servicing rights).

Gains on sales of mortgage loans and related assets increased \$210.6 million to \$698.6 million for the year ended April 30, 2003. The increase over last year is a result of a significant increase in loan origination volume, an increase in the average loan size, the closing ratio and the loan sale execution price. During the year, the Company originated \$16.6 billion in mortgage loans compared to \$11.5 billion last year, an increase of 44.7%. The execution price on mortgage loan sales increased primarily due to declining interest rates during the year, offset by a decline in the weighted-average coupon rate charged to borrowers.

In November 2002, the Company completed the sale of NIM residual interests and recorded a gain of \$130.9 million. This sale accelerated cash flows from these residual interests, effectively realizing previously recorded unrealized gains included in other comprehensive income.

Impairments of residual interests in securitizations of \$54.1 million were recognized during the year, due primarily to loan performance of older residuals and changes in assumptions to more closely align with the current economic and interest rate environment.

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

Year Ended April 30	2003	2002
<i>(dollars in 000s)</i>		
Number of loans serviced	<b>246,463</b>	209,594
Average servicing portfolio	<b>\$ 27,742,470</b>	\$ 19,901,701
Average delinquency rate	<b>7.08%</b>	7.07%
Value of MSRs at April 30	<b>\$ 99,265</b>	\$ 81,893

Loan servicing revenues increased \$21.2 million, or 14.4%, this year. The increase reflects a higher average loan servicing portfolio. The average servicing portfolio for fiscal year 2003 increased 39.4%.

Total accretion of residual interests increased \$94.6 million over the prior year. This improvement is the result of increases in the related asset values in fiscal 2002 and 2003. Increases in fair value are realized in income through accretion over the remaining expected life of the residual interest.

For the majority of fiscal year 2003, the Company's residual interests continued to perform better than expected primarily due to lower interest rates which allowed the Company to receive cash earlier than projected in the original valuation models. As a result, the Company recorded favorable pretax mark-to-market adjustments, which increased the fair value of its residual interests \$203.8 million during the year, and write-downs of \$19.1 million. Write-ups were recorded, net of write-downs and deferred taxes of \$70.5 million, in other comprehensive income and will be accreted into income throughout the remaining life of the residual interests. Future changes in interest rates or other assumptions 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 NIM residual interests would result in decreases to accretion income in future periods.

Interest income increased \$31.4 million, or 40.7%, in 2003, due to the average balance on loans held by the Trusts increasing to \$1.8 billion from \$1.2 billion in the prior year. Also contributing to the increase was higher interest margin earned. Interest margin is the difference between the rate on the underlying loans and the financing costs of the Trusts. The interest rate margin increased to 5.76% during fiscal year 2003, from 5.58% in 2002.

Total expenses increased \$111.0 million, or 28.1%, over the prior year. This increase is primarily due to a \$74.2 million increase in compensation and benefits as a result of a 23.2% increase in the number of employees, reflecting resources needed to support higher loan production volumes. Occupancy and equipment expenses increased \$11.9 million due to the opening of an additional servicing center in Jacksonville, Florida and expansion of the servicing and information technology facilities at the segment's headquarters in Irvine, California, to support the higher overall activity levels. Servicing and processing expenses declined due to an impairment of \$11.6 million on servicing assets recorded during fiscal year 2002, while only \$866 thousand was recorded in fiscal year 2003. Other expenses increased \$40.3 million, or 56.2%, for the current year, primarily due to increased consulting, depreciation and marketing expenses.

Pretax income increased \$354.6 million, or 104.5%, for fiscal year 2003.

#### **Fiscal 2002 compared to fiscal 2001**

Mortgage Operations revenues increased \$319.1 million, or 76.7%, for the year ended April 30, 2002 compared to fiscal year 2001. This improvement primarily reflects the increase in production volume and execution pricing, higher accretion, interest income and servicing revenues.

Gains on sales of mortgage loans and related assets increased \$233.7 million, or 91.9%, as a result of a significant increase in loan origination volume and better execution pricing on mortgage loan sales. During fiscal year 2002, the Company's loan origination volume increased 75.5% over 2001. The increase in loan production is a result of an increase in the average loan size, an increase in the size of the sales force, an improvement in the closing ratio and to a lesser extent, the declining interest rate environment. The average loan size increased to \$128 thousand from \$109 thousand in fiscal year 2001 and the closing ratio improved to 50.3% from 44.9% in the previous year. The execution price for fiscal year 2002 was 4.30% compared to 3.71% for the previous year.

Impairments of residual interests totaling \$31.0 million were recorded in fiscal year 2002 related to adverse changes in the timing and amount of cash flows on certain residual interests.

Loan servicing revenues increased \$36.9 million, or 33.5%, for the year ended April 30, 2002. The increase reflects a higher average loan servicing portfolio balance. The average servicing portfolio increased 25.2% compared to the previous year.

Accretion of residual interests increased \$28.8 million over the previous year. This increase is due to added residual interests from loan sale activity and unrealized gains recorded during the year.

During fiscal year 2002, the Company recorded favorable pretax mark-to-market adjustments of \$151.1 million.

Interest income for the year ended April 30, 2002 increased \$41.6 million, or 116.5%, over the previous year. This increase is primarily the result of the declining interest rate environment, which improved the interest margin earned. The interest margin for fiscal year 2002 was 5.58% compared to 2.65% for fiscal year 2001.

Total expenses increased \$117.7 million, or 42.4%, over the previous year. This increase is primarily due to increased compensation and benefits as a result of additional employees needed to support higher loan production volumes. The increase in servicing and processing expense is due to the increase in the size of the servicing portfolio and an \$11.6 million impairment of servicing assets recorded in fiscal year 2002. Fiscal year 2002 also benefited by \$13.6 million from the cessation of goodwill amortization related to the adoption of new accounting standards. Pretax income increased \$201.4 million, or 145.9%, for fiscal year 2002.

#### **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 commitments to fund M&P's operations. See additional discussion of these commitments in the "Financial Condition" section.

A substantial portion of Business Services' business is generated by one-time projects or extended services. The uncertainty surrounding the current business environment has caused clients to delay making strategic decisions and spending money on discretionary projects. This uncertainty has adversely affected consulting services and, to a lesser extent, tax services.

The Company acquired MyBenefitSource, Inc. ("MBS") and Equico Resources, LLC ("Equico") during fiscal year 2002. Both MBS and Equico generated operating losses that adversely impacted fiscal year 2003 results.

#### **Business Services — Financial Results**

Year Ended April 30	2003	2002	2001
<i>(in 000s)</i>			
Accounting, tax and consulting	\$ 388,494	\$ 368,593	\$ 332,099
Product sales	16,720	19,062	20,960
Management fee income	14,257	11,700	11,467
Other	14,669	17,571	21,642
Total revenues	434,140	416,926	386,168
Compensation and benefits	292,291	265,960	240,660
Occupancy and equipment	24,428	19,957	24,792
Depreciation and amortization	7,855	7,063	7,208
Marketing and advertising	9,815	6,285	5,485

Bad debt	9,224	11,353	9,164
Amortization of acquisition intangibles	15,189	14,276	31,576
Impairment of goodwill	11,777	—	—
Other	77,679	69,316	51,330
	<u>          </u>	<u>          </u>	<u>          </u>
Total expenses	448,258	394,210	370,215
	<u>          </u>	<u>          </u>	<u>          </u>
Pretax income (loss)	\$ (14,118)	\$ 22,716	\$ 15,953
	<u>          </u>	<u>          </u>	<u>          </u>

## Fiscal 2003 compared to fiscal 2002

Business Services' revenues for fiscal year 2003 improved \$17.2 million, or 4.1%, over the prior year. This increase was primarily due to the acquisition of Equico in December 2001, which contributed an increase of \$24.9 million over the prior year. Revenues also increased \$7.2 million over the prior year as a result of growth in core accounting and tax services, driven primarily by an increase in the collection rate per billable hour. These increases were somewhat offset by a decline of \$15.5 million in tax consulting revenues. The key drivers of this revenue stream is the volume of tax planning services sold, which declined 20% from the prior year, and lower revenues per unit sold. Additionally, this is the first year there has not been significant year-over-year growth related to new acquisitions. In fiscal year 2003 the Company acquired only a few businesses to add scale to existing offices and only one new location was added, resulting in an increase of \$1.7 million in revenues.

Deferred revenue increased \$12.2 million in fiscal year 2003 due to a backlog of scheduled business valuation projects resulting from staffing shortages. These revenues will be recognized in fiscal year 2004. Recruiting additional experienced personnel will be an area of management emphasis in fiscal year 2004.

Total expenses increased \$54.0 million, or 13.7%, over the prior year. Compensation and benefits costs increased \$26.3 million and occupancy and equipment costs increased \$4.5 million, primarily as a result of the Equico and MBS acquisitions in December 2001. Other expenses increased by \$8.4 million primarily due to increased legal and travel expenses, both related to Equico and MBS.

As part of the Company's annual goodwill impairment testing, an impairment charge of \$11.8 million was recorded related to MBS in fiscal year 2003.

The pretax loss for the year ended April 30, 2003 was \$14.1 million compared to pretax income of \$22.7 million in fiscal year 2002.

## Fiscal 2002 compared to fiscal 2001

Business Services' revenues increased \$30.8 million, or 8.0%, from fiscal year 2001. This increase was due to the addition of new firms and revenue from tax consulting and wealth management services. The effect of acquisitions completed in fiscal year 2002, plus the full year for mergers completed in fiscal year 2001, was to increase revenue for the year by \$24.8 million. Growth from tax consulting and wealth management services was \$8.3 million. Billed "out-of-pocket" expenses were \$5.4 million higher in fiscal year 2002 than in the previous year. Partially offsetting these increases, revenue from core tax services and general business consulting services declined \$9.8 million from fiscal year 2001.

Total expenses increased \$24.0 million, or 6.5%, over the previous year, primarily as a result of operating expenses for Equico and MBS during fiscal year 2002. Partially offsetting this increase was a decrease in amortization of acquisition intangibles of \$19.3 million as a result of the cessation of goodwill amortization related to the adoption of new accounting standards.

Pretax income increased \$6.8 million, or 42.4%, for fiscal year 2002.

## 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. Products and services offered to Investment Services' customers include: equity trading, annuities, fixed income products, mutual funds, margin accounts, money market funds with sweep provisions for settlement of customer transactions, checking privileges, account access/review via the internet, online trading, fee-based accounts, individual retirement accounts, dividend reinvestment and option accounts, equity research and focus lists, model portfolios, asset allocation strategies, economic commentaries and other investment tools and information. In addition, clients of the Company's U.S. Tax Operations segment are given the opportunity to open an Express IRA through HRBFA as a part of the income tax return preparation process.

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 key initiatives is to build revenues through the addition of experienced financial advisors. During fiscal year 2003, 260 experienced advisors were added, which was offset by attrition of primarily less experienced advisors. While revenues are expected to build as a result of this initiative, revenues generated by newly recruited advisors have grown slower than anticipated given the current market environment. The retention and recruitment of experienced advisors will continue to be a key initiative in fiscal year 2004.

Another initiative for fiscal year 2004 is the Licensed Referral Tax Professional ("LRTP") program. This program encourages a cooperative relationship between Investment Services and U.S. Tax Operations by helping tax preparers become licensed, teaming them with a financial advisor and providing a commission to the LRTP for business referred to Investment Services. As of April 30, 2003, there were 126 LRTPs who generated over \$2.0 million in new customer assets. The Company will continue to increase the number of LRTPs in the coming year.

## Investment Services — Operating Statistics

Year Ended April 30	2003	2002	2001
Customer trades <sup>(1)</sup>	1,218,092	1,536,930	2,361,809
Customer daily average trades	4,853	6,123	9,410
Average revenue per trade <sup>(2)</sup>	\$ 120.15	\$ 106.42	\$ 87.34
Number of active accounts	752,903	695,355	619,846
Average trades per active account per year	1.62	2.21	3.81
Ending balance of assets under administration (billions)	\$ 22.3	\$ 27.3	\$ 31.5
Average assets per active account	\$ 29,616	\$ 39,261	\$ 50,817
Ending margin balances (millions)	\$ 486	\$ 801	\$ 1,300
Ending customer payables balances (millions)	\$ 848	\$ 825	\$ 824
Number of advisors	1,071	1,228	1,326



(1) Includes both trades on which commissions are earned ("commissionable trades") and trades for which no commission is earned ("fee-based trades").

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

## Investment Services — Financial Results

Year Ended April 30	2003	2002	2001
<i>(in 000s)</i>			
Margin interest revenue	\$ 37,300	\$ 67,849	\$ 211,128
Less: interest expense	(4,830)	(14,744)	(106,265)
Net interest income	32,470	53,105	104,863
Commission revenue	86,365	103,976	166,362
Fee revenue	32,801	25,257	26,271
Firm trading revenue	44,510	44,861	63,298
Other	(182)	8,742	5,366
Total revenues <sup>(1)</sup>	195,964	235,941	366,160
Commissions	41,748	46,490	68,099
Other variable expenses	4,234	9,266	16,342
Total variable expenses	45,982	55,756	84,441
Gross profit	149,982	180,185	281,719
Compensation and benefits	92,978	93,314	93,592
Occupancy and equipment	30,323	29,106	28,804
Depreciation and amortization	22,491	20,416	17,840
Amortization of acquisition intangibles	29,300	29,450	47,530
Impairment of goodwill	24,000	—	—
Other	63,933	48,067	58,834
Allocated corporate and shared costs	15,249	14,694	25,821
Total fixed expenses	278,274	235,047	272,421
Pretax income (loss)	\$ (128,292)	\$ (54,862)	\$ 9,298

(1) Total revenues, less interest expense.

### Fiscal 2003 compared to fiscal 2002

Investment Services' revenues, net of interest expense, for fiscal year 2003 declined \$40.0 million, or 16.9%, compared to the prior year. The decrease is primarily due to lower net interest income and commission revenue.

Margin interest revenue declined \$30.5 million, or 45.0%, from the prior year primarily as a result of a 39.3% decline in margin balances coupled with lower interest rates. Margin balances have declined from an average of \$1.0 billion for fiscal year 2002 to \$577.0 million in the current year, due to weak investor confidence and declining stock market values. Accordingly, interest expense for fiscal year 2003 declined \$9.9 million, or 67.2%, from fiscal year 2002.

The Company utilizes the weighted average net interest margin to measure the profitability of margin lending activities. The weighted average net interest margin is defined as average interest earned on monthly margin loan balances, less the average cost of funding these loans. The weighted average net interest margin declined from 0.96% for 2002 to 0.51% in 2003, in conjunction with the decrease in market rates.

Commission revenue declined \$17.6 million, or 16.9%. Customer trades on which commissions are earned for fiscal year 2003 declined 32.8% from the prior year.

Fee revenue increased \$7.5 million, or 29.9%, due to the implementation of a new fee structure in November 2001 and the addition of wealth management products. Wealth management products accounted for \$5.2 million of the total increase in fee revenues.

Firm trading revenue, which includes equities, fixed income trading, underwriting, and unit investment trusts, remained relatively flat. However, revenues related to Trust Preferred Debt Securities and underwriting fees increased in fiscal year 2003. The additional revenues from underwriting primarily drove the increase in the average revenue per trade to \$120.15 from \$106.42 last year. Offsetting this increase was a 25.6% decrease in revenues from fixed income trading. Equity trading declined \$4.6 million as a result of closing the principal equity trading operations in April 2002.

Other revenues declined from the prior year due to losses incurred on the disposition of certain assets.

Total expenses increased \$33.5 million, or 11.5%, primarily due to a \$24.0 million goodwill impairment charge recorded during fiscal year 2003. Additional expense increases resulted from various new initiatives to expand products and the business, including the installation of a new back office brokerage operating system, relocation to new offices and advisor recruitment initiatives. These increases were partially offset by a decrease in commissions expense due to the decline in customer trading and cost containment measures.

During the first quarter of fiscal year 2003, in light of unsettled market conditions and the severe decline of comparable business valuations in the investment industry, the Company engaged an independent valuation firm to perform the goodwill impairment test, in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," on the Investment Services segment. As a result, the \$24.0 million impairment charge was recorded.

As a result of meeting certain three-year production goals established in connection with the acquisition of OLDE Financial Corporation, certain long-term advisors were eligible to receive a one-time retention payment. The retention period was through December 31, 2002. Retention payments under this plan of approximately \$17.0 million were accrued through the third quarter of fiscal year 2003. The retention payments were paid out in February 2003.

Pretax results for Investment Services for fiscal year 2003 declined \$73.4 million to a loss of \$128.3 million compared to the prior year loss of \$54.9 million.

#### **Fiscal 2002 compared to fiscal 2001**

Investment Services revenues, net of interest expense, for the fiscal year 2002 declined \$130.2 million, or 35.6%, from fiscal year 2001.

Margin interest revenue declined \$143.3 million, or 67.9%, during fiscal year 2002. The decrease in margin interest income was primarily due to the decline in margin balances and to a lesser extent, lower interest rates. Customer margin balances declined from an average of \$2.4 billion for fiscal year 2001 to an average of \$1.0 billion in fiscal year 2002. Total interest expense decreased \$91.5 million, or 86.1%, for fiscal year 2002. The weighted average net interest margin declined from 1.68% for fiscal year 2001 to 0.96% for 2002.

Commission revenue decreased \$62.4 million, or 37.5%. Total customer trades for fiscal year 2002 were 1.5 million, a decline of 34.9% from the previous year of 2.4 million customer trades.

Firm trading revenue decreased \$18.4 million, or 29.1%. Equity unit investment trusts decreased \$15.6 million, or 87.1%, and equity trading declined \$18.7 million, or 78.2%. Partially offsetting these declines, underwriting revenues increased \$11.5 million or, 195.3%, from fiscal year 2001, primarily due to increased demand for Trust Preferred Debt Securities.

Firm trading revenues also reflect the negative impact of decimalization and the closing down of the principal equity trading operations. Decimalization replaced fractional trading during fiscal year 2001. The impact of decimalization reduced the spread between bid and ask prices, reducing revenue opportunities. As a consequence, HRBFA closed its principal equity trading operations in April 2002, with exit costs of \$1.0 million.

Total expenses decreased \$66.1 million, or 18.5%, due primarily to a decrease in commission expense, prior year litigation settlements, and the amortization of intangible assets. The decrease in commission expense paid to financial advisors was due to the decline in trading. At the end of fiscal year 2001, HRBFA agreed to settle a class action lawsuit and accrued \$16.8 million related to this settlement. Amortization of acquisition intangibles declined \$18.1 million as a result of the cessation of goodwill amortization in fiscal year 2002 related to the adoption of new accounting standards.

Pretax results for Investment Services for fiscal year 2002 declined \$64.2 million to a loss of \$54.9 million from pretax income of \$9.3 million in fiscal year 2001.

## 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 years 2003 and 2002.

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.

The Company's operations in this segment 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 year had the impact of increasing reported revenues and income.

### International Tax Operations — Financial Results

Year Ended April 30	2003	2002	2001
<i>(in 000s)</i>			
Revenues:			
Canada	\$ 57,985	\$ 55,753	\$ 56,075
Australia	20,614	17,701	17,939
United Kingdom	1,322	1,112	1,763
Overseas	5,161	4,144	2,692
Total revenues	85,082	78,710	78,469
Pretax income (loss):			
Canada	8,108	7,728	5,556
Australia	3,802	2,912	3,472
United Kingdom	(818)	(2,536)	(1,602)
Overseas	1,688	1,682	846
Allocated corporate and shared costs	(2,316)	(2,693)	(2,248)
Pretax income	\$ 10,464	\$ 7,093	\$ 6,024

### Fiscal 2003 compared to fiscal 2002

International Tax Operations' revenues for the year ended April 30, 2003 increased \$6.4 million, or 8.1%, compared to the prior year. This improvement is primarily due to results in Australia, where tax returns prepared in company-owned offices in fiscal year 2003 increased 3.7% compared to the prior year and the average charge per return increased 3.0%. Revenues in Canada increased \$2.2 million, or 4.0%, entirely as a result of foreign exchange rates. Revenues in Canadian dollars declined 2.3% primarily due to the sale of certain operations during 2003 and a decline in the number of returns prepared. Tax returns prepared declined 3.7% as a result of increased competition in the major metropolitan areas.

Pretax income improved \$3.4 million, or 47.5%, primarily due to cost savings in the United Kingdom as a result of business restructuring and the write-off of intangible assets in the prior year.

### Fiscal 2002 compared to fiscal 2001

International Tax Operations' revenues remained relatively flat year over year. Overseas operations revenues improved by 53.9% primarily from strong revenues in Puerto Rico. The increase was partially offset by unfavorable currency exchange rates in Australia and Canada.

Pretax income increased \$1.1 million, or 17.7%. The improvement in Canadian pretax income is primarily attributed to lower real estate and occupancy costs, lower bad debt expense and other cost controls. Although revenue in local currency increased compared to the previous year,

the number of regular and discounted tax returns prepared declined 1.8%. Australian results were negatively affected by an unfavorable currency exchange rate, as well as additional costs attributed to the opening of thirteen new offices in July 2001. The number of tax returns prepared remained consistent with fiscal 2001. The United Kingdom's pretax loss increased 58.3% compared to fiscal year 2001, driven primarily by business restructuring and the write-off of intangible assets of \$800 thousand. The improvement in pretax income for Overseas operations is attributed to a 28.4% increase in tax returns prepared, primarily in Puerto Rico.

