H&R BLOCK INC
Form 10-Q
September 01, 2011

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

FORM 10-Q

(Mark One)

[**X**] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 31, 2011

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	**44-0607856**
(State or other jurisdiction of incorporation or organization)	**(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 ____

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 July 31, 2011 was 305,766,188 shares.

Form 10-Q for the Period Ended July 31, 2011

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

As of	July 31, 2011	April 30, 2011
	(Unaudited)	
ASSETS		
Cash and cash equivalents	$ 1,012,709	$ 1,677,844
Cash and cash equivalents restricted	44,402	48,383
Receivables, less allowance for doubtful accounts of $67,582 and $67,466	329,388	492,290
Prepaid expenses and other current assets	281,326	259,214
Total current assets	1,667,825	2,477,731
Mortgage loans held for investment, less allowance for loan losses of $91,303 and $92,087	466,663	485,008
Property and equipment, at cost, less accumulated depreciation and amortization of $694,321 and $677,220	295,220	307,320
Intangible assets, net	360,035	367,919
Goodwill	742,611	846,245
Other assets	775,698	723,738
Total assets	$ 4,308,052	$ 5,207,961
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Customer banking deposits	$ 666,268	$ 852,220
Accounts payable, accrued expenses and other current liabilities	522,130	618,070
Accrued salaries, wages and payroll taxes	83,257	257,038
Accrued income taxes	275,639	458,910
Current portion of long-term debt	30,940	3,437
Federal Home Loan Bank borrowings	25,000	25,000
Total current liabilities	1,603,234	2,214,675
Long-term debt	1,019,431	1,049,754
Other noncurrent liabilities	451,510	493,958
Total liabilities	3,074,175	3,758,387
Commitments and contingencies		
Stockholders equity:		
Common stock, no par, stated value $.01 per share, 800,000,000 shares authorized, shares issued of 412,440,599	4,124	4,124
Additional paid-in capital	808,668	812,666
Accumulated other comprehensive income	12,692	11,233

Retained earnings	2,437,011	2,658,103
Less treasury shares, at cost	(2,028,618)	(2,036,552)
Total stockholders equity	1,233,877	1,449,574
Total liabilities and stockholders equity	$ 4,308,052	$ 5,207,961

See Notes to Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

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

Three Months Ended July 31,	2011	2010
Revenues:		
Service revenues	$ 240,563	$ 247,419
Product and other revenues	16,638	16,753
Interest income	10,433	10,302
	267,634	274,474
Expenses:		
Cost of revenues:		
Compensation and benefits	160,255	168,047
Occupancy and equipment	94,045	94,702
Depreciation and amortization of property and equipment	21,048	23,065
Provision for bad debt and loan losses	8,823	10,049
Interest	23,301	22,962
Other	49,528	49,191
	357,000	368,016
Impairment of goodwill	99,697	
Selling, general and administrative expenses	108,166	117,029
	564,863	485,045
Operating loss	(297,229)	(210,571)
Other income, net	4,087	3,254
Loss from continuing operations before tax benefit	(293,142)	(207,317)
Income tax benefit	(119,699)	(79,679)
Net loss from continuing operations	(173,443)	(127,638)
Net loss from discontinued operations	(1,655)	(3,043)
Net loss	$ (175,098)	$ (130,681)
Basic and diluted loss per share:		
Net loss from continuing operations	$ (0.57)	$ (0.40)
Net loss from discontinued operations		(0.01)
Net loss	$ (0.57)	$ (0.41)

Basic and diluted shares	305,491	319,690
Dividends paid per share	$ 0.15	$ 0.15
Comprehensive income (loss):		
Net loss	$ (175,098)	$ (130,681)
Change in unrealized gain on available-for-sale securities, net	975	(306)
Change in foreign currency translation adjustments	484	(4,020)
Comprehensive loss	$ (173,639)	$ (135,007)

