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

FORM 10-Q

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

For the quarterly period ended February 25, 2005

or

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

For the transition period to

Commission File Number: 001-14965

The Goldman Sachs Group, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**13-4019460**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
85 Broad Street, New York, NY	**10004**
(Address of principal executive offices)	**(Zip Code)**

(212) 902-1000
(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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). ☒ Yes ☐ No

APPLICABLE ONLY TO CORPORATE ISSUERS

As of April 1, 2005 there were 475,140,437 shares of the registrant's common stock outstanding.

THE GOLDMAN SACHS GROUP, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE FISCAL QUARTER ENDED FEBRUARY 25, 2005

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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements (Unaudited)

THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)

	Three Months Ended February	
	2005	2004
	(in millions, except per share amounts)	
Revenues		
Investment banking	$ 873	$ 754
Trading and principal investments	4,141	3,819
Asset management and securities services	774	787
Interest income	4,176	2,545
Total revenues	9,964	7,905
Interest expense	3,449	1,873
Cost of power generation	110	104
Revenues, net of interest expense and cost of power generation	6,405	5,928
Operating expenses		
Compensation and benefits	3,203	2,995
Brokerage, clearing and exchange fees	252	233
Market development	82	62
Communications and technology	118	112
Depreciation and amortization	118	135
Amortization of identifiable intangible assets	31	32
Occupancy	148	170
Professional fees	96	61
Other expenses	212	199
Total non-compensation expenses	1,057	1,004
Total operating expenses	4,260	3,999
Pre-tax earnings	2,145	1,929
Provision for taxes	633	636
Net earnings	$1,512	$1,293
Earnings per share		
Basic	$ 3.06	$ 2.63
Diluted	2.94	2.50
Dividends declared per common share	$ 0.25	$ 0.25
Average common shares outstanding		
Basic	494.3	492.0
Diluted	515.1	517.1

The accompanying notes are an integral part of these condensed consolidated financial statements.

THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)

	As of	
	February 2005	November 2004
	(in millions, except share and per share amounts)	
Assets		
Cash and cash equivalents	$ 5,531	$ 4,365
Cash and securities segregated in compliance with U.S. federal and other regulations	45,202	48,179
Receivables from brokers, dealers and clearing organizations	15,800	14,458
Receivables from customers and counterparties	43,762	38,087
Securities borrowed	180,362	155,086
Securities purchased under agreements to resell	66,007	44,257
Financial instruments owned, at fair value	193,594	183,880
Financial instruments owned and pledged as collateral, at fair value	29,194	27,924
Total financial instruments owned, at fair value	222,788	211,804
Other assets	16,697	15,143
Total assets	$596,149	$531,379
Liabilities and shareholders' equity		
Secured short-term borrowings	$ 5,815	$ 8,558
Unsecured short-term borrowings	43,039	46,401
Total short-term borrowings, including the current portion of long-term borrowings	48,854	54,959
Payables to brokers, dealers and clearing organizations	9,685	8,000
Payables to customers and counterparties	154,137	153,221
Securities loaned	18,907	19,394
Securities sold under agreements to repurchase	109,137	47,573
Financial instruments sold, but not yet purchased, at fair value	125,556	132,097
Other liabilities and accrued expenses	8,221	10,360
Secured long-term borrowings	13,258	12,087
Unsecured long-term borrowings	82,319	68,609
Total long-term borrowings	95,577	80,696
Total liabilities	570,074	506,300
Commitments, contingencies and guarantees		
Shareholders' equity		
Preferred stock, par value $0.01 per share; 150,000,000 shares authorized, no shares issued and outstanding	—	—
Common stock, par value $0.01 per share; 4,000,000,000 shares authorized, 562,949,826 and 554,063,234 shares issued as of February 2005 and November 2004, respectively, and 478,390,878 and 480,959,660 shares outstanding as of February 2005 and November 2004, respectively	6	6
Restricted stock units and employee stock options	2,050	2,013
Nonvoting common stock, par value $0.01 per share; 200,000,000 shares authorized, no shares issued and outstanding	—	—
Additional paid-in capital	16,264	15,501
Retained earnings	15,354	13,970
Unearned compensation	(80)	(117)
Accumulated other comprehensive income	11	11
Treasury stock, at cost, par value $0.01 per share; 84,558,948 and 73,103,574 shares as of February 2005 and November 2004, respectively	(7,530)	(6,305)
Total shareholders' equity	26,075	25,079
Total liabilities and shareholders' equity	$596,149	$531,379

The accompanying notes are an integral part of these condensed consolidated financial statements.

THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

	Period Ended	
	February 2005	November 2004
	(in millions, except per share amounts)	
Common stock, par value $0.01 per share		
Balance, beginning of year	$ 6	$ 5
Issued	—	1
Balance, end of period	6	6
Restricted stock units and employee stock options		
Balance, beginning of year	2,013	2,984
Issued	462	1,050
Delivered	(417)	(1,948)
Forfeited	(3)	(62)
Options exercised	(5)	(11)
Balance, end of period	2,050	2,013
Additional paid-in capital		
Balance, beginning of year	15,501	13,562
Issuance of common stock	671	1,609
Excess net tax benefit related to delivery of stock-based awards	92	330
Balance, end of period	16,264	15,501
Retained earnings		
Balance, beginning of year	13,970	9,914
Net earnings	1,512	4,553
Dividends declared	(128)	(497)
Balance, end of period	15,354	13,970
Unearned compensation		
Balance, beginning of year	(117)	(339)
Restricted stock units forfeited	—	11
Amortization of restricted stock units	37	211
Balance, end of period	(80)	(117)
Accumulated other comprehensive income		
Balance, beginning of year	11	6
Currency translation adjustment, net of tax	—	5
Balance, end of period	11	11
Treasury stock, at cost, par value $0.01 per share		
Balance, beginning of year	(6,305)	(4,500)
Repurchased	(1,225)	(1,805)
Balance, end of period	(7,530)	(6,305)
Total shareholders' equity	$26,075	$25,079

The accompanying notes are an integral part of these condensed consolidated financial statements.

THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended February	
	2005	2004
	(in millions)	
Cash flows from operating activities		
Net earnings	$ 1,512	$ 1,293
Noncash items included in net earnings		
Depreciation and amortization	161	190
Amortization of identifiable intangible assets	37	32
Stock-based compensation	219	161
Changes in operating assets and liabilities		
Cash and securities segregated in compliance with U.S. federal and other regulations	3,012	(9,983)
Net receivables from brokers, dealers and clearing organizations	343	873
Net payables to customers and counterparties	(4,739)	6,656
Securities borrowed, net of securities loaned	(25,763)	1,834
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell	39,814	(4,294)
Financial instruments owned, at fair value	(11,429)	(15,322)
Financial instruments sold, but not yet purchased, at fair value	(6,541)	4,901
Other, net	(2,336)	(1,321)
Net cash used for operating activities	(5,710)	(14,980)
Cash flows from investing activities		
Purchase of property, leasehold improvements and equipment	(507)	(213)
Business combinations, net of cash acquired	(517)	(94)
Net cash used for investing activities	(1,024)	(307)
Cash flows from financing activities		
Short-term borrowings, net	(3,898)	2,964
Issuance of long-term borrowings	18,821	15,289
Repayment of long-term borrowings, including the current portion of long-term borrowings	(6,253)	(2,729)
Derivative contracts with a financing element, net	174	57
Common stock repurchased	(1,225)	(465)
Dividends paid	(128)	(125)
Proceeds from issuance of common stock	409	159
Net cash provided by financing activities	7,900	15,150
Net increase/(decrease) in cash and cash equivalents	1,166	(137)
Cash and cash equivalents, beginning of year	4,365	7,087
Cash and cash equivalents, end of period	$ 5,531	$ 6,950

SUPPLEMENTAL DISCLOSURES:

Cash payments for interest, net of capitalized interest, were $3.63 billion and $2.01 billion during the three months ended February 2005 and February 2004, respectively.

Cash payments for income taxes, net of refunds, were $216 million and $212 million during the three months ended February 2005 and February 2004, respectively.

Noncash activities:

During the three months ended February 2005 and February 2004, the firm assumed $197 million and $1.46 billion, respectively, of debt in connection with business combinations.

The accompanying notes are an integral part of these condensed consolidated financial statements.

THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended February	
	2005	2004
	(in millions)	
Net earnings	$1,512	$1,293
Currency translation adjustment, net of tax	—	23
Comprehensive income	$1,512	$1,316

The accompanying notes are an integral part of these condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Description of Business

The Goldman Sachs Group, Inc. (Group Inc.), a Delaware corporation, together with its consolidated subsidiaries (collectively, the firm), is a leading global investment banking, securities and investment management firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments and high-net-worth individuals.

