H&R BLOCK INC
Form 10-Q/A
March 31, 2006

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A
Amendment No. 1

(Mark One)

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

For the quarterly period ended October 31, 2005

OR

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

For the transition period from ____________________ to ____________________

Commission file number 1-6089

H&R Block, Inc.

(Exact name of registrant as specified in its charter)

MISSOURI	**44-0607856**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4400 Main Street
Kansas City, Missouri 64111

(Address of principal executive offices, including zip code)

(816) 753-6900

(Registrant s telephone number, including area code)

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

Yes þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Yes o No þ

The number of shares outstanding of the registrant s Common Stock, without par value, at the close of business on November 30, 2005 was 327,638,203 shares.

Form 10-Q/A for the Period Ended October 31, 2005
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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A (Form 10-Q/A) to the company s Quarterly Report on Form 10-Q for the quarterly period ended October 31, 2005, initially filed with the Securities and Exchange Commission on December 12, 2005, is being filed to reflect restatements of our consolidated balance sheets at October 31, 2005 and April 30, 2005, consolidated statements of income and comprehensive income for the three and six months ended October 31, 2005 and 2004, and of cash flows for the six months ended October 31, 2005 and 2004, and the notes related thereto. See detail discussion of the restatements in Item 1, note 2 to the condensed consolidated financial statements.

On February 22, 2006, the Company s management and the Audit Committee of the Board of Directors concluded to restate previously issued consolidated financial statements for the fiscal quarters ended October 31, 2005 and July 31, 2005, the fiscal years ended April 30, 2005 and 2004 and the related fiscal quarters. The Company arrived at this conclusion during the course of its closing process for the quarter ended January 31, 2006.

The restatement pertains primarily to errors in determining the Company s state effective income tax rate, including errors in identifying changes in state apportionment, expiring state net operating losses and related factors.

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CONDENSED CONSOLIDATED BALANCE SHEETS (amounts in 000s, except share amounts)

	Restated October 31, 2005 (Unaudited)	Restated April 30, 2005
ASSETS		
Cash and cash equivalents	$ 392,490	$ 1,100,213
Cash and cash equivalents restricted	464,480	516,909
Marketable securities trading	114,136	11,790
Receivables from customers, brokers, dealers and clearing organizations, net	577,506	590,226
Receivables, less allowance for doubtful accounts of $59,332 and $38,879	693,302	418,788
Prepaid expenses and other current assets	464,005	432,708
Total current assets	2,705,919	3,070,634
Residual interests in securitizations available-for-sale	142,782	205,936
Beneficial interest in Trusts trading	169,378	215,367
Mortgage servicing rights	245,928	166,614
Property and equipment, at cost less accumulated depreciation and amortization of $714,971 and $658,425	362,041	330,150
Intangible assets, net	247,849	247,092
Goodwill, net	1,087,587	1,015,947
Other assets	334,468	286,316
Total assets	$ 5,295,952	$ 5,538,056
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Commercial paper	$ 498,175	$
Current portion of long-term debt	16,946	25,545
Accounts payable to customers, brokers and dealers	846,913	950,684
Accounts payable, accrued expenses and other current liabilities	639,812	564,749
Accrued salaries, wages and payroll taxes	170,056	318,644
Accrued income taxes	225,245	375,174
Total current liabilities	2,397,147	2,234,796
Long-term debt	917,884	923,073
Other noncurrent liabilities	428,395	430,919
Total liabilities	3,743,426	3,588,788
Stockholders equity:		

Common stock, no par, stated value $.01 per share, 800,000,000 shares authorized, 435,890,796 shares issued at October 31, 2005 and April 30, 2005	4,359	4,359
Additional paid-in capital	612,207	598,388
Accumulated other comprehensive income	44,463	68,718
Retained earnings	2,975,058	3,161,682
Less cost of 110,565,669 and 104,649,850 shares of common stock in treasury	(2,083,561)	(1,883,879)
Total stockholders equity	1,552,526	1,949,268
Total liabilities and stockholders equity	$ 5,295,952	$ 5,538,056

See Notes to Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Unaudited, amounts in 000s, except per share amounts)

	Three months ended October 31,		Six months ended October 31,	
	Restated 2005	Restated 2004	Restated 2005	Restated 2004
Revenues:				
Service revenues	$ 384,263	$ 290,232	$ 699,391	$ 538,820
Other revenues:				
Gains on sales of mortgage assets, net	147,267	184,148	383,698	367,508
Interest income	55,010	48,552	104,263	88,272
Product and other revenues	18,503	19,021	32,684	33,904
	605,043	541,953	1,220,036	1,028,504
Operating expenses:				
Cost of services	387,217	324,084	730,435	615,059
Cost of other revenues	134,864	96,249	258,221	174,644
Selling, general and administrative	206,549	184,867	395,801	345,063
	728,630	605,200	1,384,457	1,134,766
Operating loss	(123,587)	(63,247)	(164,421)	(106,262)
Interest expense	12,385	18,081	24,820	35,874
Other income, net	2,843	1,510	10,243	3,518
Loss before taxes	(133,129)	(79,818)	(178,998)	(138,618)
Income tax benefit	(51,880)	(31,016)	(69,755)	(53,862)
Net loss	$ (81,249)	$ (48,802)	$ (109,243)	$ (84,756)
Basic and diluted loss per share	$ (0.25)	$ (0.15)	$ (0.33)	$ (0.25)
Basic and diluted shares	326,047	329,372	328,381	333,442
Dividends per share	$ 0.13	$ 0.11	$ 0.24	$ 0.21
Comprehensive income (loss):				
Net loss	$ (81,249)	$ (48,802)	$ (109,243)	$ (84,756)

Change in unrealized gain on available-for-sale securities, net	(23,653)	8,084	(29,464)	29,554
Change in foreign currency translation adjustments	4,385	8,371	5,209	8,041
Comprehensive income (loss)	$ (100,517)	$ (32,347)	$ (133,498)	$ (47,161)

See Notes to Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited, amounts in 000s)

Six months ended October 31,	Restated 2005	Restated 2004
Cash flows from operating activities:		
Net loss	$ (109,243)	$ (84,756)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	90,173	80,267
Accretion of residual interests in securitizations	(64,341)	(63,514)
Impairments of available-for-sale residual interests	20,613	2,609
Additions to trading securities residual interests in securitizations, net	(185,645)	(68,618)
Proceeds from net interest margin transactions, net	85,472	53,348
Realized gain on sale of available-for-sale residual interests	(28,675)	
Additions to mortgage servicing rights	(136,294)	(58,894)
Amortization and impairment of mortgage servicing rights	56,980	38,653
Net change in beneficial interest in Trusts	45,989	25,524
Other, net of acquisitions	(479,888)	(591,893)
Net cash used in operating activities	(704,859)	(667,274)
Cash flows from investing activities:		
Cash received from available-for-sale residual interests	64,377	73,477
Cash received from sale of available-for-sale residual interests	30,497	
Purchases of property and equipment, net	(77,635)	(60,598)
Payments made for business acquisitions, net of cash acquired	(200,309)	(5,472)
Other, net	13,151	12,138
Net cash provided by (used in) investing activities	(169,919)	19,545
Cash flows from financing activities:		
Repayments of commercial paper	(1,101,729)	(1,376,877)
Proceeds from issuance of commercial paper	1,599,904	1,692,933
Proceeds from issuance of long-term debt, net		395,221
Dividends paid	(77,381)	(69,997)
Acquisition of treasury shares	(259,745)	(529,558)
Proceeds from issuance of common stock	48,001	53,933
Other, net	(41,995)	(24,600)
Net cash provided by financing activities	167,055	141,055
Net decrease in cash and cash equivalents	(707,723)	(506,674)
Cash and cash equivalents at beginning of the period	1,100,213	1,072,745
Cash and cash equivalents at end of the period	$ 392,490	$ 566,071

See Notes to Condensed Consolidated Financial Statements

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Basis of Presentation

The condensed consolidated balance sheet as of October 31, 2005, the condensed consolidated statements of income and comprehensive income for the three and six months ended October 31, 2005 and 2004, and the condensed consolidated statements of cash flows for the six months ended October 31, 2005 and 2004 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 October 31, 2005 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 B Inc. and its subsidiaries, as appropriate to the context.

Certain reclassifications have been made to prior year amounts to conform to the current year presentation. These reclassifications had no effect on our results of operations or stockholders equity as previously reported. Adjustments related to the restatements of previously issued financial statements are detailed in note 2.

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

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in our April 30, 2005 Annual Report to Shareholders on Form 10-K/A.

