

H&R BLOCK INC
Form 10-Q
September 04, 2009

Table of Contents

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

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 31, 2009
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 1-6089

H&R Block, Inc.
(Exact name of registrant as specified in its charter)

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

44-0607856
**(I.R.S. Employer
Identification No.)**

One H&R Block Way
Kansas City, Missouri 64105
(Address of principal executive offices, including zip code)

(816) 854-3000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Edgar Filing: H&R BLOCK INC - Form 10-Q

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

The number of shares outstanding of the registrant's Common Stock, without par value, at the close of business on August 31, 2009 was 335,306,120 shares.

Form 10-Q for the Period Ended July 31, 2009

Table of Contents

| | Page | |
|---------------------------------|--|----|
| PART I | Financial Information | |
| <u>Item 1.</u> | <u>Condensed Consolidated Balance Sheets</u> <u>July 31, 2009 and April 30, 2009</u> | 1 |
| | <u>Condensed Consolidated Statements of Operations and</u> <u>Comprehensive Income (Loss)</u> <u>Three Months Ended July 31, 2009 and 2008</u> | 2 |
| | <u>Condensed Consolidated Statements of Cash Flows</u> <u>Three Months Ended July 31, 2009 and 2008</u> | 3 |
| | <u>Notes to Condensed Consolidated Financial Statements</u> | 4 |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of</u> <u>Operations</u> | 18 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 22 |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | 22 |
| PART II | Other Information | |
| <u>Item 1.</u> | <u>Legal Proceedings</u> | 23 |
| <u>Item 1A.</u> | <u>Risk Factors</u> | 26 |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 27 |
| <u>Item 6.</u> | <u>Exhibits</u> | 27 |
| <u>SIGNATURES</u> | | 28 |
| <u>EX-10.1</u> | | |
| <u>EX-10.2</u> | | |
| <u>EX-31.1</u> | | |
| <u>EX-31.2</u> | | |
| <u>EX-32.1</u> | | |
| <u>EX-32.2</u> | | |
| <u>EX-101 INSTANCE DOCUMENT</u> | | |

[EX-101 SCHEMA DOCUMENT](#)

[EX-101 CALCULATION LINKBASE DOCUMENT](#)

[EX-101 LABELS LINKBASE DOCUMENT](#)

[EX-101 PRESENTATION LINKBASE DOCUMENT](#)

[EX-101 DEFINITION LINKBASE DOCUMENT](#)

Table of Contents**CONDENSED CONSOLIDATED BALANCE SHEETS** (amounts in 000s, except share and per share amounts)

| | July 31, 2009 | April 30, 2009 |
|---|---------------------|---------------------|
| | (Unaudited) | |
| ASSETS | | |
| Cash and cash equivalents | \$ 1,006,303 | \$ 1,654,663 |
| Cash and cash equivalents restricted | 46,639 | 51,656 |
| Receivables, less allowance for doubtful accounts of \$129,433 and \$128,541 | 379,177 | 512,814 |
| Prepaid expenses and other current assets | 396,027 | 351,947 |
| Total current assets | 1,828,146 | 2,571,080 |
| Mortgage loans held for investment, less allowance for loan losses of \$91,691 and \$84,073 | 707,712 | 744,899 |
| Property and equipment, at cost, less accumulated depreciation and amortization of \$643,978 and \$625,075 | 359,408 | 368,289 |
| Intangible assets, net | 379,622 | 385,998 |
| Goodwill | 852,018 | 850,230 |
| Other assets | 418,856 | 439,226 |
| Total assets | \$ 4,545,762 | \$ 5,359,722 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Liabilities: | | |
| Customer banking deposits | \$ 712,008 | \$ 854,888 |
| Accounts payable, accrued expenses and other current liabilities | 648,470 | 705,945 |
| Accrued salaries, wages and payroll taxes | 101,410 | 259,698 |
| Accrued income taxes | 330,145 | 543,967 |
| Current portion of long-term debt | 6,093 | 8,782 |
| Federal Home Loan Bank borrowings | 25,000 | 25,000 |
| Total current liabilities | 1,823,126 | 2,398,280 |
| Long-term debt | 1,032,395 | 1,032,122 |
| Federal Home Loan Bank borrowings | 75,000 | 75,000 |
| Other noncurrent liabilities | 424,527 | 448,461 |
| Total liabilities | 3,355,048 | 3,953,863 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Common stock, no par, stated value \$.01 per share, 800,000,000 shares authorized, shares issued of 444,176,510 | 4,442 | 4,442 |
| Additional paid-in capital | 824,212 | 836,477 |

Edgar Filing: H&R BLOCK INC - Form 10-Q

| | | |
|---|--------------|--------------|
| Accumulated other comprehensive income (loss) | (2,849) | (11,639) |
| Retained earnings | 2,437,017 | 2,671,437 |
| Less treasury shares, at cost | (2,072,108) | (2,094,858) |
| Total stockholders' equity | 1,190,714 | 1,405,859 |
| Total liabilities and stockholders' equity | \$ 4,545,762 | \$ 5,359,722 |

See Notes to Condensed Consolidated Financial Statements

Table of Contents**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)**(Unaudited, amounts in 000s,
except per share amounts)

| Three Months Ended July 31, | 2009 | 2008 |
|---|--------------|--------------|
| Revenues: | | |
| Service revenues | \$ 247,985 | \$ 240,720 |
| Interest income | 12,287 | 17,847 |
| Product and other revenues | 15,233 | 13,342 |
| | 275,505 | 271,909 |
| Operating expenses: | | |
| Cost of revenues | 386,450 | 360,138 |
| Selling, general and administrative | 103,217 | 123,386 |
| | 489,667 | 483,524 |
| Operating loss | (214,162) | (211,615) |
| Other income (expense), net | 3,289 | (1,355) |
| Loss from continuing operations before tax benefit | (210,873) | (212,970) |
| Income tax benefit | (80,256) | (84,547) |
| Net loss from continuing operations | (130,617) | (128,423) |
| Net loss from discontinued operations | (3,017) | (4,296) |
| Net loss | \$ (133,634) | \$ (132,719) |
| Basic and diluted loss per share: | | |
| Net loss from continuing operations | \$ (0.39) | \$ (0.39) |
| Net loss from discontinued operations | (0.01) | (0.02) |
| Net loss | \$ (0.40) | \$ (0.41) |
| Basic and diluted shares | 334,533 | 327,141 |
| Dividends paid per share | \$ 0.15 | \$ 0.14 |
| Comprehensive income (loss): | | |
| Net loss | \$ (133,634) | \$ (132,719) |
| Change in unrealized gain on available-for-sale securities, net | (747) | (1,967) |

Edgar Filing: H&R BLOCK INC - Form 10-Q

| | | |
|--|--------------|--------------|
| Change in foreign currency translation adjustments | 9,537 | 314 |
| Comprehensive loss | \$ (124,844) | \$ (134,372) |

See Notes to Condensed Consolidated Financial Statements

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

(unaudited, amounts in 000s)

| Three Months Ended July 31, | 2009 | 2008 |
|---|--------------|--------------|
| Net cash used in operating activities | \$ (454,577) | \$ (364,923) |
| Cash flows from investing activities: | | |
| Principal repayments on mortgage loans held for investment, net | 19,264 | 31,619 |
| Purchases of property and equipment, net | (8,760) | (14,648) |
| Other, net | 4,856 | (901) |
| Net cash provided by investing activities | 15,360 | 16,070 |
| Cash flows from financing activities: | | |
| Repayments of Federal Home Loan Bank borrowings | - | (40,000) |
| Proceeds from Federal Home Loan Bank borrowings | - | 15,000 |
| Customer banking deposits, net | (143,199) | (8,795) |
| Dividends paid | (50,287) | (46,790) |
| Acquisition of treasury shares | (3,483) | (4,116) |
| Proceeds from issuance of common stock, net | 6,651 | 28,507 |
| Other, net | (25,888) | (14,387) |
| Net cash used in financing activities | (216,206) | (70,581) |
| Effects of exchange rates on cash | 7,063 | - |
| Net decrease in cash and cash equivalents | (648,360) | (419,434) |
| Cash and cash equivalents at beginning of the period | 1,654,663 | 664,897 |
| Cash and cash equivalents at end of the period | \$ 1,006,303 | \$ 245,463 |
| Supplementary cash flow data: | | |
| Income taxes paid | \$ 155,804 | \$ 83,111 |
| Interest paid on borrowings | 26,168 | 27,258 |
| Interest paid on deposits | 1,318 | 4,048 |
| Transfers of loans to foreclosed assets | 3,797 | 53,469 |

See Notes to Condensed Consolidated Financial Statements

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

(unaudited)

1. Summary of Significant Accounting Policies**Basis of Presentation**

The condensed consolidated balance sheet as of July 31, 2009, the condensed consolidated statements of operations and comprehensive income (loss) for the three months ended July 31, 2009 and 2008, and the condensed consolidated statements of cash flows for the three months ended July 31, 2009 and 2008 have been prepared by the Company, without audit. In the opinion of management, all adjustments, which include only normal recurring adjustments, necessary to present fairly the financial position, results of operations and cash flows at July 31, 2009 and for all periods presented have been made.

H&R Block, the Company, we, our and us are used interchangeably to refer to H&R Block, Inc. or to H&R Block, Inc. and its subsidiaries, as appropriate to the context.

Certain reclassifications have been made to prior year amounts to conform to the current year presentation. In addition, we realigned our segments as discussed in note 12, and accordingly restated segment disclosures in prior periods. These changes had no effect on our results of operations or stockholders' equity as previously reported. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in our April 30, 2009 Annual Report to Shareholders on Form 10-K. All amounts presented herein as of April 30, 2009 or for the year then ended, are derived from our April 30, 2009 Annual Report to Shareholders on Form 10-K. We have evaluated subsequent events through September 4, 2009, the date of issuance of our condensed consolidated financial statements.

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. Significant estimates, assumptions and judgments are applied in the determination of our allowance for loan losses, potential losses from loan repurchase and indemnity obligations associated with our discontinued mortgage business, contingent losses associated with pending litigation, fair value of reporting units, reserves for uncertain tax positions and related matters. We revise our estimates when facts and circumstances dictate. However, future events and their effects cannot be determined with absolute certainty. As such, actual results could differ materially from those estimates.

Seasonality of Business

Our operating revenues are seasonal in nature with peak revenues occurring in the months of January through April. Therefore, results for interim periods are not indicative of results to be expected for the full year.

Concentrations of Risk

Our mortgage loans held for investment include concentrations of loans to borrowers in certain states, which may result in increased exposure to loss as a result of changes in real estate values and underlying economic or market conditions related to a particular geographical location. Approximately 51% of our mortgage loan portfolio consists of loans to borrowers located in the states of Florida, California and New York.