See Notes to Condensed Consolidated Financial Statements

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

Three Months Ended July 31,	2011	2010
Net cash used in operating activities	$ (394,549)	$ (348,251)
Cash flows from investing activities:		
Purchases of available-for-sale securities	(39,275)	
Principal repayments on mortgage loans held for investment, net	11,192	17,618
Purchases of property and equipment, net	(10,953)	(8,634)
Payments made for business acquisitions, net	(3,457)	(33,226)
Proceeds from sale of businesses, net	21,230	26,387
Franchise loans:		
Loans funded	(16,477)	(33,720)
Payments received	5,320	6,724
Other, net	18,167	18,848
Net cash used in investing activities	(14,253)	(6,003)
Cash flows from financing activities:		
Customer banking deposits, net	(186,245)	(121,401)
Dividends paid	(45,894)	(48,692)
Repurchase of common stock, including shares surrendered	(2,002)	(164,369)
Proceeds from exercise of stock options	1,762	1,500
Other, net	(24,916)	(15,987)
Net cash used in financing activities	(257,295)	(348,949)
Effects of exchange rates on cash	962	(2,232)
Net decrease in cash and cash equivalents	(665,135)	(705,435)
Cash and cash equivalents at beginning of the period	1,677,844	1,804,045
Cash and cash equivalents at end of the period	$ 1,012,709	$ 1,098,610
Supplementary cash flow data:		
Income taxes paid	$ 99,357	$ 64,651
Interest paid on borrowings	37,634	27,265
Interest paid on deposits	1,820	1,915
Transfers of foreclosed loans to other assets	1,573	6,527

See Notes to Condensed Consolidated Financial Statements

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, 2011, the condensed consolidated statements of operations and comprehensive income (loss) for the three months ended July 31, 2011 and 2010, and the condensed consolidated statements of cash flows for the three months ended July 31, 2011 and 2010 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, 2011 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 Bloc Inc. and its subsidiaries, as appropriate to the context.

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, 2011 Annual Report to Shareholders on Form 10-K. All amounts presented herein as of April 30, 2011 or for the year then ended, are derived from our April 30, 2011 Annual Report to Shareholders on Form 10-K.

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, valuation allowances based on future taxable income, reserves for uncertain tax positions, credit losses on receivable balances and related matters. Estimates have been prepared on the basis of the most current and best information available as of each balance sheet date. 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.

2. Subsequent Event

In August 2011, our Board of Directors approved a non-binding letter of intent to sell substantially all assets of RSM McGladrey Business Services, Inc. (RSM) to McGladrey & Pullen LLP (M&P) which is described in a recently issued Form 8-K. The sale is dependent on, among other factors, the ability of M&P to raise financing for the purchase, and is expected to be completed by calendar year end. We also announced we are evaluating strategic alternatives for RSM EquiCo, Inc. (EquiCo). We recorded a $99.7 million impairment of goodwill in the first quarter for reporting units in our Business Services segment based on these events. These amounts related to the sale of RSM may fluctuate based on adjustments to the purchase price at closing as well as the additional realization of tax benefits related to the sale. M&P will also assume substantially all liabilities, including contingent payments and lease obligations.

3. Loss Per Share and Stockholders Equity

Basic and diluted loss per share is computed using the two-class method. 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.

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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 14.5 million shares and 14.7 million shares for the three months ended July 31, 2011 and 2010, 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,	2011	2010
Net loss from continuing operations attributable to shareholders	$ (173,443)	$ (127,638)
Amounts allocated to participating securities (nonvested shares)	(114)	(20)
Net loss from continuing operations attributable to common shareholders	$ (173,557)	$ (127,658)
Basic weighted average common shares	305,491	319,690
Potential dilutive shares	-	-
Dilutive weighted average common shares	305,491	319,690
Loss per share from continuing operations:		
Basic	$ (0.57)	$ (0.40)
Diluted	(0.57)	(0.40)

The weighted average shares outstanding for the three months ended July 31, 2011 decreased to 305.5 million from 319.7 million for the three months ended July 31, 2010 primarily due to share repurchases completed in the prior year. During the three months ended July 31, 2010, we purchased and immediately retired 15.5 million shares of our common stock at a cost of $235.7 million.

During the three months ended July 31, 2011 and 2010, we issued 0.5 million and 0.9 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, 2011, we acquired 0.1 million shares of our common stock at an aggregate cost of $2.0 million, and during the three months ended July 31, 2010, we acquired 0.2 million shares at an aggregate cost of $3.4 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.