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

2. Restatements of Previously Issued Financial Statements

(A) On February 22, 2006, management and the Audit Committee of the Board of Directors concluded to restate previously issued consolidated financial statements for the fiscal quarters ended October 31, 2005 and July 31, 2005, the fiscal years ended April 30, 2005 and 2004 and the related fiscal quarters. We arrived at this conclusion during the course of our closing process for the quarter ended January 31, 2006. This restatement pertains primarily to errors in determining the Company s state effective income tax rate, including errors in identifying changes in state apportionment, expiring state net operating losses and related factors. These errors resulted in an understatement of income tax benefit (net of federal income tax benefit) of $5.0 million and $5.4 million for the three and six months ended October 31, 2005, respectively, and $1.1 million and $1.9 million for the three and six months ended October 31, 2004, respectively, an overstatement of deferred income tax assets of $1.2 million as of October 31, 2005 and April 30, 2005, and an understatement of accrued income taxes of $20.5 million and $25.9 million as of October 31, 2005 and April 30, 2005, respectively. The effect of the above adjustments on the condensed consolidated financial statements is set forth in 2C below.

(B) On June 7, 2005, management and the Audit Committee of the Board of Directors determined that restatement of our previously issued consolidated financial statements, including financial statements for the three and six months ended October 31, 2004, was appropriate as a result of the errors noted below. All amounts listed are pretax, unless otherwise noted.

- § An error in calculating the gain on sale of residual interests in fiscal year 2003. This error was corrected by deferring a portion of the gain on sale of residual interests as of the transaction date in fiscal year 2003 and recognizing revenue from the sale as interest income from accretion of residual interests in subsequent periods. Interest income from accretion increased $2.7 million and $5.7 million for the three and six months ended October 31, 2004, respectively. This correction also decreased impairments of residual interests $0.9 million for the six months ended

October 31, 2004 and decreased comprehensive income $1.7 million and $4.0 million for the three and six months ended October 31, 2004, respectively.

§ An error in the calculation of an incentive compensation accrual at our Mortgage Services segment as of April 30, 2004. This error resulted in an overstatement of compensation expense for the six months ended October 31, 2004 of $12.1 million.

§ An error in accounting for leased properties related to rent holidays and mandatory rent escalation in our Tax Services, Mortgage Services and Investment Services segments. Rent expense was understated for the three and six months ended October 31, 2004 by $0.4 million and $0.6 million, respectively.

§ An error from the capitalization of certain branch office costs at our Investment Services segment, which should have been expensed as incurred. This error resulted in an understatement of occupancy expenses and an overstatement of depreciation expense and capital expenditures, resulting in a net overstatement of operating expenses of $5.7 million and $5.5 million for the three and six months ended October 31, 2004, respectively.

§ Errors related to accounting for acquisitions at our Business Services and Investment Services segments, the largest of which was the acquisition of OLDE in fiscal year 2000. Amortization of customer relationships was understated by $1.8 million and $3.7 million for the three and six months ended October 31, 2004, respectively, and the provision for income taxes was overstated by approximately $3.7 million and $7.5 million, respectively.

The effect of the above adjustments on the condensed consolidated financial statements is set forth in 2C below.

(C) Notes 5, 6, 8, 12, and 14 have been restated to reflect the above described adjustments.

The following is a summary of the impact of the restatement described in 2A above on our condensed consolidated balance sheet as of October 31, 2005:

(in 000s)

	As Previously Reported (1)	Adjustments (2)	Restated
Other assets	$ 335,695	$ (1,227)	$ 334,468
Total assets	5,297,179	(1,227)	5,295,952
Accrued income taxes	204,725	20,520	225,245
Total current liabilities	2,376,627	20,520	2,397,147
Total liabilities	3,722,906	20,520	3,743,426
Retained earnings	2,996,805	(21,747)	2,975,058
Total stockholders equity	1,574,273	(21,747)	1,552,526
Total liabilities and stockholders equity	5,297,179	(1,227)	5,295,952

(1) As reported in our Form 10-Q filed on December 12, 2005 for the six months ended October 31,

2005.

(2) Adjusted to reflect the restatement described in 2A above.

The following is a summary of the impact of the restatement described in 2A above on our condensed consolidated statement of income and comprehensive income for the three and six months ended October 31, 2005:

	(in 000s, except per share amounts)		
Three months ended October 31, 2005	As Previously Reported [1]	Adjustments [2]	Restated
Income tax benefit	$ (46,854)	$ (5,026)	$ (51,880)
Net loss	(86,275)	5,026	(81,249)
Basic and diluted loss per share	$ (0.26)	$ 0.01	$ (0.25)
Comprehensive income (loss)	$ (105,543)	$ 5,026	$ (100,517)

(1) As reported in our Form 10-Q filed on December 12, 2005 for the six months ended October 31, 2005.

(2) Adjusted to reflect the restatement described in 2A above.

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(in 000s, except per share amounts)

Six months ended October 31, 2005	As Previously Reported (1)	Adjustments (2)	Restated
Income tax benefit	$ (64,399)	$ (5,356)	$ (69,755)
Net loss	(114,599)	5,356	(109,243)
Basic and diluted loss per share	$ (0.35)	$ 0.02	$ (0.33)
Comprehensive income (loss)	$ (138,854)	$ 5,356	$ (133,498)

(1) As reported in our Form 10-Q filed on December 12, 2005 for the six months ended October 31, 2005.

(2) Adjusted to reflect the restatement described in 2A above.

The following is a summary of the impact of the restatements on our condensed consolidated statement of income and comprehensive income for the three and six months ended October 31, 2004:

(in 000s, except per share amounts)

	Three months ended October 31, 2004				
	As Previously Reported (1)	Adjustments (2)	As Previously Restated (3)	Adjustments (4)	Restated
Gain on sale of mortgage assets, net	$ 184,114	$ 34	$ 184,148	$	$ 184,148
Interest income	45,888	2,664	48,552		48,552
Total revenues	539,255	2,698	541,953		541,953
Total operating expenses	608,608	(3,408)	605,200		605,200
Operating loss	(69,353)	6,106	(63,247)		(63,247)
Loss before taxes	(85,924)	6,106	(79,818)		(79,818)
Income tax benefit	(33,725)	3,779	(29,946)	(1,070)	(31,016)
Net loss	(52,199)	2,327	(49,872)	1,070	(48,802)
Basic and diluted loss per share	$ (0.16)	$ 0.01	$ (0.15)	$	$ (0.15)

Change in unrealized gain on available-for-sale securities, net	$ 9,752	$ (1,668)	$ 8,084	$	$ 8,084
Comprehensive income (loss)	(34,076)	659	(33,417)	1,070	(32,347)

	Six months ended October 31, 2004				
	As Previously Reported (1)	Adjustments (2)	As Previously Restated (3)	Adjustments (4)	Restated
Gain on sale of mortgage assets, net	$ 366,648	$ 860	$ 367,508	$	$ 367,508
Interest income	82,594	5,678	88,272		88,272
Total revenues	1,021,966	6,538	1,028,504		1,028,504
Total operating expenses	1,148,098	(13,332)	1,134,766		1,134,766
Operating loss	(126,132)	19,870	(106,262)		(106,262)
Loss before taxes	(158,488)	19,870	(138,618)		(138,618)
Income tax benefit	(62,206)	10,202	(52,004)	(1,858)	(53,862)
Net loss	(96,282)	9,668	(86,614)	1,858	(84,756)
Basic and diluted loss per share	$ (0.29)	$ .03	$ (0.26)	$ 0.01	$ (0.25)
Change in unrealized gain on available-for-sale securities, net	$ 33,595	$ (4,041)	$ (29,554)	$	$ 29,554
Comprehensive income (loss)	(54,646)	5,627	(49,019)	1,858	(47,161)

(1) As reported in our Form 10-Q filed on December 8, 2004 for the six months ended October 31, 2004. Amounts have been reclassified to conform to current year presentation. See discussion of reclassifications in note 1.

(2) Adjusted to reflect the restatement described in 2B above, as derived from the Company s Form 10-K/A filed on

August 5, 2005 for the year ended April 30, 2005.

(3) As reported in our Form 10-Q filed on December 12, 2005 for the six months ended October 31, 2005.

(4) Adjusted to reflect the restatement described in 2A above.

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The following is a summary of the impact of the restatement described in 2A above on our condensed consolidated statement of cash flows for the six months ended October 31, 2005:

(in 000s)

	As Previously Reported [1]	Adjustments [2]	Restated
Net loss	$ (114,599)	$ 5,356	$ (109,243)
Other, net of acquisitions	(474,532)	(5,356)	(479,888)

(1) As reported in our Form 10-Q filed on December 12, 2005 for the six months ended October 31, 2005.

(2) Adjusted to reflect the restatement described in 2A above.