## 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 and franchise financing subsidiaries are also included within this segment.

### Corporate Operations — Financial Results

Year Ended April 30	2003	2002	2001
<i>(in 000s)</i>			
Operating revenues	\$ 6,448	\$ 12,603	\$ 12,339
Eliminations	(7,099)	(6,830)	(6,502)
Total revenues	(651)	5,773	5,837
Corporate expenses:			
Compensation and benefits	14,959	14,703	7,902
Interest expense:			
Interest on acquisition debt	72,766	79,002	98,759
Other interest	1,106	3,777	8,626
Marketing and advertising	4,518	4,600	4,568
Other	33,438	36,392	26,430
	126,787	138,474	146,285
Support departments:			
Information technology	92,899	84,834	72,281
Marketing	88,819	85,087	74,763
Finance	30,232	19,795	18,731
Other	65,730	58,749	46,858
	277,680	248,465	212,633
Allocation of corporate and shared costs	(280,677)	(247,106)	(216,848)
Investment income, net	2,436	3,097	5,977
Pretax loss	\$ (122,005)	\$ (130,963)	\$ (130,256)

### Fiscal 2003 compared to fiscal 2002

Corporate Operations' revenues declined \$6.4 million primarily as a result of a \$4.2 million decrease in operating interest income and a \$2.0 million write-off of investments at the Company's captive insurance subsidiary.

Corporate expenses declined \$11.7 million, or 8.4%, due primarily to lower interest expense. Interest expense on acquisition debt declined as a result of lower financing costs and a scheduled payment of \$39.8 million in August 2002.

Information technology department expenses increased \$8.1 million, or 9.5%, primarily due to a 20.5% increase in department personnel to support additional projects on behalf of the operating segments. Finance department expenses increased \$10.4 million, or 52.7%, primarily as a result of \$4.7 million in increased insurance costs and \$2.4 million in additional consulting fees over the prior year.

The pretax loss was \$122.0 million, compared with last year's loss of \$131.0 million.

The Company's effective income tax rate for fiscal year 2003 increased to 41.2% compared to 39.4% in fiscal year 2002, primarily as a result of non-deductible goodwill impairment charges recorded in the current year.

### Fiscal 2002 compared to fiscal 2001

Revenues for this segment remained relatively flat, while corporate expenses decreased \$7.8 million, or 5.3%. This decrease is primarily due to a \$19.8 million decline in interest expense on acquisition debt as a result of a payment in fiscal year 2002 and lower financing costs. These decreases were partially offset by a \$6.8 million increase in compensation and benefit expenses due to an increase in personnel, and a \$10.0 million increase in other expenses, resulting primarily from additional consulting fees.

Information technology department expenses increased \$12.6 million as a result of additional consulting fees related to payroll processing systems installed. Marketing department expenses increased \$10.3 million primarily due to additional tax season advertisements during fiscal year 2002. Other support department expenses increased \$11.9 million, or 25.4%, primarily as a result of increased supplies and freight costs of \$7.1 million.

The pretax loss for fiscal year 2002 was \$131.0 million compared to \$130.3 million in fiscal year 2001.

The Company's effective income tax rate for fiscal year 2002 decreased to 39.4% in fiscal year 2002 from 41.5% in fiscal year 2001, primarily

as a result of the cessation of goodwill amortization and tax planning initiatives.

## NEW ACCOUNTING STANDARDS

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 SFAS 133 to clarify the definition of a derivative and incorporate many of the implementation issues cleared as a result of the Derivatives Implementation Group process. This statement is effective for contracts entered into or modified after June 30, 2003 and should be applied prospectively after that date. The Company is currently evaluating what effect, if any, the adoption of SFAS 149 will have on the consolidated financial statements.

In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). 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 a significant variable interest 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. FIN 46 applies in the first fiscal year or interim period beginning after June 15, 2003, to VIEs in which an enterprise holds a variable interest it acquired before February 1, 2003. In addition, FIN 46 requires certain transitional disclosures if an enterprise believes it is reasonably possible that it will determine it has a significant variable interest in a VIE upon the date of application. The Company has not obtained an interest in a new or existing VIE subsequent to January 31, 2003. The Company is continuing its evaluation of interests in potential VIEs, which would be subject to the provisions of FIN 46 for the second quarter of fiscal year 2004.

In December 2002, Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS 148") was issued and amends Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends prior disclosure requirements to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition provisions are effective for financial statements for fiscal years ending after December 15, 2002. The enhanced disclosure requirements are effective for periods beginning after December 15, 2002. The Company accounts for its stock compensation plans in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), as allowed under SFAS 123 and has adopted the disclosure provisions of SFAS 148. On May 1, 2003 the Company adopted the fair value recognition provisions preferred under SFAS 123, and will prospectively recognize compensation expense on future awards granted, modified or settled after April 30, 2003. The prospective method is one of the methods provided under SFAS 148.

In November 2002, Emerging Issues Task Force Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21") was issued. 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 would be determined separately for each unit of accounting within the arrangement. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company is currently evaluating the effect of EITF 00-21 on the consolidated financial statements.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), which addresses the disclosure to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. FIN 45 also requires the guarantor to recognize a liability for the non-contingent component of the guarantee, which is the obligation to stand ready to perform if specified triggering events or conditions occur. The initial measurement of this liability is the fair value of the guarantee at inception. The Company has adopted the disclosure requirements of FIN 45 and, in accordance with the transition rules of the pronouncement, has applied the recognition and measurement provisions for all guarantees entered into or modified after December 31, 2002. See note 20 to the consolidated financial statements. The adoption of FIN 45 did not have a material effect on the consolidated financial statements.

In June 2002, Statement of Financial Accounting Standards No. 146 "Accounting for Costs associated with Exit or Disposal Activities" ("SFAS 146") was issued. SFAS 146 addresses accounting and reporting for costs associated with exit or disposal activities and nullifies EITF No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 is effective for exit or disposal activities initiated after December 31, 2002. The adoption of SFAS 146 did not have a material effect on the consolidated financial statements.

On May 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 establishes a single accounting model, based on the framework established in SFAS 121, for long-lived assets to be disposed of by sale. The adoption of SFAS 144 did not have a material effect on the consolidated financial statements.

The estimated impact of these new accounting standards reflects the Company's current views. There may be material differences between these estimates and the actual impact of these standards.



## FINANCIAL CONDITION

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 flows totaled \$690.8 million, \$741.4 million and \$248.4 million in fiscal years 2003, 2002 and 2001, respectively.

A condensed consolidating statement of cash flows by segment for the fiscal year ended April 30, 2003 follows. Generally, interest is not charged on intercompany activities between segments.

	U.S. Tax Operations	Mortgage Operations	Business Services	Investment Services	International Tax Operations	Corporate Operations	Consolidated H&R Block
<i>(in 000s)</i>							
Cash provided by (used in):							
Operating activities	\$ 410,232	\$ 144,976	\$ 7,861	\$ (19,572)	\$ 18,519	\$ 128,809	\$ 690,825
Investing activities	(72,687)	272,162	(29,401)	(8,161)	(3,184)	(33,390)	125,339
Financing activities	(355)	—	(57,469)	(1,802)	(187)	(317,143)	(376,956)
Net intercompany activities	(348,005)	(387,468)	73,802	(18,214)	(28,977)	708,862	—

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 operating cash flows to the Company. This segment 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 generated \$410.2 million in operating cash flows primarily related to its net income, as cash is generally collected from clients at the time services are rendered. Cash out flows from investing activities of \$72.7 million is due primarily to purchases of property & equipment.

A key component of this segment's operations is the ability to offer RALs and facilitate funding of RAL participations. Household and its designated bank provide funding of all RALs offered through the Company. If Household and its designated bank do not provide funding for RALs, the Company would need to find other RAL lenders to continue offering RALs to its clients.

**Mortgage Operations:** Mortgage Operations provided \$145.0 million in cash from operating activities primarily due to the sale of mortgage loans. This segment also generated \$272.2 million in cash from investing activities related to cash received on residual interests as they mature, and cash received on the sale of NIM residual interests.

Gains on sales of mortgage loans and related assets totaled \$775.3 million, of which 89% was received as cash. The cash was recorded as either operating or investing activities, depending on the asset sold.

During the third quarter of fiscal year 2003, the Company completed the sale of NIM residual interests and retained a \$57.4 million residual interest from the sale. This transaction netted the Company \$142.5 million in cash. The gain on this transaction is included in gains on sales of mortgage assets in the consolidated income statements, and in the Mortgage Operations segment, where applicable.

Gain on sales of mortgage assets consist of the following:

Year Ended April 30	2003	2002	2001
<i>(in 000s)</i>			
Gain on loans sold to the Trusts and ultimately disposed of via:			
Whole loan sales	\$ 347,241	\$ 65,219	\$ 48,187
Securitizations	378,620	437,754	209,988
Gain on sale of NIM residual interests	130,881	—	—
Gain on loans still held by the Trusts	74,987	17,028	12,671
Gain on retained mortgage servicing rights	60,078	52,844	37,832
Net change in mark-to-market on pipeline loans	6,158	(758)	7,131
Impairments of residual interests	(54,111)	(30,987)	(9,467)
Direct origination expenses	(168,513)	(84,142)	(61,553)
Total gains on sales	\$ 775,341	\$ 456,958	\$ 244,789
Percent of gains received as cash	89%	86%	58%

As further explained in “Off-Balance Sheet Financing Arrangements” below, the Mortgage Operations segment receives cash as a result of loan sales, NIM transactions, sale of NIM residual interests and as its residual interests mature. The Company began receiving cash collections from its residual interests in fiscal year 2002, which has reduced the outstanding balance of the residuals. Cash received on these residual interests was \$140.8 million for fiscal year 2003, compared with \$67.1 million for fiscal year 2002.

Mortgage Operations regularly sells loans as a source of liquidity. Loan sales in fiscal year 2003 were \$17.2 billion compared with \$11.4 billion for the same period in fiscal year 2002. Additionally, Block Financial Corporation (“BFC”), its direct corporate parent, provides this segment a \$150 million line of credit for working capital needs.

Management believes the sources of liquidity available to the Mortgage Operations segment are predictable and sufficient for its needs. Risks to the stability of these sources include external events impacting the asset-backed securities market, such as the level of and fluctuations in interest rates, changes in the securitization market and competition. 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 three warehouse facilities used by the Trusts are subject to annual renewal, each at a different time during the year, in April, October and December. Any of the above events could lead to difficulty in renewing the lines, however this risk of non-renewal is 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.

The FASB has issued an exposure draft which would amend Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS 140"). The purpose of the proposal is to provide more specific guidance on the accounting for transfers of financial assets to an off-balance sheet structure (qualifying special purpose entity). These changes may impact the Company's ability to record securitization activities utilizing its current structure and maintain its current accounting treatment. The Company is closely monitoring the progress of this project.

**Business Services:** Business Services funding requirements are largely related to receivables for completed work and "work in process." Funding is available from the Company sufficient to cover this segment's working capital needs. Business Services also has future obligations and commitments, which are summarized in the tables below under "Contractual Obligations and Commercial Commitments."

Business Services used \$29.4 million in investing activities primarily related to acquisitions.

**Investment Services:** 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 \$1 million 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 \$1 million. At the end of fiscal year 2003, HRBFA's net capital of \$95.0 million, which was 17.3% of aggregate debit items, exceeded its minimum required net capital of \$11.0 million by \$84.0 million.

In fiscal year 2003, Investment Services used cash in its operating, investing and financing activities primarily as a result of the segment's increasing losses.

To manage short-term liquidity, HRBFA maintains a \$300 million unsecured credit facility with BFC, its indirect corporate parent. Additionally, HRBFA maintains a \$125 million line of credit with a financial institution. At the end of fiscal years 2003 and 2002, there were no outstanding balances on these facilities.

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 at the end of fiscal year 2003 totaled \$39.7 million, an excess of \$4.3 million over the margin requirement. Pledged securities at the end of fiscal year 2002 totaled \$42.8 million, an excess of \$4.0 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 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 April 30, 2003, there was no commercial paper outstanding. The peak borrowing during fiscal year 2003 was \$71.0 million (Canadian).

International Tax Operations generated \$18.5 million in cash flows from operating activities primarily due to its net income because, similar to U.S. Tax Operations, cash is generally collected from clients when services are rendered.

## CAPITAL RESOURCES

Cash and cash equivalents totaled \$875.4 million at April 30, 2003. Cash provided by operations totaled \$690.8 million for fiscal year 2003 compared to \$741.4 million in the prior year.

Cash expenditures during fiscal year 2003 relating to investing and financing activities include the purchase of property and equipment (\$150.9 million), business acquisitions and related contingent payments (\$26.4 million), payments on acquisition debt (\$57.5 million), payment of dividends (\$125.9 million) and the acquisition of treasury shares (\$191.2 million, net of the proceeds from issuance of common stock).

Cash and cash equivalents — restricted totaled \$438.2 million at fiscal year end. HRBFA held \$400.1 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. The HRBFA restricted cash balance has grown from \$108.0 million at the beginning of fiscal year 2003 as customer credit balances have become larger than customer debit balances due to the significant decline in margin loan balances resulting from the slowing economy. Restricted cash held by Mortgage Operations totaled \$20.7 million at April 30, 2003 as a result of cash held for outstanding commitments to fund mortgage loans. Restricted cash of \$17.4 million at April 30, 2003 held by Business Services is related to funds held to pay payroll taxes on behalf of its customers.

Working capital increased to \$850.2 million at April 30, 2003 from \$365.4 million at April 30, 2002. The working capital ratio at April 30, 2003 is 1.45 to 1, compared to 1.19 to 1 at April 30, 2002. Historically, a large portion of tax return preparation occurs in the fourth quarter and has the effect of increasing certain assets and liabilities during the fourth quarter, including cash and cash equivalents, receivables, accrued salaries, wages and payroll taxes and accrued income taxes.

On September 12, 2001, the Company's Board of Directors authorized the repurchase of 15 million shares of common stock. During fiscal year 2003, the Company repurchased 6.6 million shares pursuant to this authorization at an aggregate price of \$316.6 million or an average price of \$47.94 per share. There are approximately 1.9 million shares remaining under the September 2001 authorization at April 30, 2003. 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.

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, securities laws restrictions and other investment opportunities available.

## OFF-BALANCE SHEET FINANCING ARRANGEMENTS

The Company is party to various transactions with an off-balance sheet component, including loan commitments and special purpose entities, or Trusts.

The Company has commitments to fund mortgage loans in its pipeline of \$2.6 billion at April 30, 2003, subject to contractual conditions being fulfilled by the borrowers. 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 in the manner described below.

The relationships with the Trusts serve to reduce the Company's capital investment in its non-prime mortgage operations. These arrangements are primarily used to purchase mortgage loans, but a portion may also be used to finance servicing advances and residual interests. Additionally, these arrangements have freed up cash and short-term borrowing capacity, improved liquidity and flexibility, and reduced balance sheet risk, while providing stability and access to liquidity in the secondary market for mortgage loans.

Substantially all non-prime mortgage loans originated are sold daily to the Trusts. The Trusts purchase the loans from the Company utilizing three warehouse facilities, arranged by the Company, totaling \$4.0 billion. These facilities are subject to various Option One Mortgage Corporation ("Option One") performance triggers, limits and financial covenants, including tangible net worth and leverage ratios. In addition, these facilities contain cross-default features in which a default in one facility would trigger a default under the other facilities as well. The material terms and features of these various facilities are as follows:

- Facility I: In December 2002, this facility was renewed, increasing capacity from \$1.0 billion to \$1.5 billion. This facility bears interest at one-month LIBOR plus 50 to 60 basis points and expires on December 19, 2003. As of April 30, 2003 the balance outstanding under this facility was \$1.1 billion.
- Facility II: In April 2003, this facility was renewed, increasing capacity from \$1.0 billion to \$1.5 billion. This facility bears interest at one-month LIBOR plus 50 to 60 basis points and expires on April 16, 2004. As of April 30, 2003 the balance outstanding under this facility was \$467.4 million.
- Facility III: In July 2003, this \$1.0 billion facility was extended to October 6, 2003. This facility bears interest at one-month LIBOR plus 50 to 60 basis points. As of April 30, 2003 the balance outstanding under this facility was \$626.4 million.

As a result of the whole loan sales to the 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 by the Trusts. This receivable is included in prepaid and other current assets on the consolidated balance sheets.

Subsequently, the Trusts, as directed by the Trustees, either sell the loans directly to third-party investors or pool the loans for a securitization, depending on market conditions. If the Trusts choose to sell the mortgage loans the Company receives cash for its receivable. In a securitization transaction, the Trusts transfer the loans, and the right to receive all payments on the loans, to a securitization trust and the Company transfers its receivable. The securitization trust issues bonds, which are supported by the 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 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 interest may also change, resulting in either additional unrealized gains or impairment of the value of the residual interests.

At the settlement of each securitization, the Company records: (i) the cash received, and (ii) the estimated fair value of the interest in the mortgage loans retained from the securitization (residual interests). Additionally, the receivable from the whole loan sale to the Trusts is reversed. The residual interests represent the discounted estimated cash flows to be received by the Company in the future. The excess of the net cash received and the assets retained by the Company over the carrying value of the loans sold, less transaction costs, equals the net gain on sale of mortgage loans recorded by the Company. The Company allocates its basis in the mortgage loans and residual interests between the portion of the mortgage loans and residual interests sold and the portion retained (the residual interests and servicing assets) based on the relative fair values of those portions on the date of sale. These residual interests are classified as trading securities.

The Company is required, under the terms of the securitization, to build and/or maintain OC to specified levels, using the excess cash flows received, until specified percentages of the securitized portfolio are attained. The Company funds the OC account from the proceeds of the sale. Future cash flows to the residual holder are used to amortize the bonds until a specific percentage of either the original or current balance is retained, which is specified in the securitization agreement. The bond holders' recourse to the Company for credit losses is limited to the excess cash flows described above and the amount of OC held by the Trusts. Upon maturity of the bonds, any remaining amounts in the Trusts are distributed. The estimated future cash flows to be distributed to the Company are included as part of the residual valuation and are valued upon distribution from the OC account.

To accelerate the cash flows from its residual interests, the Company securitizes the majority of its residual interests in NIM transactions. In a NIM transaction, the residual interests are transferred to another QSPE ("NIM trust"), which then issues bonds to third-party investors. The proceeds from the bonds are returned to the Company as payment for the residual interests. The bonds are secured by the 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.

At the settlement of each NIM transaction, the Company removes the carrying value of the residual interests sold from its consolidated balance sheet and records: (i) the cash received, and (ii) the estimated fair value of the portion of the residual interest retained. The excess of the net cash received and assets retained over the carrying value of the residuals sold, less transaction costs, equals the net gain or loss on the sale of residual interests by the Company. These residual interests are classified as available-for-sale securities.

Residual interests retained from NIM securitizations may also be bundled and sold in a subsequent securitization.

For fiscal year 2003, the disposition of loans by the Trusts was 59% securitizations and 41% whole loan sales. For fiscal year 2002, the disposition of loans by the Trusts was 89% securitizations and 11% whole loan sales.

The Company uses Trusts in a manner consistent with conventional practices in the securitization industry. Loans totaling \$2.2 billion and \$1.1 billion were held by the Trusts as of April 30, 2003 and 2002, respectively. Under generally accepted accounting principles, because these Trusts are QSPEs, the Company does not record these loans on the consolidated balance sheets.

In connection with the sale of mortgage loans, the Company provides certain representations and warranties allowing the purchaser the option of returning the purchased loans to the Company under certain conditions. The Company may recognize losses as a result of the repurchase of loans under these arrangements. The Company maintains reserves for the repurchase of loans based on historical trends. See note 20 to the consolidated financial statements.

## COMMERCIAL PAPER ISSUANCE

The Company participates in the United States and Canadian commercial paper markets to meet daily cash needs. Commercial paper is issued by BFC and H&R Block Canada, Inc., wholly owned subsidiaries of the Company. The following chart provides the debt ratings for BFC as of April 30, 2003:

	Short-Term	Long-Term	Outlook
S&P	A-2	BBB+	Stable
Moody's	P-2	A3	Stable
Fitch	F-1	A	Negative

The following chart provides the debt ratings for H&R Block Canada, Inc. as of April 30, 2003:

	Short-Term	Corporate	Trend
Moody's DBRS	P-2 R-1 (low)	A	Stable

The Company incurs short-term borrowings throughout the year primarily to fund seasonal working capital needs, dividend payments and purchases of treasury stock. Borrowings in previous years were also incurred to fund participation in RALs. Because of the seasonality of its businesses, the Company has short-term borrowings throughout the year, which peaked at \$1.4 billion in January 2003. No commercial paper was outstanding at April 30, 2003 or 2002.

U.S. commercial paper issuances are supported by an unsecured committed line of credit ("CLOC") from a consortium of twenty-two banks. The \$2.0 billion CLOC is subject to annual renewal in October 2003 and has a one-year term-out provision with a maturity date of October 22, 2004. This line is subject to various affirmative and negative covenants, including a minimum net worth covenant.

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 2003. There are no rating contingencies under the CLOCs. These CLOCs were undrawn at April 30, 2003.