2. Recent Events

Edgar Filing: H&R BLOCK INC - Form 10-Q

RSM McGladrey, Inc. (RSM) and McGladrey & Pullen LLP (M&P), an independent registered public accounting firm, collaborate to provide accounting, tax and consulting services to clients under an alternative practice structure. RSM and M&P also share in certain common overhead costs through an

Table of Contents

administrative services agreement. These services are provided by, and coordinated through, RSM, for which RSM receives a management fee. On July 21, 2009, M&P provided 210 days notice of its intent to terminate the administrative services agreement. The effect of the notice will be to terminate the alternative practice structure on February 16, 2010, unless revoked or modified prior to that time. RSM and M&P are engaged in arbitration to determine several of their rights and responsibilities under their contractual obligations to each other. An arbitration hearing is scheduled for November 2009. RSM and M&P are also engaged in negotiations to determine if there are mutually agreeable changes to the current arrangements that would allow our collaboration to continue. There are no assurances as to the outcome.

3. Earnings (Loss) Per Share and Stockholders Equity

Basic and diluted loss per share is computed using the two-class method per FASB Staff Position EITF 03-6-1,

Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities (FSP 03-6-1). See note 13 for additional information. The two-class method is an earnings allocation formula that determines net income per share for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. Per share amounts are computed by dividing net income from continuing operations attributable to common shareholders by the weighted average shares outstanding during each period. The dilutive effect of potential common shares is included in diluted earnings per share except in those periods with a loss from continuing operations. Diluted earnings per share excludes the impact of shares of common stock issuable upon the lapse of certain restrictions or the exercise of options to purchase 19.4 million shares and 25.7 million shares for the three months ended July 31, 2009 and 2008, respectively, as the effect would be antidilutive due to the net loss from continuing operations during each period.

The computations of basic and diluted loss per share from continuing operations are as follows:

(in 000s, except per share amounts)

| Three Months Ended July 31, | 2009 | 2008 |
|---|--------------|--------------|
| Net loss from continuing operations attributable to shareholders | \$ (130,617) | \$ (128,423) |
| Income allocated to participating securities (nonvested shares) | (367) | (199) |
| Net loss from continuing operations attributable to common shareholders | \$ (130,984) | \$ (128,622) |
| Basic weighted average common shares | 334,533 | 327,141 |
| Potential dilutive shares from stock options and nonvested shares | - | - |
| Convertible preferred stock | - | - |
| Dilutive weighted average common shares | 334,533 | 327,141 |
| Earnings (loss) per share from continuing operations: | | |
| Basic | \$ (0.39) | \$ (0.39) |
| Diluted | (0.39) | (0.39) |

The weighted average shares outstanding for the three months ended July 31, 2009 increased to 334.5 million from 327.1 million for the three months ended July 31, 2008, primarily due to the issuance of shares of our common stock in October 2008.

During the three months ended July 31, 2009 and 2008, we issued 1.4 million and 2.3 million shares of common stock, respectively, due to the exercise of stock options, employee stock purchases and vesting of nonvested shares. During the three months ended July 31, 2009, we acquired 0.2 million shares of our common stock at an aggregate cost of \$3.5 million, and during the three months ended July 31, 2008, we acquired 0.2 million shares at an aggregate cost of \$4.1 million. Shares acquired during these periods represented shares swapped or surrendered to us in connection with the vesting of nonvested shares and the exercise of stock options.

At July 31, 2009, we had accrued but unpaid dividends totaling \$50.5 million. This amount is included in accounts payable, accrued expenses and other current liabilities on the condensed consolidated balance sheet.

During the three months ended July 31, 2009, we granted 4.0 million stock options and 0.8 million nonvested shares and units in accordance with our stock-based compensation plans. The weighted average fair value of options granted was \$3.14 for management options and \$2.70 for options granted to

Table of Contents

our seasonal associates. Stock-based compensation expense of our continuing operations totaled \$7.3 million and \$4.5 million for the three months ended July 31, 2009 and 2008, respectively. At July 31, 2009, unrecognized compensation cost for options totaled \$17.0 million, and for nonvested shares and units totaled \$26.4 million.

4. Mortgage Loans Held for Investment and Related Assets

The composition of our mortgage loan portfolio as of July 31, 2009 and April 30, 2009 is as follows:

| | July 31, 2009 | | April 30, 2009 | |
|-------------------------------------|---------------|------------|----------------|------------|
| | Amount | % of Total | Amount | % of Total |
| Adjustable-rate loans | \$ 501,112 | 63% | \$ 534,943 | 65% |
| Fixed-rate loans | 292,014 | 37% | 286,894 | 35% |
| | 793,126 | 100% | 821,837 | 100% |
| Unamortized deferred fees and costs | 6,277 | | 7,135 | |
| Less: Allowance for loan losses | (91,691) | | (84,073) | |
| | \$ 707,712 | | \$ 744,899 | |

Activity in the allowance for loan losses for the three months ended July 31, 2009 and 2008 is as follows:

| Three Months Ended July 31, | 2009 | 2008 |
|----------------------------------|-----------|-----------|
| Balance, beginning of the period | \$ 84,073 | \$ 45,401 |
| Provision | 13,600 | 14,991 |
| Recoveries | 28 | - |
| Charge-offs | (6,010) | (13,539) |
| Balance, end of the period | \$ 91,691 | \$ 46,853 |

Our loan loss reserve as a percent of mortgage loans was 11.56% at July 31, 2009, compared to 10.23% at April 30, 2009.

In cases where we modify a loan and in so doing grant a concession to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). TDR loans totaled \$161.6 million and \$160.7 million at July 31, 2009 and April 30, 2009, respectively. The principal balance of impaired loans as of

Edgar Filing: H&R BLOCK INC - Form 10-Q

July 31, 2009 and April 30, 2009 is as follows:

(in 000s)

| | July 31, 2009 | April 30, 2009 |
|------------------------|---------------|----------------|
| 60 - 89 days | \$ 14,519 | \$ 21,415 |
| 90+ days, non-accrual | 148,603 | 121,685 |
| TDR loans, accrual | 90,275 | 60,044 |
| TDR loans, non-accrual | 71,295 | 100,697 |
| | \$ 324,692 | \$ 303,841 |

Activity related to our real estate owned is as follows:

(in 000s)

| Three Months Ended July 31, | 2009 | 2008 |
|----------------------------------|-----------|-----------|
| Balance, beginning of the period | \$ 44,533 | \$ 350 |
| Additions | 3,797 | 53,469 |
| Sales | (4,348) | - |
| Writedowns | (1,241) | (5,409) |
| Balance, end of the period | \$ 42,741 | \$ 48,410 |

Table of Contents**5. Goodwill and Intangible Assets**

Changes in the carrying amount of goodwill for the three months ended July 31, 2009 consist of the following:

(in 000s)

| | April 30, 2009 | Additions | Impairment | Other | July 31, 2009 |
|-------------------|-------------------|-----------|------------|----------|---------------|
| Tax Services | \$ 447,591 | \$ 1,004 | \$ - | \$ 1,483 | \$ 450,078 |
| Business Services | 402,639 | - | - | (699) | 401,940 |
| Total | \$ 850,230 | \$ 1,004 | \$ - | \$ 784 | \$ 852,018 |

We test goodwill for impairment annually at the beginning of our fourth quarter, or more frequently if events occur which could, more likely than not, reduce the fair value of a reporting unit's net assets below its carrying value.

We considered the July 21, 2009 notice by M&P of its intent to terminate the administrative services agreement with RSM to represent a significant change in circumstances requiring an interim evaluation of the fair value of our RSM reporting unit. Goodwill of this reporting unit totaled \$372.7 million at July 31, 2009. The net carrying value of other intangible assets of RSM totaled \$96.0 million at July 31, 2009, including \$50.8 million for an indefinite-lived trade name asset. We have concluded that, as of July 31, 2009, the fair value of this reporting unit exceeds its carrying value and also that the net carrying value of other intangible assets is recoverable.

Our conclusion is based on our current assumptions, including, but not limited to, those listed below.

We have assumed that our noncompete rights are enforceable.

We have assumed that, more likely than not, RSM and M&P will continue to collaborate; or, in the event of a separation, RSM will successfully establish an alliance with other attest firms.

We have assumed that ongoing negotiations between RSM and M&P will not result in modifications of their relationship that would be materially adverse to the financial interests of RSM.

In the event of a separation, we have made various assumptions concerning client retention and post-separation operating margins.

In the event of a separation, we have assumed M&P would be able to repay its indebtedness to RSM.

It is difficult to predict the outcome of the above matters, including the outcome of mitigating factors that we are currently pursuing. However, it is possible that changes in our assumptions, based on future events or circumstances, could result in changes in our fair value estimates and corresponding impairment charges.

Intangible assets consist of the following:

(in 000s)

| | July 31, 2009 | | | April 30, 2009 | | |
|------------------------|-----------------------------|-----------------------------|-----------|-----------------------------|-----------------------------|-----------|
| | Gross Carrying Amount | Accumulated Amortization | Net | Gross Carrying Amount | Accumulated Amortization | Net |
| Tax Services: | | | | | | |
| Customer relationships | \$ 54,907 | \$ (26,938) | \$ 27,969 | \$ 54,655 | \$ (25,267) | \$ 29,388 |

Edgar Filing: H&R BLOCK INC - Form 10-Q

| | | | | | | |
|-----------------------------|------------|--------------|------------|------------|--------------|------------|
| Noncompete agreements | 23,271 | (21,272) | 1,999 | 23,263 | (20,941) | 2,322 |
| Reacquired franchise rights | 229,438 | (2,942) | 226,496 | 229,438 | (1,838) | 227,600 |
| Franchise agreements | 19,201 | (853) | 18,348 | 19,201 | (533) | 18,668 |
| Purchased technology | 12,500 | (4,730) | 7,770 | 12,500 | (4,240) | 8,260 |
| Trade name | 1,325 | (250) | 1,075 | 1,025 | (217) | 808 |
| Business Services: | | | | | | |
| Customer relationships | 146,011 | (113,408) | 32,603 | 146,040 | (111,017) | 35,023 |
| Noncompete agreements | 33,061 | (20,468) | 12,593 | 33,068 | (19,908) | 13,160 |
| Trade name amortizing | 2,600 | (2,600) | - | 2,600 | (2,600) | - |
| Trade name non-amortizing | 55,637 | (4,868) | 50,769 | 55,637 | (4,868) | 50,769 |
| | \$ 577,951 | \$ (198,329) | \$ 379,622 | \$ 577,427 | \$ (191,429) | \$ 385,998 |

Amortization of intangible assets for the three months ended July 31, 2009 and 2008 was \$6.9 million and \$5.6 million, respectively. Estimated amortization of intangible assets for fiscal years 2010 through 2014 is \$28.8 million, \$26.5 million, \$23.5 million, \$19.2 million and \$15.8 million, respectively.

Table of Contents**6. Income Taxes**

We file a consolidated federal income tax return in the United States and file tax returns in various state and foreign jurisdictions. Consolidated tax returns for the years 1999 through 2007 are currently under examination by the Internal Revenue Service (IRS). Tax years prior to 1999 are closed by statute. Historically, tax returns in various foreign and state jurisdictions are examined and settled upon completion of the exam.

During the three months ended July 31, 2009, we accrued an additional \$1.2 million of interest and penalties related to our uncertain tax positions. We had unrecognized tax benefits of \$126.0 million and \$124.6 million at July 31, 2009 and April 30, 2009, respectively. The unrecognized tax benefits increased \$1.4 million in the current year, due primarily to positions related to prior years. We have classified the liability for unrecognized tax benefits, including corresponding accrued interest, as long-term at July 31, 2009, which is included in other noncurrent liabilities on the condensed consolidated balance sheet. Amounts that we expect to pay, or for which statutes expire, within the next twelve months have been included in accounts payable, accrued expenses and other current liabilities on the condensed consolidated balance sheet.