During the three months ended July 31, 2011, we granted 2.3 million stock options and 0.9 million nonvested shares and units in accordance with our stock-based compensation plans. The weighted average fair value of options granted was $3.37 for management options. These awards vest over a three year period with one-third vesting each year. Stock-based compensation expense of our continuing operations totaled $4.1 million and $3.4 million for the three months ended July 31, 2011 and 2010, respectively. At July 31, 2011, unrecognized compensation cost for options totaled $9.6 million, and for nonvested shares and units totaled $22.5 million.

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4. Receivables

Our short-term receivables consist of the following:

		(in 000s)
As of	July 31, 2011	April 30, 2011
Business Services receivables	$ 224,631	$ 281,847
Loans to franchisees	62,313	62,181
Receivables for tax preparation and related fees	36,203	38,930
Emerald Advance lines of credit	30,699	31,645
Royalties from franchisees	707	11,645
Tax client receivables related to RALs	1,971	2,412
Other	40,446	131,096
	396,970	559,756
Allowance for doubtful accounts	(67,582)	(67,466)
	$ 329,388	$ 492,290

The short-term portion of Emerald Advance lines of credit (EAs), tax client receivables related to refund anticipation loans (RALs) and loans made to franchisees is included in receivables, while the long-term portion is included in other assets in the condensed consolidated financial statements. These amounts are as follows:

			(in 000s)
	Emerald Advance Lines of Credit	Tax Client Receivables - RALs	Loans to Franchisees
As of July 31, 2011:			
Short-term	$ 30,699	$ 1,971	$ 62,313
Long-term	18,539	5,271	123,962
	$ 49,238	$ 7,242	$ 186,275
As of April 30, 2011:			
Short-term	$ 31,645	$ 2,412	$ 62,181
Long-term	21,619	5,855	110,420
	$ 53,264	$ 8,267	$ 172,601

We review the credit quality of our EA receivables and tax client receivables related to RALs based on pools, which are segregated by the year of origination, with older years being deemed more unlikely to be repaid. These amounts as of July 31, 2011, by year of origination, are as follows:

		(in 000s)
	Emerald Advance Lines of Credit	Tax Client Receivables - RALs
Credit Quality Indicator Year of origination:		
2011	$ 25,738	$ -
2010	5,006	86
2009	4,953	2,124
2008 and prior	2,082	5,032
Revolving loans	11,459	-
	$ 49,238	$ 7,242

As of July 31, 2011 and April 30, 2011, $44.6 million and $46.8 million, respectively, of EAs were on non-accrual status and classified as impaired, or more than 60 days past due. All tax client receivables related to RALs are considered impaired.

Loans made to franchisees totaled $186.3 million at July 31, 2011, and consisted of $140.0 million in term loans made to finance the purchase of franchises and $46.3 million in revolving lines of credit made to existing franchisees primarily for the purpose of funding their off-season needs.

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Our allowance for doubtful accounts consists of the following:

		(in 000s)
As of	July 31, 2011	April 30, 2011
Allowance related to:		
Emerald Advance lines of credit	$ 5,350	$ 4,400
Tax client receivables related to RALs	-	-
Loans to franchisees	-	-
All other receivables	62,232	63,066
	$ 67,582	$ 67,466

Activity in the allowance for doubtful accounts for the three months ended July 31, 2011 and 2010 is as follows:

					(in 000s)
	Emerald Advance Lines of Credit	Tax Client Receivables - RALs	Loans to Franchisees	All Other	Total
Balance as of April 30, 2011	$ 4,400	$ -	$ -	$ 63,066	$ 67,466
Provision	950	-	-	1,955	2,905
Recoveries	-	-	-	51	51
Charge-offs	-	-	-	(2,840)	(2,840)
Balance as of July 31, 2011	$ 5,350	$ -	$ -	$ 62,232	$ 67,582
Balance as of April 30, 2010	$ 35,239	$ 12,191	$ 4	$ 65,041	$ 112,475
Provision	710	2	-	1,078	1,790
Recoveries	-	-	-	128	128
Charge-offs	-	-	(4)	(2,015)	(2,019)
Balance as of July 31, 2010	$ 35,949	$ 12,193	$ -	$ 64,232	$ 112,374

There were no changes to our methodology related to the calculation of our allowance for doubtful accounts during the three months ended July 31, 2011.