Management believes the commercial paper market to be stable. Risks to the stability of the Company's commercial paper market participation would be a short-term rating downgrade, adverse changes in the Company's financial performance, non-renewal or termination of the CLOCs, adverse publicity and operational risk within the commercial paper market. Management believes if any of these events were to occur, the CLOCs, to the extent available, could be used for an orderly exit from the commercial paper market, though at a higher cost to the Company. Additionally, the Company could turn to other sources of liquidity, including cash, debt issuance under the existing shelf registration and asset sales or securitizations.

## CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

A summary of the Company's obligations to make future payments is as follows:

Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
<i>(in 000s)</i>					
Long-term debt	\$ 749,093	\$ 1,123	\$ 250,345	\$ 497,625	\$ —
Operating leases	522,011	171,041	220,353	75,415	55,202
Acquisition payments	115,874	54,055	48,039	13,780	—
Pension obligation assumed	19,547	2,042	3,110	2,630	11,765
Capital lease obligations	13,013	500	942	1,083	10,488
Total contractual cash obligations	\$ 1,419,538	\$ 228,761	\$ 522,789	\$ 590,533	\$ 77,455

In April 2000, the Company issued \$500 million of 8 1/2% Senior Notes, due 2007. The Senior Notes are not redeemable prior to maturity. The net proceeds of this transaction were initially used to repay a portion of the short-term borrowings that initially funded the acquisition of OLDE Financial Corporation.

In October 1997, the Company issued \$250 million of 6 3/4% Senior Notes, due 2004. The Senior Notes are not redeemable prior to maturity. The net proceeds of this transaction were used to repay short-term borrowings that initially funded the acquisition of Option One.

Long-term debt at April 30, 2003 was comprised of the \$750 million of Senior Notes described above, future payments related to the acquisitions of RSM McGladrey and other Business Services acquisitions, capital lease obligations and mortgage notes. The Company's debt to total capital ratio was 34.5% at April 30, 2003, compared with 40.4% at April 30, 2002.

As of April 30, 2003, the Company had \$250 million remaining under its shelf registration of debt securities for additional debt issuance.

In connection with the Company's acquisition of the non-attest assets of M&P in August 1999, the Company assumed certain pension liabilities related to M&P's retired partners. The Company makes payments in varying amounts on a monthly basis. Included in other noncurrent liabilities at April 30, 2003 and 2002 are \$19.5 million and \$25.7 million, respectively, related to this liability.



A summary of the Company's commitments, which may or may not require future payments, expire as follows:

Other Commercial Commitments	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
<i>(in 000s)</i>					
Commitments to fund mortgage loans	\$2,614,500	\$ 2,614,500	\$ —	\$ —	\$ —
Commitments to sell mortgage loans	1,470,031	1,470,031	—	—	—
Major franchise acquisition payments	105,000	96,500	8,500	—	—
Acquisition contingent payments	52,290	41,740	7,400	3,150	—
Pledged securities	39,719	39,719	—	—	—
Commitment to fund M&P	26,173	—	26,173	—	—
Franchise Equity Lines of Credit	22,729	6,897	9,163	6,648	21
Mortgage loan repurchase obligations	18,859	18,859	—	—	—
Other commercial commitments	8,375	8,375	—	—	—
Total commercial commitments	\$4,357,676	\$ 4,296,621	\$ 51,236	\$ 9,798	\$ 21

The Company has commitments to fund mortgage loans to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. External market forces impact the probability of commitments being exercised, and therefore, total commitments outstanding do not necessarily represent future cash requirements.

The Company has entered into whole loan sale agreements with investors in the normal course of business, which included 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.

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 will 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 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. If the Company were to acquire all of the major franchises with expiring franchise agreements, the minimum purchase price is estimated to be \$105.0 million. The Company may potentially acquire the franchise businesses over the next several fiscal years, however, due to continuing litigation and possible negotiations with major franchisees, there is no certainty all of the major franchisees involved in the litigation will be acquired or that HRB Royalty and certain major franchisees will not agree to other arrangements, some of which may not require the above payment. Additionally, the timing and cost of acquisition as to any major franchise business is not certain due partially to related litigation.

In connection with Business Services' acquisitions, the purchase agreements provide for possible future contingent consideration, which is based on achieving certain revenue, profitability and working capital requirements over the next six years. The Company estimates the potential payments (undiscounted) total approximately \$52.3 million as of April 30, 2003. This estimate is based on current financial conditions. Should actual results differ materially from the assumptions, the potential payments will differ from the estimate.

The Company has pledged securities totaling \$39.7 million, which satisfy margin deposit requirements as April 30, 2003.

At April 30, 2003, the Company had a receivable from M&P of \$31.0 million. Commitments exist to loan M&P up to the value of its accounts receivable, work-in-process and fixed assets (\$57.1 million at April 30, 2003) on a revolving basis through July 31, 2004, subject to certain termination clauses. This revolving facility bears interest at the prime rate plus four and one-half percent on the outstanding amount and a commitment fee of one-half percent per annum on the unused portion of the commitment. The loan is fully secured by the accounts receivable, work-in-process and fixed assets of M&P.

The Company has contractual commitments to fund certain franchises requesting Franchise Equity Lines of Credit ("FELCs"). The commitment to fund FELCs as of April 30, 2003 totaled \$56.1 million, with a related receivable balance of \$33.3 million included in the consolidated balance sheets. The receivable represents the amount drawn on the FELCs as of April 30, 2003.

See additional discussion of commitments in note 20 to the consolidated financial statements.



## REGULATORY ENVIRONMENT

Certain state laws restrict or prohibit prepayment penalties on mortgage loans, and the Company has 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 federally chartered depository institutions, the federal preemption that federally chartered depository institutions enjoy. However, on September 25, 2002, the OTS released a new rule that will reduce the scope of the Parity Act preemption and, as a result, the Company will no longer be able to rely on the Parity Act to preempt state restrictions on prepayment penalties. The effective date of the new rule, originally January 1, 2003, was subsequently extended by the OTS until July 1, 2003 in response to concerns from interested parties about the burdens associated with compliance. The elimination of this federal preemption will require compliance with state restrictions on prepayment penalties. It is expected that these restrictions will prohibit the Company from charging any prepayment penalty in six states and will restrict the amount or duration of prepayment penalties that the Company may impose in an additional eleven states. This may place the Company at a competitive disadvantage relative to financial institutions that will continue to enjoy federal preemption of such state restrictions. Such institutions will be able to 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 \$29.0 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.

## CRITICAL ACCOUNTING POLICIES

The policies discussed below are considered by management to be critical to securing an understanding of the Company's financial statements, as they require the use of significant judgment and estimation in order to measure, at a specific point in time, matters that are inherently uncertain. Specific risks for these critical accounting policies are described in the following paragraphs. For all of these policies, management cautions that future events rarely develop precisely as forecast, and estimates routinely require adjustment and may require material adjustment.

**Gains on sales of mortgage loans:** The Company sells substantially all of the non-prime mortgage loans it originates to the Trusts, which are QSPes, with servicing rights retained. Prime mortgage loans are sold in whole loan sales, servicing released, to third-party buyers. The Company records the gains on sales as the difference between cash proceeds and the allocated cost of loans sold.

The Company determines the allocated cost of loans sold based on the relative fair values of loans sold, mortgage servicing rights ("MSRs") and a receivable which represents the ultimate expected outcome from the disposition of the loans by the Trusts. The relative fair value of the MSRs and the receivable is determined using discounted cash flow models, which require various management assumptions (see discussion below in "Valuation of residual interests" and "Valuation of mortgage servicing rights"). Variations in these assumptions affect the estimated fair values, which would affect the reported gains on sales.

The Trusts, as directed by the Trustees, ultimately dispose of the mortgage loans either through a securitization or a whole loan sale, depending on market conditions. The ultimate disposition of the loans by the Trusts determines the timing of the receipt of cash by the Company. If the Trusts choose to sell the mortgage loans, the Company receives cash for its receivable.

In a securitization transaction, the Trusts transfer the loans and the right to receive all payments on the loans to a securitization trust, and the company transfers its receivable. The securitization trust is a QSPE. The securitization trust issues bonds to third-party investors, which are supported by the cash flows from the pooled loans. The Company retains an interest in the loans in the form of a residual interest (including 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 value of the residual interests.

The Company securitizes the majority of its residual interests in NIM transactions, receives cash and retains a smaller residual interest. The Company generally receives cash flows on its residual interests only after the bonds issued to the third-party investors have matured.

Residual interests retained from NIM securitizations may also be bundled and sold in a subsequent securitization. The sale of mortgage assets requires management to make various assumptions that may materially affect the gains on sales.

**Valuation of residual interests:** The Company uses discounted cash flow models to arrive at the estimated fair values of its residual interests. The fair value of residual interests is estimated by computing the present value of the excess of the weighted-average coupon on the loans sold over the sum of (1) the coupon on the securitization bonds, (2) a base servicing fee paid to the servicer of the loans (usually the Company), (3) expected losses to be incurred on the portfolio of the loans sold (as projected to occur) over the lives of the loans, (4) fees payable to the trustee and insurer, if applicable, (5) estimated collections of prepayment penalty income, and (6) payments made to investors on NIM bonds, if applicable. The residual valuation takes into consideration the current and expected interest rate environment, including projected changes in future interest rates and the timing of such changes. Prepayment and loss assumptions used in estimating the cash flows are based on evaluations of the actual experience of the Company's servicing portfolio, the characteristics of the applicable loan portfolio, as well as taking into consideration the current economic and interest rate environment and its expected impact. The estimated cash flows are discounted at an interest rate the Company believes an unaffiliated third-party purchaser would require as a rate of return on a financial instrument with a similar risk profile. The Company evaluates the fair values of residual interests quarterly by updating the actual and expected assumptions in the discounted cash flow models based on current information and events and by estimating, or validating with third-party experts, if necessary, what a market participant would use in determining the current fair value. Variations in the above assumptions, as well as the discount rate and interest rate assumptions, could materially affect the estimated fair values, which may require the Company to record impairments or unrealized gains. In addition, variations will also affect the amount of residual interest accretion recorded on a monthly basis. See note 7 to the consolidated financial statements for current assumptions.

**Valuation of mortgage servicing rights:** The Company sells non-prime mortgage loans with servicing retained. MSRs are recorded at allocated carrying amounts based on relative fair values when the loans are sold (see discussion above in "Gain on sale of mortgage loans"). Fair values of MSRs are determined based on the present value of estimated future cash flows related to servicing loans. Assumptions used in estimating the value of MSRs include discount rates, prepayment speeds (including default), ancillary fee income and other economic factors. The prepayment speeds are somewhat correlated with the movement of market interest rates. As market interest rates decline there is a corresponding increase in actual and expected borrower prepayments as customers refinance existing mortgages under more favorable interest rate terms. This in turn reduces the anticipated cash flows associated with servicing resulting in a reduction, or impairment, to the fair value of the capitalized MSR. Non-prime loans tend to have a prepayment penalty in place for the first two to three years, which has the effect of making prepayment speeds more predictable, regardless of market interest rate movements. Prepayment rates are estimated using the Company's historical experience and third party market sources. Variations in these assumptions could materially affect the carrying value of the MSRs.

MSRs are carried at the lower of cost or market and are reviewed quarterly for impairment by management. Impairment is assessed based on the fair value of each risk stratum. MSRs are stratified by: loan sale date (which approximates date of origination) and loan type (6-month adjustable, 2 to 3-year adjustable and fixed rate). Fair values take into account the historical prepayment activity of the related loans and management's estimates of the remaining future cash flows to be generated by the underlying mortgage loans. If actual prepayment rates prove to be higher than the estimate made by management, impairment of the MSRs could occur.

**Valuation of goodwill:** The Company tests goodwill for impairment annually or more frequently whenever events occur or circumstances change which would more likely than not reduce the fair value of a reporting unit below its carrying amount. The Company has defined its reporting units as its operating segments or one level below. The first step of the impairment test is to compare the estimated fair value of the reporting unit to its carrying value. If the carrying value is less than fair value, no impairment exists. If the carrying value is greater than fair value, a second step is performed to determine the fair value of goodwill and the amount of impairment loss, if any. In estimating each reporting unit's fair value using discounted cash flow projections and market comparables, when available, management makes assumptions, including discount rates, growth rates and terminal values. Changes in the projections or assumptions could materially affect fair values.

**Litigation:** The Company's policy is to routinely assess the likelihood of any adverse judgments or outcomes related to legal matters, as well as ranges of probable losses. A determination of the amount of the reserves required, if any, for these contingencies is made after thoughtful analysis of each known issue and an analysis of historical experience in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," and related pronouncements. Therefore, the Company has recorded reserves related to certain legal matters for which it is probable that a loss has been incurred and the range of such loss can be estimated. With respect to other matters, management has concluded that a loss is only reasonably possible or remote and, therefore, no liability is recorded. In addition, there are certain gain contingencies for which the Company has not recorded an asset because realization is not considered probable as of the balance sheet date.

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

## CONTROLS AND PROCEDURES

Disclosure controls are procedures that are designed to ensure information is recorded, processed, summarized and reported in accordance with the rules of the Securities and Exchange Commission. Disclosure controls are also designed to ensure such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

In conjunction with management, including the Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures within 90 days prior to the filing date of this annual report. Based on this evaluation, the Chief Executive Officer and Chief Financial 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.

## FORWARD-LOOKING INFORMATION

The Notes to the Consolidated Financial Statements, as well as other information contained in this Annual Report to Shareholders 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 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, earnings 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; 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 RAL litigation; the uncertainty as to the timing or cost of acquisition as to any 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.

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

Year Ended April 30	2003	2002	2001
<b>REVENUES:</b>			
Service revenues	\$ 2,375,212	\$ 2,333,064	\$ 2,179,896
Gains on sales of mortgage assets	775,341	456,958	244,789
Interest income	297,185	206,433	279,833
Product sales	144,691	127,226	101,489
Royalties	174,659	164,615	149,683
Other	12,679	29,440	25,647
	<u>3,779,767</u>	<u>3,317,736</u>	<u>2,981,337</u>
<b>OPERATING EXPENSES:</b>			
Employee compensation and benefits	1,401,434	1,308,705	1,192,294
Occupancy and equipment	345,960	305,387	283,181
Depreciation and amortization	161,821	155,386	205,608
Marketing and advertising	150,172	155,729	110,973
Interest	92,644	116,141	242,551
Supplies, freight and postage	88,748	75,710	70,440
Texas litigation reserve	41,672	—	—
Impairment of goodwill	35,777	—	—
Other	481,297	485,250	411,224
	<u>2,799,525</u>	<u>2,602,308</u>	<u>2,516,271</u>
Operating income	980,242	715,428	465,066
Other income, net	6,835	1,412	8,012
Income before taxes	987,077	716,840	473,078
Income taxes	407,013	282,435	196,330
<b>NET INCOME BEFORE CHANGE IN ACCOUNTING PRINCIPLE</b>	<b>580,064</b>	<b>434,405</b>	<b>276,748</b>
Cumulative effect of change in accounting principle for derivatives and hedging activities less applicable income taxes of \$2,717)	—	—	4,414
<b>NET INCOME</b>	<b>\$ 580,064</b>	<b>\$ 434,405</b>	<b>\$ 281,162</b>
<b>BASIC EARNINGS PER SHARE:</b>			
Net earnings before change in accounting principle	\$ 3.23	\$ 2.38	\$ 1.50
Cumulative effect of change in accounting principle	—	—	.03
Net earnings	<u>\$ 3.23</u>	<u>\$ 2.38</u>	<u>\$ 1.53</u>
<b>DILUTED EARNINGS PER SHARE:</b>			
Net earnings before change in accounting principle	\$ 3.15	\$ 2.31	\$ 1.49
Cumulative effect of change in accounting principle	—	—	.03
Net earnings	<u>\$ 3.15</u>	<u>\$ 2.31</u>	<u>\$ 1.52</u>

*See notes to consolidated financial statements on pages 50-75.*

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

April 30	2003	2002
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 875,353	\$ 436,145
Cash and cash equivalents — restricted	438,242	152,173
Marketable securities — trading	23,859	28,370
Receivables from customers, brokers, dealers and clearing organizations, net	517,037	844,538
Receivables, net	403,197	368,345
Prepaid expenses and other current assets	489,673	415,572
Total current assets	2,747,361	2,245,143
<b>OTHER ASSETS</b>		
Investments in available-for-sale marketable securities	17,030	15,260
Residual interests in securitizations	264,337	365,371
Mortgage servicing rights	99,265	81,893
Intangible assets, net	341,865	383,085
Goodwill, net	714,215	723,856
Property and equipment, net	288,594	286,500
Other	131,238	129,683
	<u>\$ 4,603,905</u>	<u>\$ 4,230,791</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Current portion of long-term debt	\$ 55,678	\$ 59,656
Accounts payable to customers, brokers and dealers	862,694	903,201
Accounts payable, accrued expenses and deposits	468,933	410,622
Accrued salaries, wages and payroll taxes	210,629	253,401
Accrued income taxes	299,262	252,822
Total current liabilities	1,897,196	1,879,702
<b>LONG-TERM DEBT</b>	822,302	868,387
<b>OTHER NONCURRENT LIABILITIES</b>	220,698	113,282
<b>COMMITMENTS AND CONTINGENCIES</b> (Note 20)		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, no par, stated value \$.01 per share, authorized 500,000,000 shares	2,179	2,179
Convertible preferred stock, no par, stated value \$.01 per share, authorized 500,000 shares	—	—
Additional paid-in capital	496,393	468,052
Accumulated other comprehensive income	36,862	44,128
Retained earnings	2,221,868	1,767,702
Less cost of common stock in treasury	(1,093,593)	(912,641)
Total stockholders' equity	1,663,709	1,369,420
	<u>\$ 4,603,905</u>	<u>\$ 4,230,791</u>

*See notes to consolidated financial statements on pages 50-75.*

**CONSOLIDATED STATEMENTS OF CASH FLOWS**
*Amounts in thousands*
**H&R BLOCK, INC.**

Year Ended April 30	2003	2002	2001
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 580,064	\$ 434,405	\$ 281,162
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	161,821	155,386	205,608
Provision for bad debt	49,748	76,804	84,422
Accretion of acquisition liabilities	9,200	11,700	11,863
Provision for deferred taxes on income	63,849	30,136	(38,870)
Net (gain) loss on sale of marketable securities	185	(423)	(17,744)
Accretion of residual interests in securitizations	(145,165)	(50,583)	(21,824)
Impairment of residual interests in securitizations	54,111	30,987	9,467
Realized gain on sale of residual interests in securitizations	(130,881)	—	—
Additions to trading securities — residual interests in securitizations	(542,544)	(809,228)	(386,207)
Proceeds from net interest margin transactions	541,791	783,171	319,620
Additions to mortgage servicing rights	(65,345)	(65,630)	(37,661)
Amortization of mortgage servicing rights	47,107	33,890	18,147
Impairment of mortgage servicing rights	866	11,643	—
Impairment of goodwill	35,777	—	—
Tax benefit from stock option exercises	37,304	57,809	2,235
Changes in assets and liabilities, net of acquisitions:			
Cash and cash equivalents — restricted	(286,069)	(67,976)	(51,014)
Receivables from customers, brokers, dealers and clearing organizations	326,824	465,926	1,544,640
Receivables	(87,140)	(86,531)	(399,239)
Mortgage loans held for sale:			
Originations and purchases	(17,827,828)	(11,771,688)	(7,254,552)
Sales and principal repayments	17,837,323	11,780,758	7,336,659
Prepaid expenses and other current assets	(24,636)	(179,694)	(88,515)
Accounts payable to customers, brokers and dealers	(40,507)	(154,799)	(1,512,200)
Accounts payable, accrued expenses and deposits	59,265	57,608	133,695
Accrued salaries, wages and payroll taxes	(42,772)	31,751	48,901
Accrued income taxes	46,440	(42,777)	66,465
Other, net	32,037	8,801	(6,707)
Net cash provided by operating activities	690,825	741,446	248,351
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Available-for-sale securities:			
Purchases of available-for-sale securities	(14,614)	(7,241)	(10,636)
Cash received from residual interests in securitizations	140,795	67,070	16,024
Cash proceeds from sale of residual interests in securitizations	142,486	—	—
Maturities of other available-for-sale securities	—	8,250	5,500
Sales of other available-for-sale securities	14,081	23,173	356,192
Purchases of property, plant and equipment, net	(150,897)	(111,775)	(92,411)
Payments made for business acquisitions, net of cash acquired	(26,408)	(46,738)	(21,143)
Other, net	19,896	8,228	1,231
Net cash provided by (used in) investing activities	125,339	(59,033)	254,757
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Repayments of notes payable	(9,925,516)	(10,622,011)	(18,219,741)
Proceeds from issuance of notes payable	9,925,516	10,622,011	17,935,944
Payments on acquisition debt	(57,469)	(50,594)	(68,743)
Dividends paid	(125,898)	(115,725)	(108,374)
Payments to acquire treasury shares	(317,570)	(462,938)	(222,895)
Proceeds from issuance of common stock	126,325	195,233	19,550
Other, net	(2,344)	140	2,049
Net cash used in financing activities	(376,956)	(433,884)	(662,210)
Net increase (decrease) in cash and cash equivalents	439,208	248,529	(159,102)
Cash and cash equivalents at beginning of the year	436,145	187,616	346,718
Cash and cash equivalents at end of the year	\$ 875,353	\$ 436,145	\$ 187,616



**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

Amounts in thousands, except per share amounts

H&R BLOCK, INC.