The following is a summary of the impact of the restatements on our condensed consolidated statement of cash flows for the six months ended October 31, 2004:

(in 000s)

	As Previously Reported [1]	Adjustments [2]	As Previously Restated [3]	Adjustments [4]	Restated
Net loss	$ (96,282)	$ 9,668	$ (86,614)	$ 1,858	$ (84,756)
Depreciation and amortization	76,768	3,499	80,267		80,267
Accretion of residual interests in securitizations	(57,835)	(5,679)	(63,514)		(63,514)
Impairment of available-for-sale residual interests	3,469	(860)	2,609		2,609
Other, net of acquisitions	(588,756)	(1,279)	(590,035)	(1,858)	(591,893)
Net cash used in operating activities	(672,623)	5,349	(667,274)		(667,274)
Purchases of property and equipment, net	(55,249)	(5,349)	(60,598)		(60,598)
Net cash provided by (used in) investing activities	24,894	(5,349)	19,545		19,545

(1) As reported in our Form 10-Q filed on December 8, 2004 for the six months ended October 31, 2004. Amounts have been reclassified to conform to current year presentation. See discussion of reclassifications in note 1.

(2) Adjusted to reflect the restatement described in 2B above, as derived from the Company s Form 10-K/A filed on August 5, 2005 for the fiscal year ended April 30, 2005.

(3) As reported in our Form 10-Q filed on December 12, 2005 for the six months ended October 31, 2005.

(4) Adjusted to reflect the restatement described in 2A above.

The restatements had no impact on our cash flows from financing activities as previously reported.

3. Business Combinations

Effective October 1, 2005, we acquired all outstanding common stock of American Express Tax and Business Services, Inc. for cash payments totaling $191.4 million. The initial purchase price is subject to a post-closing adjustment based upon determination of the final September 30, 2005 net asset value. Results related to American Express Tax and Business Services, Inc. have been included in our condensed consolidated financial statements since October 1, 2005. Pro forma results of operations have not been presented because the effects of this acquisition were not material to our results. The accompanying balance sheet reflects a preliminary allocation of the purchase price to assets acquired and liabilities assumed as follows:

	(in 000s)
Property and equipment	$ 18,590
Other assets	136,169
Liabilities	(57,420)
Amortizing intangible assets	28,100
Goodwill	65,987
Total cash paid	$ 191,426

Goodwill recognized in these transactions is included in the Business Services segment and is not deductible for tax purposes. The preliminary purchase price allocations are subject to change and will be adjusted based upon resolution of several matters including, but not limited to, the following:

§ Determination of the post-closing adjustment and final purchase price;

§ Completion of our valuation of intangible assets and determination of useful lives;

- § Determination of final liabilities relating to planned exit activities; and
- § Determination of the tax basis of acquired assets and liabilities, and deferred tax balances of the acquired business.

4. Earnings (Loss) Per Share

Basic earnings (loss) per share is computed using the weighted average shares outstanding during each period. The dilutive effect of potential common shares is included in diluted earnings (loss) per share except in those periods with a loss. 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 32.6 million shares of stock for the three and six months ended October 31, 2005 and 35.2 million shares for the three and six months ended October 31, 2004, as the effect would be antidilutive due to the net loss recorded during the periods.

The weighted average shares outstanding for the three and six months ended October 31, 2005 decreased to 326.0 million and 328.4 million, respectively, from 329.4 million and 333.4 million last year, primarily due to our purchases of treasury shares. The effect of these purchases was partially offset by the issuance of treasury shares related to our stock-based compensation plans.

During each of the six month periods ended October 31, 2005 and 2004, we issued 3.3 million shares of common stock pursuant to the exercise of stock options, employee stock purchases and awards of restricted shares, in accordance with our stock-based compensation plans.

During the six months ended October 31, 2005, we acquired 9.2 million shares of our common stock, of which 9.0 million shares were purchased from third parties with the remaining shares swapped or surrendered to us, at an aggregate cost of $259.7 million. During the six months ended October 31, 2004, we acquired 22.5 million shares of our common stock, nearly all of which were purchased from third parties, at an aggregate cost of $529.6 million.

5. Mortgage Banking Activities

Activity related to available-for-sale residual interests in securitizations consists of the following:

		(in 000s)
		Restated
Six months ended October 31,	2005	2004
Balance, beginning of period	$ 205,936	$ 210,973
Additions from net interest margin (NIM) transactions	8,724	15,270
Cash received	(64,377)	(73,477)
Cash received on sale of residual interests	(30,497)	
Accretion	61,925	63,514
Impairments of fair value	(20,613)	(2,609)
Other	366	
Changes in unrealized holding gains, net	(18,682)	47,832
Balance, end of period	$ 142,782	$ 261,503

We sold $23.3 billion and $13.3 billion of mortgage loans in loan sales to warehouse trusts (Trusts) or other buyers during the six months ended October 31, 2005 and 2004, respectively, with gains totaling $288.8 million and $372.0 million, respectively, recorded on these sales.

Net additions to trading residual interests recorded in connection with the securitization of mortgage loans totaled $185.6 million and $68.6 million during the six months ended October 31, 2005 and 2004, respectively. Trading residuals valued at $94.2 million were securitized in net interest margin (NIM) transactions during the current year, with net cash proceeds of $85.5 million received in connection with NIM transactions. In the prior year, all trading residuals, which totaled $68.6 million, were securitized with net cash proceeds of $53.3 million received on the transactions. Total net additions to residual interests from NIM transactions for the six months ended October 31, 2005 and 2004 were $8.7 million and $15.3 million, respectively.

During the six months ended October 31, 2005, we completed the sale of $40.5 million of previously securitized residual interests and recorded a gain of $28.7 million. We received cash proceeds of $30.5 million and retained a $10.0 million residual interest in the sale. This sale accelerates cash flows from the residual interests and recognition of unrealized gains included in other comprehensive income.

At October 31, 2005, we had $93.9 million in residual interests classified as trading securities. These residual interests are the result of the initial securitization of mortgage loans and are expected to be securitized in a NIM transaction during our third quarter. Trading residuals are included in marketable securities trading on the condensed consolidated balance sheet with mark-to-market adjustments included in gains on sales of mortgage assets on the condensed consolidated income statement. Such adjustments resulted in a net loss of $1.4 million and a net gain of $2.1 million for the three and six months ended October 31, 2005, respectively. Similar adjustments resulted in a net gain of $4.9 million for the three and six months ended October 31, 2004. Cash flows from trading residuals of $7.9 million were received for the six months ended October 31, 2005 and are included in operating activities in the accompanying condensed consolidated statement of cash flows. There were no such trading securities recorded as of April 30, 2005.

Cash flows from available-for-sale residual interests of $64.4 million and $73.5 million were received from the securitization trusts for the six months ended October 31, 2005 and 2004, respectively. Cash received on available-for-sale residual interests is included in investing activities in the condensed consolidated statements of cash flows.

Aggregate net unrealized gains on residual interests not yet accreted into income totaled $67.9 million at October 31, 2005 and $115.4 million at April 30, 2005. These unrealized gains are recorded net of deferred taxes in other comprehensive income, and may be recognized in income in future periods either through accretion or upon further securitization or sale of the related residual interest.

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

		(in 000s)
Six months ended October 31,	2005	2004
Balance, beginning of period	$ 166,614	$ 113,821
Additions	136,294	58,894
Amortization	(56,660)	(38,653)
Impairment	(320)	
Balance, end of period	$ 245,928	$ 134,062

Estimated amortization of MSRs for fiscal years 2006 through 2010 is $69.9 million, $100.9 million, $48.0 million, $18.9 million and $8.2 million, respectively.

During the current quarter, we completed an evaluation of assumptions used to value our MSRs. The changes in our assumptions as a result of this evaluation resulted in an increase to MSRs recorded in conjunction with loans originated during the second quarter. This change in assumptions increased our weighted average value of MSRs by approximately 14 basis points, primarily as a result of lower servicing costs, in particular interest paid to bondholders on monthly loan prepayments. As a result, additions to MSRs and gains on sales of mortgage loans during our second quarter were approximately $16.8 million higher than would have been recorded under our previous assumptions.

The key weighted average assumptions we used to estimate the cash flows and values of the residual interests initially recorded during the six months ended October 31, 2005 are as follows:

Six months ended October 31,	2005	2004
Estimated credit losses	2.82%	3.08%
Discount rate	20.02%	25.00%
Variable returns to third-party beneficial interest holders	LIBOR forward curve at closing	

The key weighted average assumptions we used to estimate the cash flows and values of the residual interests and MSRs at October 31, 2005 and April 30, 2005 are as follows:

	October 31, 2005	April 30, 2005
Estimated credit losses	2.96%	3.03%
Discount rate residual interests	19.24%	21.01%
Discount rate MSRs	15.00%	12.80%
Variable returns to third-party beneficial interest holders	LIBOR forward curve at valuation date	

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

	Prior to Initial Rate Reset Date	Months Outstanding After Initial Rate Reset Date	
		Zero - 3	Remaining Life
Adjustable rate mortgage loans:			
With prepayment penalties	31%	70%	43%
Without prepayment penalties	37%	53%	41%
Fixed rate mortgage loans:			
With prepayment penalties	30%	50%	41%

For fixed rate mortgages without prepayment penalties, we use an average prepayment rate of 34% over the life of the loans. Prepayment rate is projected based on actual paydown including voluntary, involuntary and scheduled principal payments.