Based upon the expiration of statutes of limitations, payments of tax and other factors in several jurisdictions, we believe it is reasonably possible that the total amount of previously unrecognized tax benefits may decrease by approximately \$18 million within twelve months of July 31, 2009.

7. Interest Income and Expense

The following table shows the components of interest income and expense of our continuing operations:

(in 000s)

| Three Months Ended July 31, | 2009 | 2008 |
|-----------------------------|-----------|-----------|
| Interest income: | | |
| Mortgage loans, net | \$ 7,896 | \$ 13,265 |
| Other | 4,391 | 4,582 |
| | \$ 12,287 | \$ 17,847 |
| Interest expense: | | |
| Borrowings | \$ 18,957 | \$ 18,172 |
| Deposits | 2,049 | 4,043 |
| FHLB advances | 509 | 1,328 |
| | \$ 21,515 | \$ 23,543 |

8. Fair Value

The following table presents for each hierarchy level the financial assets that are measured at fair value on both a recurring and non-recurring basis at July 31, 2009:

(dollars in 000s)

| Total | Level 1 | Level 2 | Level 3 |
|-------|---------|---------|---------|
|-------|---------|---------|---------|

Edgar Filing: H&R BLOCK INC - Form 10-Q

| | | | | |
|---|------------|------|-----------|------------|
| Recurring: | | | | |
| Available-for-sale securities | \$ 42,430 | \$ - | \$ 42,430 | \$ - |
| Non-recurring: | | | | |
| Impaired mortgage loans held for investment | 248,529 | - | - | 248,529 |
| | \$ 290,959 | \$ - | \$ 42,430 | \$ 248,529 |
| As a percentage of total assets | 6.4% | -% | 0.9% | 5.5% |

There were no significant changes to the unobservable inputs used in determining the fair values of our level 2 and level 3 financial assets.

The carrying amounts and estimated fair values of our financial instruments at July 31, 2009 are as follows:

(in 000s)

| | Carrying Amount | Estimated Fair Value |
|------------------------------------|--------------------|-------------------------|
| Mortgage loans held for investment | \$ 707,712 | \$ 549,497 |
| IRAs and other time deposits | 479,758 | 479,375 |
| Long-term debt | 1,038,488 | 1,064,855 |

Table of Contents**9. Regulatory Requirements**

H&R Block Bank (HRB Bank) files its regulatory Thrift Financial Report (TFR) on a calendar quarter basis with the Office of Thrift Supervision (OTS). The following table sets forth HRB Bank's regulatory capital requirements at June 30, 2009, as calculated in the most recently filed TFR:

| | (dollars in 000s) | | | | | |
|--|-------------------|-------|-------------------------------|-------|--|-------|
| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total risk-based capital ratio ⁽¹⁾ | \$ 142,490 | 21.9% | \$ 52,020 | 8.0% | \$ 65,025 | 10.0% |
| Tier 1 risk-based capital ratio ⁽²⁾ | \$ 133,811 | 20.6% | n/a | n/a | \$ 39,015 | 6.0% |
| Tier 1 capital ratio (leverage) ⁽³⁾ | \$ 133,811 | 13.6% | \$ 118,381 | 12.0% | \$ 49,325 | 5.0% |
| Tangible equity ratio ⁽⁴⁾ | \$ 133,811 | 13.6% | \$ 14,798 | 1.5% | n/a | n/a |

⁽¹⁾ Total risk-based capital divided by risk-weighted assets.

⁽²⁾ Tier 1 (core) capital less deduction for low-level recourse and residual interest divided by risk-weighted assets.

⁽³⁾ Tier 1 (core) capital divided by adjusted total assets.

⁽⁴⁾ Tangible capital divided by tangible assets.

As of July 31, 2009, HRB Bank's leverage ratio was 13.8%.

10. Commitments and Contingencies

Changes in deferred revenue balances related to our Peace of Mind (POM) program, the current portion of which is included in accounts payable, accrued expenses and other current liabilities and the long-term portion of which is included in other noncurrent liabilities in the condensed consolidated balance sheets, are as follows:

| Three Months Ended July 31, | (in 000s) | |
|--|------------|------------|
| | 2009 | 2008 |
| Balance, beginning of period | \$ 146,807 | \$ 140,583 |
| Amounts deferred for new guarantees issued | 583 | 513 |
| Revenue recognized on previous deferrals | (27,913) | (27,241) |
| Balance, end of period | \$ 119,477 | \$ 113,855 |

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

| As of | July 31, 2009 | April 30, 2009 |
|---|---------------|----------------|
| Franchise Equity Lines of Credit undrawn commitment | \$ 35,976 | \$ 38,055 |
| Contingent business acquisition obligations | 24,504 | 24,165 |
| Media advertising purchase obligation | 45,768 | 45,768 |

We routinely enter into contracts that include embedded indemnifications that have characteristics similar to guarantees. Guarantees and indemnifications of the Company and its subsidiaries include obligations to protect counterparties from losses arising from the following: (1) tax, legal and other risks related to the purchase or disposition of businesses; (2) penalties and interest assessed by federal and state taxing authorities in connection with tax returns prepared for clients; (3) indemnification of our directors and officers; and (4) 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 terms of the indemnities may vary and in many cases are limited only by the applicable statute of limitations. The likelihood of any claims being asserted against us and the ultimate liability related to any such claims, if any, is difficult to predict. While we cannot provide assurance we will ultimately prevail in the event any such claims are asserted, we believe the fair value of guarantees and indemnifications relating to our continuing operations is not material as of July 31, 2009.

Table of Contents

Discontinued Operations

Sand Canyon Corporation (SCC), formerly Option One Mortgage Corporation, maintains recourse with respect to loans previously sold or securitized under indemnification of loss provisions relating to breach of representations and warranties made to purchasers or insurers.

At July 31, 2009 and April 30, 2009, our loan repurchase liability totaled \$202.4 million and \$206.6 million, respectively. This liability is included in accounts payable, accrued expenses and other current liabilities on our consolidated balance sheets.

11. Litigation and Related Contingencies

We are party to investigations, legal claims and lawsuits arising out of our business operations. We accrue our best estimate of the probable loss upon resolution of such matters. Amounts accrued, including obligations under indemnifications, totaled \$25.3 million and \$27.9 million at July 31, 2009 and April 30, 2009, respectively.

RAL Litigation

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

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

We have settled all but one of the RAL Cases. The sole remaining RAL Case is a putative class action entitled *Sandra J. Basile, et al. v. H&R Block, Inc., et al.*, April Term 1992 Civil Action No. 3246 in the Court of Common Pleas, First Judicial District Court of Pennsylvania, Philadelphia County, instituted on April 23, 1993. In *Basile*, the court decertified the class in December 2003, and the Pennsylvania appellate court subsequently reversed the trial court's decertification decision. In September 2006, the Pennsylvania Supreme Court reversed the appellate court's reversal of the trial court's decertification decision. In June 2007, the appellate court affirmed its earlier decision to reverse the trial court's decertification decision. In June 2009, the Pennsylvania Supreme Court again reversed the appellate court's reversal of the trial court's decertification decision and remanded the case to the appellate court for additional review. We believe we have meritorious defenses to this case and we intend to defend it vigorously. There can be no assurances, however, as to the outcome of this case or its impact on our financial statements.

Peace of Mind Litigation

We are defendants in lawsuits regarding our Peace of Mind program (collectively, the "POM Cases"), under which our applicable tax return preparation subsidiary assumes liability for additional tax assessments attributable to tax return preparation error. The POM Cases are described below.

Lorie J. Marshall, et al. v. H&R Block Tax Services, Inc., et al., Case No. 08-CV-591 in the U.S. District Court for the Southern District of Illinois, is a class action case originally filed in the Circuit Court of Madison County, Illinois on January 18, 2002, in which class certification was granted in August 2003. The plaintiffs allege that the sale of POM guarantees constitutes (1) statutory fraud by selling insurance without a license, (2) an unfair trade practice, by omission and by cramming (i.e., charging customers for the guarantee even though they did not request it or want it), and (3) a breach of fiduciary duty. A class was certified consisting of all persons residing in 13 states who from January 1, 1997 to final judgment (1) were charged a separate fee for POM by H&R Block; (2) were charged a

separate fee for POM by an H&R Block entity not licensed to sell insurance; or (3) had an unsolicited charge for POM posted to their bills by H&R Block. Persons who received the POM guarantee through an H&R Block

Table of Contents

Premium office were excluded from the plaintiff class. In August 2008, we removed the case from state court in Madison County, Illinois to the U.S. District Court for the Southern District of Illinois. In December 2008, the U.S. District Court remanded the case back to state court. On April 3, 2009, the United States Court of Appeals for the Seventh Circuit reversed the decision to remand the case back to state court, ruling that the case had been properly removed to federal court. The plaintiffs filed a petition for rehearing of this decision with the Seventh Circuit, which was denied in August 2009.

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

We believe we have meritorious defenses to the claims in the POM Cases, and we intend to defend them vigorously. The amounts claimed in the POM Cases are substantial, however, and there can be no assurances as to the outcome of these pending actions individually or in the aggregate.

Express IRA Litigation

On March 15, 2006, the New York Attorney General filed a lawsuit in the Supreme Court of the State of New York, County of New York (Index No. 06/401110) entitled *The People of New York v. H&R Block, Inc. and H&R Block Financial Advisors, Inc. et al.* The complaint alleges fraudulent business practices, deceptive acts and practices, common law fraud and breach of fiduciary duty with respect to the Express IRA product and seeks equitable relief, disgorgement of profits, damages and restitution, civil penalties and punitive damages. In July 2007, the Supreme Court of the State of New York issued a ruling that dismissed all defendants other than H&R Block Financial Advisors, Inc. (HRBFA) and the claims of common law fraud. The intermediate appellate court reversed this ruling in January 2009. We believe we have meritorious defenses to the claims in this case and intend to defend this case vigorously, but there are no assurances as to its outcome.

On January 2, 2008, the Mississippi Attorney General filed a lawsuit in the Chancery Court of Hinds County, Mississippi First Judicial District (Case No. G 2008 6 S 2) entitled *Jim Hood, Attorney for the State of Mississippi v. H&R Block, Inc., et al.* The complaint alleges fraudulent business practices, deceptive acts and practices, common law fraud and breach of fiduciary duty with respect to the Express IRA product and seeks equitable relief, disgorgement of profits, damages and restitution, civil penalties and punitive damages. The defendants have filed a motion to dismiss. We believe we have meritorious defenses to the claims in this case, and we intend to defend this case vigorously, but there are no assurances as to its outcome.