	Common Stock		Convertible Preferred Stock		Additional Paid-in Capital
	Shares	Amount	Shares	Amount	
Balances at April 30, 2000	217,945	\$ 2,179	—	\$ —	\$ 420,594
Net income	—	—	—	—	—
Unrealized loss on translation	—	—	—	—	—
Change in net unrealized gain on marketable securities	—	—	—	—	—
Comprehensive income	—	—	—	—	—
Stock options exercised	—	—	—	—	(68)
Restricted stock awards	—	—	—	—	(382)
Stock issued for ESPP	—	—	—	—	(187)
Acquisition of treasury shares	—	—	—	—	—
Cash dividends paid - \$.5875 per share	—	—	—	—	—
Balances at April 30, 2001	217,945	2,179	—	—	419,957
Net income	—	—	—	—	—
Unrealized loss on translation	—	—	—	—	—
Change in net unrealized gain on marketable securities	—	—	—	—	—
Comprehensive income	—	—	—	—	—
Stock options exercised	—	—	—	—	47,590
Restricted stock awards	—	—	—	—	237
Stock issued for ESPP	—	—	—	—	268
Acquisition of treasury shares	—	—	—	—	—
Cash dividends paid - \$.63 per share	—	—	—	—	—
Balances at April 30, 2002	217,945	2,179	—	—	468,052
Net income	—	—	—	—	—
Unrealized gain on translation	—	—	—	—	—
Change in net unrealized gain on marketable securities	—	—	—	—	—
Comprehensive income	—	—	—	—	—
Stock options exercised	—	—	—	—	27,241
Restricted stock awards	—	—	—	—	5
Stock issued for ESPP	—	—	—	—	1,095
Acquisition of treasury shares	—	—	—	—	—
Cash dividends paid - \$.70 per share	—	—	—	—	—
Balances at April 30, 2003	217,945	\$ 2,179	—	\$ —	\$ 496,393

[Additional columns below]

[Continued from above table, first column(s) repeated]

	Accumulated Other Comprehensive Income (loss)	Retained Earnings	Treasury Stock		Total Equity
			Shares	Amount	
Balances at April 30, 2000	\$ (26,241)	\$ 1,276,234	(21,875)	\$ (454,177)	\$ 1,218,589
Net income	—	281,162	—	—	—
Unrealized loss on translation	(11,864)	—	—	—	—
Change in net unrealized gain on marketable securities	(4,662)	—	—	—	—
Comprehensive income	—	—	—	—	264,636
Stock options exercised	—	—	1,001	19,121	19,053
Restricted stock awards	—	—	114	2,252	1,870
Stock issued for ESPP	—	—	55	1,049	862
Acquisition of treasury shares	—	—	(13,632)	(222,895)	(222,895)
Cash dividends paid - \$.5875 per share	—	(108,374)	—	—	(108,374)
Balances at April 30, 2001	(42,767)	1,449,022	(34,337)	(654,650)	1,173,741



Net income	—	434,405	—	—	—
Unrealized loss on translation	(875)	—	—	—	—
Change in net unrealized gain on marketable securities	87,770	—	—	—	—
Comprehensive income	—	—	—	—	521,300
Stock options exercised	—	—	9,662	202,500	250,090
Restricted stock awards	—	—	17	400	637
Stock issued for ESPP	—	—	97	2,047	2,315
Acquisition of treasury shares	—	—	(12,259)	(462,938)	(462,938)
Cash dividends paid - \$.63 per share	—	(115,725)	—	—	(115,725)
Balances at April 30, 2002	44,128	1,767,702	(36,820)	(912,641)	1,369,420
Net income	—	580,064	—	—	—
Unrealized gain on translation	17,415	—	—	—	—
Change in net unrealized gain on marketable securities	(24,681)	—	—	—	—
Comprehensive income	—	—	—	—	572,798
Stock options exercised	—	—	5,070	135,409	162,650
Restricted stock awards	—	—	(64)	(1,306)	(1,301)
Stock issued for ESPP	—	—	94	2,515	3,610
Acquisition of treasury shares	—	—	(6,624)	(317,570)	(317,570)
Cash dividends paid - \$.70 per share	—	(125,898)	—	—	(125,898)
Balances at April 30, 2003	\$ 36,862	\$ 2,221,868	(38,344)	\$ (1,093,593)	\$ 1,663,709

See notes to consolidated financial statements on pages 50-75.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*Dollars in thousands, except share data*

### NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Nature of operations:** The operating subsidiaries of H&R Block, Inc. (the "Company") provide a variety of financial services to the general public, principally in the United States, but also in Canada, Australia and the United Kingdom. Specifically, the Company offers tax return preparation and electronic filing of tax returns; origination, sale and servicing of non-prime and prime mortgages; investment services through a broker-dealer; personal productivity software, refund anticipation loan products offered by a third-party lending institution; and accounting, tax and consulting services to business clients.

**Principles of consolidation:** The consolidated financial statements include the accounts of the Company, all majority-owned subsidiaries and companies it directly or indirectly controls. All material intercompany transactions and balances have been eliminated.

Some of the Company's subsidiaries operate in regulated industries, and their underlying accounting records reflect the policies and requirements of these industries.

**Reclassifications:** 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 shareholders' equity as previously reported.

**Management estimates:** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

**Cash and cash equivalents:** Cash and cash equivalents include cash on hand, cash due from banks and securities purchased under agreements to resell. For purposes of the consolidated balance sheets and consolidated statements of cash flows, all non-restricted highly liquid instruments purchased with an original maturity of three months or less are considered to be cash equivalents.

The Company's broker-dealers purchase securities under agreements to resell and account for them as collateralized financings. The securities are carried at the amounts at which the securities will be subsequently resold, as specified in the respective agreements. Collateral relating to investments in repurchase agreements is held by independent custodian banks. The securities are revalued daily and collateral added whenever necessary to bring market value of the underlying collateral equal to or greater than the repurchase amount specified in the contracts.

**Cash and cash equivalents — restricted:** Cash and cash equivalents — restricted consists primarily of securities purchased under agreements to resell and cash which has been segregated in a special reserve account for the exclusive benefit of customers pursuant to federal regulations under Rule 15c3-3 of the Securities Exchange Act of 1934. Also included are cash balances held for outstanding commitments to fund mortgage loans and funds held to pay payroll taxes on behalf of customers.

**Marketable securities — trading:** Certain marketable debt securities held by the Company's broker-dealers are classified as trading, carried at market value (based on quoted prices) and marked to market through the consolidated income statements. Certain residual interests in securitizations of mortgage loans are classified as trading, based on management's intentions and criteria as established by the Company, are carried at market value (based on discounted cash flow models) and marked to market through the consolidated income statements.

**Receivables from customers, brokers, dealers and clearing organizations and accounts payable to customers, brokers and dealers:** Customer receivables and payables consist primarily of amounts due on margin and cash transactions. These receivables are collateralized by customers' securities held, which are not reflected in the accompanying consolidated financial statements.

Receivables from brokers are collateralized by securities in physical possession of, or on deposit with, the Company or receivables from customers or other brokers. The allowance for doubtful accounts represents an amount considered by management to be adequate to cover potential losses.

Securities borrowed and securities loaned transactions are generally reported as collateralized financing. These transactions require deposits of cash and/or collateral with the lender. Securities loaned consist of securities owned by customers that were purchased on margin. When loaning securities, cash collateral approximately equal to the value of the securities loaned is received. 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.

**Receivables:** Receivables consist primarily of Business Services accounts receivable and mortgage loans held for sale. Mortgage loans held for sale are carried at the lower of aggregate cost or market value as determined by outstanding commitments from investors or current investor-yield requirements calculated on an aggregate basis. The allowance for doubtful accounts represents an amount considered by management to be adequate to cover potential losses related to its non-mortgage loan receivable balance.

**Marketable securities — available-for-sale:** Certain marketable debt and equity securities are classified as available-for-sale, based on management's intentions and criteria as established by the Company, and are carried at market value (based on quoted prices) with unrealized gains and losses included in other comprehensive income. If losses are determined to be other-than-temporary, the security is written down to fair value with the realized loss, net of any unrealized gain previously recorded in other comprehensive income, included in the consolidated income statements. The cost of marketable securities sold is determined on the specific identification method.

**Residual interests in securitizations:** Residual interests are classified as available-for-sale securities, and are carried at market value (based on discounted cash flow models) with unrealized gains included in other comprehensive income. The residual interests are accreted over the estimated life of the securitization structure. If the carrying value exceeds market value, the residual is written down to market value with the realized loss, net of any unrealized gain previously recorded in other comprehensive income, included in gains on sales of mortgage assets in the consolidated income statements.



The Company estimates future cash flows from these residuals and values them utilizing assumptions it believes to be consistent with those of unaffiliated third-party purchasers. The Company estimates the fair value of residuals by computing the present value of the excess of the weighted-average interest rate on the loans sold over the sum of (1) the coupon on the securitization bonds, (2) a base servicing fee paid to the servicer of the loans (which is usually the Company), (3) expected losses to be incurred on the portfolio of the loans sold (as projected to occur) over the lives of the loans, (4) fees payable to the trustee and insurer, if applicable, (5) estimated collections of prepayment penalty fee income, and (6) payments made to investors on NIM bonds, if applicable. The residual valuation takes into consideration the current and expected interest rate environment, including projected changes in future interest rates and the timing of such changes. Prepayment and loss assumptions used in estimating the cash flows are based on evaluation of the actual experience of the servicing portfolio, the characteristics of the applicable loan portfolio, as well as also taking into consideration the current and expected economic and interest rate environment and its expected impact. The estimated cash flows are discounted at an interest rate the Company believes an unaffiliated third-party purchaser would require as a rate of return on a financial instrument with a similar risk profile. The Company evaluates the fair values of residual interests quarterly by updating the actual and expected assumptions in the discounted cash flow models based on current information and events and by estimating, or validating with third-party experts, if necessary, what a market participant would use in determining the current fair value. To the extent that actual excess cash flows are different from estimated excess cash flows, the fair value of the residual could increase or decrease.

**Mortgage servicing rights:** Mortgage servicing rights ("MSRs") are retained in the sale of mortgage loans and are recorded at allocated carrying amounts based on relative fair values at the time of the sale. The MSRs are carried at the lower of cost or fair value. Fair values of MSRs are determined based on the present value of estimated future cash flows related to servicing loans. Assumptions used in estimating the value of MSRs include market discount rates and anticipated prepayment speeds (including default), estimated ancillary fee income and other economic factors. The prepayment speeds are estimated using the Company's historical experience and third-party market sources.

The MSRs are amortized to earnings in proportion to, and over the period of, estimated net future servicing income. MSRs are reviewed quarterly for impairment. MSRs are stratified by: loan sale date (which approximates date of origination) and loan type (6-month adjustable, 2 to 3-year adjustable and fixed rate). Impairment is assessed based on the fair value of each risk stratum. When MSRs are reviewed, management makes an estimate of the future prepayment rates and other key variables of the underlying mortgage loans. If actual performance proves to be worse than the estimate, impairment of MSRs could occur.

**Intangible assets and goodwill:** In May 2001, the Company elected early adoption of Statement of Financial Accounting Standards No. 141, "Business Combinations," and No. 142, "Goodwill and Other Intangible Assets" ("SFAS 141 and 142").

In applying SFAS 142, the Company re-evaluated the useful lives of these separable intangible assets. The weighted-average life of the remaining intangible assets with finite lives is 10 years. In accordance with SFAS 141, on the date of adoption, the previously identified intangible assets of assembled workforce and management infrastructure were subsumed into goodwill.

The adoption of SFAS 141 and 142 has had a significant effect on the consolidated income statements for fiscal years 2003 and 2002, due to the cessation of goodwill amortization beginning May 1, 2001. Had the provisions of SFAS 141 and 142 been applied for the year ended April 30, 2001 net income and earnings per basic and diluted share would have been as follows:

	2001		
	Net income	Basic per share	Diluted per share
Net income:			
As reported	\$ 281,162	\$ 1.53	\$ 1.52
Add amortization (net of tax):			
Goodwill	29,509	.16	.16
Assembled workforce	15,733	.09	.09
Management infrastructure	902	—	—
Trade name	1,722	.01	.01
Adjusted net income	\$ 329,028	\$ 1.79	\$ 1.78

On the date of adoption and at least annually, SFAS 142 requires testing of goodwill for impairment. No indications of goodwill impairment were found during fiscal year 2002. During fiscal year 2003, impairment charges of \$24,000 and \$11,777 were recorded in the Investment Services and Business Services segments, respectively.

In addition, long-lived assets, including intangible assets, are assessed for impairment whenever events or circumstances indicate the carrying value may not be fully recoverable by comparing the carrying value to future undiscounted cash flows. To the extent there is impairment, analysis is performed based on several criteria, including, but not limited to, revenue trends, discounted operating cash flows and other operating factors to determine the impairment amount. No material impairment adjustments to other intangible assets or other long-lived assets were made during fiscal year 2003 or 2002.

**Property and equipment:** Buildings and equipment are stated at cost and are depreciated over the estimated useful lives of the assets using the straight-line method. Leasehold improvements are stated at cost and are amortized over the lesser of the term of the respective lease or the estimated useful life, using the straight-line method. Estimated useful lives are 15 to 40 years for buildings, 3 to 5 years for computers and other equipment and up to 8 years for leasehold improvements.

The Company capitalizes certain costs associated with software developed or obtained for internal use. These costs are amortized over 36 months using the straight-line method.

**Notes payable:** Short-term borrowings are used to finance temporary liquidity needs and various financial activities conducted by the Company. There were no notes payable outstanding at April 30, 2003 and 2002.

**Revenue recognition:** Service revenues consist primarily of fees for preparation and filing of tax returns, system administration fees associated with refund anticipation loans ("RALs") and refund anticipation checks, mortgage loan servicing fees, brokerage commissions and fees for consulting services. Generally, service revenues are recorded in the period in which the service is performed. Commissions revenue is recognized on a trade-date basis. Revenues for services rendered in connection with the Business Services segment are recognized on a time and materials basis.

Gains on sales of mortgage assets are recognized when control of the assets are surrendered (when loans are sold to qualifying special purpose entities ("Trusts")) and are based on the difference between cash proceeds and the allocated cost of the assets sold.

Interest income consists primarily of interest earned on customer margin loan balances and mortgage loans, and accretion income. Interest income on customer margin loan balances is recognized daily as earned based on current rates charged to customers for their margin balance. Accretion income represents interest earned over the life of residual interests using the effective interest method.

Product sales consist mainly of tax preparation software, other personal productivity software, online do-it-yourself tax preparation and the Peace of Mind guarantee program. Sales of software are recognized when the product is ultimately sold to the end user. A portion of Peace of Mind revenues is recognized when the product is sold. The remaining revenues are recognized over the guarantee period in proportion to the costs expected to be incurred under the contract.

Franchise royalties, based upon the contractual percentages of franchise revenues, are recorded in the period in which the franchise provides the service.

**Advertising expense:** Advertising costs are expensed the first time the advertisement is run.

**Income taxes:** The Company and its subsidiaries file a consolidated Federal income tax return on a calendar year basis. Therefore, the current liability for income taxes recorded in the balance sheet at each fiscal year end consists principally of income taxes for the period January 1 to April 30 of the respective year. Deferred taxes are provided for temporary differences between financial and tax reporting, which consist principally of deductible goodwill, residual interests, accrued expenses, deferred compensation, mortgage servicing rights and allowances for credit losses.

**Litigation:** The Company's policy is to routinely assess the likelihood of any adverse judgments or outcomes related to legal matters, as well as ranges of probable losses. A determination of the amount of the reserves required, if any, for these contingencies is made after thoughtful analysis of each known issue and an analysis of historical experience in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," and related pronouncements. Therefore, the Company has recorded reserves related to certain legal matters for which it is probable that a loss has been incurred and the range of such loss can be estimated. With respect to other matters, management has concluded that a loss is only reasonably possible or remote and, therefore, no liability is recorded. In addition, there are certain gain contingencies for which the Company has not recorded an asset because realization is not considered probable as of the balance sheet date.

**Foreign currency translation:** Assets and liabilities of foreign subsidiaries are translated into U.S. dollars at exchange rates prevailing at the end of the year. Revenue and expense transactions are translated at the average of exchange rates in effect during the period. Translation gains and losses are recorded in other comprehensive income.

**Stock-based compensation plans:** The Company accounts for its stock-based compensation plans in accordance with Accounting Principles Board 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").

Had compensation cost for the stock compensation plans been determined in accordance with the fair value accounting method prescribed under SFAS 123, the Company's net income and earnings per share would have been as follows:

Year Ended April 30	2003	2002	2001
Net income, as reported	\$ 580,064	\$ 434,405	\$ 281,162
Less: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(19,820)	(34,045)	(18,461)
Pro forma net income	\$ 560,244	\$ 400,360	\$ 262,701
Basic earnings per share:			
As reported	\$ 3.23	\$ 2.38	\$ 1.53
Pro forma	3.12	2.19	1.43
Diluted earnings per share:			
As reported	\$ 3.15	\$ 2.31	\$ 1.52
Pro forma	3.06	2.13	1.42

**Derivative activities:** Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," ("SFAS 133") and Statement of Financial Accounting Standards No. 138, "Accounting for Derivative Instruments and Certain Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS 138") establishes accounting and reporting standards for derivative and hedging activities, and requires companies to record derivative instruments as assets or liabilities, measured at fair value. The recognition of gains or losses resulting from changes in the values of those derivative instruments is based on the use of each derivative instrument and whether it qualifies for hedge accounting.

In fiscal year 2001, the Company adopted SFAS 133 and 138 and initially identified derivative instruments related to certain of its commitments to originate residential mortgage loans. The commitments that qualified as derivative instruments totaled \$252,593 at April 30, 2001. The transition adjustment for the adoption of SFAS 133 and SFAS 138 of \$4,414, net of taxes, is shown as the cumulative effect of a change in accounting principle in the consolidated income statement for the year ended April 30, 2001.

The Company uses derivative instruments as part of its overall strategy to reduce exposure to fluctuations in interest rates and to fair value changes in mortgage loans held for sale. The primary derivative instruments utilized by the Company include forward sales of mortgage-backed securities. Derivative instruments with a positive fair value at year-end, representing a receivable from a counterparty, are included in prepaid expenses and other current assets on the consolidated balance sheet. Derivative instruments with a negative fair value at year-end, representing a

payable to a counterparty, are included in accounts payable, accrued expenses and deposits in the consolidated balance sheet. Changes in the fair value of derivative instruments are reflected in income.

Commitments to fund loans are freestanding derivative instruments and do not qualify for hedge accounting treatment. The mark-to-market of these commitments is included in prepaid expenses and other current assets, while changes in the fair value are recognized in gains on sales of mortgage assets on the consolidated income statements.

**Disclosure regarding certain financial instruments:** The carrying values reported in the balance sheet for cash equivalents, receivables, accounts payable, accrued liabilities and the current portion of long-term debt approximate fair market value due to the relative short-term nature of the respective instruments.

**New accounting standards:** 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 SFAS 133 to clarify the definition of a derivative and incorporate many of the implementation issues cleared as a result of the Derivatives Implementation Group process. This statement is effective for contracts entered into or modified after June 30, 2003 and should be applied prospectively after that date. The Company is currently evaluating what effect, if any, the adoption of SFAS 149 will have on the consolidated financial statements.

In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). 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 that 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 a significant variable interest 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. FIN 46 applies, in the first fiscal year or interim period beginning after June 15, 2003, to VIEs in which an enterprise holds a variable interest it acquired before February 1, 2003. In addition, FIN 46 requires certain transitional disclosures if an enterprise believes it is reasonably possible that it will determine it has a significant variable interest in a VIE upon the date of application. The Company has not obtained an interest in a new or existing VIE subsequent to January 31, 2003. The Company is continuing its evaluation of interests in potential VIEs, which would be subject to the provisions of FIN 46 for the second quarter of fiscal year 2004.

In December 2002, Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure" ("SFAS 148") was issued and amends SFAS 123. SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends prior disclosure requirements to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition provisions are effective for financial statements for fiscal years ending after December 15, 2002. The enhanced disclosure requirements are effective for periods beginning after December 15, 2002. The Company accounts for stock-based compensation in accordance with APB 25, and has adopted the disclosure provisions of SFAS 148. On May 1, 2003 the Company will adopt the fair value recognition provisions preferred under SFAS 123, and will prospectively recognize compensation expense on future awards granted, modified or settled after April 30, 2003.

In November 2002, Emerging Issues Task Force Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21") was issued. EITF 00-21 requires consideration received in connection with arrangements involving multiple revenue generating activities to be measured and allocated to each separate unit of accounting in the arrangement. Revenue recognition would be determined separately for each unit of accounting within the arrangement. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company is currently evaluating the effect of EITF 00-21 on the consolidated financial statements.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), which addresses the disclosure to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. FIN 45 also requires the guarantor to recognize a liability for the non-contingent component of the guarantee, which is the obligation to stand ready to perform if specified triggering events or conditions occur. The initial measurement of this liability is the fair value of the guarantee at inception. The Company has adopted the disclosure requirements of FIN 45 and, in accordance with the transition rules of the pronouncement, has applied the recognition and measurement provisions for all guarantees entered into or modified after December 31, 2002 (see note 20). The adoption of FIN 45 did not have a material effect on the consolidated financial statements.