The firm's activities are divided into three segments:

- **Investment Banking.** The firm provides a broad range of investment banking services to a diverse group of corporations, financial institutions, governments and individuals.
- **Trading and Principal Investments.** The firm facilitates customer transactions with a diverse group of corporations, financial institutions, governments and individuals and takes proprietary positions through market making in, and trading of, fixed income and equity products, currencies, commodities and derivatives on such products. In addition, the firm engages in floor-based and electronic market making as a specialist on U.S. equities and options exchanges and clears customer transactions on major stock, options and futures exchanges worldwide. In connection with the firm's merchant banking and other investment activities, the firm makes principal investments directly and through funds that the firm raises and manages.
- **Asset Management and Securities Services.** The firm offers a broad array of investment strategies, advice and planning across all major asset classes to a diverse group of institutions and individuals worldwide, and provides prime brokerage, financing services and securities lending services to mutual funds, pension funds, hedge funds, foundations and high-net-worth individuals worldwide.

Note 2. Significant Accounting Policies

Basis of Presentation

These condensed consolidated financial statements include the accounts of Group Inc. and all other entities in which the firm has a controlling financial interest. All material intercompany transactions and balances have been eliminated. The firm determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity, a variable interest entity (VIE) or a qualifying special-purpose entity (QSPE) under generally accepted accounting principles.

- **Voting Interest Entities.** Voting interest entities are entities in which (i) the total equity investment at risk is sufficient to enable each entity to finance itself independently and (ii) the equity holders have the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity's activities. Voting interest entities are consolidated in accordance with Accounting Research Bulletin (ARB) No. 51, ''Consolidated Financial Statements,'' as amended. ARB No. 51 states that the usual condition for a controlling financial interest in an entity is ownership of a majority voting interest. Accordingly, the firm consolidates voting interest entities in which it has the majority of the voting interest.
- **Variable Interest Entities.** VIEs are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in a VIE is present when an enterprise has a variable interest, or a combination of variable interests, that will absorb a majority of the VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. The

enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE. In accordance with FASB Interpretation (FIN) No. 46-R, ''Consolidation of Variable Interest Entities,'' the firm consolidates all VIEs for which it is the primary beneficiary.

The firm determines whether it is the primary beneficiary of a VIE by first performing a qualitative analysis of the VIE that includes, among other factors, its capital structure, contractual terms, which variable interests create or absorb variability, related party relationships and the design of the VIE. Where qualitative analysis is not conclusive, the firm performs a quantitative analysis. For purposes of allocating a VIE's expected losses and expected residual returns to the VIE's variable interest holders, the firm utilizes the ''top down'' method. Under that method, the firm calculates its share of the VIE's expected losses and expected residual returns using the specific cash flows that would be allocated to it, based on contractual arrangements and/or the firm's position in the capital structure of the VIE, under various probability-weighted scenarios.

- **QSPEs.** QSPEs are passive entities that hold financial assets transferred to them and are commonly used in mortgage and other securitization transactions. In accordance with Statement of Financial Accounting Standards (SFAS) No. 140, ''Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,'' and FIN No. 46-R, the firm does not consolidate QSPEs.
- **Equity-Method Investments.** When the firm does not have a controlling financial interest in an entity but exerts significant influence over the entity's operating and financial policies (generally defined as owning a voting interest of 20% to 50%) and has an investment in common stock or in-substance common stock, the firm accounts for its investment in accordance with the equity method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 18, ''The Equity Method of Accounting for Investments in Common Stock.''
- **Other.** If the firm does not consolidate an entity or apply the equity method of accounting, the firm accounts for its investment at fair value.

The firm also has formed numerous nonconsolidated merchant banking funds with third-party investors that are typically organized as limited partnerships. The firm acts as general partner for these funds and does not hold a majority of the economic interests in any fund. Where the firm holds more than a minor interest in a fund, it is subject to removal as general partner. Such fund investments are included in ''Financial instruments owned, at fair value'' in the condensed consolidated statements of financial condition.

These condensed consolidated financial statements are unaudited and should be read in conjunction with the audited consolidated financial statements incorporated by reference in the Annual Report on Form 10-K of Group Inc. for the fiscal year ended November 26, 2004. The condensed consolidated financial information as of November 26, 2004 has been derived from audited consolidated financial statements not included herein. Certain reclassifications have been made to previously reported amounts to conform to the current presentation.

These condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles that require management to make certain estimates and assumptions regarding fair value measurements, the accounting for goodwill and identifiable intangible assets, the provision for potential losses that may arise from litigation and regulatory proceedings, tax audits and other matters that affect the condensed consolidated financial statements and related disclosures. These estimates and assumptions are based on the best available information; nonetheless, actual results could be materially different from these estimates.

These unaudited condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. These adjustments are of a normal, recurring nature. Interim period operating results may not be indicative of the operating results for a full year.

Unless otherwise stated herein, all references to February 2005 and February 2004 refer to the firm's fiscal periods ended, or the dates, as the context requires, February 25, 2005 and February 27, 2004, respectively. All references to November 2004 refer to the firm's fiscal year ended, or the date, as the context requires, November 26, 2004.

Revenue Recognition

Investment Banking. Underwriting revenues and fees from mergers and acquisitions and other corporate finance advisory assignments are recorded when the services related to the underlying transaction are completed under the terms of the engagement. Expenses associated with such transactions are deferred until the related revenue is recognized or the engagement is otherwise concluded. Underwriting revenues are presented net of related expenses. Expenses associated with advisory transactions are recorded as non-compensation expenses, net of client reimbursements.

Repurchase Agreements and Collateralized Financing Arrangements. Securities purchased under agreements to resell and securities sold under agreements to repurchase, principally U.S. government, federal agency and investment-grade foreign sovereign obligations, represent short-term collateralized financing transactions and are carried in the condensed consolidated statements of financial condition at their contractual amounts plus accrued interest. These amounts are presented on a net-by-counterparty basis when the requirements of FIN No. 41, ''Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements,'' or FIN No. 39, ''Offsetting of Amounts Related to Certain Contracts,'' are satisfied. The firm receives securities purchased under agreements to resell, makes delivery of securities sold under agreements to repurchase, monitors the market value of these securities on a daily basis and delivers or obtains additional collateral as appropriate.

Securities borrowed and loaned are recorded based on the amount of cash collateral advanced or received. These transactions are generally collateralized by cash, securities or letters of credit. The firm receives securities borrowed, makes delivery of securities loaned, monitors the market value of securities borrowed and loaned, and delivers or obtains additional collateral as appropriate. Interest income or expense on repurchase agreements and collateralized financing arrangements is recognized in net revenues over the life of the transaction.

Financial Instruments. The condensed consolidated statements of financial condition reflect purchases and sales of financial instruments on a trade-date basis.

''Total financial instruments owned, at fair value'' and ''Financial instruments sold, but not yet purchased, at fair value'' in the condensed consolidated statements of financial condition consist of financial instruments carried at fair value or amounts that approximate fair value, with related unrealized gains or losses recognized in the firm's results of operations. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

In determining fair value, the firm separates financial instruments into three categories — cash (i.e., nonderivative) trading instruments, derivative contracts and principal investments.

- **Cash Trading Instruments.** Fair values of the firm's cash trading instruments are generally obtained from quoted market prices in active markets, broker or dealer price quotations, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued in this manner include U.S. government and agency securities, other sovereign government obligations, liquid mortgage products, investment-grade corporate bonds, listed equities, money market securities, state, municipal and provincial obligations, and physical commodities.

  Certain cash trading instruments trade infrequently and, therefore, have little or no price transparency. Such instruments may include certain high-yield debt, corporate bank loans, mortgage whole loans and distressed debt. The firm values these instruments using methodologies such as the present value of known or estimated cash flows and generally does not adjust underlying valuation assumptions unless there is substantive evidence supporting a change in the value of the underlying instrument or valuation assumptions (such as similar market transactions, changes in financial ratios and changes in the credit ratings of the underlying companies).

  Cash trading instruments owned by the firm (long positions) are marked to bid prices and instruments sold but not yet purchased (short positions) are marked to offer prices. If liquidating a position is reasonably expected to affect its prevailing market price, the valuation is adjusted generally based on market evidence or predetermined policies. In certain circumstances, such as for highly illiquid positions, management's estimates are used to determine this adjustment.