5. Mortgage Loans Held for Investment and Related Assets

The composition of our mortgage loan portfolio as of July 31, 2011 and April 30, 2011 is as follows:

(dollars in 000s)

As of	July 31, 2011 Amount	July 31, 2011 % of Total	April 30, 2011 Amount	April 30, 2011 % of Total
Adjustable-rate loans	$ 320,539	58%	$ 333,828	58%
Fixed-rate loans	233,452	42%	239,146	42%
	553,991	100%	572,974	100%
Unamortized deferred fees and costs	3,975		4,121	
Less: Allowance for loan losses	(91,303)		(92,087)	
	$ 466,663		$ 485,008	

Our loan loss allowance as a percent of mortgage loans was 16.5% at July 31, 2011, compared to 16.1% at April 30, 2011.

Activity in the allowance for loan losses for the three months ended July 31, 2011 and 2010 is as follows:

(in 000s)

Three Months Ended July 31,	2011	2010
Balance, beginning of the period	$ 92,087	$ 93,535
Provision	5,625	8,000
Recoveries	49	33
Charge-offs	(6,458)	(13,172)
Balance, end of the period	$ 91,303	$ 88,396

When determining our allowance for loan losses, we evaluate loans less than 60 days past due on a pooled basis, while loans we consider impaired, including those loans more than 60 days past due or

modified as troubled debt restructurings (TDRs), are evaluated individually. The balance of these loans and the related allowance is as follows:

(in 000s)

	July 31, 2011		April 30, 2011	
As of	Portfolio Balance	Related Allowance	Portfolio Balance	Related Allowance
Pooled (less than 60 days past due)	$ 290,762	$ 10,914	$ 304,325	$ 11,238
Impaired:				
Individually (TDRs)	95,417	9,499	106,328	11,056
Individually (60 days or more past due)	167,812	70,890	162,321	69,793
	$ 553,991	$ 91,303	$ 572,974	$ 92,087

Our portfolio includes loans originated by Sand Canyon Corporation (SCC) and purchased by H&R Block Bank (HRB Bank) which constitute 63% of the total loan portfolio at July 31, 2011. 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 $207.3 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, 2011 is as follows:

(dollars in 000s)

	Outstanding Principal Balance	Loan Loss Allowance		% 30+ Days Past Due
		Amount	% of Principal	
Purchased from SCC	$ 346,695	$ 80,640	23.3%	44.8%
All other	207,296	10,663	5.1%	12.4%
	$ 553,991	$ 91,303	16.5%	32.7%

Credit quality indicators at July 31, 2011 include the following:

(in 000s)

Credit Quality Indicators	Purchased from SCC	All Other	Total Portfolio
Occupancy status:			
Owner occupied	$ 244,259	$ 132,132	$ 376,391
Non-owner occupied	102,436	75,164	177,600
	$ 346,695	$ 207,296	$ 553,991
Documentation level:			
Full documentation	$ 105,547	$ 150,972	$ 256,519
Limited documentation	10,447	22,411	32,858
Stated income	198,898	21,168	220,066
No documentation	31,803	12,745	44,548
	$ 346,695	$ 207,296	$ 553,991
Internal risk rating:			
High	$ 143,931	$ 357	$ 144,288
Medium	202,764	-	202,764
Low	-	206,939	206,939
	$ 346,695	$ 207,296	$ 553,991

Loans given our internal risk rating of high are generally originated by SCC, have no documentation or are stated income and are non-owner occupied. Loans given our internal risk rating of medium are generally full documentation or stated income, with loan-to-value at origination of more than 80% and have credit scores at origination below 700. Loans given our internal risk rating of low are generally full documentation, with loan-to-value at origination of less than 80% and have credit scores greater than 700.