In June 2002, Statement of Financial Accounting Standards No. 146 "Accounting for Costs associated with Exit or Disposal Activities" ("SFAS 146") was issued. SFAS 146 addresses accounting and reporting for costs associated with exit or disposal activities and nullifies EITF No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 is effective for exit or disposal activities initiated after December 31, 2002. The adoption of SFAS 146 did not have a material effect on the consolidated financial statements.

On May 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 establishes a single accounting model, based on the framework established in SFAS 121, for long-lived assets to be disposed of by sale. The adoption of SFAS 144 did not have a material effect on the consolidated financial statements.

The estimated impact of these new accounting standards reflects current views. There may be material differences between these estimates and the actual impact of these standards.



**NOTE 2: BUSINESS COMBINATIONS AND DISPOSALS**

During fiscal year 2003, the Company acquired two accounting firms. Cash payments related to these acquisitions totaled \$2,568, with additional cash payments of \$2,848 over the next five years. Each acquisition was accounted for as a purchase and, accordingly, results for each acquisition are included since the date of acquisition. The purchase agreements also provide for possible future contingent consideration of approximately \$250. The following intangible assets were valued in the acquisitions: customer relationships of \$2,242 and noncompete agreements of \$728. The weighted average life of the intangible assets is eleven years. Goodwill recognized in these transactions was \$2,404, which is deductible for tax purposes and is included in the Business Services segment.

In December 2001, the Company acquired a controlling interest in MyBenefitSource, Inc., an integrated payroll and benefits processing company, with an option to acquire the remaining shares. The Company also acquired 100% of Equico Resources, LLC ("Equico"), a valuation, merger and acquisition consulting company. These acquisitions were accounted for as purchases, and the results of operations for these businesses have been consolidated since the date of acquisition. Cash payments related to these acquisitions totaled \$28,510 with additional cash payments of \$31,000 over the next five years. The purchase agreements also provide for possible future contingent consideration of approximately \$45,000, which is based on achieving certain revenue, profitability and working capital targets over the next six years, and such consideration will be treated as purchase price if paid. The following intangible assets were valued in the acquisitions: customer relationships of \$4,126, noncompete agreements of \$5,892 and trade names of \$2,428. The weighted-average life of the intangible assets is five years. Goodwill recognized in these transactions was \$40,312, which is not deductible for tax purposes. The goodwill is included in the Business Services segment.

During fiscal year 2002, the Company acquired six accounting firms, giving the Business Services segment a geographic presence in Seattle and San Francisco, as well as expanding its existing presence in New York City and Dallas. Cash payments related to these acquisitions totaled \$6,899, with additional cash payments of \$26,125 over the next five years. Each acquisition was accounted for as a purchase and, accordingly, results for each acquisition are included since the date of acquisition. The purchase agreements also provide for possible future contingent consideration of approximately \$6,567, which is based on achieving certain revenue and profitability over the next five years, and such consideration will be treated as purchase price if paid. The following intangible assets were valued in the acquisition: customer relationships of \$9,314 and noncompete agreements of \$3,584. The weighted-average life of the intangible assets is eleven years. Goodwill recognized in these transactions was \$15,842, of which \$8,834 is expected to be fully deductible for tax purposes. The goodwill is included in the Business Services segment.

During fiscal year 2001, the Company acquired several accounting firms. The purchase prices aggregated \$54,443. Each acquisition was accounted for as a purchase and, accordingly, results for each acquisition are included since the date of acquisition. The excess of cost over fair value of net tangible assets acquired was \$54,322.

During fiscal year 2003, 2002 and 2001, the Company made other acquisitions which were accounted for as purchases with cash payments totaling \$3,045, \$1,579 and \$2,897, respectively. Their operations, which are not material, are included in the consolidated income statements since the date of acquisition.

On December 31, 2000, the Company completed the sale of the assets of KSM Business Services, part of the Company's Business Services segment. The Company recorded a gain before taxes of \$2,040 on the transaction.

**NOTE 3: EARNINGS PER SHARE**

Basic earnings per share is computed using the weighted-average number of common shares outstanding. The dilutive effect of potential common shares outstanding is included in diluted earnings per share. The computations of basic and diluted earnings per share before change in accounting principle are as follows (shares in thousands):

Year Ended April 30	2003	2002	2001
Net income before change in accounting principle	\$ 580,064	\$ 434,405	\$ 276,748
Basic weighted-average common shares	179,638	182,903	183,893
Dilutive potential common shares:			
Common stock options	4,439	5,423	1,241
Convertible preferred stock	1	1	1
Diluted weighted-average common shares	184,078	188,327	185,135
Earnings per share before change in accounting principle:			
Basic	\$ 3.23	\$ 2.38	\$ 1.50
Diluted	3.15	2.31	1.49

Diluted earnings per share excludes the impact of weighted-average common shares issuable upon the exercise of stock options of 2,597,320, 682,802, and 13,906,602 shares for 2003, 2002 and 2001, respectively, because the options' exercise prices were greater than the average market price of the common shares and therefore, the effect would be antidilutive.

**NOTE 4: CASH AND CASH EQUIVALENTS**

The components of cash and cash equivalents are as follows:

April 30	2003	2002
Cash and interest-bearing deposits	\$ 770,808	\$ 118,382
Other interest-bearing securities	86,944	315,845
Certificates of deposit	17,601	1,918
	<u>\$ 875,353</u>	<u>\$ 436,145</u>

**NOTE 5: RECEIVABLES**

The components of receivables are as follows:

April 30	2003	2002
Business Services accounts receivable	\$ 185,023	\$ 177,321
Mortgage loans held for sale	68,518	71,855
Software receivables	36,810	34,679
Loans to franchises	33,341	31,055
Refund anticipation loans	12,871	33,530
Other	89,054	83,962
	<u>425,617</u>	<u>432,402</u>
Less: Allowance for doubtful accounts	(17,038)	(56,385)
Less: Lower of cost or market adjustment on mortgage loans held for sale	(5,382)	(7,672)
	<u>\$ 403,197</u>	<u>\$ 368,345</u>

The components of receivables from customers, brokers, dealers and clearing organizations are as follows:

April 30	2003	2002
Gross receivables	\$ 518,558	\$ 846,323
Less: Allowance for doubtful accounts	(1,521)	(1,785)
	<u>\$ 517,037</u>	<u>\$ 844,538</u>

**NOTE 6: MARKETABLE SECURITIES AVAILABLE-FOR-SALE**

The amortized cost and market value of marketable securities classified as available-for-sale at April 30, 2003 and 2002 are summarized below:

	2003				2002			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Noncurrent:								
Municipal bonds	\$ 11,959	\$ 516	\$ 8	\$ 12,467	\$ 9,402	\$ 333	\$ 33	\$ 9,702
Common stock	4,491	169	97	4,563	6,699	270	1,411	5,558
	<u>16,450</u>	<u>685</u>	<u>105</u>	<u>17,030</u>	<u>16,101</u>	<u>603</u>	<u>1,444</u>	<u>15,260</u>
Residual interests	166,248	98,089	—	264,337	225,879	139,492	—	365,371
	<u>\$ 182,698</u>	<u>\$ 98,774</u>	<u>\$ 105</u>	<u>\$ 281,367</u>	<u>\$ 241,980</u>	<u>\$ 140,095</u>	<u>\$ 1,444</u>	<u>\$ 380,631</u>

Proceeds from the sales of available-for-sale securities were \$156,567, \$23,173 and \$356,192 during 2003, 2002 and 2001, respectively. Gross realized gains on those sales during 2003, 2002 and 2001 were \$131,441, \$635 and \$17,936, respectively; gross realized losses were \$745, \$212 and \$192, respectively.

Contractual maturities of available-for-sale debt securities (municipal bonds) at April 30, 2003 occur at varying dates over the next five to ten years. Because expected maturities differ from contractual maturities due to the issuers' rights to prepay certain obligations or the seller's rights to call certain obligations, the first call date, put date or auction date for municipal bonds and notes is considered the contractual maturity date.

**NOTE 7: MORTGAGE BANKING ACTIVITIES**

The Company originates mortgage loans and sells most non-prime loans the same day the loans are funded to Trusts. These Trusts meet the criteria of qualifying special purpose entities ("QSPEs") and are therefore not consolidated. The sale is recorded in accordance with Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS 140"). The Trusts purchase the loans from the Company utilizing three warehouse facilities arranged by the Company. As a result of the whole loan sales to the 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 by the Trusts. This receivable is included in prepaid and other current assets on the consolidated balance sheets. The balance was \$122,130 and \$52,601 at April 30, 2003 and 2002, respectively.

The Trusts, as directed by the Trustees, either sell the loans directly to third-party investors or pool the loans for a securitization, depending on market conditions. If the Trusts choose to sell the mortgage loans, the Company receives cash for its receivable. In a securitization transaction, the Trusts transfer the loans to a securitization trust, and the Company transfers its receivable. The securitization trust issues bonds, which are supported by the 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 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 interest may also change, resulting in either additional unrealized gains or impairment of the value of the residual interests. These residual interests are classified as trading securities and had no balance as of April 30, 2003 and 2002.

To accelerate the 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, the residual interests are transferred to another QSPE ("NIM trust"), which then issues bonds to third-party investors. The proceeds from the bonds are returned to the Company as payment for the residual interests. The bonds are secured by the 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. These residual interests are classified as available-for-sale securities (see note 6).

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

Activity related to residual interests in securitizations consists of the following:

April 30	2003	2002
Balance, beginning of year	\$ 365,371	\$ 238,600
Additions (resulting from NIM transactions)	753	26,057
Cash received	(140,795)	(67,070)
Cash received on sales of residual interests	(142,486)	—
Accretion	145,165	50,583
Impairments of fair value	(54,111)	(30,987)
Change in unrealized holding gains (losses) arising during the period	90,440	148,188
Balance, end of year	\$ 264,337	\$ 365,371

The Company sold \$17,225,774 and \$11,440,190 of mortgage loans in whole loan sales to the Trusts during the years ended April 30, 2003 and 2002, respectively. Gains totaling \$698,571 and \$487,945 were recorded on these sales, respectively. Residual interests valued at \$542,544 and \$809,228 were securitized in NIM transactions during the years ended April 30, 2003 and 2002, respectively. Net cash proceeds of \$541,791 and \$783,171 were received from the NIM transactions for the years ended April 30, 2003 and 2002, respectively. Total net additions to residual interests for the years ended April 30, 2003 and 2002 were \$753 and \$26,057, respectively.

Cash flows from the residual interests of \$140,795 and \$67,070 were received from the securitization trusts for the years ended April 30, 2003 and 2002, respectively. Cash received on the residual interests is included in investing activities on the consolidated statements of cash flows.

During the third quarter of fiscal year 2003, the Company completed the sale of NIM residual interests and recorded a gain of \$130,881 on the transaction. Cash proceeds of \$142,486 were received from the transaction and a residual interest of \$57,378 was retained. This sale accelerated cash flows from these residual interests, effectively realizing previously recorded unrealized gains included in other comprehensive income.

Residual interests are considered available-for-sale securities and are therefore reported at fair value. Gross unrealized holding gains represent the write-up of residual interests as a result of lower interest rates, loan losses or loan prepayments to date than most recently projected in the Company's valuation models. Gross unrealized holding losses represent reductions of unrealized gains on previous write-ups.

Aggregate net unrealized gains on residual interests, which had not yet been accreted into income, totaled \$98,089 and \$139,492 at April 30, 2003 and 2002, respectively. These unrealized gains are recorded net of deferred taxes in other comprehensive income, and will be recognized in income in future periods either through accretion or upon further securitization of the related residual interest.

Assumptions used in estimating the value of MSRs include market discount rates and anticipated prepayment speeds (including default), estimated ancillary fee income, servicing costs and other economic factors. The prepayment speeds are estimated using the Company's historical experience and third party market sources. Activity related to mortgage servicing rights consists of the following:

Year Ended April 30	2003	2002
Balance, beginning of year	\$ 81,893	\$ 61,796
Additions	65,345	65,630
Amortization	(47,107)	(33,890)
Impairments of fair value	(866)	(11,643)
Balance, end of year	\$ 99,265	\$ 81,893

The key assumptions the Company utilizes to estimate the cash flows of the residual interests and MSRs are as follows:

Estimated annual prepayments	20-90%
Estimated annual credit losses	2-11.86%
Discount rate — residual interests	12-37%
Discount rate — MSRs	12.8%

At April 30, 2003, the sensitivities of the current fair value of the residuals and MSRs to 10% and 20% adverse changes in the above key assumptions are as follows. These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also in this table, the effect of a variation of a particular assumption on the fair value of the retained interest is calculated without changing any other assumptions; in reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

	Residential Mortgage Loans		
	Cross-collateralized	NIM Residuals	Servicing Assets
Carrying amount/fair value	\$ 33,821	\$ 230,516	\$ 99,265
Weighted-average life (in years)	7.4	1.7	1.2
Annual prepayments:			
Adverse 10% — impact on fair value	\$ (482)	\$ (27,424)	\$ (18,641)
Adverse 20% — impact on fair value	(905)	(26,097)	(26,751)
Annual credit losses: <sup>(1)</sup>			
Adverse 10% — impact on fair value	\$ (2,910)	\$ (31,267)	Not applicable
Adverse 20% — impact on fair value	(5,783)	(61,077)	Not applicable
Discount rate:			
Adverse 10% — impact on fair value	\$ (2,213)	\$ (6,276)	\$ (1,562)
Adverse 20% — impact on fair value	(4,248)	(11,927)	(3,088)
Variable interest rates:			
Adverse 10% — impact on fair value	\$ 211	\$ (17,175)	Not applicable
Adverse 20% — impact on fair value	448	(33,429)	Not applicable

(1) Includes both default and severity factors.

#### NOTE 8: INTANGIBLE ASSETS AND GOODWILL

The components of intangible assets are as follows:

April 30	2003		2002	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Business Services:				
Customer relationships	\$ 120,178	\$ (44,192)	\$ 116,814	\$ (31,881)
Noncompete agreements	26,909	(6,157)	26,387	(3,624)
Trade name — amortizing	1,450	(205)	2,428	—
Trade name — non-amortizing	55,637	(4,868)	55,637	(4,868)
Investment Services:				
Customer relationships	293,000	(100,108)	293,000	(70,808)
Corporate Operations:				
Customer relationships	172	(10)	—	—
Noncompete agreements	60	(1)	—	—
Total intangible assets	\$ 497,406	\$ (155,541)	\$ 494,266	\$ (111,181)

Amortization of intangible assets for the year ended April 30, 2003, 2002 and 2001 was \$44,499, \$43,435 and \$104,276, respectively. Estimated amortization of intangible assets for fiscal years 2004, 2005, 2006, 2007 and 2008 is \$44,441, \$44,081, \$43,463, \$40,562 and \$39,071, respectively.

Changes in the carrying amount of goodwill by segment for the year ended April 30, 2003, are as follows:

	2002	Acquisitions	Other	2003
U.S. Tax Operations	\$ 128,745	\$ 1,757	\$ —	\$ 130,502
Mortgage Operations	152,467	—	—	152,467
Business Services	267,625	23,802	(11,777)	279,650
Investment Services	169,732	—	(24,000)	145,732
International Tax Operations	5,287	—	379	5,666
Corporate Operations	—	198	—	198
Total goodwill	\$ 723,856	\$ 25,757	\$ (35,398)	\$ 714,215

The Company tests goodwill for impairment annually, or more frequently if events occur which indicate a potential reduction in the fair value of a reporting unit's net assets below its carrying value. In light of unsettled market conditions and the severe decline of comparable business valuations in the investment industry, the Company engaged an independent valuation firm in fiscal year 2003 to perform the goodwill impairment test on the Investment Services segment in accordance with SFAS 142. Based on this valuation, a goodwill impairment charge of \$24,000 was recorded during fiscal year 2003. Also during 2003, the Company's annual impairment test resulted in an impairment of \$11,777 for a reporting unit within the Business Services segment. No other impairments were identified.

#### NOTE 9: PROPERTY AND EQUIPMENT

The components of property and equipment are as follows:

April 30	2003	2002
Land	\$ 37,614	\$ 41,637
Buildings	81,631	89,220
Computers and other equipment	433,649	386,546
Capitalized software	113,826	93,664
Leasehold improvements	107,482	86,318
	774,202	697,385
Less: Accumulated depreciation and amortization	485,608	410,885
	\$ 288,594	\$ 286,500

Depreciation and amortization expense for 2003, 2002 and 2001 was \$117,322, \$110,860 and \$101,332, respectively. Included in depreciation and amortization expense is amortization of capitalized software of \$29,881, \$25,426 and \$16,122 for fiscal years 2003, 2002 and 2001, respectively.

As of April 30, 2003 and 2002, the Company has property and equipment under capital lease with a cost of \$17,645 and \$17,875, respectively, and accumulated depreciation of \$4,156 and \$3,512, respectively. The Company has an agreement to lease real estate and buildings under a noncancelable capital lease for the next 17 years with an option to purchase after four years.

#### NOTE 10: DERIVATIVE INSTRUMENTS

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of its customers. These financial instruments represent commitments to fund loans. The Company's total commitments to fund loans have a notional value of \$2,614,500 and \$1,726,620, and a fair market value of \$2,727,067 and \$1,800,057 as of April 30, 2003 and 2002, respectively. The estimated mark-to-market adjustment 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.

The Company mitigates its interest rate risk by utilizing commitments to sell loans to investors. The Company manages its interest rate risk by entering into forward loan sale commitments to be settled at a future date. The Company had commitments to sell loans of \$1,470,031 and \$1,233,869 as of April 30, 2003 and 2002, respectively.

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. The adjustment to the payments will be made in January 2004. This adjustment is a derivative and will be marked-to-market monthly through the payment date. At April 30, 2003 the Company recognized \$5,171 of revenues related to this instrument.

**NOTE 11: LONG-TERM DEBT**

The components of long-term debt are as follows:

April 30	2003	2002
Senior Notes, 8 1/2%, due April 2007	\$ 497,625	\$ 497,025
Senior Notes, 6 3/4%, due November 2004	249,925	249,875
Business Services acquisition obligations, due from August 2003 to January 2008	115,874	164,242
Mortgage Notes	1,543	2,959
Capital lease obligations	13,013	13,942
	<u>877,980</u>	<u>928,043</u>
Less: current portion	<u>55,678</u>	<u>59,656</u>
	<u>\$ 822,302</u>	<u>\$ 868,387</u>

On April 13, 2000, the Company issued \$500,000 of 8 1/2% Senior Notes under a shelf registration statement. The Senior Notes are due April 15, 2007, and are not redeemable prior to maturity. The net proceeds of this transaction were used to repay a portion of the short-term borrowings that initially funded the acquisition of OLDE Financial Corporation and Financial Marketing Services, Inc. (collectively, "OLDE").

On October 21, 1997, the Company issued \$250,000 of 6 3/4% Senior Notes under a shelf registration statement. The Senior Notes are due November 1, 2004, and are not redeemable prior to maturity. The net proceeds of this transaction were used to repay short-term borrowings, which initially funded the acquisition of Option One Mortgage Corporation ("Option One").

The Company had obligations related to Business Services acquisitions of \$115,874 and \$164,242 at April 30, 2003 and 2002, respectively. The current portion of these amounts is included in the current portion of long-term debt on the consolidated balance sheet. The long-term portions are due from August 2004 to January 2008.

The Company had mortgage notes and capitalized lease obligations of \$14,556 at April 30, 2003 that are collateralized by land, buildings and equipment. The obligations are due at varying dates for up to 17 years.

The aggregate payments required to retire long-term debt are \$55,678, \$276,531, \$22,795, \$511,408, \$1,080 and \$10,488 in 2004, 2005, 2006, 2007, 2008 and beyond, respectively.

Based upon borrowing rates currently available for indebtedness with similar terms, the fair value of long-term debt was approximately \$915,387 and \$938,920 at April 30, 2003 and 2002, respectively.

**NOTE 12: OTHER NONCURRENT LIABILITIES**

The Company has deferred compensation plans that permit directors and certain employees to defer portions of their compensation and accrue income on the deferred amounts. The compensation, together with Company matching of deferred amounts, has been accrued. Included in other noncurrent liabilities are \$65,369 and \$54,174 at April 30, 2003 and 2002, respectively, to reflect the liability under these plans. The Company purchases whole-life insurance contracts on certain director and employee participants to recover distributions made or to be made under the plans and records the cash surrender value of the policies in other assets.

In connection with the Company's acquisition of the non-attest assets of McGladrey & Pullen, LLP ("M&P") in August 1999, the Company assumed certain pension liabilities related to M&P's retired partners. The Company makes payments in varying amounts on a monthly basis. Included in other noncurrent liabilities at April 30, 2003 and 2002 are \$19,547 and \$25,655, respectively, related to this liability.

**NOTE 13: STOCKHOLDERS' EQUITY**

On June 20, 2001, the Company's Board of Directors declared a two-for-one stock split of its Common Stock in the form of a 100% stock distribution effective August 1, 2001, to shareholders of record as of the close of business on July 10, 2001. All share and per share amounts have been adjusted to reflect the retroactive effect of the stock split.

The Company is authorized to issue 6,000,000 shares of Preferred Stock, without par value. At April 30, 2003, the Company had 5,560,833 shares of authorized but unissued Preferred Stock. Of the unissued shares, 600,000 shares have been designated as Participating Preferred Stock in connection with the Company's shareholder rights plan.