- **Derivative Contracts.** Fair values of the firm's derivative contracts consist of exchange-traded and over-the-counter (OTC) derivatives and reflect cash that the firm has paid and received (for example, option premiums or cash paid or received pursuant to credit support agreements). Fair values of the firm's exchange-traded derivatives are generally determined from quoted market prices. OTC derivatives are valued using valuation models. The firm uses a variety of valuation models including the present value of known or estimated cash flows, option-pricing models and option-adjusted spread models. The valuation models used to derive the fair values of the firm's OTC derivatives require inputs including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. The selection of a model to value an OTC derivative depends upon the contractual terms of, and specific risks inherent in, the instrument as well as the availability of pricing information in the market. The firm generally uses similar models to value similar instruments. Where possible, the firm verifies the values produced by its pricing models to market transactions. For OTC derivatives that trade in liquid markets, such as generic forwards, swaps and options, model selection does not involve significant judgment because market prices are readily available. For OTC derivatives that trade in less liquid markets, model selection requires more judgment because such instruments tend to be more complex and pricing information is less available in the market. As markets continue to develop and more pricing information becomes available, the firm continues to review and refine the models it uses.

  At the inception of an OTC derivative contract (day one), the firm values the contract at the model value if the firm can verify all of the significant model inputs to observable market data and verify the model to market transactions. When appropriate, valuations are adjusted to reflect various factors such as liquidity, bid/offer and credit considerations. These adjustments are generally based on market evidence or predetermined policies. In certain circumstances, such as for highly illiquid positions, management's estimates are used to determine these adjustments.

Where the firm cannot verify all of the significant model inputs to observable market data and verify the model to market transactions, the firm values the contract at the transaction price at inception and, consequently, records no day one gain or loss in accordance with Emerging Issues Task Force (EITF) Issue No. 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities."

Following day one, the firm adjusts the inputs to valuation models only to the extent that changes in such inputs can be verified by similar market transactions, third-party pricing services and/or broker quotes or can be derived from other substantive evidence such as empirical market data. In circumstances where the firm cannot verify the model to market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value.

- **Principal Investments.** In valuing corporate and real estate principal investments, the firm's portfolio is separated into investments in private companies, investments in public companies (excluding the firm's investment in the convertible preferred stock of Sumitomo Mitsui Financial Group, Inc. (SMFG)) and the firm's investment in SMFG.

  The firm's private principal investments, by their nature, have little or no price transparency. Such investments are initially carried at cost as an approximation of fair value. Adjustments to carrying value are made if there are third-party transactions evidencing a change in value. Downward adjustments are also made, in the absence of third-party transactions, if it is determined that the expected realizable value of the investment is less than the carrying value. In reaching that determination, many factors are considered, including, but not limited to, the operating cash flows and financial performance of the companies or properties relative to budgets or projections, trends within sectors and/or regions, underlying business models, expected exit timing and strategy, and any specific rights or terms associated with the investment, such as conversion features and liquidation preferences.

  The firm's public principal investments, which tend to be large, concentrated holdings that result from initial public offerings or other corporate transactions, are valued using quoted market prices discounted for restrictions on sale. If liquidating a position is reasonably expected to affect market prices, valuations are adjusted accordingly based on predetermined written policies.

  The firm's investment in the convertible preferred stock of SMFG is carried at fair value, which is derived from a model that incorporates SMFG's common stock price and credit spreads, the impact of nontransferability and illiquidity and downside protection on the conversion strike price. The firm's convertible preferred investment is generally nontransferable. Restrictions on the firm's ability to hedge or sell one-third of the common stock underlying its investment in SMFG lapsed in February 2005. Restrictions on the firm's ability to hedge or sell the remaining shares of common stock underlying its investment in SMFG will lapse in equal installments on February 7, 2006 and February 7, 2007. The current conversion price of the firm's SMFG preferred stock into shares of SMFG common stock is ¥322,300, but this price is subject to downward adjustment if the price of SMFG common stock at the time of conversion is less than the conversion price (subject to a floor of ¥106,300).

In general, transfers of financial assets are accounted for as sales under SFAS No. 140 when the firm has relinquished control over the transferred assets. For transfers accounted for as sales, any related gains or losses are recognized in net revenues. Transfers that are not accounted for as sales are accounted for as collateralized financing arrangements, with the related interest expense recognized in net revenues over the lives of the transactions.

Commissions. The firm generates commissions from executing and clearing client transactions on stock, options and futures markets worldwide. These commissions are recorded on a trade-date basis in ''Trading and principal investments'' in the condensed consolidated statements of earnings.