In addition to the New York and Mississippi Attorney General actions, a number of civil actions were filed against HRBFA and us concerning the Express IRA product, the first of which was filed on March 15, 2006. Except for two cases pending in state court, all of the civil actions have been consolidated by the panel for Multi-District Litigation into a single action styled *In re H&R Block, Inc. Express IRA Marketing Litigation* (Case No. 06-1786-MD-RED) in the United States District Court for the Western District of Missouri. The amounts claimed in these cases are substantial. We believe we have meritorious defenses to the claims in these cases and intend to defend these cases vigorously, but there are no assurances as to their outcome.

Although we sold HRBFA effective November 1, 2008, we remain responsible for any liabilities relating to the Express IRA litigation through an indemnification agreement.

Securities Litigation

On April 6, 2007, a putative class action styled *In re H&R Block Securities Litigation* (Case No. 06-0236-CV-W-ODS) was filed against the Company and certain of its officers in the United States District Court for the Western District of Missouri. The complaint alleged, among other things, deceptive, material and misleading financial statements and failure to prepare financial statements in accordance with generally accepted accounting principles. The complaint sought unspecified damages and equitable relief. The court dismissed the complaint in February 2008, and the plaintiffs appealed the dismissal in March 2008. In addition, plaintiffs in a shareholder derivative action that was consolidated into the securities litigation filed a separate appeal in March 2008, contending

that the derivative action was improperly consolidated. The derivative action is *Iron Workers Local 16 Pension Fund v. H&R Block, et al.*, in the United States

Table of Contents

District Court for the Western District of Missouri, Case No. 06-cv-00466-ODS (instituted on June 8, 2006) and was brought against certain of our directors and officers purportedly on behalf of the Company. The derivative action alleged breach of fiduciary duty, abuse of control, gross mismanagement, waste, and unjust enrichment pertaining to (1) our restatement of financial results in fiscal year 2006 due to errors in determining our state effective income tax rate and (2) certain of our products and business activities. We believe we have meritorious defenses to the claims in these cases and intend to defend this litigation vigorously. We currently do not believe that we will incur a material loss with respect to this litigation.

RSM McGladrey Litigation

RSM McGladrey Business Services, Inc. and certain of its subsidiaries are parties to a class action filed on July 11, 2006 and entitled *Do Right's Plant Growers, et al. v. RSM EquiCo, Inc., et al.* Case No. 06 CC00137, in the California Superior Court, Orange County. The complaint contains allegations relating to business valuation services provided by RSM EquiCo, Inc., including allegations of fraud, negligent misrepresentation, breach of contract, breach of implied covenant of good faith and fair dealing, breach of fiduciary duty and unfair competition and seeks unspecified damages, restitution and equitable relief. On March 17, 2009, the court granted plaintiffs' motion for class certification on all claims. The class consists of all RSM EquiCo U.S. clients who signed platform agreements and for whom RSM EquiCo did not ultimately market their business for sale. RSM EquiCo filed a writ petition for interlocutory appeal of this certification ruling, which was denied. We intend to defend this case vigorously. The amount claimed in this action is substantial and could have a material adverse impact on our consolidated results of operations. There can be no assurance regarding the outcome of this matter.

RSM McGladrey, Inc. (RSM) has a relationship with certain public accounting firms (collectively, the Attest Firms) pursuant to which (1) some RSM employees are also partners or employees of the Attest Firms, (2) many clients of the Attest Firms are also RSM clients, and (3) our RSM McGladrey brand is closely linked to the Attest Firms. The Attest Firms are parties to claims and lawsuits (collectively, Attest Firm Claims) arising in the normal course of business. Judgments or settlements arising from Attest Firm Claims exceeding the Attest Firms' insurance coverage could have a direct adverse effect on Attest Firm operations and could impair RSM's ability to attract and retain clients and quality professionals. For example, accounting and auditing firms (including one of the Attest Firms) have become subject to claims based on losses their clients suffered from investments in investment funds managed by third-parties. Although RSM may not have a direct liability for significant Attest Firm Claims, such Attest Firm Claims could have a material adverse effect on RSM's operations and impair the value of our investment in RSM. There is no assurance regarding the outcome of the Attest Firm Claims.

Litigation and Claims Pertaining to Discontinued Mortgage Operations

Although mortgage loan origination activities were terminated and the loan servicing business was sold during fiscal year 2008, SCC remains subject to investigations, claims and lawsuits pertaining to its loan origination and servicing activities that occurred prior to such termination and sale. These investigations, claims and lawsuits include actions by state attorneys general, other state regulators, municipalities, individual plaintiffs, and cases in which plaintiffs seek to represent a class of others alleged to be similarly situated. Among other things, these investigations, claims and lawsuits allege discriminatory or unfair and deceptive loan origination and servicing practices, public nuisance, fraud, and violations of the Truth in Lending Act, Equal Credit Opportunity Act and the Fair Housing Act. In the current non-prime mortgage environment, the number of these investigations, claims and lawsuits has increased over historical experience and is likely to continue at increased levels. The amounts claimed in these investigations, claims and lawsuits are substantial in some instances, and the ultimate resulting liability is difficult to predict. In the event of unfavorable outcomes, the amounts SCC may be required to pay in the discharge of liabilities or settlements could be substantial and, because SCC's operating results are included in our consolidated financial statements, could have a material adverse impact on our consolidated results of operations.

On June 3, 2008, the Massachusetts Attorney General filed a lawsuit in the Superior Court of Suffolk County, Massachusetts (Case No. 08-2474-BLS) entitled *Commonwealth of Massachusetts v. H&R Block, Inc., et al.*, alleging unfair, deceptive and discriminatory origination and servicing of mortgage loans and seeking equitable relief,

disgorgement of profits, restitution and statutory penalties. In November

Table of Contents

2008, the court granted a preliminary injunction limiting the ability of the owner of SCC's former loan servicing business to initiate or advance foreclosure actions against certain loans originated by SCC or its subsidiaries without (1) advance notice to the Massachusetts Attorney General and (2) if the Attorney General objects to foreclosure, approval by the court. The preliminary injunction generally applies to loans meeting all of the following four characteristics: (1) adjustable rate mortgages with an introductory period of three years or less; (2) the borrower has a debt-to-income ratio generally exceeding 50 percent; (3) an introductory interest rate at least 2 percent lower than the fully indexed rate (unless the debt-to-income ratio is 55% or greater); and (4) loan-to-value ratio of 97 percent or certain prepayment penalties. We have appealed this preliminary injunction. We believe the claims in this case are without merit, and we intend to defend this case vigorously, but there are no assurances as to its outcome. SCC also remains subject to potential claims for indemnification and loan repurchases pertaining to loans previously sold. In the current non-prime mortgage environment, it is likely that the frequency of repurchase and indemnification claims may increase over historical experience and give rise to additional litigation. In some instances, H&R Block, Inc. was required to guarantee SCC's obligations. The amounts involved in these potential claims may be substantial, and the ultimate resulting liability is difficult to predict. Because SCC's operating results are included in our consolidated financial statements, the amounts SCC may be required to pay in the discharge or settlement of these claims in the event of unfavorable outcomes could have a material adverse impact on our consolidated results of operations.

Other Claims and Litigation

We are from time to time party to investigations, claims and lawsuits not discussed herein arising out of our business operations. These investigations, claims and lawsuits include actions by state attorneys general, other state regulators, individual plaintiffs, and cases in which plaintiffs seek to represent a class of others similarly situated. Some of these investigations, claims and lawsuits pertain to RALs, the electronic filing of customers' income tax returns, the POM guarantee program, wage and hour claims and investment products. We believe we have meritorious defenses to each of these investigations, claims and lawsuits, and we are defending or intend to defend them vigorously. The amounts claimed in these matters are substantial in some instances, however the ultimate liability with respect to such matters is difficult to predict. In the event of an unfavorable outcome, the amounts we may be required to pay in the discharge of liabilities or settlements could be material.

In addition to the aforementioned types of matters, we are party to claims and lawsuits that we consider to be ordinary, routine litigation incidental to our business, including claims and lawsuits (collectively, "Other Claims") concerning the preparation of customers' income tax returns, the fees charged customers for various products and services, relationships with franchisees, intellectual property disputes, employment matters and contract disputes. While we cannot provide assurance that we will ultimately prevail in each instance, we believe the amount, if any, we are required to pay in the discharge of liabilities or settlements in these Other Claims will not have a material adverse effect on our consolidated operating results, financial position or cash flows.

Table of Contents**12. Segment Information**

Results of our continuing operations by reportable operating segment are as follows:

| | (in 000s) | |
|--|--------------|--------------|
| Three Months Ended July 31, | 2009 | 2008 |
| Revenues: | | |
| Tax Services | \$ 87,963 | \$ 81,700 |
| Business Services | 177,618 | 174,651 |
| Corporate | 9,924 | 15,558 |
| | \$ 275,505 | \$ 271,909 |
| Pretax income (loss): | | |
| Tax Services | \$ (171,974) | \$ (163,657) |
| Business Services | 1,321 | (295) |
| Corporate | (40,220) | (49,018) |
| Loss from continuing operations before tax benefit | \$ (210,873) | \$ (212,970) |

Effective May 1, 2009, we realigned certain segments of our business to reflect a new management reporting structure. The operations of HRB Bank, which was previously reported as the Consumer Financial Services segment, have now been reclassified, with activities that support our retail tax network included in the Tax Services segment, and the net interest margin and gains and losses relating to our portfolio of mortgage loans held for investment and related assets included in corporate. Presentation of prior period results reflects the new segment reporting structure. These segment changes also resulted in the shifting of assets between segments. Identifiable assets by reportable segment at July 31, 2009 were as follows:

(in 000s)

| | |
|-------------------|--------------|
| Tax Services | \$ 1,794,754 |
| Business Services | 829,772 |
| Corporate | 1,921,236 |
| | \$ 4,545,762 |

13. Accounting Pronouncements

In June 2009, Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R) (SFAS 167) was issued. SFAS 167 changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting, or similar rights, should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity's purpose

and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance. SFAS 167 will require a reporting entity to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. SFAS 167 will be effective for our fiscal year 2011. We are currently evaluating the effect of this statement on our consolidated financial statements.

In June 2009, Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets (SFAS 166), was issued. SFAS 166 is a revision to FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and will require more disclosure about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a qualifying special purpose entity, changes the requirements for derecognizing financial assets. SFAS 166 will be effective at the start of our fiscal year 2011. We are currently evaluating the effect of this statement on its consolidated financial statements.

In May 2009, Statement of Financial Accounting Standards No. 165, Subsequent Events (SFAS 165) was issued. SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 is effective for fiscal years and interim periods ending after June 15, 2009 and is

Table of Contents

applied prospectively. We adopted the new disclosure requirements in the condensed consolidated financial statements effective July 31, 2009. See note 1 for the related disclosure.