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 52% of our

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mortgage loan portfolio consists of loans to borrowers located in the states of Florida, California and New York. Detail of the aging of the mortgage loans in our portfolio that are past due as of July 31, 2011 is as follows:

(in 000s)

	Less than 60 Days Past Due	60-89 Days Past Due	90+Days Past Due[1]	Total Past Due	Current	Total
Purchased from SCC	$ 35,960	$ 8,886	$ 133,767	$ 178,613	$ 168,082	$ 346,695
All other	10,470	1,735	20,479	32,684	174,612	207,296
	$ 46,430	$ 10,621	$ 154,246	$ 211,297	$ 342,694	$ 553,991

[1] No loans past due 90 days or more are still accruing interest.

Information related to our non-accrual loans is as follows:

(in 000s)

As of	July 31, 2011	April 30, 2011
Loans:		
Purchased from SCC	$ 138,277	$ 143,358
Other	22,964	14,106
	161,241	157,464
TDRs:		
Purchased from SCC	3,767	2,849
Other	178	329
	3,945	3,178
Total non-accrual loans	$ 165,186	$ 160,642

Information related to impaired loans is as follows:

(in 000s)

		Portfolio Balance With Allowance		Portfolio Balance With No Allowance		Total Portfolio Balance		Related Allowance
As of July 31, 2011:								
Purchased from SCC	$	180,494	$	47,081	$	227,575	$	70,964
Other		27,954		7,700		35,654		9,425
	$	208,448	$	54,781	$	263,229	$	80,389
As of April 30, 2011:								
Purchased from SCC [1]	$	180,387	$	51,674	$	232,061	$	71,733
Other [1]		29,027		7,561		36,588		9,116
	$	209,414	$	59,235	$	268,649	$	80,849

[1] Classification of amounts as of April 30, 2011 have been restated to conform to the current period presentation.
Information related to the allowance for impaired loans is as follows:

(in 000s)

As of		July 31, 2011		April 30, 2011
Portion of total allowance for loan losses allocated to impaired loans and TDR loans:				
Based on collateral value method	$	70,890	$	69,794
Based on discounted cash flow method		9,499		11,055
	$	80,389	$	80,849

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Information related to activities of our non-performing assets is as follows:

		(in 000s)
Three Months Ended July 31,	2011	2010
Average impaired loans:		
Purchased from SCC	$ 230,150	
All other	36,477	
	$ 266,627	$ 303,767
Interest income on impaired loans:		
Purchased from SCC	$ 1,556	
All other	119	
	$ 1,675	$ 1,749
Interest income on impaired loans recognized on a cash basis on non-accrual status:		
Purchased from SCC	$ 1,498	
All other	114	
	$ 1,612	$ 1,636

Our real estate owned includes loans accounted for as in-substance foreclosures of $7.2 million and $7.7 million at July 31, 2011 and April 30, 2011, respectively. Activity related to our real estate owned is as follows:

		(in 000s)
Three Months Ended July 31,	2011	2010
Balance, beginning of the period	$ 19,532	$ 29,252
Additions	1,573	6,527
Sales	(3,722)	(8,827)
Writedowns	(793)	(643)
Balance, end of the period	$ 16,590	$ 26,309

6. Assets and Liabilities Measured at Fair Value

We use the following valuation methodologies for assets and liabilities measured at fair value and the general classification of these instruments pursuant to the fair value hierarchy.

Available-for-sale securities Available-for-sale securities are carried at fair value on a recurring basis. When available, fair value is based on quoted prices in an active market and as such, would be classified as Level 1. If quoted market prices are not available, we use a third-party pricing service to determine fair value and classify the securities as Level 2. The service s pricing model is based on market data and utilizes available trade, bid and other market information. Available-for-sale securities that we classify as Level 2 include certain agency and non-agency mortgage-backed securities, U.S. states and political subdivisions debt securities and other debt and equity securities.

Real estate owned REO includes foreclosed properties securing mortgage loans. Foreclosed assets are adjusted to fair value less costs to sell upon transfer of the loans to REO. Fair value is generally based on independent market prices or appraised values of the collateral. Subsequent holding period losses and losses arising from the sale of REO are expensed as incurred. Because our REO is valued based on significant inputs that are unobservable in the market and our own estimates of assumptions that we believe market participants would use in pricing the asset, these assets are classified as Level 3.

Impaired mortgage loans held for investment The fair value of impaired mortgage loans held for investment is generally based on the net present value of discounted cash flows for TDR loans or the appraised value of the underlying collateral for all other loans. These loans are classified as Level 3.