On March 8, 1995, the Board of Directors authorized the issuance of a series of 500,000 shares of nonvoting Preferred Stock designated as Convertible Preferred Stock, without par value. In April 1995, 401,768 shares of Convertible Preferred Stock were issued in connection with an acquisition. In addition, options to purchase 51,828 shares of Convertible Preferred Stock were issued as a part of the acquisition and 37,399 shares of Convertible Preferred Stock were issued in connection with these options. Each share of Convertible Preferred Stock became convertible on April 5, 1998 into four shares of Common Stock of the Company (eight shares after the August 1, 2001 stock split), subject to adjustment upon certain events. The holders of the Convertible Preferred Stock are not entitled to receive dividends paid in cash, property or securities and, in the event of any dissolution, liquidation or wind-up of the Company, will share ratably with the holders of Common Stock then outstanding in the assets of the Company after any distribution or payments are made to the holders of Participating Preferred Stock or the holders of any other class or series of stock of the Company with preference over the Common Stock.



**NOTE 14: COMPREHENSIVE INCOME**

The Company's comprehensive income is comprised of net income, foreign currency translation adjustments and the change in the net unrealized gain or loss on available-for-sale marketable securities. Included in stockholders' equity at April 30, 2003 and 2002, the net unrealized holding gain on available-for-sale securities was \$61,001 and \$85,682, respectively, and the foreign currency translation adjustment was \$(24,139) and \$(41,554), respectively. The net unrealized holding gain on available-for-sale securities relates primarily to residual interests in securitizations.

Year Ended April 30	2003	2002	2001
Net income	\$ 580,064	\$ 434,405	\$ 281,162
Unrealized gains on securities (less applicable taxes (benefit) of (\$15,290), \$56,156 and (\$3,307)):			
Unrealized holding gains (losses) arising during period (less applicable taxes of \$70,983, \$58,248, and \$4,057)	114,885	92,629	5,718
Less: Reclassification adjustment for gains included in income (less applicable taxes of \$86,273, \$2,092, and \$7,364)	(139,566)	(4,859)	(10,380)
Foreign currency translation adjustments	17,415	(875)	(11,864)
Comprehensive income	\$ 572,798	\$ 521,300	\$ 264,636

**NOTE 15: STOCK-BASED COMPENSATION AND RETIREMENT BENEFITS**

The Company has four stock-based compensation plans: the 2003 Long-Term Executive Compensation Plan, the 1989 Stock Option Plan for Outside Directors, the 1999 Stock Option Plan for Seasonal Employees, and the 2000 Employee Stock Purchase Plan ("ESPP"). The shareholders have approved all of the Company's stock-based compensation plans.

The shareholders approved the 2003 Plan in September 2002 to replace the 1993 Long-Term Executive Compensation Plan, effective July 1, 2003. The 1993 Plan terminated at that time, except with respect to outstanding awards thereunder. The shareholders had approved the 1993 Plan in September 1993 to replace the 1984 Long-Term Executive Compensation Plan, which terminated at that time except with respect to outstanding awards thereunder. Under the 2003 and 1989 plans, options may be granted to selected employees and outside directors to purchase the Company's Common Stock for periods not exceeding 10 years at a price that is not less than 100% of fair market value on the date of the grant. Options granted under the Plans are exercisable either (1) starting one year after the date of the grant, (2) starting one, two or three years after the date of the grant on a cumulative basis at the annual rate of 33 1/3% of the total number of option shares, or (3) starting three years after the date of the grant on a cumulative basis at the rate of 40%, 30%, and 30% over the following three years. In addition, certain option grants have accelerated vesting provisions based on the Company's stock price reaching specified levels.

The 1999 Stock Option Plan for Seasonal Employees provided for the grant of options on June 30, 2002, 2001 and 2000 at the market price on the date of the grant. The options are exercisable during September through November in each of the two years following the calendar year of the grant, subject to certain conditions.

Changes during the years ended April 30, 2003, 2002 and 2001 under the stock option plans were as follows:

	2003		2002		2001	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Options outstanding, beginning of year	15,909,937	\$ 26.33	18,908,062	\$ 20.40	16,881,228	\$ 22.11
Options granted	5,363,526	44.32	8,816,071	32.85	8,611,034	16.26
Options exercised	(5,097,600)	24.65	(9,659,116)	19.82	(1,020,916)	17.04
Options expired/cancelled	(403,561)	34.53	(2,155,080)	30.21	(5,563,284)	19.78
Options outstanding, end of year	15,772,302	32.14	15,909,937	26.33	18,908,062	20.40
Shares exercisable, end of year	6,835,888	25.21	6,410,311	20.46	8,673,714	21.17
Shares reserved for future grants, end of year	14,562,958		19,523,123		8,055,518	

A summary of stock options outstanding and exercisable at April 30, 2003 follows:

Range of Exercise Prices	Outstanding			Exercisable	
	Number Outstanding at April 30	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at April 30	Weighted-Average Exercise Price
\$16.125 - 19.9688	2,025,693	7 years	\$ 16.43	1,899,793	\$ 16.34
\$20.0625 - 27.8125	3,647,896	7 years	24.10	2,061,038	23.00
\$32.10 - 39.96	6,079,320	7 years	33.00	2,874,259	32.66
\$40.00 - 51.35	4,019,393	6 years	46.05	798	46.22
	<b>15,772,302</b>			<b>6,835,888</b>	

The 2000 ESPP provides the option to purchase shares of the Company's Common Stock through payroll deductions to a majority of the employees of subsidiaries of the Company. The purchase price of the stock is 90% of the lower of either the fair market value of the Company's Common Stock on the first trading day within the Option Period or on the last trading day within the Option Period. The Option Periods are six-month periods beginning January 1 and July 1 each year. During fiscal year 2003 and 2002, 93,657 and 97,052 shares, respectively, were purchased under the ESPP out of a total authorized 6,000,000 shares.

For purposes of computing the pro forma effects of stock compensation plans under the fair value accounting method, disclosed in note 1, the fair value of each stock option grant or purchase right grant was estimated on the date of the grant using the Black-Scholes option pricing model. The weighted-average fair value of stock options granted during 2003, 2002 and 2001 was \$8.29, \$5.77 and \$9.34, respectively. The weighted-average fair value of purchase rights granted during 2003, 2002 and 2001 was \$9.02, \$5.88 and \$4.58, respectively. The following weighted-average assumptions were used for stock option grants and purchase right grants during the following periods:

Year Ended April 30	2003	2002	2001
Stock option grants:			
Risk-free interest rate	3.37%	4.48%	6.25%
Expected life	4 years	3 years	3 years
Expected volatility	29.04%	28.81%	61.21%
Dividend yield	1.50%	1.84%	3.39%
Purchase right grants:			
Risk-free interest rate	1.45%	2.70%	6.05%
Expected life	6 months	6 months	4 months
Expected volatility	44.38%	33.07%	26.37%
Dividend yield	1.60%	1.60%	3.38%

The Company has defined contribution plans covering all employees following the completion of an eligibility period. Company contributions to these plans are discretionary and totaled \$20,652, \$15,547 and \$22,213 for fiscal years 2003, 2002 and 2001, respectively.

**NOTE 16: SHAREHOLDER RIGHTS PLAN**

On July 25, 1998, the rights under a shareholder rights plan adopted by the Company's Board of Directors on March 25, 1998 became effective. The 1998 plan was adopted to deter coercive or unfair takeover tactics and to prevent a potential acquirer from gaining control of the Company without offering a fair price to all of the Company's stockholders. Under the 1998 plan, a dividend of one right (a "Right") per share was declared and paid on each share of the Company's Common Stock outstanding on July 25, 1998. Rights automatically attach to shares issued after such date.

Under the 1998 plan, a Right becomes exercisable when a person or group of persons acquires beneficial ownership of 15% or more of the outstanding shares of the Company's Common Stock without the prior written approval of the Company's Board of Directors (an "Unapproved Stock Acquisition"), and at the close of business on the tenth business day following the commencement of, or the public announcement of an intent to commence, a tender offer that would result in an Unapproved Stock Acquisition. The Company may, prior to any Unapproved Stock Acquisition, amend the plan to lower such 15% threshold to not less than the greater of (1) any percentage greater than the largest percentage of beneficial ownership by any person or group of persons then known by the Company, and (2) 10% (in which case the acquisition of such lower percentage of beneficial ownership then constitutes an Unapproved Stock Acquisition and the Rights become exercisable). When exercisable, the registered holder of each Right may purchase from the Company one two-hundredth of a share of a class of the Company's Participating Preferred Stock, without par value, at a price of \$107.50, subject to adjustment. The registered holder of each Right then also has the right (the "Subscription Right") to purchase for the exercise price of the Right, in lieu of shares of Participating Preferred Stock, a number of shares of the Company's Common Stock having a market value equal to twice the exercise price of the Right. Following an Unapproved Stock Acquisition, if the Company is involved in a merger, or 50% or more of the Company's assets or earning power are sold, the registered holder of each Right has the right (the "Merger Right") to purchase for the exercise price of the Right a number of shares of the common stock of the surviving or purchasing company having a market value equal to twice the exercise price of the Right.

After an Unapproved Stock Acquisition, but before any person or group of persons acquires 50% or more of the outstanding shares of the Company's Common Stock, the Board of Directors may exchange all or part of the then outstanding and exercisable Rights for Common Stock at an exchange ratio of one share of Common Stock per Right (the "Exchange"). Upon any such Exchange, the right of any holder to exercise a Right terminates. Upon the occurrence of any of the events giving rise to the exercisability of the Subscription Right or the Merger Right or the ability of the Board of Directors to effect the Exchange, the Rights held by the acquiring person or group under the new plan will become void as they relate to the Subscription Right, the Merger Right or the Exchange.

The Company may redeem the Rights at a price of \$.000625 per Right at any time prior to the earlier of (i) an Unapproved Stock Acquisition, or (ii) the expiration of the rights. The Rights under the plan will expire on March 25, 2008, unless extended by the Board of Directors. Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder of the Company, including the right to vote or to receive dividends. The issuance of the Rights alone has no dilutive effect and does not affect reported earnings per share.

**NOTE 17: OTHER EXPENSES AND INTEREST EXPENSE**

Included in other expenses are the following:

Year Ended April 30	2003	2002	2001
Legal and professional	\$ 125,887	\$ 76,630	\$ 76,232
Purchased services	66,876	74,850	55,985
Loan servicing	65,118	78,516	29,396
Bad debt	49,748	76,804	84,422
Travel and entertainment	42,613	35,982	26,668
Employee development	31,853	18,597	17,451
Insurance	21,820	27,418	20,705
Taxes and licenses	18,195	14,669	13,250
RAL servicing fees	—	27,312	27,315

The components of interest expense are as follows:

Year Ended April 30	2003	2002	2001
Acquisition debt	\$ 72,766	\$ 79,002	\$ 98,759
Margin lending	4,830	14,744	106,265
Mortgage loans	3,229	4,955	13,727
RAL-related	3,244	3,902	3,338
Loans to franchises	851	950	2,044
Canadian cashback program	99	78	230
Other	7,625	12,510	18,188
	<u>\$ 92,644</u>	<u>\$ 116,141</u>	<u>\$ 242,551</u>

**NOTE 18: INCOME TAXES**

The components of income upon which domestic and foreign income taxes have been provided are as follows:

Year Ended April 30	2003	2002	2001
United States	\$ 976,078	\$ 709,940	\$ 466,437
Foreign	10,999	6,900	6,641
	<b>\$ 987,077</b>	<b>\$ 716,840</b>	<b>\$ 473,078</b>

Deferred income tax provisions (benefits) reflect the impact of temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. The current and deferred components of taxes on income are as follows:

Year Ended April 30	2003	2002	2001
Current:			
Federal	\$ 314,616	\$ 227,185	\$ 204,060
State	22,442	22,453	27,701
Foreign	6,106	2,661	3,439
	<b>343,164</b>	<b>252,299</b>	<b>235,200</b>
Deferred:			
Federal	59,351	26,973	(33,724)
State	3,537	2,828	(4,578)
Foreign	961	335	(568)
	<b>63,849</b>	<b>30,136</b>	<b>(38,870)</b>
	<b>\$ 407,013</b>	<b>\$ 282,435</b>	<b>\$ 196,330</b>

Unremitted earnings of foreign subsidiaries aggregated \$87,513 at April 30, 2003. Management intends to indefinitely reinvest foreign earnings, therefore, a provision has not been made for income taxes which might be payable upon remittance of such earnings. Moreover, due to the availability of foreign income tax credits, management believes the amount of federal income taxes would be immaterial in the event foreign earnings were repatriated.

The following table reconciles the U.S. Federal income tax rate to the Company's effective tax rate:

Year Ended April 30	2003	2002	2001
Statutory rate	35.0%	35.0%	35.0%
Increases (reductions) in income taxes resulting from:			
State income taxes, net of Federal income tax benefit	2.6%	2.3%	3.2%
Amortization and impairment of goodwill and intangibles	2.3%	1.5%	3.6%
Other	1.3%	0.6%	(0.3)%
Effective rate	<b>41.2%</b>	<b>39.4%</b>	<b>41.5%</b>

The components of deferred taxes are as follows:

April 30	2003	2002
Gross deferred tax assets:		
Accrued expenses	\$ 58,635	\$ 19,114
Allowance for credit losses	35,817	7,422
Current	<b>94,452</b>	<b>26,536</b>
Deferred compensation	<b>24,940</b>	<b>21,585</b>
Residual interest income	—	34,747
Depreciation	—	6,375
Amortization of intangibles	—	28

Noncurrent	<b>24,940</b>	62,735
Gross deferred tax liabilities:		
Mark-to-market adjustments	—	(7,002)
Accrued income	<b>(24,865)</b>	(1,098)
Current	<b>(24,865)</b>	(8,100)
Residual interest income	<b>(47,923)</b>	—
Mortgage servicing rights	<b>(39,339)</b>	(30,002)
Unrealized gain on available-for-sale marketable securities	<b>(36,076)</b>	(51,047)
Amortization of intangibles	<b>(19,451)</b>	—
Depreciation	<b>(494)</b>	—
Noncurrent	<b>(143,283)</b>	(81,049)
Net deferred tax assets (liabilities)	<b>\$ (48,756)</b>	<b>\$ 122</b>

**NOTE 19: SUPPLEMENTAL CASH FLOW INFORMATION**

The Company made the following cash payments:

Year Ended April 30	2003	2002	2001
Income taxes paid	\$ 247,057	\$ 236,784	\$ 150,784
Interest paid	84,094	105,072	230,448

The Company treated the following as non-cash investing activities:

Year Ended April 30	2003	2002	2001
Receivable from Trusts	\$ 753	\$ 26,057	\$ 66,587
Additions to trading securities	542,544	809,228	386,207
Residual interest mark-to-market	38,880	148,188	14,467

**NOTE 20: COMMITMENTS, CONTINGENCIES, LITIGATION AND RISKS**

**Commitments and contingencies:** At April 30, 2003, the Company maintained a \$2,000,000 backup credit facility to support the commercial paper program and for general corporate purposes. The annual commitment fee required to support the availability of this facility is eleven basis points per annum on the unused portion of the facility. Among other provisions, the credit agreement limits the Company's indebtedness.

The Company maintains a revolving credit facility in an amount not to exceed \$125,000 (Canadian) in Canada to support a commercial paper program with varying borrowing levels throughout the year, reaching its peak during February and March for the Canadian tax season.

The Company offers a separately priced guarantee to tax clients under the POM program. The Company may be liable for certain additional taxes due that are attributable to tax return preparation error. The Company defers a portion of the revenue associated with these guarantees, and recognizes these amounts over the guarantee period in proportion to the costs expected to be incurred under the contract. The related liability is included in accounts payable, accrued expenses and deposits on the consolidated balance sheets. The changes in the deferred revenue liability for the fiscal years ended April 30, 2003 and 2002 are as follows:

April 30	2003	2002
Balance, beginning of year	\$ 44,982	\$ 31,483
Amounts deferred for new guarantees issued	28,854	28,945
Revenue recognized on previous deferrals	(24,556)	(15,446)
Balance, end of year	\$ 49,280	\$ 44,982

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 will 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 be not less than eighty percent 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. If the Company were to acquire all of the major franchises with expiring franchise agreements, the minimum purchase price is estimated to be \$105,000. The Company may potentially acquire the franchise businesses over the next several fiscal years, however, due to continuing litigation and possible negotiations with major franchisees, there is no certainty all of the major franchisees involved in the litigation will be acquired or that HRB Royalty and certain major franchisees will not agree to other arrangements, some of which may not require the above payment. Additionally, the timing and cost of acquisition as to any major franchise business is not certain due partially to related litigation.

The Company has commitments to fund mortgage loans to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. The commitments to fund loans amounted to \$2,614,500 and \$1,726,620 at April 30, 2003 and 2002, respectively. External market forces impact the probability of commitments being exercised, and therefore, total commitments outstanding do not necessarily represent future cash requirements.

The Company is responsible for servicing mortgage loans for others of \$27,669,447, subservicing loans of \$3,664,365, and the master servicing of \$246,450 previously securitized mortgage loans held in trust at April 30, 2003. Fiduciary bank accounts maintained on behalf of investors and for impounded collections were \$848,879 at April 30, 2003. These bank accounts are not assets of the Company and are not reflected in the accompanying consolidated financial statements.

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. The Company has commitments to sell loans of \$1,470,031 and \$1,233,869 as of April 30, 2003 and 2002, respectively.

Violations of these representations and warranties may require the Company to repurchase loans previously sold. In accordance with these loan sale agreements, the Company repurchased loans with an outstanding principal balance of \$181,984 and \$253,740 during the fiscal years ended April 30, 2003 and 2002, respectively. A liability has been established related to the potential loss on repurchase of loans previously sold of \$18,859 and \$10,393 at April 30, 2003 and 2002, respectively. Repurchased loans are normally sold in subsequent sale transactions. On an ongoing basis, management monitors the adequacy of this liability, which is established upon the initial sale of the loans, and is included in accounts payable, accrued expenses and deposits in the consolidated balance sheets. In determining the adequacy of the recourse liability,

management considers such factors as known problem loans, underlying collateral values, historical loan loss experience, assessment of economic conditions and other appropriate data to identify the risks in the mortgage loans held for sale.

The Company is required, under the terms of its securitizations, to build and/or maintain overcollateralization ("OC") to specified levels, using the excess cash

flows received, until specified percentages of the securitized portfolio are attained. The Company funds the OC account from the proceeds of the sale. Future cash flows to the residual holder are used to amortize the bonds until a specific percentage of either the original or current balance is retained, which is specified in the securitization agreement. The bond holders' recourse to the Company for credit losses is limited to the excess cash flows received and the amount of OC held by the trust. Upon maturity of the bonds, any remaining amounts in the trust are distributed. The estimated future cash flows to be distributed to the Company are included as part of the residual valuation and are valued upon distribution from the OC account. As of April 30, 2003 and 2002, \$309,593 and \$263,708, respectively, was maintained in the various OC accounts.

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 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 April 30, 2003 and 2002 was \$2,176,286 and \$1,080,047, respectively. The fair value of mortgage loans held by the Trusts as of April 30, 2003 and 2002 was \$2,273,130 and \$1,126,381, respectively.

The Company is required, in the event of non-delivery of customers' securities owed to it by other broker-dealers or by its customers, to purchase identical securities in the open market. Such purchases could result in losses not reflected in the accompanying consolidated financial statements.

As of April 30, 2003, the Company had pledged securities totaling \$39,719, which satisfied margin deposit requirements of \$35,402.

The Company monitors the credit standing of brokers and dealers and customers with whom it does business. In addition, the Company monitors the market value of collateral held and the market value of securities receivable from others, and seeks to obtain additional collateral if insufficient protection against loss exists.

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 \$52,290 as of April 30, 2003. The Company's estimate is based on current financial conditions. Should actual results differ materially from the assumptions, the potential payments will differ from the above estimate. Such payments, if and when paid, would be recorded as additional goodwill.

At April 30, 2003, the Company had a receivable from M&P of \$30,976. This amount is included in receivables in the consolidated balance sheet. Commitments exist to loan M&P up to the value of their accounts receivable, work-in-process and fixed assets (\$57,149 at April 30, 2003) on a revolving basis through July 31, 2004, subject to certain termination clauses. This revolving facility bears interest at prime rate plus four and one-half percent on the outstanding amount and a commitment fee of one-half percent per annum on the unused portion of the commitment. The loan is fully secured by the accounts receivable, work-in-process and fixed assets of M&P.

The Company has contractual commitments to fund certain franchises requesting Franchise Equity Lines of Credit ("FELCs"). The commitment to fund FELCs as of April 30, 2003 totaled \$56,070, with a related receivable balance of \$33,341 included in the consolidated balance sheets. The receivable represents the amount drawn on the FELCs as of April 30, 2003.

Substantially all of the operations of the Company's subsidiaries are conducted in leased premises. Most of the operating leases are for a three-year period with renewal options and provide for fixed monthly rentals.

Future minimum lease commitments at April 30, 2003 are as follows:

2004	\$	171,041
2005		131,940
2006		88,413
2007		49,346
2008		26,069
2009 and beyond		55,202
	\$	522,011

The Company's rent expense for fiscal years 2003, 2002 and 2001 aggregated \$211,721, \$190,373 and \$177,803, respectively.