Power Generation. Power generation revenues associated with the firm's consolidated power plant operations are included in ''Trading and principal investments'' in the condensed consolidated statements of earnings when power is delivered. ''Cost of power generation'' in the condensed consolidated statements of earnings includes all of the direct costs of these plant operations (e.g., fuel, operations and maintenance), as well as the depreciation and amortization associated with the plant and related contractual assets.

The following table sets forth the power generation revenues and costs directly associated with the firm's consolidated power plant operations:

	Three Months Ended February	
	2005	2004
	(in millions)	
Revenues [1]	$130	$123
Cost of power generation	110	104

[1] Excludes revenues from nonconsolidated power plant operations, accounted for in accordance with the equity method of accounting, as well as revenues associated with the firm's power trading activities.

Asset Management. Asset management fees are generally recognized over the period that the related service is provided based upon average net asset values. In certain circumstances, the firm is entitled to receive incentive fees when the return on assets under management exceeds certain benchmark returns or other performance targets. Incentive fees are generally based on investment performance over a twelve-month period and are subject to adjustment prior to the end of the measurement period. Accordingly, incentive fees are recognized in the condensed consolidated statements of earnings when the measurement period ends. Asset management fees and incentive fees are included in ''Asset management and securities services'' in the condensed consolidated statements of earnings.

Merchant Banking Overrides. The firm is entitled to receive merchant banking overrides (i.e., an increased share of a fund's income and gains) when the return on the funds' investments exceeds certain threshold returns. Overrides are based on investment performance over the life of each merchant banking fund, and future investment underperformance may require amounts previously distributed to the firm to be returned to the funds. Accordingly, overrides are recognized in the condensed consolidated statements of earnings only when all material contingencies have been resolved. Overrides are included in ''Trading and principal investments'' in the condensed consolidated statements of earnings.

Stock-Based Compensation

Effective for fiscal 2003, the firm began to account for stock-based employee compensation in accordance with the fair-value method prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure," using the prospective adoption method. Under this method of adoption, compensation expense is recognized over the relevant service period based on the fair value of stock options and restricted stock units granted for fiscal 2003 and future years. No unearned compensation is included in "Shareholders' equity" for such stock options and restricted stock units granted. Rather, such stock options and restricted stock units are included in "Shareholders' equity" under SFAS No. 123 when services required from employees in exchange for the awards are rendered and expensed.

Compensation expense resulting from stock options and restricted stock units granted for the year ended November 2002 and prior years is accounted for under the intrinsic-value-based method prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees," as permitted by SFAS No. 123. Therefore, no compensation expense is recognized for those unmodified stock options issued for years prior to fiscal 2003 that had no intrinsic value on the date of grant. Compensation expense for restricted stock units issued for the years prior to fiscal 2003 was, and continues to be, recognized over the relevant service periods using amortization schedules based on the applicable vesting provisions.

The firm pays cash dividend equivalents on outstanding restricted stock units. Dividend equivalents paid on restricted stock units accounted for under SFAS No. 123 are charged to retained earnings when paid. Dividend equivalents paid on restricted stock units that are later forfeited by employees are reclassified to compensation expense from retained earnings. Dividend equivalents paid on restricted stock units granted for the year ended November 2002 and prior years, accounted for under APB Opinion No. 25, are charged to compensation expense.

If the firm were to recognize compensation expense over the relevant service period under the fair-value method of SFAS No. 123 with respect to stock options granted for the year ended November 2002 and all prior years, net earnings would have decreased, resulting in pro forma net earnings and earnings per share (EPS) as set forth below:

	Three Months Ended February	
	2005	2004
	(in millions, except per share amounts)	
Net earnings, as reported	$1,512	$1,293
Add: Stock-based employee compensation expense, net of related tax effects, included in reported net earnings	141	104
Deduct: Stock-based employee compensation expense, net of related tax effects, determined under the fair-value method for all awards	(153)	(152)
Pro forma net earnings	$1,500	$1,245
EPS, as reported		
Basic	$ 3.06	$ 2.63
Diluted	2.94	2.50
Pro forma EPS		
Basic	$ 3.03	$ 2.53
Diluted	2.91	2.41

Goodwill

Goodwill is the cost of acquired companies in excess of the fair value of identifiable net assets at acquisition date. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill is tested at least annually for impairment. An impairment loss is triggered if the estimated fair value of an operating segment is less than its estimated net book value. Such loss is calculated as the difference between the estimated fair value of goodwill and its carrying value.