Expected static pool credit losses are as follows:

	Mortgage Loans Securitized in Fiscal Year					
	Prior to 2002	2002	2003	2004	2005	2006
As of:						
October 31, 2005	4.52%	2.49%	2.05%	2.16%	2.93%	2.84%
July 31, 2005	4.53%	2.53%	2.03%	2.20%	2.86%	2.70%
April 30, 2005	4.52%	2.53%	2.08%	2.30%	2.83%	
April 30, 2004	4.46%	3.58%	4.35%	3.92%		

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

At October 31, 2005, the sensitivities of the current fair value of the residual interests and MSRs to 10% and 20% adverse changes in the above key assumptions are as follows:

(dollars in 000s)

	Residential Mortgage Loans			
	NIM Residuals	Beneficial Interest in Trusts	Trading Residual	Servicing Assets
Carrying amount/fair value	$142,782	$ 169,378	$93,865	$ 245,928
Weighted average remaining life (in years)	1.4	2.1	1.9	1.3
Prepayments (including defaults):				
Adverse 10% $ impact on fair value	$ 4,200	$ (3,523)	$ (1,303)	$ (32,334)
Adverse 20% $ impact on fair value	11,888	(2,511)	(2,112)	(53,876)

Credit losses:					
Adverse 10%	$ impact on fair value	$ (34,306)	$ (8,044)	$ (3,060)	Not applicable
Adverse 20%	$ impact on fair value	(59,982)	(15,179)	(6,101)	Not applicable
Discount rate:					
Adverse 10%	$ impact on fair value	$ (3,572)	$ (3,441)	$ (2,485)	$ (3,732)
Adverse 20%	$ impact on fair value	(6,924)	(6,786)	(4,849)	(7,364)
Variable interest rates (LIBOR forward curve):					
Adverse 10%	$ impact on fair value	$ (10,099)	$ (59,826)	$ 3,270	Not applicable
Adverse 20%	$ impact on fair value	(19,190)	(93,728)	6,264	Not applicable

These sensitivities are hypothetical and should be used with caution. Changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also in this table, the effect of a variation of a particular assumption on the fair value is calculated without changing any other assumptions. It is likely that changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

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Mortgage loans that have been securitized at October 31, 2005 and April 30, 2005, past due sixty days or more and the related credit losses incurred are presented below:

(in 000s)

	Total Principal Amount of Loans Outstanding		Principal Amount of Loans 60 Days or More Past Due		Credit Losses (net of recoveries)	
					Three months ended	
	October 31, 2005	April 30, 2005	October 31, 2005	April 30, 2005	October 31, 2005	April 30, 2005
Securitized mortgage loans	$ 11,716,390	$ 10,300,805	$ 992,040	$ 1,128,376	$ 29,153	$ 21,641
Mortgage loans in warehouse Trusts	9,566,572	6,742,387				
Total loans	$ 21,282,962	$ 17,043,192	$ 992,040	$ 1,128,376	$ 29,153	$ 21,641

6. Goodwill and Intangible Assets

Changes in the carrying amount of goodwill for the six months ended October 31, 2005 consist of the following:

(in 000s)

	April 30, 2005	Additions	Other	October 31, 2005
Tax Services	$ 360,781	$ 5,648	$ 289	$ 366,718
Mortgage Services	152,467			152,467
Business Services	328,745	66,428	(725)	394,448
Investment Services	173,954			173,954
Total goodwill	$ 1,015,947	$ 72,076	$ (436)	$ 1,087,587

We test goodwill for impairment annually at the beginning of our fourth quarter, or more frequently if events occur indicating it is more likely than not the fair value of a reporting unit s net assets has been reduced below its carrying value. No such impairment or events indicating impairment were identified within any of our segments during the six months ended October 31, 2005. Our evaluation of impairment is dependent upon various assumptions, including assumptions regarding projected operating results and cash flows of reporting units. Actual results could differ materially from our projections and those differences could alter our conclusions regarding the fair value of a reporting unit and its goodwill.

Intangible assets consist of the following:

(in 000s)

	October 31, 2005	April 30, 2005

	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Tax Services:						
Customer relationships	$ 24,327	$ (8,868)	$ 15,459	$ 23,717	$ (7,207)	$ 16,510
Noncompete agreements	18,501	(14,607)	3,894	17,677	(11,608)	6,069
Business Services:						
Customer relationships	153,186	(74,193)	78,993	130,585	(68,433)	62,152
Noncompete agreements	31,470	(12,558)	18,912	27,796	(11,274)	16,522
Trade name amortizing	4,550	(1,030)	3,520	1,450	(995)	455
Trade name non-amortizing	55,637	(4,868)	50,769	55,637	(4,868)	50,769
Investment Services:						
Customer relationships	293,000	(216,698)	76,302	293,000	(198,385)	94,615
Total intangible assets	$ 580,671	$ (332,822)	$ 247,849	$ 549,862	$ (302,770)	$ 247,092

Amortization of intangible assets for the three and six months ended October 31, 2005 was $15.3 million and $30.6 million, respectively. Amortization of intangible assets for the three and six months ended October 31, 2004 was $15.3 million and $30.4 million, respectively. Estimated amortization of intangible assets for fiscal years 2006 through 2010 is $64.1 million, $54.5 million, $37.4 million, $14.7 million and $12.6 million, respectively.

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The goodwill and intangible assets added in the Business Services segment relate primarily to the acquisition of American Express Tax and Business Services, Inc. and are preliminary, as discussed in note 3. Additionally, due to the preliminary nature of these assets and their associated useful lives, amounts included above in estimated future amortization are subject to change.

7. Derivative Instruments

We enter into derivative instruments to reduce risks relating to mortgage loans we originate and sell, and therefore all gains or losses are included in gains on sales of mortgage assets, net in the condensed consolidated income statements. A summary of our derivative instruments as of October 31, 2005 and April 30, 2005, and gains or losses incurred during the three and six months ended October 31, 2005 and 2004 is as follows:

(in 000s)

	Asset (Liability) Balance at		Gain (Loss) for the Three Months Ended October 31,		Gain (Loss) for the Six Months Ended October 31,	
	October 31, 2005	April 30, 2005	2005	2004	2005	2004
Interest rate swaps	$ 27,118	$ (1,325)	$ 59,742	$ (2,104)	$ 85,285	$ (2,104)
Interest rate caps	69	12,458	162		802	
Rate-lock equivalents	62	801	354	215	(738)	1,699
Prime short sales	1,329	(805)	492	(717)	1,487	(1,525)
	$ 28,578	$ 11,129	$ 60,750	$ (2,606)	$ 86,836	$ (1,930)

We generally use interest rate swaps and forward loan sale commitments to reduce interest rate risk associated with non-prime loans. We generally enter into interest rate swap arrangements related to existing loan applications with rate-lock commitments and for rate-lock commitments we expect to make in the next 30 days. Interest rate swaps represent an agreement to exchange interest rate payments. These contracts increase in value as rates rise and decrease in value as rates fall. The notional amount of interest rate swaps to which we were a party at October 31, 2005 was $10.0 billion, with a weighted average duration of 1.77 years.

We generally enter into interest rate caps or swaps to mitigate interest rate risk associated with mortgage loans that will be securitized and residual interests that are classified as trading securities because they will be sold in a subsequent NIM transaction. These instruments enhance the marketability of the securitization and NIM transactions. An interest rate cap represents a right to receive cash if interest rates rise above a contractual strike rate, its value therefore increases as interest rates rise. The interest rate used in our interest rate caps is based on LIBOR.

We enter into forward loan commitments to sell our non-prime mortgage loans to manage interest rate risk. Forward loan sale commitments for non-prime loans are not considered derivative instruments and therefore cannot be recorded in our financial statements. The notional value and the contract value of the forward commitments at October 31, 2005 were $3.5 billion and $3.6 billion, respectively. Most of our forward commitments give us the option to under- or over-deliver by five to ten percent.

In the normal course of business, we enter into commitments with our customers to fund both non-prime and prime mortgage loans for specified periods of time at locked-in interest rates. These derivative instruments represent commitments to fund loans (rate-lock equivalents). The fair value of non-prime loan commitments is calculated using a binomial option model, although we do not initially record an asset for non-prime commitments to fund loans. The fair value of prime loan commitments is calculated based on the current market pricing of short sales of FNMA, FHLMC and GNMA mortgage-backed securities and the coupon rates of the eligible loans.

We sell short FNMA, FHLMC and GNMA mortgage-backed securities to reduce our risk related to our commitments to fund fixed-rate prime loans. The position on certain or all of the fixed-rate mortgage loans is closed approximately 10-15 days prior to standard Public Securities Association (PSA) settlement dates.

None of our derivative instruments qualify for hedge accounting treatment as of October 31, 2005 or April 30, 2005.