The Company and its subsidiaries also 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 counterparties from losses arising from the following: a) tax, legal and other risks related to the purchase or disposition of businesses; b) penalties and interest assessed by Federal and state taxing authorities in connection with tax returns prepared for clients; and c) 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 April 30, 2003.

In the regular course of business, the Company is subject to routine examinations by Federal, state and local taxing authorities. In management's opinion, the disposition of matters raised by such taxing authorities, if any, in such tax examinations would not have a material adverse impact on the Company's consolidated financial statements.

**Litigation:** 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 refund anticipation loans (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, 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, 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. Through April 30, 2003, the Company has recorded an additional liability and pretax expense of \$1,837 in connection with this settlement for a total liability and pretax charge of \$43,509. In addition to this liability, the Company would recognize the cost of the tax preparation coupons as they are redeemed each year. The settlement was approved by the court as a part of a final judgment entered on June 24, 2003. The court also approved an award of \$49.0 million in attorneys' fees to class counsel conditioned on payment by class counsel of \$26.0 million of that amount to class members.

The Company has been involved in a number of other putative RAL class action cases since 1990 and has successfully defended many cases. 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.*, 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 \$12.5 million toward a \$25 million 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 million 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. On April 15, 2003, the District Court judge declined to approve the \$25 million 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 after the conclusion of fiscal year 2003 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 requested the release of the escrowed settlement fund. The Company has recorded a receivable in the amount of its \$12.5 million share of the settlement fund in the fourth quarter of fiscal year 2003 and recorded a reserve in such quarter of \$12.5 million consistent with the existing settlement authority of the Board of Directors. The Company intends to defend the case and the remaining RAL class action litigation vigorously and there are no assurances that any of the matters will result in settlements.

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., Yuchong Smith, et al. v. H&R Block, Inc., et al., Richard J. Rodney, et al. v. H&R Block, Inc., et al., and Michael F. McCormack, et al. v. H&R Block, Inc., et al.*, Case Numbers 02CV8965, 02CV9661, 02CV9682 and 02CV9830, respectively, pending in the United States District Court for the Southern District of New York. These matters were filed in 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 1, 2002, and allege that the defendants violated Section 10(b)(5) 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, and by failing to set adequate reserves for those cases. The four securities law cases have all been assigned to the same judge and consolidated for pre-trial matters. On January 13, 2003, the judge signed an order relieving the defendants from an obligation to respond to any of the four complaints until after a consolidated complaint was filed. The consolidated complaint was filed in March 2003, and the defendants filed a motion to dismiss in April 2003. In response to defendants' motion to dismiss, plaintiffs informed defendants that they wished further to amend their complaint. Defendants consented to the filing of an amended complaint, and intends to file a motion to dismiss it. The Company believes the claims in these actions are without merit, and intends to defend them vigorously.

The Company is a named defendant in litigation entitled *Armstrong Business Services, Inc., et al. v. H&R Block, Inc., et al.*, Case No. 99-CV-206379, pending in the Circuit Court of Jackson County, Missouri. The action was filed by 24 "major" franchisees against the Company and certain of its subsidiaries relating to alleged breaches of contract and other matters. The Company's subsidiary, HRB Royalty, Inc., franchisor under the applicable franchise agreements, filed a counterclaim and subsequently a motion for summary judgment seeking a declaration that HRB Royalty, Inc. could elect not to renew the major franchise agreements when their present five-year terms came to an end. Such motion for summary judgment was granted in March 2001 and the plaintiffs appealed. The Missouri Court of Appeals ruled in favor of HRB Royalty on December 24, 2002, holding that the provision in the franchise agreements for automatic renewal will not be held to require the renewal for additional five-year periods "except upon the mutual assent of the parties." The plaintiff major franchisees' motions to the Missouri Court of Appeals for a rehearing and for transfer to the Missouri Supreme Court were denied in January 2003. In February 2003, the plaintiffs applied to the Missouri Supreme Court for transfer of the case to that Court and such application was denied. HRB Royalty notified the plaintiff major franchisees in 2000 that it did not intend to renew their franchise agreements at the expiration of the current renewal terms and that the agreements would terminate at that time. The renewal dates vary among the franchisees. Pursuant to the franchise agreements, HRB Royalty must pay a "fair and equitable price" to the franchisee for franchisee's franchise business, and such price must be no less than 80% of the franchisee's revenues for the most recent 12 months ended April 30, plus the value of equipment and supplies, and certain off-season expenses. The Circuit Court ruled on May 31, 2003, that major franchise agreements with renewal terms scheduled to expire prior to July 1, 2003, will expire on July 1, 2003, and other major franchise agreements will expire as their renewal terms expire commencing in September 2003. The Court ordered defendants to pay for the franchise businesses as provided in the franchise agreements on the applicable dates of expiration. There is no certainty as to the timing and final cost of acquisition as to any franchise business.

In *Armstrong*, plaintiffs' claims against the Company and its subsidiaries remain in the trial court. In their second amended petition, the plaintiffs seek in excess of \$20 million in actual damages, punitive damages, unspecified statutory damages, declaratory, injunctive and other relief, including attorneys' fees under allegations of breach of contract, breach of the covenant of good faith and fair dealing, unfair business practices, state anti-trust violations, breach of fiduciary duty, prima facie tort, violations of various state franchise statutes, fraud and misrepresentation, waiver and estoppel, ambiguity and reformation, relief with respect to a post-termination covenant not to compete in the franchise agreements, and a request for a fair and equitable payment upon nonrenewal of the franchise agreements. The major franchisees allege, among other things, that the sale of TaxCut income tax

return preparation software and online tax services and the purchase of accounting firms encroached on their exclusive franchise territories. The defendants believe that the allegations against them are without merit and continue to defend the case vigorously. A trial is scheduled for two of the plaintiffs in September 2003. Management believes that amounts, if any, required to be paid by the Company and its subsidiaries in the discharge of liabilities or settlements relating to plaintiffs' claims in this litigation will not have a material adverse effect on the Company's consolidated results of operations or financial position.

In addition to the aforementioned cases, the Company and its subsidiaries have from time to time been party 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 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 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.

**Risks:** Loans to borrowers who do not meet traditional underwriting criteria (non-prime borrowers) present a higher level of risk of default than federal agency prime loans, because of the increased potential for default by borrowers who may have previous credit problems or who do not have any credit history. Loans to non-prime borrowers also involve additional liquidity risks, as these loans generally have a more limited secondary market than prime loans. The actual rates of delinquencies, foreclosures and losses on loans to non-prime borrowers could be higher under adverse economic conditions than those currently experienced in the mortgage lending industry in general. While the Company believes the underwriting procedures and appraisal processes it employs enable it to mitigate certain risks inherent in loans made to these borrowers, no assurance can be given that such procedures or processes will afford adequate protection against such risks.

Commitments to fund loans involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amount recognized in the financial statements. Credit risk is mitigated by the Company's evaluation of the creditworthiness of potential borrowers on a case-by-case basis.

Risks to the stability of Mortgage Operations include external events impacting the asset-backed securities market, such as the level of and fluctuations in interest rates, real estate and other asset values, changes in the securitization market and competition.

#### **NOTE 21: SEGMENT INFORMATION**

The principal business activity of the Company's operating subsidiaries is providing tax and financial services to the general public. Management has determined the reportable segments identified below according to types of services offered, geographic locations in which operations are conducted, and the manner in which operational decisions are made. A majority of the foreign countries in which subsidiaries of the Company operate, which are individually immaterial, are included in International Tax Operations. Included below is the financial information of each segment. The Company operates in the following reportable segments:

**U.S. Tax Operations:** This segment is primarily engaged in providing tax return preparation, filing, and related services to the general public in the United States. Tax-related service revenues include fees from company-owned tax offices and royalties from franchised offices. This segment includes the Company's tax preparation software - TaxCut® from H&R Block, and other personal productivity software offered to the general public, and offers online do-it-yourself-tax preparation, online professional tax review, online tax advice to the general public through the hrblock.com website and online tax preparation through a tax professional (whereby the client fills out an online tax organizer and sends it to a tax professional for preparation). Revenues of this segment are seasonal in nature.

**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 in the United States. This segment mainly offers, through a network of mortgage brokers, a flexible product line to borrowers who are creditworthy but do not meet traditional underwriting criteria. Prime mortgage loan products, as well as the same flexible product line available through brokers, are offered through some H&R Block Financial Advisor branch offices and H&R Block Mortgage Corporation retail offices.

**Business Services:** This segment is engaged in providing accounting, tax, consulting, payroll, employee benefits and capital markets services to business clients and tax, estate planning, financial planning, wealth management and insurance services to individuals. This segment offers services through offices located throughout the United States. Revenues of this segment are seasonal in nature.

**Investment Services:** This segment is primarily engaged in offering investment services and securities products through H&R Block Financial Advisors, Inc., a full-service securities broker, to the general public. Investment advice and services are offered through H&R Block Financial Advisors branch offices.

**International Tax Operations:** This segment is primarily engaged in providing local tax return preparation, filing, and related services to the general public in Canada, Australia and the United Kingdom. In addition, International Tax Operations has company-owned and franchise offices in eight countries that prepare U.S. tax returns for U.S. citizens living abroad. Tax-related service revenues include fees from company-owned tax offices and royalties from franchised offices. Revenues of this segment are seasonal in nature.

**Corporate Operations:** This segment consists primarily of corporate support departments that 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 and franchise financing subsidiaries are also included within this segment.

**Identifiable assets:** Identifiable assets are those assets, including goodwill and intangible assets, associated with each reportable segment. The remaining assets are classified as corporate assets and consist primarily of cash, marketable securities and equipment.

Information concerning the Company's operations by reportable segment as of and for the years ended April 30, 2003, 2002 and 2001 is as follows:

	2003	2002	2001
<b>REVENUES:</b>			
U.S. Tax Operations	\$ 1,859,993	\$ 1,830,752	\$ 1,622,636
Mortgage Operations	1,200,409	734,890	415,802
Business Services	434,140	416,926	386,168
Investment Services	200,794	250,685	472,425
International Tax Operations	85,082	78,710	78,469
Corporate Operations	(651)	5,773	5,837
Total revenues	\$ 3,779,767	\$ 3,317,736	\$ 2,981,337
<b>INCOME BEFORE TAXES:</b>			
U.S. Tax Operations	\$ 547,078	\$ 533,468	\$ 434,067
Mortgage Operations	693,950	339,388	137,992
Business Services	(14,118)	22,716	15,953
Investment Services	(128,292)	(54,862)	9,298
International Tax Operations	10,464	7,093	6,024
Corporate Operations	(122,005)	(130,963)	(130,256)
Income before taxes	\$ 987,077	\$ 716,840	\$ 473,078
<b>DEPRECIATION AND AMORTIZATION:</b>			
U.S. Tax Operations	\$ 58,131	\$ 59,258	\$ 69,891
Mortgage Operations	21,703	14,753	22,813
Business Services	23,134	21,390	38,821
Investment Services	53,984	52,182	67,289
International Tax Operations	3,356	4,854	5,429
Corporate Operations	1,513	2,949	1,365
	161,821	155,386	205,608
Goodwill impairments:			
Business Services	11,777	—	—
Investment Services	24,000	—	—
Total goodwill impairments	35,777	—	—
Total depreciation and amortization	\$ 197,598	\$ 155,386	\$ 205,608
<b>CAPITAL EXPENDITURES:</b>			
U.S. Tax Operations	\$ 62,383	\$ 58,683	\$ 42,260
Mortgage Operations	38,204	23,087	34,423
Business Services	15,248	10,676	9,762
Investment Services	15,562	10,268	3,557
International Tax Operations	3,086	4,407	2,328
Corporate Operations	16,414	4,654	81
Total capital expenditures	\$ 150,897	\$ 111,775	\$ 92,411
<b>IDENTIFIABLE ASSETS:</b>			
U.S. Tax Operations	\$ 281,340	\$ 269,476	\$ 266,383
Mortgage Operations	1,156,830	1,233,925	938,379

Business Services	<b>674,566</b>	665,018	575,998
Investment Services	<b>1,489,297</b>	1,656,469	2,011,517
International Tax Operations	<b>33,142</b>	47,820	42,627
Corporate Operations	<b>968,730</b>	358,083	278,801
	<hr/>	<hr/>	<hr/>
Total assets	<b>\$ 4,603,905</b>	<b>\$ 4,230,791</b>	<b>\$ 4,113,705</b>
	<hr/>	<hr/>	<hr/>

**NOTE 22: QUARTERLY FINANCIAL DATA (UNAUDITED)**

	Fiscal 2003 Quarter Ended				Fiscal 2002 Quarter Ended			
	April 30, 2003	Jan. 31, 2003	Oct. 31, 2002	July 31, 2002	April 30, 2002	Jan. 31, 2002	Oct. 31, 2001	July 31, 2001
Revenues	\$ 1,918,592	\$ 958,413	\$ 471,396	\$ 431,366	\$ 1,881,327	\$ 733,532	\$ 373,896	\$ 328,981
Income (loss) before taxes (benefit)	842,294	222,934	(62,245)	(15,906)	765,881	49,774	(47,077)	(51,738)
Income taxes (benefit)	347,652	90,621	(24,898)	(6,362)	302,297	20,158	(19,066)	(20,954)
Net income (loss)	\$ 494,642	\$ 132,313	\$ (37,347)	\$ (9,544)	\$ 463,584	\$ 29,616	\$ (28,011)	\$ (30,784)
Basic earnings per share:								
Net earnings (loss)	\$ 2.76	\$ .74	\$ (.21)	\$ (.05)	\$ 2.54	\$ .16	\$ (.15)	\$ (.17)
Diluted earnings per share:								
Net earnings (loss)	\$ 2.71	\$ .73	\$ (.21)	\$ (.05)	\$ 2.46	\$ .16	\$ (.15)	\$ (.17)

The accumulation of four quarters in fiscal year 2003 and 2002 for earnings per share may not equal the related per share amounts for the years ended April 30, 2003 and 2002 due to the repurchase of treasury shares, the timing of the exercise of stock options, and the antidilutive effect of stock options in the first two quarters.

**NOTE 23: CONDENSED CONSOLIDATING FINANCIAL STATEMENTS**

Block Financial Corporation ("BFC") is an indirect, wholly owned subsidiary of the Company. BFC is the Issuer and the Company is the Guarantor of the \$250,000 6 3/4% Senior Notes issued on October 21, 1997 and of the \$500,000 8 1/2% Senior Notes issued on April 13, 2000. The Company's guarantee is full and unconditional. The following condensed consolidating financial statements present separate information for BFC, the Company and for the Company's other subsidiaries, and should be read in conjunction with the consolidated financial statements of the Company.

These condensed consolidating financial statements have been prepared using the equity method of accounting. Income of subsidiaries is, 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**

Year Ended April 30, 2003	H&R Block, Inc. (Guarantor)	BFC (Subsidiary Issuer)	Other Subsidiaries	Eliminations	Consolidated H&R Block
Total revenues	\$ —	\$ 1,601,902	\$ 2,179,334	\$ (1,469)	\$ 3,779,767
Expenses:					
Compensation and benefits	—	405,306	995,867	261	1,401,434
Occupancy and equipment	—	73,837	272,123	—	345,960
Interest	—	62,294	30,350	—	92,644
Depreciation and amortization	—	101,613	95,985	—	197,598
Marketing and advertising	—	34,612	116,435	(875)	150,172
Supplies, freight and postage	—	21,717	67,031	—	88,748
Other	—	276,286	247,518	(835)	522,969
	—	975,665	1,825,309	(1,449)	2,799,525
Operating income	—	626,237	354,025	(20)	980,242
Other income, net	987,077	—	6,835	(987,077)	6,835
Income before taxes	987,077	626,237	360,860	(987,097)	987,077
Income taxes	407,013	265,079	141,926	(407,005)	407,013
Net income	\$ 580,064	\$ 361,158	\$ 218,934	\$ (580,092)	\$ 580,064

Year Ended April 30, 2002	H&R Block, Inc. (Guarantor)	BFC (Subsidiary Issuer)	Other Subsidiaries	Eliminations	Consolidated H&R Block
Total revenues	\$ —	\$ 1,219,990	\$ 2,112,438	\$ (14,692)	\$ 3,317,736
Expenses:					
Compensation and benefits	—	334,146	974,622	(63)	1,308,705
Occupancy and equipment	—	65,305	240,015	67	305,387
Interest	—	100,800	15,341	—	116,141
Depreciation and amortization	—	69,497	85,889	—	155,386
Marketing and advertising	—	20,642	136,342	(1,255)	155,729
Supplies, freight and postage	—	15,000	60,804	(94)	75,710
Other	—	313,475	184,993	(13,218)	485,250
	—	918,865	1,698,006	(14,563)	2,602,308
Operating income	—	301,125	414,432	(129)	715,428
Other income, net	716,840	(2,028)	3,440	(716,840)	1,412
Income before taxes	716,840	299,097	417,872	(716,969)	716,840
Income taxes	282,435	123,884	158,602	(282,486)	282,435
Net income	\$ 434,405	\$ 175,213	\$ 259,270	\$ (434,483)	\$ 434,405

Year Ended April 30, 2001	H&R Block, Inc. (Guarantor)	BFC (Subsidiary Issuer)	Other Subsidiaries	Eliminations	Consolidated H&R Block
Total revenues	\$ —	\$ 1,072,855	\$ 1,920,398	\$ (11,916)	\$ 2,981,337
Expenses:					
Compensation and benefits	—	299,263	893,031	—	1,192,294
Occupancy and equipment	—	56,093	227,088	—	283,181
Interest	—	223,816	18,735	—	242,551
Depreciation and amortization	—	90,660	114,948	—	205,608
Marketing and advertising	—	30,824	80,606	(457)	110,973
Supplies, freight and postage	—	20,949	49,491	—	70,440
Other	—	240,474	182,434	(11,684)	411,224
	—	962,079	1,566,333	(12,141)	2,516,271
Operating income	—	110,776	354,065	225	465,066
Other income, net	480,209	(29)	8,041	(480,209)	8,012
Income before taxes	480,209	110,747	362,106	(479,984)	473,078
Income taxes	199,047	61,814	134,430	(198,961)	196,330
Net income from continuing operations before change in accounting principle	281,162	48,933	227,676	(281,023)	276,748
Change in accounting principle	—	4,414	—	—	4,414
Net income	\$ 281,162	\$ 53,347	\$ 227,676	\$ (281,023)	\$ 281,162

# CONDENSED CONSOLIDATING BALANCE SHEETS

April 30, 2003	H&R Block, Inc. (Guarantor)	BFC (Subsidiary Issuer)	Other Subsidiaries	Eliminations	Consolidated H&R Block
Cash and cash equivalents	\$ —	\$ 180,181	\$ 695,172	\$ —	\$ 875,353
Cash and cash equivalents — restricted	—	420,787	17,455	—	438,242
Receivables from customers, brokers, dealers and clearing organizations	—	517,037	—	—	517,037
Receivables	168	171,612	231,417	—	403,197
Intangible assets and goodwill	—	491,091	564,989	—	1,056,080
Investment 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	\$ 3,545,581	\$ 2,800,041	\$ 1,804,068	\$ (3,545,785)	\$ 4,603,905
Accounts 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	1,663,709	867,448	2,678,802	(3,546,250)	1,663,709
Total liabilities and stockholders' equity	\$ 3,545,581	\$ 2,800,041	\$ 1,804,068	\$ (3,545,785)	\$ 4,603,905
April 30, 2002	H&R Block, Inc. (Guarantor)	BFC (Subsidiary Issuer)	Other Subsidiaries	Eliminations	Consolidated H&R Block
Cash and cash equivalents	\$ —	\$ 197,959	\$ 238,186	\$ —	\$ 436,145
Cash and cash equivalents — restricted	—	140,180	11,993	—	152,173
Receivables from customers, brokers, dealers and clearing organizations	—	844,538	—	—	844,538
Receivables	151	157,747	210,447	—	368,345
Intangible assets and goodwill	—	544,391	562,550	—	1,106,941
Investment in subsidiaries	2,973,936	215	1,609	(2,973,936)	1,824
Other assets	—	1,006,531	314,381	(87)	1,320,825
Total assets	\$ 2,974,087	\$ 2,891,561	\$ 1,339,166	\$ (2,974,023)	\$ 4,230,791
Accounts payable to customers, brokers and dealers	\$ —	\$ 903,201	\$ —	\$ —	\$ 903,201
Long-term debt	—	746,900	121,487	—	868,387
Other liabilities	6,032	335,687	748,347	(283)	1,089,783
Net intercompany advances	1,598,635	373,975	(1,972,935)	325	—
Stockholders' equity	1,369,420	531,798	2,442,267	(2,974,065)	1,369,420
Total liabilities and stockholders' equity	\$ 2,974,087	\$ 2,891,561	\$ 1,339,166	\$ (2,974,023)	\$ 4,230,791



# CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

Year Ended April 30, 2003	H&R Block, Inc. (Guarantor)	BFC (Subsidiary Issuer)	Other Subsidiaries	Eliminations	Consolidated H&R Block
Net cash provided by operating activities	\$ 36,560	\$ 150,171	\$ 504,094	\$ —	\$ 690,825
Cash flows from investing activities:					
Purchases of available-for-sale securities	—	—	(14,614)	—	(14,614)
Maturities of available-for-sale securities	—	140,795	—	—	140,795
Sales of available-for-sale securities	—	142,486	14,081	—	156,567
Purchases of property and equipment, net	—	(37,999)	(112,898)	—	(150,897)
Payments made for business acquisitions	—	—	(26,408)	—	(26,408)
Net intercompany advances	280,583	—	—	(280,583)	—
Other, net	—	(1,480)	21,376	—	19,896
Net cash provided by (used in) investing activities	280,583	243,802	(118,463)	(280,583)	125,339
Cash flows from financing activities:					
Repayments of notes payable	—	(9,925,516)	—	—	(9,925,516)
Proceeds from issuance of notes payable	—	9,925,516	—	—	9,925,516
Payments on acquisition debt	—	—	(57,469)	—	(57,469)
Dividends paid	(125,898)	—	—	—	(125,898)
Payments to acquire treasury shares	(317,570)	—	—	—	(317,570)
Proceeds from issuance of common stock	126,325	—	—	—	126,325
Net intercompany advances	—	(411,751)	131,168	280,583	—
Other, net	—	—	(2,344)	—	(2,344)
Net cash provided by (used in) financing activities	(317,143)	(411,751)	71,355	280,583	(376,956)
Net increase in cash and cash equivalents	—	(17,778)	456,986	—	439,208
Cash and cash equivalents at beginning of the year	—	197,959	238,186	—	436,145
Cash and cash equivalents at end of the year	\$ —	\$ 180,181	\$ 695,172	\$ —	\$ 875,353

Year Ended April 30, 2002	H&R Block, Inc. (Guarantor)	BFC (Subsidiary Issuer)	Other Subsidiaries	Eliminations	Consolidated H&R Block
Net cash provided by operating activities	\$ 58,927	\$ 357,698	\$ 324,821	\$ —	\$ 741,446
Cash flows from investing activities:					
Purchases of available-for-sale securities	—	—	(7,241)	—	(7,241)
Maturities of available-for-sale securities	—	67,070	8,250	—	75,320
Sales of available-for-sale securities	—	—	23,173	—	23,173
Purchases of property and equipment, net	—	(36,434)	(75,341)	—	(111,775)
Payments made for business acquisitions	—	—	(46,738)	—	(46,738)
Net intercompany advances	324,503	—	—	(324,503)	—
Other, net	—	(4,069)	12,297	—	8,228
Net cash provided by (used in) investing activities	324,503	26,567	(85,600)	(324,503)	(59,033)
Cash flows from financing activities:					
Repayments of notes payable	—	(10,622,011)	—	—	(10,622,011)
Proceeds from issuance of notes payable	—	10,622,011	—	—	10,622,011
Payments on acquisition debt	—	—	(50,594)	—	(50,594)
Dividends paid	(115,725)	—	—	—	(115,725)
Payments to acquire treasury shares	(462,938)	—	—	—	(462,938)
Proceeds from issuance of common stock	195,233	—	—	—	195,233
Net intercompany advances	—	(269,248)	(55,255)	324,503	—
Other, net	—	—	140	—	140
Net cash used in financing activities	(383,430)	(269,248)	(105,709)	324,503	(433,884)
Net increase in cash and cash equivalents	—	115,017	133,512	—	248,529
Cash and cash equivalents at beginning of the year	—	82,942	104,674	—	187,616
Cash and cash equivalents at end of the year	\$ —	\$ 197,959	\$ 238,186	\$ —	\$ 436,145

Year Ended April 30, 2001	H&R Block, Inc. (Guarantor)	BFC (Subsidiary Issuer)	Other Subsidiaries	Eliminations	Consolidated H&R Block
Net cash provided by (used in) operating activities	\$ 2,235	\$ (237,185)	\$ 483,301	\$ —	\$ 248,351
Cash flows from investing activities:					
Purchases of available-for-sale securities	—	—	(10,636)	—	(10,636)
Maturities of available-for-sale securities	—	16,024	5,500	—	21,524
Sales of available-for-sale securities	—	319,620	36,572	—	356,192
Purchases of property and equipment, net	—	(47,462)	(44,949)	—	(92,411)
Payments made for business acquisitions	—	—	(21,143)	—	(21,143)
Proceeds from sale of subsidiary	—	—	23,200	—	23,200
Net intercompany advances	308,656	—	—	(308,656)	—
Other, net	—	14,458	(36,427)	—	(21,969)
Net cash provided by (used in) investing activities	308,656	302,640	(47,883)	(308,656)	254,757
Cash flows from financing activities:					
Repayments of notes payable	—	(18,219,741)	—	—	(18,219,741)
Proceeds from issuance of notes payable	—	17,935,944	—	—	17,935,944
Payments on acquisition debt	—	—	(68,743)	—	(68,743)
Dividends paid	(108,374)	—	—	—	(108,374)
Payments to acquire treasury shares	(222,895)	—	—	—	(222,895)
Proceeds from issuance of common stock	19,550	—	—	—	19,550
Net intercompany advances	—	77,644	(386,300)	308,656	—
Other, net	828	—	1,221	—	2,049
Net cash used in financing activities	(310,891)	(206,153)	(453,822)	308,656	(662,210)
Net decrease in cash and cash equivalents	—	(140,698)	(18,404)	—	(159,102)
Cash and cash equivalents at beginning of the year	—	223,640	123,078	—	346,718
Cash and cash equivalents at end of the year	\$ —	\$ 82,942	\$ 104,674	\$ —	\$ 187,616

## MANAGEMENT REPORT

We at H&R Block are guided by our core values of client focus, excellence, integrity, respect and teamwork. These values govern the manner in which we serve clients and each other, and are embedded in the execution and delivery of our financial reporting responsibilities to our shareholders. To that end, we maintain a comprehensive system of internal accounting controls designed to provide reasonable assurance the Company's assets are safeguarded against material loss from unauthorized use or disposition, and authorized transactions are properly recorded. We support an extensive program of internal audits and require the management teams of our individual subsidiaries to certify their respective financial information. Appropriate communication programs aimed at assuring our policies, procedures and principles of business conduct are understood and practiced by our associates are also an integral part of the control environment at H&R Block.

PricewaterhouseCoopers LLP audited our 2003, 2002 and 2001 consolidated financial statements and issued opinions thereon. Their audits were conducted in accordance with generally accepted auditing standards and included an objective, independent review and testing of the system of internal controls necessary to express an opinion on the financial statements.

The Audit Committee of the Board of Directors, composed solely of outside and independent directors, meets periodically with management, the independent accountants and the chief internal auditor to review matters relating to the annual financial statements, internal audit activities, internal accounting controls and non-audit services provided by the independent accountants. The independent accountants and the chief internal auditor have full access to the Audit Committee and meet, both with and without management present, to discuss the scope and results of their audits, including internal control, audit and financial matters.

The financial information in this Annual Report, including the consolidated financial statements, is the responsibility of management. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States and, where appropriate, reflect management's best estimates and judgments.

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

/s/ Frank J. Cotroneo  
Frank J. Cotroneo  
Senior Vice President and Chief Financial Officer

## REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders of  
H&R Block, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of cash flows and of stockholders' equity appearing on pages 46-75 present fairly, in all material respects, the financial position of H&R Block, Inc. and its subsidiaries (the "Company") at April 30, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended April 30, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP  
  
Kansas City, Missouri  
June 10, 2003

## COMMON STOCK DATA

	Stock Price		Cash Dividend
	High	Low	Paid per Share
<b>2002 FISCAL YEAR:</b>			
Quarter ended 7/31/01	\$ 35.69	\$ 26.50	\$ .15
Quarter ended 10/31/01	41.10	32.78	.16
Quarter ended 1/31/02	46.26	34.48	.16
Quarter ended 4/30/02	50.78	39.23	.16
<b>2003 FISCAL YEAR:</b>			
Quarter ended 7/31/02	\$ 48.28	\$ 40.00	\$ .16
Quarter ended 10/31/02	53.15	37.45	.18
Quarter ended 1/31/03	43.05	30.74	.18
Quarter ended 4/30/03	44.35	35.47	.18

Traded on the New York Stock Exchange; Ticker Symbol: HRB

# SELECTED FINANCIAL DATA

Amounts in thousands, except per share amounts and number of shareholders

	April 30,				
	2003	2002	2001	2000	1999
<b>FOR THE YEAR:</b>					
Total revenues	\$3,779,767	\$3,317,736	\$2,981,337	\$2,425,685	\$1,619,577
Net earnings from continuing operations	\$ 580,064	\$ 434,405	\$ 276,748	\$ 251,895	\$ 237,795
Net earnings	\$ 580,064	\$ 434,405	\$ 281,162	\$ 251,895	\$ 215,366
<b>AT YEAR END:</b>					
Total assets	\$4,603,905	\$4,230,791	\$4,113,705	\$5,700,146	\$1,903,923
Cash, cash equivalents and marketable securities	\$1,618,821	\$ 997,319	\$ 596,396	\$ 681,567	\$ 454,867
Long-term debt	\$ 822,302	\$ 868,387	\$ 870,974	\$ 872,396	\$ 249,725
Stockholders' equity	\$1,663,709	\$1,369,420	\$1,173,741	\$1,218,589	\$1,061,987
Shares outstanding	179,601	181,126	183,608	196,070	195,258
Number of shareholders	30,716	31,094	31,523	33,557	34,624
<b>MEASUREMENTS:</b>					
Per basic share of common stock:					
Net earnings from continuing operations	\$ 3.23	\$ 2.38	\$ 1.50	\$ 1.28	\$ 1.19
Net earnings	\$ 3.23	\$ 2.38	\$ 1.53	\$ 1.28	\$ 1.08
Per diluted share of common stock:					
Net earnings from continuing operations	\$ 3.15	\$ 2.31	\$ 1.49	\$ 1.27	\$ 1.18
Net earnings	\$ 3.15	\$ 2.31	\$ 1.52	\$ 1.27	\$ 1.07
Other per share data:					
Cash dividends declared	\$ 0.70	\$ 0.63	\$ 0.59	\$ 0.54	\$ 0.48
Net book value	\$ 9.26	\$ 7.56	\$ 6.39	\$ 6.22	\$ 5.44
Return on total revenues	15.3%	13.1%	9.3%	10.4%	14.7%
Return on stockholders' equity	45.2%	41.1%	29.7%	25.1%	22.0%
Return on average assets	14.0%	9.9%	5.3%	7.0%	9.0%
Working capital ratio	1.45	1.19	1.14	1.10	1.97
Debt to total capital ratio	34.5%	40.4%	44.0%	50.1%	23.2%
Total equity to total assets	0.36	0.32	0.29	0.21	0.56
Dividend yield	1.8%	1.6%	2.1%	2.6%	2.0%
Dividend payout ratio	21.7%	26.6%	38.5%	41.9%	44.1%

## SUBSIDIARIES OF H&amp;R BLOCK, INC.

The following is a list of the direct and indirect subsidiaries of H&R Block, Inc., a Missouri corporation. All active subsidiaries do business under their corporate names listed below or close derivatives thereof:

NAME -----	JURISDICTION IN WHICH ORGANIZED -----
1)Block Investment Corporation.....	Delaware (1)
2)H&R Block Group, Inc.....	Delaware (1)
3)HRB Management, Inc.....	Missouri (2)
4)H&R Block Tax and Financial Services Limited.....	United Kingdom (3)
5)Companion Insurance, Ltd.....	Bermuda (3)
6)H&R Block Services, Inc.....	Missouri (2)
7)H&R Block Tax Services, Inc.....	Missouri (4)
8)H&R Block of Dallas, Inc.....	Texas (5)
9)HRB Partners, Inc.....	Delaware (6)
10)HRB Texas Enterprises, Inc.....	Missouri (5)
11)H&R Block and Associates, L.P.....	Delaware (7)
12)H&R Block Texas Tax Company, LP.....	Delaware (8)
13)H&R Block Texas Support Services, LP.....	Delaware (8)
14)BWA Advertising, Inc.....	Missouri (5)
15)H&R Block (Guam), Inc.....	Guam (5)
16)H&R Block Enterprises (Guam), Inc.....	Guam (9)
17)H&R Block Canada, Inc.....	Canada (5)
18)Financial Stop, Inc.....	British Columbia (10)
19)H&R Block Canada Financial Services, Inc.....	Canada (10)
20)H&R Block Enterprises, Inc.....	Missouri (5)
21)H&R Block Tax Company, LLC.....	Missouri (11)
22)H&R Block Support Services, LLC.....	Missouri (11)
23)H&R Block Tax Company.....	California (5)
24)H&R Block Eastern Tax Services, Inc.....	Missouri (4)
25)H&R Block Eastern Enterprises, Inc.....	Missouri (12)
26)H&R Block Indiana Tax Company, LP.....	Delaware (13)
27)H&R Block Indiana Support Services, LP.....	Delaware (14)
28)H&R Block Eastern Tax Company, LLC.....	Missouri (15)
29)H&R Block Eastern Support Services, LLC.....	Missouri (15)
30)HRB Royalty, Inc.....	Delaware (4)
31)H&R Block Limited.....	New South Wales (16)
32)Block Financial Corporation.....	Delaware (2)
33)Option One Mortgage Corporation.....	California (17)
34)Option One Mortgage Acceptance Corporation.....	Delaware (18)
35)Option One Mortgage Securities Corp.....	Delaware (18)
36)Option One Mortgage Securities II Corp.....	Delaware (18)
37)Premier Trust Deed Services, Inc.....	California (18)
38)Premier Mortgage Services of Washington, Inc.....	Washington (18)
39)H&R Block Mortgage Corporation.....	Massachusetts (18)
40)Option One Direct Insurance Agency, Inc.....	California (18)
41)Woodbridge Mortgage Acceptance Corporation.....	Delaware (18)
42)Option One Loan Warehouse Corporation.....	Delaware (18)
43)Companion Mortgage Corporation.....	Delaware (17)
44)Franchise Partner, Inc.....	Nevada (17)
45)NCS Mortgage Services, L.L.C.....	Georgia (19)
46)National Consumer Services Corp. II, L.L.C.....	Georgia (19)
47)OLDE Financial Corporation.....	Michigan (17)
48)H&R Block Financial Advisors, Inc.....	Michigan (20)

49)OLDE Discount of Canada.....	Canada (21)
50)H&R Block Insurance Agency of Massachusetts, Inc.....	Massachusetts (21)
51)OLDE Property Corporation.....	Michigan (20)
52)OLDE Realty Corporation.....	Michigan (20)
53)420 South Garden, Inc.....	Florida (22)
54)44 East Central, Inc.....	Florida (22)
55)4240 Hunt Road, Inc.....	Ohio (22)
56)3340 Gallows Road, Inc.....	Michigan (22)
57)450 Silver Spur, Inc.....	Michigan (22)
58)4230 West Green Oaks, Inc.....	Michigan (22)
59)3414 Shawnee Mission, Inc.....	Michigan (22)
60)OLDE Equipment Corporation.....	Michigan (20)
61)Financial Marketing Services, Inc.....	Michigan (17)
62)2430472 Nova Scotia Co.....	Nova Scotia (23)
63)Sumner Canadian Direct Holdings Company.....	Canada (23)
64)RSM McGladrey Business Services, Inc.....	Delaware (2)
65)RSM McGladrey, Inc.....	Delaware (24)
66)Toback, Inc.....	Arizona (25)
67)McGladrey Contract Business Services, L.L.C.....	Minnesota (26)
68)Birchtree Financial Services, Inc.....	Oklahoma (25)
69)Birchtree Insurance Agency, Inc.....	Missouri (29)
70)Pension Resources, Inc.....	Illinois (25)
71)Freed Maxick ABL Services, Inc.....	Delaware (25)
72)FM Business Services, Inc.....	Delaware (25)
73)O'Rourke, Sacher & Moulton, Inc.....	California (25)
74)O'Rourke Consulting, LLC.....	California (26)
75)O'Rourke Career Connections, LLC.....	California (27)
76)Credit Union Jobs, LLC.....	California (28)
77)PDI Global, Inc. ....	Delaware (24)
78)Rex Investments, Inc.....	Texas (24)
79)W-1 Holdings, L.L.C.....	Texas (30)
80)C.W. Amos Business Services, Inc. ....	Delaware (24)
81)C.W. Amos Investment Advisors, L.L.C.....	Maryland (31)
82)RSM Equico, Inc.....	Delaware (24)
83)RSM Equico Capital Markets, LLC.....	Delaware (32)
84)Equico, Inc.....	California (33)
85)Equico Limited.....	United Kingdom (33)
86)RSM Equico Canada, Inc.....	Canada (33)
87)RSM McGladrey Business Solutions, Inc.....	Delaware (24)
88)MyBenefitSource, Inc.....	Georgia (34)
89)MyBenefitSource.com Agency, Inc.....	Georgia (35)
90)MyBenefitSource.com Agency of Alabama, Inc.....	Alabama (35)

91)MyBenefitSource.com Agency of Florida, Inc.....	Georgia (35)
92)HRB Retail Services, Inc.....	Delaware (2)
93)H&R Block Small Business Resources, Inc.....	Delaware (2)

Notes to Subsidiaries of H&R Block, Inc.:

- (1) Wholly owned subsidiary of H&R Block, Inc.
- (2) Wholly owned subsidiary of H&R Block Group, Inc.
- (3) Wholly owned subsidiary of HRB Management, Inc.
- (4) Wholly owned subsidiary of H&R Block Services, Inc.
- (5) Wholly owned subsidiary of H&R Block Tax Services, Inc.
- (6) Wholly owned subsidiary of H&R Block of Dallas, Inc.
- (7) Limited partnership in which HRB Texas Enterprises, Inc. is a 1% general partner and HRB Partners, Inc. is a 99% limited partner



- (8) Limited partnership in which HRB Texas Enterprises, Inc. is a 1% general partner and H&R Block and Associates, L.P. is a 99% limited partner
- (9) Wholly owned subsidiary of H&R Block (Guam), Inc.
- (10) Wholly owned subsidiary of H&R Block Canada, Inc.
- (11) Limited liability company in which H&R Block Tax Services, Inc. has a 100% membership interest
- (12) Wholly owned subsidiary of H&R Block Eastern Tax Services, Inc.
- (13) Limited partnership in which H&R Block Eastern Enterprises, Inc. is a 1% general partner and H&R Block Eastern Tax Company, LLC is a 99% limited partner.
- (14) Limited partnership in which H&R Block Eastern Enterprises, Inc. is a 1% general partner and H&R Block Eastern Support Services, LLC is a 99% limited partner.
- (15) Limited liability company in which H&R Block Eastern Tax Services, Inc. has a 100% membership interest
- (16) Wholly owned subsidiary of HRB Royalty, Inc.
- (17) Wholly owned subsidiary of Block Financial Corporation
- (18) Wholly owned subsidiary of Option One Mortgage Corporation
- (19) Limited liability company in which Block Financial Corporation has a 96.25% membership interest and Companion Mortgage Corporation has a 3.75% membership interest
- (20) Wholly owned subsidiary of OLDE Financial Corporation
- (21) Wholly owned subsidiary of H&R Block Financial Advisors, Inc.
- (22) Wholly owned subsidiary of OLDE Realty Corporation
- (23) Wholly owned subsidiary of Financial Marketing Services, Inc.
- (24) Wholly owned subsidiary of RSM McGladrey Business Services, Inc.
- (25) Wholly owned subsidiary of RSM McGladrey, Inc.
- (26) Limited liability company in which RSM McGladrey, Inc. has a 100% membership interest
- (27) Limited liability company in which RSM McGladrey, Inc. owns a 50% membership interest and the California Credit Union League owns a 50% membership interest
- (28) Limited liability company in which O'Rourke Consulting, LLC has a 50% membership interest and Credit Union Jobs, Inc. has a 50% membership interest
- (29) Wholly owned subsidiary of Birchtree Financial Services, Inc.
- (30) Limited liability company in which RSM McGladrey Business Services, Inc. has a 100% membership interest
- (31) Limited liability company in which C.W. Amos Business Services, Inc. has a 100% membership interest
- (32) Limited liability company in which RSM Equico, Inc. has 100% membership interest.
- (33) Wholly owned subsidiary of RSM Equico, Inc.
- (34) Company in which RSM McGladrey Business Services, Inc. owns approximately 80% of the issued and outstanding stock.
- (35) Wholly owned subsidiary of MyBenefitSource, Inc.



CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-3 (No. 333-33655) of Block Financial Corporation and in the Registration Statements on Form S-3 (No. 333-33655-01) and Form S-8 (Nos. 33-64147, 333-42143, 333-42736, 333-42740, 333-56400, 333-70400, 333-70402, 333-106710) of H&R Block, Inc. of our report dated June 10, 2003 relating to the financial statements of H&R Block, Inc., which appears in the 2003 Annual Report to Shareholders, which is incorporated by reference in this Annual Report on Form 10-K. We also consent to the incorporation by reference of our report dated June 10, 2003 relating to the financial statement schedule, which appears in this Annual Report on Form 10-K.

PricewaterhouseCoopers LLP  
Kansas City, Missouri  
July 15, 2003

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 annual report of H&R Block, Inc. (the "Company") on Form 10-K for the fiscal year ending April 30, 2003 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

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Mark A. Ernst  
Chief Executive Officer  
H&R Block, Inc.  
July 15, 2003

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 annual report of H&R Block, Inc. (the "Company") on Form 10-K for the fiscal year ending April 30, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Frank J. Cotroneo, Chief Financial 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/ Frank J. Cotroneo

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Frank J. Cotroneo  
Chief Financial Officer  
H&R Block, Inc.  
July 15, 2003