Identifiable Intangible Assets

Identifiable intangible assets, which consist primarily of above-market power contracts, customer lists and specialist rights, are amortized over their useful lives. Identifiable intangible assets are tested for potential impairment whenever events or changes in circumstances suggest that an asset's or asset group's carrying value may not be fully recoverable in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." An impairment loss, calculated as the difference between the estimated fair value and the carrying value of an asset or asset group, is recognized if the sum of the estimated undiscounted cash flows relating to the asset or asset group is less than the corresponding carrying value.

Property, Leasehold Improvements and Equipment

Property, leasehold improvements and equipment, net of accumulated depreciation and amortization, are included in "Other assets" in the condensed consolidated statements of financial condition.

Property and equipment placed in service prior to December 1, 2001 are depreciated under the accelerated cost recovery method. Property and equipment placed in service on or after December 1, 2001 are depreciated on a straight-line basis over the useful life of the asset. Leasehold improvements for which the useful life of the improvement is shorter than the term of the lease are amortized under the accelerated cost recovery method if placed in service prior to December 2001. All other leasehold improvements are amortized over the useful life of the improvement or the term of the lease, whichever is shorter. Certain costs of software developed or obtained for internal use are amortized on a straight-line basis over the useful life of the software.

Property, leasehold improvements and equipment are tested for potential impairment whenever events or changes in circumstances suggest that an asset's or asset group's carrying value may not be fully recoverable in accordance with SFAS No. 144. An impairment loss, calculated as the difference between the estimated fair value and the carrying value of an asset or asset group, is recognized if the sum of the expected undiscounted cash flows relating to the asset or asset group is less than the corresponding carrying value.

The firm's operating leases include space held in excess of current needs. Rent expense relating to space held for growth is included in "Occupancy" in the condensed consolidated statements of earnings. In accordance with SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," the firm records a liability, based on the remaining lease rentals reduced by any potential or existing sublease rentals, for leases where the firm has ceased using the space and management has concluded that the firm will not derive any future economic benefits. Costs to terminate a lease before the end of its term are recognized and measured at fair value upon termination.

Foreign Currency Translation

Assets and liabilities denominated in non-U.S. currencies are translated at rates of exchange prevailing on the date of the condensed consolidated statement of financial condition, and revenues and expenses are translated at average rates of exchange for the fiscal period. Gains or losses on translation of the financial statements of a non-U.S. operation, when the functional currency is other than the U.S. dollar, are included, net of hedges and taxes, on the condensed consolidated statements of comprehensive income. The firm seeks to reduce its net investment exposure to fluctuations in foreign exchange rates through the use of foreign currency forward contracts and foreign currency denominated debt. For foreign currency forward contracts, hedge effectiveness is assessed based on changes in forward exchange rates; accordingly, forward points are reflected as a component of the currency translation adjustment in the condensed consolidated statements of comprehensive income. For foreign currency denominated debt, hedge effectiveness is assessed based on changes in spot rates. Foreign currency remeasurement gains or losses on transactions in nonfunctional currencies are included in the condensed consolidated statements of earnings.

Income Taxes

Deferred tax assets and liabilities are recognized for temporary differences between the financial reporting and tax bases of the firm's assets and liabilities. Valuation allowances are established to reduce deferred tax assets to the amount that more likely than not will be realized. The firm's tax assets and liabilities are presented as a component of ''Other assets'' and ''Other liabilities and accrued expenses,'' respectively, in the condensed consolidated statements of financial condition. Tax provisions are computed in accordance with SFAS No. 109, ''Accounting for Income Taxes.'' Contingent liabilities related to income taxes are recorded when the criteria for loss recognition under SFAS No. 5, ''Accounting for Contingencies,'' as amended, have been met.

Earnings Per Share

Basic EPS is calculated by dividing net earnings by the weighted average number of common shares outstanding. Common shares outstanding includes common stock and restricted stock units for which no future service is required as a condition to the delivery of the underlying common stock. Diluted EPS includes the determinants of basic EPS and, in addition, reflects the dilutive effect of the common stock deliverable pursuant to stock options and to restricted stock units for which future service is required as a condition to the delivery of the underlying common stock.

Cash and Cash Equivalents

The firm defines cash equivalents as highly liquid overnight deposits held in the ordinary course of business.