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8. Stock-Based Compensation

Effective May 1, 2003, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123), under the prospective transition method as described in Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Had compensation cost for all stock-based compensation plan grants been determined in accordance with the fair value accounting method prescribed under SFAS 123, our net loss and loss per share would have been as follows:

	(in 000s, except per share amounts)			
	Three months ended October 31,		Six months ended October 31,	
	Restated 2005	Restated 2004	Restated 2005	Restated 2004
Net loss as reported	$ (81,249)	$ (48,802)	$ (109,243)	$ (84,756)
Add: Stock-based compensation expense included in reported net loss, net of related tax effects	6,246	5,242	12,011	8,342
Deduct: Total stock-based compensation expense determined under fair value method for all awards, net of related tax effects	(8,790)	(7,923)	(17,098)	(13,705)
Pro forma net loss	$ (83,793)	$ (51,483)	$ (114,330)	$ (90,119)
Basic and diluted loss per share:				
As reported	$ (0.25)	$ (0.15)	$ (0.33)	$ (0.25)
Pro forma	(0.26)	(0.16)	(0.35)	(0.27)

9. Supplemental Cash Flow Information

During the six months ended October 31, 2005, we paid $169.2 million and $50.1 million for income taxes and interest, respectively. During the six months ended October 31, 2004, we paid $316.8 million and $37.3 million for income taxes and interest, respectively. See note 3 for discussion of cash payments made, assets acquired and liabilities assumed related to our acquisition of American Express Tax and Business Services, Inc.

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

		(in 000s)
Six months ended October 31,	2005	2004
Residual interest mark-to-market	$ 25,791	$ 88,867
Additions to residual interests	8,724	15,270

10. Commitments and Contingencies

We maintain two unsecured committed lines of credit (CLOCs) for working capital, support of our commercial paper program and general corporate purposes. The two CLOCs are from a consortium of thirty-one banks and expire in August 2010. These lines are subject to various affirmative and negative covenants, including a minimum net worth covenant. These CLOCs were undrawn at October 31, 2005.

We offer guarantees under our Peace of Mind (POM) program to tax clients whereby we will assume the cost of additional taxes attributable to tax return preparation errors for which we are responsible. We defer all revenues and direct costs associated with these guarantees, recognizing these amounts over the term of the guarantee based upon historic and actual payment of claims. Changes in the deferred revenue liability are as follows:

		(in 000s)
Six months ended October 31,	2005	2004
Balance, beginning of period	$ 130,762	$ 123,048
Amounts deferred for new guarantees issued	1,107	798
Revenue recognized on previous deferrals	(44,476)	(41,627)
Balance, end of period	$ 87,393	$ 82,219

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We have commitments to fund mortgage loans to customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. The commitments to fund loans amounted to $4.1 billion and $3.9 billion at October 31, 2005 and April 30, 2005, respectively. External market forces impact the probability of commitments being exercised, and therefore, total commitments outstanding do not necessarily represent future cash requirements.

We have entered into loan sale agreements with investors in the normal course of business, which include standard representations and warranties customary to the mortgage banking industry. Violations of these representations and warranties may require us to repurchase loans previously sold. A liability has been established related to the potential loss on repurchase of loans previously sold of $54.9 million and $41.2 million at October 31, 2005 and April 30, 2005, respectively, based on historical experience. Repurchased loans are normally sold in subsequent sale transactions.

Option One Mortgage Corporation provides a guarantee up to a maximum amount equal to approximately 10% of the aggregate principal balance of mortgage loans held by the Trusts before ultimate disposition of the loans. This guarantee would be called upon in the event adequate proceeds were not available from the sale of the mortgage loans to satisfy the payment obligations of the Trusts. No losses have been sustained on this commitment since its inception. The total principal amount of Trust obligations outstanding as of October 31, 2005 and April 30, 2005 was $9.5 billion and $6.7 billion, respectively. The fair value of mortgage loans held by the Trusts as of October 31, 2005 and April 30, 2005 was $9.6 billion and $6.8 billion, respectively.

We have various contingent purchase price obligations in connection with prior acquisitions. In many cases, contingent payments to be made in connection with these acquisitions are not subject to a stated limit. We estimate the potential payments (undiscounted) total approximately $8.8 million and $5.1 million as of October 31, 2005 and April 30, 2005, respectively. Our estimate is based on current financial conditions. Should actual results differ materially from our assumptions, the potential payments will differ from the above estimate. Such payments, if and when paid, would be recorded as additional cost of the acquired business, generally goodwill.

We have contractual commitments to fund certain franchises requesting draws on Franchise Equity Lines of Credit (FELCs). Our commitment to fund FELCs as of October 31, 2005 and April 30, 2005 totaled $72.1 million and $68.9 million, respectively. We have a receivable of $47.9 million and $39.0 million, which represents the amounts drawn on the FELCs, as of October 31, 2005 and April 30, 2005, respectively.

We routinely enter into contracts that include embedded indemnifications that have characteristics similar to guarantees, including obligations to protect counterparties from losses arising from the following: (a) tax, legal and other risks related to the purchase or disposition of businesses; (b) penalties and interest assessed by Federal and state taxing authorities in connection with tax returns prepared for clients; (c) indemnification of our directors and officers; and (d) third-party claims relating to various arrangements in the normal course of business. Typically, there is no stated maximum payment related to these indemnifications, and the term of indemnities may vary and in many cases is limited only by the applicable statute of limitations. The likelihood of any claims being asserted against us and the ultimate liability related to any such claims, if any, is difficult to predict. While we cannot provide assurance that such claims will not be successfully asserted, we believe the fair value of these guarantees and indemnifications is not material as of October 31, 2005.

11. Litigation Commitments and Contingencies

We have been involved in a number of class actions and putative class action cases since 1990 regarding our RAL programs. These cases are based on a variety of legal theories and allegations. These theories and allegations include, among others, that (i) we improperly did not disclose license fees we received from RAL lending banks for RALs they make to our clients, (ii) we owe and breached a fiduciary duty to our clients and (iii) the RAL program violates laws such as state credit service organization laws and the federal Racketeer Influenced and Corrupt Organizations (RICO) Act. Although we have successfully defended many RAL cases, we incurred a pretax expense of $43.5 million in fiscal year 2003 in connection with settling one RAL case. Several of the RAL cases are still pending and the amounts claimed in some of them are very substantial. The ultimate cost of this litigation could be substantial. We intend to continue defending the RAL cases vigorously, although there are no assurances as to their outcome.

We are also parties to claims and lawsuits pertaining to our electronic tax return filing services and our POM guarantee program associated with income tax preparation services. These claims and lawsuits include actions by individual plaintiffs, as well as cases in which plaintiffs seek to represent a class of similarly situated customers. The amounts claimed in these claims and lawsuits are substantial in some instances, and the ultimate liability with respect to such litigation and claims is difficult to predict. We intend to continue defending these cases vigorously, although there are no assurances as to their outcome.

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

It is our policy to accrue for amounts related to legal matters if it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. Many of the various legal proceedings are covered in whole or in part by insurance. Any receivable for insurance recoveries is recorded separately from the corresponding litigation reserve, and only if recovery is determined to be probable. Receivables for insurance recoveries at October 31, 2005 were immaterial.

12. Segment Information

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

				(in 000s)
	Three months ended October 31,		Six months ended October 31,	
	2005	Restated 2004	2005	Restated 2004
Revenues:				
Tax Services	$ 80,813	$ 74,106	$ 138,004	$ 124,553
Mortgage Services	286,151	284,332	646,589	556,305
Business Services	166,805	129,047	293,651	238,149
Investment Services	70,018	53,761	138,001	107,342
Corporate	1,256	707	3,791	2,155
	$ 605,043	$ 541,953	$ 1,220,036	$ 1,028,504
Pretax income (loss):				
Tax Services	$ (142,864)	$ (133,932)	$ (287,370)	$ (246,578)
Mortgage Services	46,239	108,472	180,707	217,497
Business Services	(2,143)	(4,892)	(8,908)	(14,937)
Investment Services	(7,906)	(20,764)	(15,458)	(41,107)
Corporate	(26,455)	(28,702)	(47,969)	(53,493)

Loss before taxes	$ (133,129)	$ (79,818)	$ (178,998)	$ (138,618)

13. New Accounting Pronouncements

Exposure Drafts Amendments of SFAS 140

In August 2005, the Financial Accounting Standards Board (FASB) issued three exposure drafts which amend Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

The first exposure draft seeks to clarify the derecognition requirements for financial assets and the initial measurement of interests related to transferred financial assets that are held by a transferor. Our current off-balance sheet warehouse facilities (the Trusts) in our Mortgage Services segment would be required to be consolidated in our financial statements based on the provisions of the exposure draft. We will continue to monitor the status of the exposure draft and consider what changes, if any, could be made to the structure of the Trusts to continue to derecognize mortgage loans transferred to the Trusts. At October 31, 2005, the Trusts held loans totaling $9.5 billion, which we would be required to consolidate into our financial statements under the provisions of this exposure draft.