In December 2007, Statement of Financial Accounting Standards No. 141(R), Business Combinations, (SFAS 141R), and Statement of Financial Accounting Standards No. 160, Non-Controlling Interests in Consolidated Financial Statements An Amendment of ARB No. 51 (SFAS 160) were issued. These standards require an acquiring entity to recognize all the assets acquired and liabilities assumed in a transaction, including non-controlling interests, at the acquisition-date fair value with limited exceptions. SFAS 141R will require acquisition-related expenses to be expensed and will generally require contingent consideration to be recorded as a liability at the time of acquisition. Under SFAS 141R, subsequent changes to deferred tax valuation allowances relating to acquired businesses and acquired liabilities for uncertain tax positions will no longer be applied to goodwill but will instead be typically recognized as an adjustment to income tax expense. We adopted the provisions of these standards as of May 1, 2009. The adoption of SFAS 141R and SFAS 160 did not have a material impact on our consolidated financial statements. In June 2008, FSP 03-6-1 was issued. FSP 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, should be included in the process of allocating earnings for purposes of computing earnings per share. We adopted the provisions of FSP 03-6-1 as of May 1, 2009. The adoption and retrospective application of the provisions of FSP 03-6-1 did not change the current year or prior period earnings per share amounts for the fiscal quarter. The adoption of this standard will reduce earnings per share as previously reported for fiscal year 2009 by \$0.01. See additional discussion in note 3.

14. Condensed Consolidating Financial Statements

Block Financial LLC (BFC) is an indirect, wholly-owned consolidated subsidiary of the Company. BFC is the Issuer and the Company is the Guarantor of the Senior Notes issued on January 11, 2008 and October 26, 2004, our unsecured committed lines of credit (CLOCs) and other indebtedness issued from time to time. These condensed consolidating financial statements have been prepared using the equity method of accounting. Earnings of subsidiaries are, therefore, reflected in the Company's investment in subsidiaries account. The elimination entries eliminate investments in subsidiaries, related stockholders' equity and other intercompany balances and transactions.

| Condensed Consolidating Income Statements | | | | | | (in 000s) |
|---|-----------------------------------|-----------------|-----------------------|---------|---------------------------|-----------|
| Three Months Ended July 31, 2009 | H&R Block, Inc. (Guarantor) | BFC (Issuer) | Other Subsidiaries | Elims | Consolidated H&R Block | |
| Total revenues | \$ - | \$ 23,196 | \$ 252,365 | \$ (56) | \$ 275,505 | |
| Cost of revenues | - | 45,560 | 340,890 | - | 386,450 | |
| Selling, general and administrative | - | 2,498 | 100,775 | (56) | 103,217 | |
| Total expenses | - | 48,058 | 441,665 | (56) | 489,667 | |
| Operating income (loss) | - | (24,862) | (189,300) | - | (214,162) | |
| Other income (expense), net | (210,873) | (1,233) | 4,522 | 210,873 | 3,289 | |
| Income (loss) from continuing operations before taxes (benefit) | (210,873) | (26,095) | (184,778) | 210,873 | (210,873) | |

Edgar Filing: H&R BLOCK INC - Form 10-Q

| | | | | | |
|--|--------------|-------------|--------------|------------|--------------|
| Income taxes (benefit) | (80,256) | (10,692) | (69,564) | 80,256 | (80,256) |
| Net income (loss) from continuing operations | (130,617) | (15,403) | (115,214) | 130,617 | (130,617) |
| Net loss from discontinued operations | (3,017) | (3,017) | - | 3,017 | (3,017) |
| Net income (loss) | \$ (133,634) | \$ (18,420) | \$ (115,214) | \$ 133,634 | \$ (133,634) |

Table of Contents

| Three Months Ended July 31, 2008 | H&R Block, Inc. (Guarantor) | BFC (Issuer) | Other Subsidiaries | Elims | Consolidated H&R Block |
|---|-----------------------------------|-----------------|-----------------------|------------|---------------------------|
| Total revenues | \$ - | \$ 20,775 | \$ 252,572 | \$ (1,438) | \$ 271,909 |
| Cost of revenues | - | 39,362 | 320,772 | 4 | 360,138 |
| Selling, general and administrative | - | 19,396 | 104,083 | (93) | 123,386 |
| Total expenses | - | 58,758 | 424,855 | (89) | 483,524 |
| Operating loss | - | (37,983) | (172,283) | (1,349) | (211,615) |
| Other income, net | (212,970) | (4,350) | 2,995 | 212,970 | (1,355) |
| Loss from continuing operations before tax benefit | (212,970) | (42,333) | (169,288) | 211,621 | (212,970) |
| Income tax benefit | (84,547) | (16,438) | (67,535) | 83,973 | (84,547) |
| Net loss from continuing operations | (128,423) | (25,895) | (101,753) | 127,648 | (128,423) |
| Net loss from discontinued operations | (4,296) | (5,071) | - | 5,071 | (4,296) |
| Net loss | \$ (132,719) | \$ (30,966) | \$ (101,753) | \$ 132,719 | \$ (132,719) |

Condensed Consolidating Balance Sheets

(in 000s)

| July 31, 2009 | H&R Block, Inc. (Guarantor) | BFC (Issuer) | Other Subsidiaries | Elims | Consolidated H&R Block |
|--|-----------------------------------|-----------------|-----------------------|-------------|---------------------------|
| Cash & cash equivalents | \$ - | \$ 122,895 | \$ 883,968 | \$ (560) | \$ 1,006,303 |
| Cash & cash equivalents restricted | - | 355 | 46,284 | - | 46,639 |
| Receivables, net | 1,110 | 109,803 | 268,264 | - | 379,177 |
| Mortgage loans held for investment | - | 707,712 | - | - | 707,712 |
| Intangible assets and goodwill, net | - | - | 1,231,640 | - | 1,231,640 |
| Investments in subsidiaries | 3,055,015 | - | 185 | (3,055,015) | 185 |
| Other assets | - | 317,877 | 856,229 | - | 1,174,106 |

Edgar Filing: H&R BLOCK INC - Form 10-Q

| | | | | | | | | | | |
|---|----|-----------|----|-----------|----|-------------|----|-------------|----|-----------|
| Total assets | \$ | 3,056,125 | \$ | 1,258,642 | \$ | 3,286,570 | \$ | (3,055,575) | \$ | 4,545,762 |
| Customer deposits | \$ | - | \$ | 712,568 | \$ | - | \$ | (560) | \$ | 712,008 |
| Long-term debt | | - | | 998,335 | | 34,060 | | - | | 1,032,395 |
| FHLB borrowings | | - | | 100,000 | | - | | - | | 100,000 |
| Other liabilities | | 50,500 | | 124,914 | | 1,335,231 | | - | | 1,510,645 |
| Net intercompany advances | | 1,814,911 | | (811,975) | | (1,002,936) | | - | | - |
| Stockholders equity | | 1,190,714 | | 134,800 | | 2,920,215 | | (3,055,015) | | 1,190,714 |
| Total liabilities and stockholders equity | \$ | 3,056,125 | \$ | 1,258,642 | \$ | 3,286,570 | \$ | (3,055,575) | \$ | 4,545,762 |

| April 30, 2009 | | H&R Block, Inc. (Guarantor) | | BFC (Issuer) | | Other Subsidiaries | | Elims | | Consolidated H&R Block |
|---|----|-----------------------------------|----|-----------------|----|-----------------------|----|-------------|----|---------------------------|
| Cash & cash equivalents | \$ | - | \$ | 241,350 | \$ | 1,419,535 | \$ | (6,222) | \$ | 1,654,663 |
| Cash & cash equivalents restricted | | - | | 4,303 | | 47,353 | | - | | 51,656 |
| Receivables, net | | 38 | | 114,442 | | 398,334 | | - | | 512,814 |
| Mortgage loans held for investment | | - | | 744,899 | | - | | - | | 744,899 |
| Intangible assets and goodwill, net | | - | | - | | 1,236,228 | | - | | 1,236,228 |
| Investments in subsidiaries | | 3,289,435 | | - | | 194 | | (3,289,435) | | 194 |
| Other assets | | - | | 308,481 | | 850,787 | | - | | 1,159,268 |
| Total assets | \$ | 3,289,473 | \$ | 1,413,475 | \$ | 3,952,431 | \$ | (3,295,657) | \$ | 5,359,722 |
| Customer deposits | \$ | - | \$ | 861,110 | \$ | - | \$ | (6,222) | \$ | 854,888 |
| Long-term debt | | - | | 998,245 | | 33,877 | | - | | 1,032,122 |
| FHLB borrowings | | - | | 100,000 | | - | | - | | 100,000 |
| Other liabilities | | 2 | | 130,362 | | 1,836,477 | | 12 | | 1,966,853 |
| Net intercompany advances | | 1,883,612 | | (827,453) | | (1,056,147) | | (12) | | - |
| Stockholders equity | | 1,405,859 | | 151,211 | | 3,138,224 | | (3,289,435) | | 1,405,859 |
| Total liabilities and stockholders equity | \$ | 3,289,473 | \$ | 1,413,475 | \$ | 3,952,431 | \$ | (3,295,657) | \$ | 5,359,722 |

Table of Contents

| Condensed Consolidating Statements of Cash Flows | | | | | | (in 000s) |
|---|-----------------------------------|-----------------|-----------------------|----------|---------------------------|-----------|
| Three Months Ended July 31, 2009 | H&R Block, Inc. (Guarantor) | BFC (Issuer) | Other Subsidiaries | Elims | Consolidated H&R Block | |
| Net cash used in operating activities: | \$ 868 | \$ (4,881) | \$ (450,564) | \$ - | \$ (454,577) | |
| Cash flows from investing: | | | | | | |
| Mortgage loans originated for investment, net | - | 19,264 | - | - | 19,264 | |
| Purchase property & equipment | - | - | (8,760) | - | (8,760) | |
| Net intercompany advances | 45,536 | - | - | (45,536) | - | |
| Other, net | - | 6,803 | (1,947) | - | 4,856 | |
| Net cash provided by (used in) investing activities | 45,536 | 26,067 | (10,707) | (45,536) | 15,360 | |
| Cash flows from financing: | | | | | | |
| Customer banking deposits | - | (148,861) | - | 5,662 | (143,199) | |
| Dividends paid | (50,287) | - | - | - | (50,287) | |
| Acquisition of treasury shares | (3,483) | - | - | - | (3,483) | |
| Proceeds from issuance of common stock, net | 6,651 | - | - | - | 6,651 | |
| Net intercompany advances | - | 18,058 | (63,594) | 45,536 | - | |
| Other, net | 715 | (8,838) | (17,765) | - | (25,888) | |
| Net cash provided by financing activities | (46,404) | (139,641) | (81,359) | 51,198 | (216,206) | |
| Effects of exchange rates on cash | - | - | 7,063 | - | 7,063 | |
| Net increase (decrease) in cash | - | (118,455) | (535,567) | 5,662 | (648,360) | |
| Cash beginning of period | - | 241,350 | 1,419,535 | (6,222) | 1,654,663 | |
| Cash end of period | \$ - | \$ 122,895 | \$ 883,968 | \$ (560) | \$ 1,006,303 | |

| Three Months Ended July 31, 2008 | H&R Block, Inc. (Guarantor) | BFC (Issuer) | Other Subsidiaries | Elims | Consolidated H&R Block |
|-------------------------------------|-----------------------------------|-----------------|-----------------------|-------|---------------------------|
|-------------------------------------|-----------------------------------|-----------------|-----------------------|-------|---------------------------|