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The following table presents for each hierarchy level the assets that were remeasured at fair value on both a recurring and non-recurring basis during the three months ended July 31, 2011 and 2010 and the gains (losses) on those remeasurements:

(dollars in 000s)

	Total	Level 1	Level 2	Level 3	Gain (loss)
As of July 31, 2011:					
Recurring:					
Mortgage-backed securities	$ 192,491	$ -	$ 192,491	$ -	$ 1,936
Municipal bonds	7,758	-	7,758	-	449
Non-recurring:					
REO	3,446	-	-	3,446	(482)
Impaired mortgage loans held for investment	61,997	-	-	61,997	(1,473)
	$ 265,692	$ -	$ 200,249	$ 65,443	$ 430
As a percentage of total assets	6.2%	-%	4.7%	1.5%	
As of July 31, 2010:[1]					
Recurring:					
Mortgage-backed securities	$ 21,893	$ -	$ 21,893	$ -	$ (20)
Municipal bonds	8,981	-	8,981	-	566
Trust preferred security	32	-	32	-	(1,618)
Non-recurring:					
REO	3,321	-	-	3,321	(589)
Impaired mortgage loans held for investment	69,467	-	-	69,467	(2,227)
	$ 103,694	$ -	$ 30,906	$ 72,788	$ (3,888)
As a percentage of total assets	2.3%	-%	0.7%	1.6%	

(1) Amounts have been restated to conform to the current period presentation.

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

The following methods were used to determine the fair values of our other financial instruments:

Cash equivalents, accounts receivable, investment in FHLB stock, accounts payable, accrued liabilities, commercial paper borrowings and the current portion of long-term debt The carrying values reported in the balance sheet for these items approximate fair market value due to the relative short-term nature of the respective instruments.

Mortgage loans held for investment The fair value of mortgage loans held for investment is generally determined using market pricing sources based on origination channel and performance characteristics.

Deposits The estimated fair value of demand deposits is the amount payable on demand at the reporting date. The estimated fair value of IRAs and other time deposits is estimated by discounting the future cash flows using the rates currently offered by HRB Bank for products with similar remaining maturities.

Long-term borrowings and FHLB borrowings The fair value of borrowings is based on rates currently available to us for obligations with similar terms and maturities, including current market yields on our Senior Notes.

The carrying amounts and estimated fair values of our financial instruments at July 31, 2011 are as follows:

(in 000s)

	Carrying Amount	Estimated Fair Value
Mortgage loans held for investment	$ 466,663	$ 282,546
Deposits	678,071	678,352
Long-term borrowings	1,050,371	1,105,686
FHLB advances	25,000	24,998

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7. Goodwill and Intangible Assets

Changes in the carrying amount of goodwill for the three months ended July 31, 2011 consist of the following:

(in 000s)

	Tax Services	Business Services	Total
Balance at April 30, 2011:			
Goodwill	$ 459,039	$ 427,094	$ 886,133
Accumulated impairment losses	(24,888)	(15,000)	(39,888)
	434,151	412,094	846,245
Changes:			
Acquisitions	3,478	34	3,512
Disposals and foreign currency changes	112	(7,561)	(7,449)
Impairments	-	(99,697)	(99,697)
Balance at July 31, 2011:			
Goodwill	462,629	419,567	882,196
Accumulated impairment losses	(24,888)	(114,697)	(139,585)
	$ 437,741	$ 304,870	$ 742,611

We test goodwill and other indefinite-life intangible assets for impairment annually or more frequently if events occur or circumstances change which would, more likely than not, reduce the fair value of a reporting unit below its carrying value. In August 2011, our Board of Directors approved a non-binding letter of intent to sell substantially all assets of RSM to M&P. The sale is dependent on, among other factors, the ability of M&P to raise financing for the purchase. In conjunction with this sale, we are also evaluating strategic alternatives for EquiCo. Both of these businesses are separate reporting units within the Business Services segment.