The second exposure draft would require mortgage servicing rights to be initially valued at fair value. This provision would not have a material impact to our financial statements. In addition, this exposure draft would permit us to choose to continue to amortize mortgage servicing rights in proportion to and over the period of estimated net servicing income, as currently required under SFAS 140, or report mortgage servicing rights at fair value at each reporting date and report changes in fair value in earnings in the period in which the changes occur. We have not yet determined how we would elect to account for mortgage servicing rights under this provision or the potential impact to the financial statements.

The third exposure draft, among other things, would establish a requirement to evaluate beneficial interests in securitized financial assets to identify interests that are free-standing derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. Alternatively, this exposure draft would permit fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. Our residual interests in securitizations typically have interests in derivative instruments embedded within the securitization trusts. We have not yet determined if these embedded derivatives meet the criteria for bifurcation as outlined in the exposure draft.

The final standard for the first exposure draft is scheduled to be issued in the second quarter of calendar year 2006, and the final standards for the second and third exposure drafts are scheduled for the first quarter of calendar year 2006.

American Jobs Creation Act

In October 2004, the American Jobs Creation Act (the Act) was signed into law. The Act introduces a one-time deduction for dividends received from the repatriation of certain foreign earnings, provided certain criteria are met. During the three months ended October 31, 2005, we completed our evaluation of the effects of the Act, and have elected not to repatriate foreign earnings. Because we intend to indefinitely reinvest foreign earnings outside the United States, we have not provided deferred taxes on such earnings.

14. Condensed Consolidating Financial Statements

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

Condensed Consolidating Income Statements (in 000s)

Three months ended October 31, 2005 (Restated)	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Total revenues	$	$ 395,825	$ 213,175	$ (3,957)	$ 605,043
Cost of services		115,818	271,356	43	387,217
Cost of other revenues		129,316	5,548		134,864
Selling, general and administrative		96,960	113,589	(4,000)	206,549
Total expenses		342,094	390,493	(3,957)	728,630

Operating income (loss)	53,731	(177,318)	(123,587)
Interest expense	11,811	574	12,385

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Three months ended October 31, 2005 (Restated)	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Other income, net	(133,129)		2,843	133,129	2,843
Income (loss) before taxes	(133,129)	41,920	(175,049)	133,129	(133,129)
Income taxes (benefit)	(51,880)	16,349	(68,229)	51,880	(51,880)
Net income (loss)	$ (81,249)	$ 25,571	$ (106,820)	$ 81,249	$ (81,249)

Three months ended October 31, 2004 (Restated)	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Total revenues	$	$ 340,865	$ 204,440	$ (3,352)	$ 541,953
Cost of services		93,705	230,316	63	324,084
Cost of other revenues		90,764	5,485		96,249
Selling, general and administrative		71,454	116,828	(3,415)	184,867
Total expenses		255,923	352,629	(3,352)	605,200
Operating income (loss)		84,942	(148,189)		(63,247)
Interest expense		17,348	733		18,081
Other income, net	(79,818)		1,510	79,818	1,510
Income (loss) before taxes	(79,818)	67,594	(147,412)	79,818	(79,818)
Income taxes (benefit)	(31,016)	26,395	(57,411)	31,016	(31,016)
Net income (loss)	$ (48,802)	$ 41,199	$ (90,001)	$ 48,802	$ (48,802)

Six months ended October 31, 2005 (Restated)	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Total revenues	$	$ 856,465	$ 370,840	$ (7,269)	$ 1,220,036
Cost of service revenues		225,171	505,132	132	730,435
Cost of other revenues		250,216	8,005		258,221
Selling, general and administrative		188,148	215,054	(7,401)	395,801
Total expenses		663,535	728,191	(7,269)	1,384,457

Operating income (loss)		192,930	(357,351)		(164,421)
Interest expense		23,621	1,199		24,820
Other income, net	(178,998)		10,243	178,998	10,243
Income (loss) before taxes	(178,998)	169,309	(348,307)	178,998	(178,998)
Income taxes (benefit)	(69,755)	66,031	(135,786)	69,755	(69,755)
Net income (loss)	$ (109,243)	$ 103,278	$ (212,521)	$ 109,243	$ (109,243)

Six months ended October 31, 2004 (Restated)	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Total revenues	$	$ 669,468	$ 365,655	$ (6,619)	$ 1,028,504
Cost of services		186,970	427,980	109	615,059
Cost of other revenues		167,745	6,899		174,644
Selling, general and administrative		143,642	208,149	(6,728)	345,063
Total expenses		498,357	643,028	(6,619)	1,134,766
Operating income (loss)		171,111	(277,373)		(106,262)
Interest expense		34,150	1,724		35,874
Other income, net	(138,618)		3,518	138,618	3,518
Income (loss) before taxes	(138,618)	136,961	(275,579)	138,618	(138,618)
Income taxes (benefit)	(53,862)	53,483	(107,345)	53,862	(53,862)
Net income (loss)	$ (84,756)	$ 83,478	$ (168,234)	$ 84,756	$ (84,756)

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Condensed Consolidating Balance Sheets (in 000s)

October 31, 2005 (Restated)	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Cash & cash equivalents	$	$ 184,945	$ 207,545	$	$ 392,490
Cash & cash equivalents restricted		405,743	58,737		464,480
Receivables from customers, brokers and dealers, net		577,506			577,506
Receivables, net	1,724	376,076	315,502		693,302
Intangible assets and goodwill, net		405,600	929,836		1,335,436
Investments in subsidiaries	4,719,456	215	539	(4,719,456)	754
Other assets		1,476,631	354,722	631	1,831,984
Total assets	$ 4,721,180	$ 3,426,716	$ 1,866,881	$ (4,718,825)	$ 5,295,952
Commercial paper	$	$ 498,175	$	$	$ 498,175
Accts. payable to customers, brokers and dealers		846,913			846,913
Long-term debt		897,008	20,876		917,884
Other liabilities	2	554,760	925,692		1,480,454
Net intercompany advances	3,168,652	(976,206)	(2,192,829)	383	
Stockholders equity	1,552,526	1,606,066	3,113,142	(4,719,208)	1,552,526
Total liabilities and stockholders equity	$ 4,721,180	$ 3,426,716	$ 1,866,881	$ (4,718,825)	$ 5,295,952

April 30, 2005 (Restated)	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Cash & cash equivalents	$	$ 162,983	$ 937,230	$	$ 1,100,213
Cash & cash equivalents restricted		488,761	28,148		516,909
Receivables from customers, brokers and dealers, net		590,226			590,226
Receivables, net	101	199,990	218,697		418,788
Intangible assets and goodwill, net		421,036	842,003		1,263,039
Investments in subsidiaries	4,851,680	210	449	(4,851,680)	659
Other assets		1,407,082	241,532	(392)	1,648,222
Total assets	$ 4,851,781	$ 3,270,288	$ 2,268,059	$ (4,852,072)	$ 5,538,056
Accts. payable to customers, brokers and dealers	$	$ 950,684	$	$	$ 950,684
Long-term debt		896,591	26,482		923,073

Other liabilities	2	532,562	1,182,459	8	1,715,031
Net intercompany advances	2,902,511	(641,611)	(2,262,818)	1,918	
Stockholders equity	1,949,268	1,532,062	3,321,936	(4,853,998)	1,949,268
Total liabilities and stockholders equity	$ 4,851,781	$ 3,270,288	$ 2,268,059	$ (4,852,072)	$ 5,538,056

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Condensed Consolidating Statements of Cash Flows (in 000s)

Six months ended October 31, 2005 (Restated)	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Net cash provided by (used in) operating activities:	$ 24,257	$ (229,003)	$ (500,113)	$	$ (704,859)
Cash flows from investing:					
Cash received on residuals		64,377			64,377
Cash received on sale of residuals		30,497			30,497
Purchase property & equipment		(20,228)	(57,407)		(77,635)
Payments for business acquisitions		(2,948)	(197,361)		(200,309)
Net intercompany advances	264,868			(264,868)	
Other, net			13,151		13,151
Net cash provided by (used in) investing activities	264,868	71,698	(241,617)	(264,868)	(169,919)
Cash flows from financing:					
Repayments of commercial paper		(1,101,729)			(1,101,729)
Proceeds from commercial paper		1,599,904			1,599,904
Dividends paid	(77,381)				(77,381)
Acquisition of treasury shares	(259,745)				(259,745)
Proceeds from common stock	48,001				48,001
Net intercompany advances		(322,298)	57,430	264,868	
Other, net		3,390	(45,385)		(41,995)
Net cash provided by (used in) financing activities	(289,125)	179,267	12,045	264,868	167,055
Net increase (decrease) in cash		21,962	(729,685)		(707,723)
Cash beginning of period		162,983	937,230		1,100,213
Cash end of period	$	$ 184,945	$ 207,545	$	$ 392,490