Edgar Filing: H&R BLOCK INC - Form 10-Q

| | | | | | | | | | | |
|--|----------|----------|-----------|----------|-----------|-----------|----|-------|----|-----------|
| Net cash provided by (used in) operating activities: | \$ | (11,615) | \$ | 58,425 | \$ | (411,733) | \$ | - | \$ | (364,923) |
| Cash flows from investing: | | | | | | | | | | |
| Mortgage loans originated for investment, net | - | 31,619 | - | - | - | - | - | - | - | 31,619 |
| Purchase property & equipment | - | (186) | (14,462) | - | - | - | - | - | - | (14,648) |
| Net intercompany advances | 29,630 | - | - | - | (29,630) | - | - | - | - | - |
| Other, net | - | 1,365 | (2,266) | - | - | - | - | - | - | (901) |
| Net cash provided by (used in) investing activities | 29,630 | 32,798 | (16,728) | (29,630) | 16,070 | | | | | |
| Cash flows from financing: | | | | | | | | | | |
| Repayments of FHLB borrowings | - | (40,000) | - | - | - | - | - | - | - | (40,000) |
| Proceeds from FHLB borrowings | - | 15,000 | - | - | - | - | - | - | - | 15,000 |
| Customer banking deposits | - | (8,964) | - | - | 169 | - | - | - | - | (8,795) |
| Dividends paid | (46,790) | - | - | - | - | - | - | - | - | (46,790) |
| Acquisition of treasury shares | (4,116) | - | - | - | - | - | - | - | - | (4,116) |
| Proceeds from issuance of common stock, net | 28,507 | - | - | - | - | - | - | - | - | 28,507 |
| Net intercompany advances | - | (50,203) | 20,573 | 29,630 | - | - | - | - | - | - |
| Other, net | 4,384 | (3,828) | (14,943) | - | - | - | - | - | - | (14,387) |
| Net cash provided by (used in) financing activities | (18,015) | (87,995) | 5,630 | 29,799 | (70,581) | | | | | |
| Net increase (decrease) in cash | - | 3,228 | (422,831) | 169 | (419,434) | | | | | |
| Cash beginning of period | - | 34,611 | 630,933 | (647) | 664,897 | | | | | |
| Cash end of period | \$ | - | \$ | 37,839 | \$ | 208,102 | \$ | (478) | \$ | 245,463 |

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****RESULTS OF OPERATIONS**

H&R Block provides tax services, banking services and business and consulting services. Our Tax Services segment provides income tax return preparation services, electronic filing services and other services and products related to income tax return preparation to the general public primarily in the United States, Canada and Australia. This segment also offers The H&R Block Prepaid Emerald MasterCard® and Emerald Advance lines of credit through H&R Block Bank (HRB Bank), which was previously reported in our Consumer Financial Services segment. Our Business Services segment consists of RSM McGladrey, Inc. (RSM), a national accounting, tax and business consulting firm primarily serving mid-sized businesses. Corporate operating losses include interest income from U.S. passive investments, interest expense on borrowings, net interest margin and gains or losses relating to mortgage loans held for investment, real estate owned, residual interests in securitizations and other corporate expenses, principally related to finance, legal and other support departments. All periods presented reflect our new segment reporting structure.

Recent Events. RSM and McGladrey & Pullen LLP (M&P), an independent registered public accounting firm, collaborate to provide accounting, tax and consulting services to clients under an alternative practice structure. RSM and M&P also share in certain common overhead costs through an administrative services agreement. These services are provided by, and coordinated through, RSM, for which RSM receives a management fee. On July 21, 2009, M&P provided 210 days notice of its intent to terminate the administrative services agreement. The effect of the notice will be to terminate the alternative practice structure on February 16, 2010, unless revoked or modified prior to that time. RSM and M&P are engaged in arbitration to determine several of their rights and responsibilities under their contractual obligations to each other. An arbitration hearing is scheduled for November 2009. RSM and M&P are also engaged in negotiations to determine if there are mutually agreeable changes to the current arrangements that would allow our collaboration to continue. There are no assurances as to the outcome.

TAX SERVICES

This segment primarily consists of our income tax preparation businesses – retail, online and software. Additionally, this segment includes the product offerings and activities of HRB Bank that primarily support the tax network, our participations in refund anticipation loans, and our commercial tax businesses, which provide tax preparation software to CPAs and other tax preparers.

| Tax Services – Operating Results | (in 000s) | |
|---|---------------|---------------|
| Three Months Ended July 31, | 2009 | 2008 |
| Tax preparation fees | \$ 33,625 | \$ 29,432 |
| Fees from Peace of Mind guarantees | 27,913 | 27,241 |
| Fees from Emerald Card activities | 11,691 | 10,893 |
| Royalties | 3,607 | 3,684 |
| Other | 11,127 | 10,450 |
| Total revenues | 87,963 | 81,700 |
| Compensation and benefits: | | |
| Field wages | 39,379 | 39,819 |
| Corporate wages | 29,880 | 28,810 |
| Benefits and other compensation | 21,316 | 13,903 |

| | | |
|-------------------------------|--------------|--------------|
| | 90,575 | 82,532 |
| Occupancy and equipment | 87,920 | 86,056 |
| Depreciation and amortization | 22,316 | 17,110 |
| Marketing and advertising | 6,839 | 5,544 |
| Other | 52,287 | 54,115 |
| Total expenses | 259,937 | 245,357 |
| Pretax loss | \$ (171,974) | \$ (163,657) |

Table of Contents**Three months ended July 31, 2009 compared to July 31, 2008**

Tax Services revenues increased \$6.3 million, or 7.7%, for the three months ended July 31, 2009 compared to the prior year. Tax preparation fees increased \$4.2 million, or 14.2%, primarily due to favorable results in our Australian tax operations.

Total expenses increased \$14.6 million, or 5.9%, for the three months ended July 31, 2009. Approximately \$9 million of this increase was the result of the November 2008 acquisition of our last major independent franchise operator, which includes approximately \$2 million of amortization due to higher intangible asset balances and additional pre-season expenses. Benefits and other compensation increased \$7.4 million, or 53.3%, primarily as a result of severance costs and related payroll taxes in the current year.

The pretax loss for the three months ended July 31, 2009 and 2008 was \$172.0 million and \$163.7 million, respectively.

BUSINESS SERVICES

This segment offers accounting, tax and consulting services to middle-market companies.

Business Services Operating Results

(in 000s)

| Three Months Ended July 31, | 2009 | 2008 |
|-----------------------------------|-----------------|-----------------|
| Tax services | \$ 77,584 | \$ 76,301 |
| Business consulting | 61,921 | 53,508 |
| Accounting services | 11,529 | 12,960 |
| Capital markets | 1,517 | 5,818 |
| Reimbursed expenses | 4,149 | 4,205 |
| Other | 20,918 | 21,859 |
| Total revenues | 177,618 | 174,651 |
| Compensation and benefits | 134,380 | 122,908 |
| Occupancy | 19,449 | 19,834 |
| Amortization of intangible assets | 2,965 | 3,419 |
| Other | 19,503 | 28,785 |
| Total expenses | 176,297 | 174,946 |
| Pretax income (loss) | \$ 1,321 | \$ (295) |

Three months ended July 31, 2009 compared to July 31, 2008

Business Services revenues for the three months ended July 31, 2009 increased \$3.0 million, or 1.7% from the prior year. Revenues from core tax, consulting and accounting services increased \$8.3 million, or 5.8%, over the prior year primarily due to revenues from consulting engagements related to financial institutions.

Capital markets revenues decreased \$4.3 million, or 73.9%, primarily due to a 72.7% decline in the number of transactions closed in the current year due to the continued weak economic conditions. Given the continued limited availability of financing for acquisitions in the middle-market, our capital markets revenues may continue to fall

below our expectations, which could lead us to consider impairment of the \$29.3 million carrying value of goodwill related to our capital markets business.

Total expenses increased \$1.4 million, or 0.8%, from the prior year. Compensation and benefits increased \$11.5 million, or 9.3%, primarily due to increases in managing director compensation and outside contractor costs related to consulting engagements. Other expenses decreased \$9.3 million primarily as a result of our cost reduction program.

Pretax income for the three months ended July 31, 2009 was \$1.3 million compared to a loss of \$0.3 million in the prior year.

CORPORATE, ELIMINATIONS AND INCOME TAXES ON CONTINUING OPERATIONS

Corporate operating losses include interest income from U.S. passive investments, interest expense on borrowings, net interest margin and gains or losses relating to mortgage loans held for investment, real estate

Table of Contents

owned, residual interests in securitizations and other corporate expenses, principally related to finance, legal and other support departments.

| Corporate Operating Results | (in 000s) | |
|---|-------------|-------------|
| Three Months Ended July 31, | 2009 | 2008 |
| Interest income: | | |
| Mortgage loans held for investment, net | \$ 7,896 | \$ 13,265 |
| Other investments | 824 | 1,094 |
| | 8,720 | 14,359 |
| Other | 1,204 | 1,199 |
| Total revenues | 9,924 | 15,558 |
| Interest expense: | | |
| Borrowings HRB Bank | 2,011 | 5,125 |
| Borrowings Corporate | 17,647 | 17,617 |
| | 19,658 | 22,742 |
| Provision for loan losses | 13,600 | 14,991 |
| Compensation and benefits | 13,301 | 12,748 |
| Other | 3,585 | 14,095 |
| Total expenses | 50,144 | 64,576 |
| Pretax loss | \$ (40,220) | \$ (49,018) |

Three months ended July 31, 2009 compared to July 31, 2008

Interest income earned on mortgage loans held for investment decreased \$5.4 million from the prior year, primarily as a result of declining rates and non-performing loans. Other expenses declined \$10.5 million due to impairments of residual interests totaling \$5.0 million recorded in the prior year, coupled with a \$4.2 million decline in impairments of real estate owned.

Income Taxes

Our effective tax rate for continuing operations was 38.1% and 39.7% for the three months ended July 31, 2009 and 2008, respectively. Our effective tax rate declined from the prior year due to non-deductible losses from investments in company-owned life insurance assets recorded in the first fiscal quarter of last year. We expect our effective tax rate for full fiscal year 2010 to be approximately 40%.

Mortgage Loans Held for Investment

Mortgage loans held for investment include loans originated by our affiliate, Sand Canyon Corporation (SCC), and purchased by HRB Bank totaling \$514.3 million, or approximately 65% of the total loan portfolio at July 31, 2009.

Edgar Filing: H&R BLOCK INC - Form 10-Q

We have experienced higher rates of delinquency and have greater exposure to loss with respect to this segment of our loan portfolio. Our remaining loan portfolio totaled \$278.9 million and is characteristic of a prime loan portfolio, and we believe subject to a lower loss exposure.

Detail of our mortgage loans held for investment and the related allowance at July 31, 2009 and April 30, 2009 is as follows:

| | | | (dollars in 000s) |
|-----------------------|-------------------------------------|------------------------|----------------------|
| | Outstanding Principal Balance | Loan Loss Allowance | %30+Days Past Due |
| As of July 31, 2009: | | | |
| Purchased from SCC | \$ 514,267 | \$ 85,644 | 32.55% |
| All other | 278,859 | 6,047 | 6.94% |
| | \$ 793,126 | \$ 91,691 | 23.67% |
| As of April 30, 2009: | | | |
| Purchased from SCC | \$ 531,233 | \$ 78,067 | 28.74% |
| All other | 290,604 | 6,006 | 4.44% |
| | \$ 821,837 | \$ 84,073 | 20.23% |

Table of Contents

We recorded a provision for loan losses of \$13.6 million during the current quarter, compared to \$15.0 million in the prior year. Our allowance for loan losses as a percent of mortgage loans was 11.56%, or \$91.7 million, at July 31, 2009, compared to 10.23%, or \$84.1 million, at April 30, 2009. This allowance represents our best estimate of credit losses inherent in the loan portfolio as of the balance sheet dates.