These decisions triggered an interim review of the goodwill for our RSM and EquiCo reporting units. The fair values of both reporting units were reviewed based on expected sale prices in the market compared to book value. As a result of that review, we recorded a goodwill impairment of $85.4 million related to our RSM reporting unit, leaving a remaining goodwill balance of approximately $304.9 million. We have also recorded a goodwill impairment of $14.3 million related to our EquiCo reporting unit, leaving no remaining goodwill balance.

Intangible assets consist of the following:

(in 000s)

As of	July 31, 2011	April 30, 2011
	Gross	Gross

	Carrying Amount	Accumulated Amortization	Net	Carrying Amount	Accumulated Amortization	Net
Tax Services:						
Customer relationships	$ 86,678	$ (43,031)	$ 43,647	$ 87,624	$ (41,076)	$ 46,548
Noncompete agreements	23,451	(22,278)	1,173	23,456	(22,059)	1,397
Reacquired franchise rights	214,330	(10,991)	203,339	214,330	(9,961)	204,369
Franchise agreements	19,201	(3,414)	15,787	19,201	(3,093)	16,108
Purchased technology	14,700	(9,070)	5,630	14,700	(8,505)	6,195
Trade name	1,325	(650)	675	1,325	(600)	725
Business Services:						
Customer relationships	147,208	(125,848)	21,360	152,079	(128,738)	23,341
Noncompete agreements	35,551	(25,101)	10,450	35,818	(24,662)	11,156
Attest firm affiliation	7,629	(424)	7,205	7,629	(318)	7,311
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
	$ 608,310	$ (248,275)	$ 360,035	$ 614,399	$ (246,480)	$ 367,919

Amortization of intangible assets for the three months ended July 31, 2011 and 2010 was $7.7 and $6.9 million respectively. Estimated amortization of intangible assets for fiscal years 2012 through 2016 is $27.1 million, $22.7 million, $19.2 million, $14.4 million and $13.0 million, respectively.

In connection with a prior acquisition, we have a liability related to unfavorable operating lease terms in the amount of $5.9 million, which will be amortized over the remaining contractual life of the operating lease. The net balance was $5.3 million at July 31, 2011.

8. Income Taxes

We file a consolidated federal income tax return in the United States and file tax returns in various state and foreign jurisdictions. The U.S. Federal consolidated tax returns for the years 1999 through 2009 are currently under examination by the Internal Revenue Service, with the 1999-2005 years currently at the appellate level. Federal returns for 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, 2011, we reduced our gross interest and penalties accrued by $3.1 million related to our uncertain tax positions due to statute of limitations expirations and settlements made with various taxing authorities. We had gross unrecognized tax benefits of $145.5 million and $154.8 million at July 31, 2011 and April 30, 2011, respectively. The gross unrecognized tax benefits decreased $9.3 million net in the current year, due to statute of limitations expirations and settlements with taxing authorities, partially offset by accruals of tax and interest on positions related to prior years. Except as noted below, we have classified the liability for unrecognized tax benefits, including corresponding accrued interest, as long-term at July 31, 2011, and included this amount in other noncurrent 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 gross amount of reserves for previously unrecognized tax benefits may decrease by $16.9 million within twelve months of July 31, 2011. This portion of our liability for unrecognized tax benefits has been classified as current and is included in accounts payable, accrued expenses and other current liabilities on the condensed consolidated balance sheets.

9. 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,	2011	2010
Interest income:		
Mortgage loans, net	$ 5,661	$ 6,323
Other	4,772	3,979
	$ 10,433	$ 10,302
Interest expense:		
Borrowings	$ 21,494	$ 20,643
Deposits	1,656	1,923
FHLB advances	151	396
	$ 23,301	$ 22,962

10. Regulatory Requirements

HRB Bank files its regulatory Thrift Financial Report (TFR) on a calendar quarter basis with the Office of Thrift Supervision (OTS). In July 2011, as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Reform Act), the responsibility and authority of the OTS moved to the Office of the Comptroller of the Currency (OCC). HRB Bank will continue to file TFR reports with the OCC through December 31, 2011. Beginning March 31, 2012, HRB Bank will file Reports of Condition and Income (Call Report) with the OCC quarterly.

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The following table sets forth HRB Bank s regulatory capital requirements, as calculated in its TFR:

(dollars in 000s)

To Be Well