Six months ended October 31, 2004 (Restated)	H&R Block, Inc. (Guarantor)	BFC (Issuer)	Other Subsidiaries	Elims	Consolidated H&R Block
Net cash provided by (used in) operating activities:	$ 810	$ 37,152	$ (705,236)	$	$ (667,274)
Cash flows from investing:					
Cash received on residuals		73,477			73,477
Purchase property & equipment		(18,135)	(42,463)		(60,598)
Payments for business acquisitions			(5,472)		(5,472)

Net intercompany advances	544,812			(544,812)	
Other, net		(96)	12,234		12,138
Net cash provided by (used in) investing activities	544,812	55,246	(35,701)	(544,812)	19,545
Cash flows from financing:					
Repayments of commercial paper		(1,376,877)			(1,376,877)
Proceeds from commercial paper		1,692,933			1,692,933
Proceeds from long-term debt		395,221			395,221
Dividends paid	(69,997)				(69,997)
Acquisition of treasury shares	(529,558)				(529,558)
Proceeds from common stock	53,933				53,933
Net intercompany advances		(770,746)	225,934	544,812	
Other, net			(24,600)		(24,600)
Net cash provided by (used in) financing activities	(545,622)	(59,469)	201,334	544,812	141,055
Net increase (decrease) in cash		32,929	(539,603)		(506,674)
Cash beginning of period		133,188	939,557		1,072,745
Cash end of period	$	$ 166,117	$ 399,954	$	$ 566,071

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

RESULTS OF OPERATIONS

H&R Block is a diversified company delivering tax services and financial advice, investment and mortgage services, and business and consulting services. For 50 years, we have been developing relationships with millions of tax clients and our strategy is to expand on these relationships. Our Tax Services segment provides income tax return preparation services, electronic filing services and other services and products related to income tax return preparation to the general public in the United States, Canada, Australia and the United Kingdom. We also offer investment services through H&R Block Financial Advisors, Inc. (HRBFA). Our Mortgage Services segment offers a full range of home mortgage services through Option One Mortgage Corporation (OOMC) and H&R Block Mortgage Corporation (HRBMC). RSM McGladrey Business Services, Inc. (RSM), together with its attest-firm affiliations, is the fifth largest national accounting, tax and consulting firm primarily serving mid-sized businesses.

Our Mission

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

Key to achieving our mission is the enhancement of client experiences through consistent delivery of valuable services and advice. Operating through multiple lines of business allows us to better meet the changing financial needs of our clients.

The accompanying Management s Discussion and Analysis of Financial Condition and Results of Operations reflects the restatements of previously issued financial statements, as discussed in note 2 to our condensed consolidated financial statements. The analysis that follows should be read in conjunction with the tables below and the condensed consolidated income statements found on page 2.

Consolidated H&R Block, Inc. Operating Results (in 000s, except per share amounts)

	Three months ended October 31,		Six months ended October 31,	
	Restated 2005	Restated 2004	Restated 2005	Restated 2004
Revenues:				
Tax Services	$ 80,813	$ 74,106	$ 138,004	$ 124,553
Mortgage Services	286,151	284,332	646,589	556,305
Business Services	166,805	129,047	293,651	238,149
Investment Services	70,018	53,761	138,001	107,342
Corporate	1,256	707	3,791	2,155
	$ 605,043	$ 541,953	$ 1,220,036	$ 1,028,504
Pretax income (loss):				
Tax Services	$ (142,864)	$ (133,932)	$ (287,370)	$ (246,578)
Mortgage Services	46,239	108,472	180,707	217,497
Business Services	(2,143)	(4,892)	(8,908)	(14,937)
Investment Services	(7,906)	(20,764)	(15,458)	(41,107)
Corporate	(26,455)	(28,702)	(47,969)	(53,493)
	(133,129)	(79,818)	(178,998)	(138,618)
Income tax benefit	(51,880)	(31,016)	(69,755)	(53,862)
Net loss	$ (81,249)	$ (48,802)	$ (109,243)	$ (84,756)

Basic and diluted loss per share	$	(0.25)	$	(0.15)	$	(0.33)	$	(0.25)

OVERVIEW

A summary of our results compared to the prior year is as follows:

Basic and diluted loss per share for the three months ended October 31, 2005 and 2004 was $0.25 and $0.15 per share, and $0.33 and $0.25 per share in the respective six month periods.

Tax Services revenues increased $6.7 million and $13.5 million for the three and six months ended October 31, 2005, respectively. Tax Services pretax loss increased $8.9 million to $142.9

million for the quarter, while the pretax loss increased $40.8 million to $287.4 million for the six months compared to the prior year. The higher losses were primarily due to off-season costs related to offices added during fiscal year 2005 and costs incurred for new offices to be opened in the coming tax season.

Mortgage Services revenues increased $1.8 million and $90.3 million for the three and six months ended October 31, 2005, respectively, while pretax income decreased $62.2 million and $36.8 million, respectively. Higher revenues are due to increased gains on derivatives, higher loan servicing revenue and a gain on sales of residual interests, partially offset by lower margins on mortgage loans sold. Declining profits reflect lower origination margins due to increases in funding costs outpacing our increases in coupon rates.

Business Services revenues increased $37.8 million and $55.5 million for the three and six months ended October 31, 2005, respectively, primarily due to a higher billed rate per hour in our accounting, tax and consulting business, coupled with acquisition-related growth in our payroll processing and financial process outsourcing businesses. The acquisition of American Express Tax and Business Services, Inc., effective as of October 1, 2005, contributed $20.6 million in revenues and $3.3 million in losses since acquisition. The pretax loss for the segment improved $2.7 million and $6.0 million for the three and six month periods, primarily due to revenue growth.

Investment Services revenues increased $16.3 million and $30.7 million for the three and six months, respectively. The pretax loss for the three and six months ended October 31, 2005 improved $12.9 million and $25.6 million, respectively. This improvement is primarily due to higher production and interest revenues, and actions implemented to reduce costs and enhance advisor performance.

TAX SERVICES

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

Tax Services Operating Results (in 000s)

	Three months ended October 31,		Six months ended October 31,	
	2005	Restated 2004	2005	Restated 2004
Service revenues:				
Tax preparation and related fees	$ 40,185	$ 33,933	$ 63,822	$ 52,977
Online tax services	620	609	1,253	1,309
Other services	31,644	28,722	59,978	53,059
	72,449	63,264	125,053	107,345
Royalties	4,161	3,739	6,557	5,351
Software sales	1,016	1,324	2,209	2,707
Other	3,187	5,779	4,185	9,150
Total revenues	80,813	74,106	138,004	124,553
Cost of services:				
Compensation and benefits	49,255	43,239	90,152	73,923

Occupancy	62,283	52,799	121,596	103,127
Depreciation	10,328	9,636	20,497	18,614
Other	35,743	38,121	72,935	69,349
	157,609	143,795	305,180	265,013
Cost of software sales	3,852	3,985	6,737	7,152
Selling, general and administrative	62,216	60,258	113,457	98,966
Total expenses	223,677	208,038	425,374	371,131
Pretax loss	$ (142,864)	$ (133,932)	$ (287,370)	$ (246,578)

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Three months ended October 31, 2005 compared to October 31, 2004

Tax Services revenues increased $6.7 million, or 9.1%, for the three months ended October 31, 2005 compared to the prior year.

Tax preparation and related fees increased $6.3 million, or 18.4%, for the current quarter. This increase is primarily due to an increase in the average fee per U.S. client served, coupled with an increase in U.S. clients served in company-owned offices. The average fee per U.S. client served increased 12.6% over last year, and U.S. clients served in company-owned offices increased 7.4%. Improved performance during the Australian tax season also contributed $2.5 million of additional tax preparation revenues in the current quarter.

Other service revenues increased $2.9 million primarily as a result of additional revenues associated with POM guarantees and Express IRAs.

Other revenues declined $2.6 million primarily due to lower supply sales to franchises during the current quarter.

Total expenses increased $15.6 million, or 7.5%. Cost of services for the three months ended October 31, 2005 increased $13.8 million, or 9.6%, from the prior year. Our real estate expansion efforts have contributed to a total increase of $9.1 million across all cost of services categories. Compensation and benefits increased $6.0 million primarily due to the addition of costs related to our small business initiatives in the current year, an increase in the number of off-season support staff needed for our new offices and related payroll taxes. Occupancy expenses increased $9.5 million, or 18.0%, primarily as a result of higher rent expenses, due to a 7.6% increase in company-owned offices under lease and an 8.9% increase in the average rent. Utilities and real estate taxes related to these new offices also contributed to the increase.

The pretax loss was $142.9 million for the three months ended October 31, 2005 compared to a prior year loss of $133.9 million.

Due to the seasonal nature of this segment s business, operating results for the three months ended October 31, 2005 are not comparable to the three months ended July 31, 2005 and are not indicative of the expected results for the entire fiscal year.

Six months ended October 31, 2005 compared to October 31, 2004

Tax Services revenues increased $13.5 million, or 10.8%, for the six months ended October 31, 2005 compared to the prior year.