Our non-performing assets consist of the following:

| | (in 000s) | |
|----------------------------------|---------------|----------------|
| As of | July 31, 2009 | April 30, 2009 |
| Impaired loans: | | |
| 60 - 89 days | \$ 14,519 | \$ 21,415 |
| 90+ days, non-accrual | 148,603 | 121,685 |
| TDR loans, accrual | 90,275 | 60,044 |
| TDR loans, non-accrual | 71,295 | 100,697 |
| | 324,692 | 303,841 |
| Real estate owned ⁽¹⁾ | 42,741 | 44,533 |
| Total non-performing assets | \$ 367,433 | \$ 348,374 |

⁽¹⁾ Includes loans accounted for as in-substance foreclosures of \$23.5 million and \$27.4 million at July 31, 2009 and April 30, 2009, respectively.

FINANCIAL CONDITION

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

CAPITAL RESOURCES AND LIQUIDITY Our sources of capital include cash from operations, issuances of common stock and debt. We use capital primarily to fund working capital, pay dividends, repurchase treasury shares and acquire businesses. Our operations are highly seasonal and therefore generally require the use of cash to fund operating losses during the period May through mid-January.

Given the likely availability of a number of liquidity options discussed herein, including borrowing capacity under our unsecured committed lines of credit (CLOCs), we believe, that in the absence of any unexpected developments, our existing sources of capital at July 31, 2009 are sufficient to meet our operating needs.

CASH FROM OPERATING ACTIVITIES Cash used by operations totaled \$454.6 million for the first three months of fiscal year 2010, compared with \$364.9 million for the same period last year. The increase was primarily due to increases in income tax payments made during the quarter.

CASH FROM INVESTING ACTIVITIES Cash provided by investing activities totaled \$15.4 million for the first three months of fiscal year 2010, compared to \$16.1 million for the same period last year.

Mortgage Loans Held for Investment. We received net payments of \$19.3 million and \$31.6 million on our mortgage loans held for investment for the first three months of fiscal years 2010 and 2009, respectively. Cash payments declined due primarily due to non-performing loans and continued run-off of our portfolio.

Purchases of Property and Equipment. Total cash paid for property and equipment was \$8.8 million and \$14.6 million for the first three months of fiscal years 2010 and 2009, respectively.

CASH FROM FINANCING ACTIVITIES Cash used in financing activities totaled \$216.2 million for the first three months of fiscal year 2010, compared to \$70.6 million for the same period last year.

Customer Banking Deposits. Customer banking deposits used cash of \$143.2 million for the three months ended July 31, 2009 compared to \$8.8 million in the prior year, due to declines in prepaid debit card deposits.

Dividends. We have consistently paid quarterly dividends. Dividends paid totaled \$50.3 million and \$46.8 million for the three months ended July 31, 2009 and 2008, respectively.

Issuances of Common Stock. Proceeds from the issuance of common stock resulting from stock compensation plans totaled \$6.7 million and \$28.5 million for the three months ended July 31, 2009 and 2008, respectively. This decline is due to a reduction in stock option exercises and the related tax benefits.

BORROWINGS

At July 31, 2009, we maintained \$2.0 billion in revolving credit facilities to support commercial paper issuance and for general corporate purposes. These CLOCs, and outstanding borrowings thereunder, have a maturity date of August 2010 and an annual facility fee in a range of six to fifteen basis points per annum, based on our

Table of Contents

credit ratings. We had no balance outstanding as of July 31, 2009. The CLOCs, among other things, require we maintain at least \$650.0 million of net worth on the last day of any fiscal quarter. We had net worth of \$1.2 billion at July 31, 2009.

Aurora Bank, FSB (Aurora), formerly known as Lehman Brothers Bank, FSB, is a participating lender in our \$2.0 billion CLOCs, with a \$50.0 million credit commitment. In September 2008, Aurora's parent company declared bankruptcy. Since then, Aurora has not honored any funding requests under these facilities, thereby effectively reducing our available liquidity under our CLOCs to \$1.95 billion. We do not expect this change to have a material impact on our liquidity.

There have been no material changes in our borrowings or debt ratings from those reported at April 30, 2009 in our Annual Report on Form 10-K.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

There have been no material changes in our contractual obligations and commercial commitments from those reported at April 30, 2009 in our Annual Report on Form 10-K.

REGULATORY ENVIRONMENT

There have been no material changes in our regulatory environment from those reported at April 30, 2009 in our Annual Report on Form 10-K.

FORWARD-LOOKING INFORMATION

This report and other documents filed with the Securities and Exchange Commission (SEC) may contain forward-looking statements. In addition, our senior management may make forward-looking statements orally to analysts, investors, the media and others. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words such as expects, anticipates, intends, plans, believes, seeks, estimates, will, would, should, could or may. Forward-looking statements provide management's current expectations or predictions of future conditions, events or results. They may include projections of revenues, income, earnings per share, capital expenditures, dividends, liquidity, capital structure or other financial items, descriptions of management's plans or objectives for future operations, products or services, or descriptions of assumptions underlying any of the above. They are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and uncertainties. These statements speak only as of the date made and management does not undertake to update them to reflect changes or events occurring after that date except as required by federal securities laws.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in our market risks from those reported at April 30, 2009 in our Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this Form 10-Q, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures. The controls evaluation was done under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based on this evaluation, we have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

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

Table of Contents

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information below should be read in conjunction with the information included in note 11 to our condensed consolidated financial statements.

RAL Litigation

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

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

We have settled all but one of the RAL Cases. The sole remaining RAL Case is a putative class action entitled *Sandra J. Basile, et al. v. H&R Block, Inc., et al.*, April Term 1992 Civil Action No. 3246 in the Court of Common Pleas, First Judicial District Court of Pennsylvania, Philadelphia County, instituted on April 23, 1993. In *Basile*, the court decertified the class in December 2003, and the Pennsylvania appellate court subsequently reversed the trial court's decertification decision. In September 2006, the Pennsylvania Supreme Court reversed the appellate court's reversal of the trial court's decertification decision. In June 2007, the appellate court affirmed its earlier decision to reverse the trial court's decertification decision. In June 2009, the Pennsylvania Supreme Court again reversed the appellate court's reversal of the trial court's decertification decision and remanded the case to the appellate court for additional review. We believe we have meritorious defenses to this case and we intend to defend it vigorously. There can be no assurances, however, as to the outcome of this case or its impact on our financial statements.

Peace of Mind Litigation

We are defendants in lawsuits regarding our Peace of Mind program (collectively, the "POM Cases"), under which our applicable tax return preparation subsidiary assumes liability for additional tax assessments attributable to tax return preparation error. The POM Cases are described below.

Lorie J. Marshall, et al. v. H&R Block Tax Services, Inc., et al., Case No. 08-CV-591 in the U.S. District Court for the Southern District of Illinois, is a class action case originally filed in the Circuit Court of Madison County, Illinois on January 18, 2002, in which class certification was granted in August 2003. The plaintiffs allege that the sale of POM guarantees constitutes (1) statutory fraud by selling insurance without a license, (2) an unfair trade practice, by omission and by cramming (i.e., charging customers for the guarantee even though they did not request it or want it), and (3) a breach of fiduciary duty. A class was certified consisting of all persons residing in 13 states who from January 1, 1997 to final judgment (1) were charged a separate fee for POM by H&R Block; (2) were charged a separate fee for POM by an H&R Block entity not licensed to sell insurance; or (3) had an unsolicited charge for POM posted to their bills by H&R Block. Persons who received the POM guarantee through an H&R Block Premium office were excluded from the plaintiff class. In August 2008, we removed the case from state court in Madison County, Illinois to the U.S. District Court for the Southern District of Illinois. In December 2008, the U.S. District Court remanded the case back to state court. On April 3, 2009, the United States Court of Appeals for the Seventh Circuit reversed the decision to remand the case back to state court, ruling that the case had been properly removed to federal

court. The plaintiffs filed a petition for rehearing of this decision with the Seventh Circuit, which was denied in August 2009.

Table of Contents

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

We believe we have meritorious defenses to the claims in the POM Cases, and we intend to defend them vigorously. The amounts claimed in the POM Cases are substantial, however, and there can be no assurances as to the outcome of these pending actions individually or in the aggregate.

Express IRA Litigation

On March 15, 2006, the New York Attorney General filed a lawsuit in the Supreme Court of the State of New York, County of New York (Index No. 06/401110) entitled *The People of New York v. H&R Block, Inc. and H&R Block Financial Advisors, Inc. et al.* The complaint alleges fraudulent business practices, deceptive acts and practices, common law fraud and breach of fiduciary duty with respect to the Express IRA product and seeks equitable relief, disgorgement of profits, damages and restitution, civil penalties and punitive damages. In July 2007, the Supreme Court of the State of New York issued a ruling that dismissed all defendants other than H&R Block Financial Advisors, Inc. (HRBFA) and the claims of common law fraud. The intermediate appellate court reversed this ruling in January 2009. We believe we have meritorious defenses to the claims in this case and intend to defend this case vigorously, but there are no assurances as to its outcome.

On January 2, 2008, the Mississippi Attorney General filed a lawsuit in the Chancery Court of Hinds County, Mississippi First Judicial District (Case No. G 2008 6 S 2) entitled *Jim Hood, Attorney for the State of Mississippi v. H&R Block, Inc., et al.* The complaint alleges fraudulent business practices, deceptive acts and practices, common law fraud and breach of fiduciary duty with respect to the Express IRA product and seeks equitable relief, disgorgement of profits, damages and restitution, civil penalties and punitive damages. The defendants have filed a motion to dismiss. We believe we have meritorious defenses to the claims in this case, and we intend to defend this case vigorously, but there are no assurances as to its outcome.

In addition to the New York and Mississippi Attorney General actions, a number of civil actions were filed against HRBFA and us concerning the Express IRA product, the first of which was filed on March 15, 2006. Except for two cases pending in state court, all of the civil actions have been consolidated by the panel for Multi-District Litigation into a single action styled *In re H&R Block, Inc. Express IRA Marketing Litigation* (Case No. 06-1786-MD-RED) in the United States District Court for the Western District of Missouri. The amounts claimed in these cases are substantial. We believe we have meritorious defenses to the claims in these cases and intend to defend these cases vigorously, but there are no assurances as to their outcome.

Although we sold HRBFA effective November 1, 2008, we remain responsible for any liabilities relating to the Express IRA litigation through an indemnification agreement.