Tax preparation and related fees increased $10.8 million, or 20.5%, primarily due to an increase in the average fee per U.S. client served, coupled with an increase in U.S. clients served in company-owned offices. The average fee per U.S. client served increased 11.0% over last year, and U.S. clients served in company-owned offices increased 6.6%. Additionally, the extension of the Canadian tax season into the month of May resulted in a $1.7 million increase to our current year revenues. Improved performance during the Australian tax season also contributed $2.6 million of additional tax preparation revenues in the current year.

Other service revenues increased $6.9 million primarily as a result of additional revenues associated with POM guarantees, Express IRAs and our small business initiatives.

Other revenues declined $5.0 million primarily due to lower supply sales to franchises.

Total expenses increased $54.2 million, or 14.6%. Cost of services for the six months ended October 31, 2005 increased $40.2 million, or 15.2%, from the prior year. Our real estate expansion efforts have contributed to a total increase of $16.6 million across all cost of services categories. Compensation and benefits increased $16.2 million primarily due to the addition of costs related to our small business initiatives and an increase in the number of off-season support staff needed for our new offices. Occupancy expenses increased $18.5 million, or 17.9%, primarily as a result of higher rent expenses, due to a 6.8% increase in company-owned offices under lease and a 9.7% increase in the average rent. Utilities and real estate taxes related to these new offices also contributed to the increase. Other cost of service expenses increased $3.6 million primarily due to additional expenses associated with our POM program.

Selling, general and administrative expenses increased $14.5 million over the prior year primarily due to a $7.2 million increase in legal expenses, $3.5 million in additional national office wages, $3.4

million in additional costs from corporate shared services and a $1.2 million increase in consulting expenses.

The pretax loss was $287.4 million for the six months ended October 31, 2005 compared to a prior year loss of $246.6 million.

Fiscal 2006 outlook

Our fiscal year 2006 outlook for the Tax Services segment has not changed materially from the discussion in our April 30, 2005 Form 10-K/A. We currently believe we will meet or exceed the high-end of our goal to open between 500 and 700 company-owned and franchise offices this year.

RAL Litigation

We have been named as a defendant in a number of lawsuits alleging that we engaged in wrongdoing with respect to the RAL program. We believe we have strong defenses to the various RAL cases and will vigorously defend our position. Nevertheless, the amounts claimed by the plaintiffs are, in some instances, very substantial, and there can be no assurances as to the ultimate outcome of the pending RAL cases, or as to the impact of the RAL cases on our financial statements. See additional discussion of RAL Litigation in note 11 to the condensed consolidated financial statements and in Part II, Item 1, Legal Proceedings.

MORTGAGE SERVICES

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

Mortgage Services Operating Statistics (dollars in 000s)

Three months ended	October 31, 2005	Restated October 31, 2004	July 31, 2005
Volume of loans originated:			
Wholesale (non-prime)	$ 11,078,960	$ 5,528,361	$ 9,537,227
Retail: Non-prime	1,111,924	800,975	950,806
Prime	429,924	183,647	399,596
	$ 12,620,808	$ 6,512,983	$ 10,887,629
Loan characteristics:			
Weighted average FICO score [1]	629	609	623
Weighted average interest rate for borrowers [1]	7.48%	7.46%	7.52%
Weighted average loan-to-value [1]	80.6%	78.3%	81.1%
Origination margin (% of origination volume): [2]			
Loan sale premium	0.55%	2.95%	2.32%
Residual cash flows from beneficial interest in Trusts	0.41%	0.80%	0.47%
Gain (loss) on derivative instruments	0.48%	(0.04%)	0.24%
Loan sale repurchase reserves	(0.16%)	(0.13%)	(0.15%)
Retained mortgage servicing rights	0.69%	0.47%	0.45%
	1.97%	4.05%	3.33%
Cost of acquisition	(0.40%)	(0.47%)	(0.48%)
Direct origination expenses	(0.56%)	(0.75%)	(0.57%)
Net gain on sale gross margin [3]	1.01%	2.83%	2.28%
Other revenues	0.02%	0.03%	0.01%
Other cost of origination	(1.23%)	(1.72%)	(1.37%)
Net margin	(0.20%)	1.14%	0.92%
Total cost of origination	1.79%	2.47%	1.94%
Total cost of origination and acquisition	2.19%	2.94%	2.42%
Loan delivery:			
Loan sales	$ 12,497,526	$ 6,560,780	$ 10,843,006
Execution price [4]	1.63%	2.94%	2.50%

(1) Represents non-prime production.

(2) See Reconciliation

of Non-GAAP Financial Information on page 44.

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

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

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Mortgage Services Operating Results (in 000s)

Three months ended	October 31, 2005	Restated October 31, 2004	July 31, 2005
Components of gains on sales:			
Gain on mortgage loans	$ 66,580	$ 186,754	$ 222,220
Gain (loss) on derivatives	60,750	(2,606)	26,086
Gain on sales of residual interests	28,675		
Impairment of residual interests	(8,738)		(11,875)
	147,267	184,148	236,431
Interest income:			
Accretion residual interests	33,564	34,837	30,777
Other interest income	4,605	2,444	2,768
	38,169	37,281	33,545
Loan servicing revenue	100,386	62,596	90,269
Other	329	307	193
Total revenues	286,151	284,332	360,438
Cost of services	67,811	52,931	64,392
Cost of other revenues:			
Compensation and benefits	84,151	55,214	80,283
Occupancy	10,531	8,913	12,629
Other	28,737	21,062	22,878
	123,419	85,189	115,790
Selling, general and administrative	48,682	37,740	45,788
Total expenses	239,912	175,860	225,970
Pretax income	$ 46,239	$ 108,472	$ 134,468

Three months ended October 31, 2005 compared to October 31, 2004

Mortgage Services revenues increased $1.8 million, or 0.6%, for the three months ended October 31, 2005 compared to the prior year. Revenues increased as a result of higher gains on derivatives, higher loan servicing revenue and a gain on sales of residual interests, offset by lower margins on mortgage loans sold.

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

(dollars in 000s)

Three months ended October 31,	2005	2004
Application process:		

Total number of applications	105,444	72,699
Number of sales associates [1]	3,910	3,369
Closing ratio [2]	63.8%	57.0%
Originations:		
Total number of originations	67,264	41,422
Weighted average interest rate for borrowers (WAC)	7.48%	7.46%
Average loan size	$ 188	$ 157
Total originations	$ 12,620,808	$ 6,512,983
Direct origination and acquisition expenses, net	$ 120,981	$ 79,850
Revenue (loan value):		
Net gain on sale gross margin [3]	1.01%	2.83%

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

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

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

Despite substantial increases in loan origination volume, gains on sales of mortgage loans decreased $120.2 million, primarily as a result of rapidly rising two-year swap rates, additional credit enhancement requirements by rating agencies and moderating demand by loan buyers. Market interest rates, based on the two-year swap, increased from an average of 2.88% last year to 4.46% in the current quarter. However, our WAC increased only 2 basis points, up to 7.48% from 7.46% in the prior year. Because our WAC was not more aligned with market rates, and because of increases in our funding costs offset by derivative gains, our gross margin declined 182 basis points, to 1.01% from 2.83% last year. Origination volumes increased 93.8% over the prior year, due to increased productivity of our account executives and support staff, new product introductions, increased applications and a higher closing ratio.

In the current quarter, we completed an evaluation of the assumptions used to value our MSRs. Based on the changes in our assumptions as a result of this evaluation, the gain on sale for our retained MSRs increased by approximately 14 basis points, or approximately $16.8 million, from the prior year, primarily as a result of lower servicing costs, in particular interest paid to bondholders on monthly loan prepayments. In addition, the increase in average loan size from $157,000 in the prior year to $188,000 in the current year resulted in an approximate 8 basis point increase in the value of the MSRs recorded in the quarter. Overall, the value of MSRs we recorded in the quarter increased to 69 basis points from 47 basis points in the prior year, which coupled with an increase in origination volume from $6.5 billion in the prior year quarter to $12.6 billion in the current year, resulted in an increase of $56.6 million in gains on sales of mortgage loans.

To mitigate the risk of short-term changes in market interest rates related to our loan originations, we use interest rate swaps and forward loan sale commitments. We generally enter into interest rate swap arrangements related to existing loan applications with rate-lock commitments and for rate-lock commitments we expect to make in the next 30 days. During the current quarter, we recorded a net $60.8 million in gains, compared to a net loss of $2.6 million in the prior year, related to our various derivative instruments. The higher gains in the current quarter are primarily a result of rising interest rates and an increase in the notional amounts of interest rate swaps in place as a result of increased origination volumes. See note 7 to the condensed consolidated financial statements.

During the current quarter, we recorded a $28.7 million gain on the sale of available-for-sale residual interests. This gain accelerated cash flows from residual interests, and resulted in realization of previously recorded unrealized gains included in other comprehensive income. We had no similar tra