Securities Litigation

On April 6, 2007, a putative class action styled *In re H&R Block Securities Litigation* (Case No. 06-0236-CV-W-ODS) was filed against the Company and certain of its officers in the United States District Court for the Western District of Missouri. The complaint alleged, among other things, deceptive, material and misleading financial statements and failure to prepare financial statements in accordance with generally accepted accounting principles. The complaint sought unspecified damages and equitable relief. The court dismissed the complaint in February 2008, and the plaintiffs appealed the dismissal in March 2008. In addition, plaintiffs in a shareholder derivative action that was consolidated into the securities litigation filed a separate appeal in March 2008, contending that the derivative action was improperly consolidated. The derivative action is *Iron Workers Local 16 Pension Fund v. H&R Block, et al.*, in the United States District Court for the Western District of Missouri, Case No. 06-cv-00466-ODS (instituted on June 8, 2006) and was brought against certain of our directors and officers purportedly on behalf of the Company. The derivative action alleged breach of fiduciary duty, abuse of control, gross mismanagement, waste, and unjust enrichment pertaining to (1) our restatement of financial results in fiscal year 2006 due to errors in determining our state effective income tax rate and (2) certain of our products and business activities.

We believe we have meritorious defenses to the claims in these cases and intend to defend this litigation vigorously. We currently do not believe that we will incur a material loss with respect to this litigation.

Table of Contents**RSM McGladrey Litigation**

RSM McGladrey Business Services, Inc. and certain of its subsidiaries are parties to a class action filed on July 11, 2006 and entitled *Do Right s Plant Growers, et al. v. RSM EquiCo, Inc., et al.* Case No. 06 CC00137, in the California Superior Court, Orange County. The complaint contains allegations relating to business valuation services provided by RSM EquiCo, Inc., including allegations of fraud, negligent misrepresentation, breach of contract, breach of implied covenant of good faith and fair dealing, breach of fiduciary duty and unfair competition and seeks unspecified damages, restitution and equitable relief. On March 17, 2009, the court granted plaintiffs motion for class certification on all claims. The class consists of all RSM EquiCo U.S. clients who signed platform agreements and for whom RSM EquiCo did not ultimately market their business for sale. RSM EquiCo filed a writ petition for interlocutory appeal of this certification ruling, which was denied. We intend to defend this case vigorously. The amount claimed in this action is substantial and could have a material adverse impact on our consolidated results of operations. There can be no assurance regarding the outcome of this matter.

RSM McGladrey, Inc. (RSM) has a relationship with certain public accounting firms (collectively, the Attest Firms) pursuant to which (1) some RSM employees are also partners or employees of the Attest Firms, (2) many clients of the Attest Firms are also RSM clients, and (3) our RSM McGladrey brand is closely linked to the Attest Firms. The Attest Firms are parties to claims and lawsuits (collectively, Attest Firm Claims) arising in the normal course of business. Judgments or settlements arising from Attest Firm Claims exceeding the Attest Firms insurance coverage could have a direct adverse effect on Attest Firm operations and could impair RSM s ability to attract and retain clients and quality professionals. For example, accounting and auditing firms (including one of the Attest Firms) have become subject to claims based on losses their clients suffered from investments in investment funds managed by third-parties. Although RSM may not have a direct liability for significant Attest Firm Claims, such Attest Firm Claims could have a material adverse effect on RSM s operations and impair the value of our investment in RSM. There is no assurance regarding the outcome of the Attest Firm Claims.

Litigation and Claims Pertaining to Discontinued Mortgage Operations

Although mortgage loan origination activities were terminated and the loan servicing business was sold during fiscal year 2008, SCC remains subject to investigations, claims and lawsuits pertaining to its loan origination and servicing activities that occurred prior to such termination and sale. These investigations, claims and lawsuits include actions by state attorneys general, other state regulators, municipalities, individual plaintiffs, and cases in which plaintiffs seek to represent a class of others alleged to be similarly situated. Among other things, these investigations, claims and lawsuits allege discriminatory or unfair and deceptive loan origination and servicing practices, public nuisance, fraud, and violations of the Truth in Lending Act, Equal Credit Opportunity Act and the Fair Housing Act. In the current non-prime mortgage environment, the number of these investigations, claims and lawsuits has increased over historical experience and is likely to continue at increased levels. The amounts claimed in these investigations, claims and lawsuits are substantial in some instances, and the ultimate resulting liability is difficult to predict. In the event of unfavorable outcomes, the amounts SCC may be required to pay in the discharge of liabilities or settlements could be substantial and, because SCC s operating results are included in our consolidated financial statements, could have a material adverse impact on our consolidated results of operations.

On June 3, 2008, the Massachusetts Attorney General filed a lawsuit in the Superior Court of Suffolk County, Massachusetts (Case No. 08-2474-BLS) entitled *Commonwealth of Massachusetts v. H&R Block, Inc., et al.*, alleging unfair, deceptive and discriminatory origination and servicing of mortgage loans and seeking equitable relief, disgorgement of profits, restitution and statutory penalties. In November 2008, the court granted a preliminary injunction limiting the ability of the owner of SCC s former loan servicing business to initiate or advance foreclosure actions against certain loans originated by SCC or its subsidiaries without (1) advance notice to the Massachusetts Attorney General and (2) if the Attorney General objects to foreclosure, approval by the court. The preliminary injunction generally applies to loans meeting all of the following four characteristics: (1) adjustable rate mortgages with an introductory period of three years or less; (2) the borrower has a debt-to-income ratio generally exceeding 50 percent; (3) an introductory interest rate at least 2 percent lower than the fully indexed rate (unless the

debt-to-income ratio is 55% or greater); and (4) loan-to-value ratio of 97 percent or certain prepayment penalties. We have appealed this preliminary injunction. We believe

Table of Contents

the claims in this case are without merit, and we intend to defend this case vigorously, but there are no assurances as to its outcome.

SCC also remains subject to potential claims for indemnification and loan repurchases pertaining to loans previously sold. In the current non-prime mortgage environment, it is likely that the frequency of repurchase and indemnification claims may increase over historical experience and give rise to additional litigation. In some instances, H&R Block, Inc. was required to guarantee SCC's obligations. The amounts involved in these potential claims may be substantial, and the ultimate resulting liability is difficult to predict. Because SCC's operating results are included in our consolidated financial statements, the amounts SCC may be required to pay in the discharge or settlement of these claims in the event of unfavorable outcomes could have a material adverse impact on our consolidated results of operations.

Other Claims and Litigation

We are from time to time party to investigations, claims and lawsuits not discussed herein arising out of our business operations. These investigations, claims and lawsuits include actions by state attorneys general, other state regulators, individual plaintiffs, and cases in which plaintiffs seek to represent a class of others similarly situated. Some of these investigations, claims and lawsuits pertain to RALs, the electronic filing of customers' income tax returns, the POM guarantee program, wage and hour claims and investment products. We believe we have meritorious defenses to each of these investigations, claims and lawsuits, and we are defending or intend to defend them vigorously. The amounts claimed in these matters are substantial in some instances, however the ultimate liability with respect to such matters is difficult to predict. In the event of an unfavorable outcome, the amounts we may be required to pay in the discharge of liabilities or settlements could be material.

In addition to the aforementioned types of matters, we are party to claims and lawsuits that we consider to be ordinary, routine litigation incidental to our business, including claims and lawsuits (collectively, "Other Claims") concerning the preparation of customers' income tax returns, the fees charged customers for various products and services, relationships with franchisees, intellectual property disputes, employment matters and contract disputes. While we cannot provide assurance that we will ultimately prevail in each instance, we believe the amount, if any, we are required to pay in the discharge of liabilities or settlements in these Other Claims will not have a material adverse effect on our consolidated operating results, financial position or cash flows.

ITEM 1A. RISK FACTORS

Alternative Practice Structure with Public Accounting Firms. As previously disclosed, under an alternative practice structure arrangement, RSM and M&P and other public accounting firms (collectively, "the Attest Firms") market their services jointly and provide services to a significant number of common clients. Through an administrative services agreement, RSM also provides operational and administrative support services to the Attest Firms, including accounting, payroll, human resources, marketing, administrative services and personnel, and office space and equipment. In return for these services, RSM receives a management fee and reimbursement of certain costs, mainly for the use of RSM-owned or leased real estate, property and equipment. If the RSM/Attest Firms relationship under the alternative practice structure were to be terminated, RSM could lose key employees and clients and may not be able to recoup its costs associated with the infrastructure used to provide the operational and administrative support services to the Attest Firms. A separation from M&P could result in reduced revenue, increased costs and reduced earnings and, if sufficiently significant, impairment of our investment in RSM.

On July 21, 2009, M&P provided notice of its intent to terminate the administrative services agreement between RSM and M&P. The effect of the notice will be to terminate the alternative practice structure on February 16, 2010, unless revoked or modified prior to that time. RSM and M&P are engaged in arbitration to determine several of their rights and responsibilities under their contracts, including rights of RSM relating to noncompete provisions of the contracts. In addition, the parties have held a series of meetings and discussions regarding several aspects of the relationship between RSM and M&P. If the parties do not reach an agreement to continue their relationship, RSM intends to seek alternative attest firms with which to affiliate and to continue to directly provide a full range of tax and business

consulting services. The extent of the impact of a separation by M&P cannot be determined at this time, although it could be material to RSM's financial condition and results of operations.

Table of Contents

There have been no other material changes in our risk factors from those reported at April 30, 2009 in our Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

A summary of our purchases of H&R Block common stock during the first quarter of fiscal year 2010 is as follows:

| | | (in 000s, except per share amounts) | | | |
|--------|---------|-------------------------------------|------------|----------------------|-----------------------|
| | | Total Number of | Average | Total Number of | Maximum \$Value |
| | | Shares | Price Paid | Shares | of Shares that May |
| | | Purchased ⁽¹⁾ | per Share | Purchased as Part of | Be Purchased Under |
| | | | | Publicly Announced | the Plans or Programs |
| | | | | Plans or Programs | |
| May 1 | May 31 | - | \$ - | - | \$ 1,901,419 |
| June 1 | June 30 | 134 | \$ 17.13 | - | \$ 1,901,419 |
| July 1 | July 31 | 70 | \$ 16.89 | - | \$ 1,901,419 |

⁽¹⁾ We purchased 204,373 shares in connection with the funding of employee income tax withholding obligations arising upon the exercise of stock options or the lapse of restrictions on nonvested shares.

ITEM 6. EXHIBITS

- 10.1 Separation and Release Agreement dated July 28, 2009, by and between HRB Tax Group, Inc. and Timothy C. Gokey.*
- 10.2 H&R Block, Inc. Executive Severance Plan*
- 31.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification by Chief Executive Officer furnished pursuant to 18 U.S.C. 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by Chief Financial Officer furnished pursuant to 18 U.S.C. 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema
- 101.CAL XBRL Extension Calculation Linkbase
- 101.LAB XBRL Taxonomy Extension Label Linkbase
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase
- 101.REF XBRL Taxonomy Extension Reference Linkbase

* Indicates management contracts, compensatory plans or arrangements.

Table of Contents

SIGNATURES

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

H&R BLOCK, INC.

Russell P. Smyth
President and Chief Executive Officer
September 4, 2009

Becky S. Shulman
Senior Vice President, Treasurer and
Chief Financial Officer
September 4, 2009

Jeffrey T. Brown
Vice President and
Corporate Controller
September 4, 2009