Recent Accounting Developments

In December 2004, the FASB issued a revision to SFAS No. 123, ''Accounting for Stock-Based Compensation,'' SFAS No. 123-R, ''Share-Based Payment.'' SFAS No. 123-R focuses primarily on transactions in which an entity exchanges its equity instruments for employee services and generally establishes standards for the accounting for transactions in which an entity obtains goods or services in share-based payment transactions. SFAS No. 123-R is effective for the firm's fourth quarter of fiscal 2005. Management is currently evaluating the effect of adoption of SFAS No. 123-R, but does not expect adoption to have a material effect on the firm's financial condition, results of operations or cash flows.

Note 3. Financial Instruments

Fair Value of Financial Instruments

The following table sets forth the firm's financial instruments owned, including those pledged as collateral, at fair value, and financial instruments sold, but not yet purchased, at fair value:

	As of			
	February 2005		November 2004	
	Assets	Liabilities	Assets	Liabilities
	(in millions)			
Commercial paper, certificates of deposit, time deposits and other money market instruments	$ 8,303 [1]	$ —	$ 7,386 [1]	$ —
U.S. government, federal agency and sovereign obligations	47,946	44,423	46,777	40,866
Corporate and other debt obligations				
Mortgage whole loans and collateralized debt obligations	25,095	813	18,346	671
Investment-grade corporate bonds	11,562	4,914	11,783	5,163
Bank loans	9,727	584	8,900	428
High-yield securities	6,815	1,833	6,057	1,725
Preferred stock	5,353	101	4,792	109
Other	613	247	885	248
	59,165	8,492	50,763	8,344
Equities and convertible debentures	46,438	20,644	42,263	18,766
State, municipal and provincial obligations	1,231	—	1,308	—
Derivative contracts	58,691	51,662	62,495	64,001
Physical commodities	1,014	335	812	120
Total	$222,788	$125,556	$211,804	$132,097

[1] Includes $5.75 billion and $5.04 billion, as of February 2005 and November 2004, respectively, of money market instruments held by William Street Funding Corporation to support the William Street credit extension program.

Derivative Activities

Derivative contracts are instruments, such as futures, forwards, swaps or option contracts, which derive their value from underlying assets, indices, reference rates or a combination of these factors. Derivative instruments may be privately negotiated contracts, which are often referred to as OTC derivatives, or they may be listed and traded on an exchange. Derivatives may involve future commitments to purchase or sell financial instruments or commodities, or to exchange currency or interest payment streams. The amounts exchanged are based on the specific terms of the contract with reference to specified rates, securities, commodities, currencies or indices.

Certain cash instruments, such as mortgage-backed securities, interest-only and principal-only obligations, and indexed debt instruments, are not considered derivatives even though their values or contractually required cash flows are derived from the price of some other security or index. However, certain commodity-related contracts are included in the firm's derivatives disclosure, as these contracts may be settled in cash or are readily convertible into cash.

Substantially all of the firm's derivative transactions are entered into for trading purposes, in order to facilitate customer transactions, to take proprietary positions or as a means of risk management. Risk exposures are managed through diversification, by controlling position sizes and by establishing hedges in related securities or derivatives. For example, the firm may hedge a portfolio of common stock by taking an offsetting position in a related equity-index futures contract. Gains and losses on derivatives used for trading purposes are generally included in ''Trading and principal investments'' in the condensed consolidated statements of earnings.

In addition to derivative transactions entered into for trading purposes, the firm enters into derivative contracts to hedge its net investment in non-U.S. operations (see Note 2 for further information regarding the firm's policy on foreign currency translation) and to manage the interest rate and currency exposure on its long-term borrowings and certain short-term borrowings. To manage exposure on its borrowings, the firm uses derivatives to effectively convert a substantial portion of its long-term borrowings into U.S. dollar-based floating rate obligations. The firm applies fair-value hedge accounting to derivative contracts that hedge the benchmark interest rate (i.e., LIBOR) on its long-term borrowings.

Fair values of the firm's derivative contracts reflect cash paid or received pursuant to credit support agreements and are reported on a net-by-counterparty basis in the firm's condensed consolidated statements of financial condition when management believes a legal right of setoff exists under an enforceable netting agreement. The fair value of derivative financial instruments, computed in accordance with the firm's netting policy, is set forth below:

	As of			
	February 2005		November 2004	
	Assets	Liabilities	Assets	Liabilities
	(in millions)			
Forward settlement contracts	$10,038	$11,052	$13,137	$14,578
Swap agreements	35,024	24,366	34,727	30,836
Option contracts	13,629	16,244	14,631	18,587
Total	$58,691	$51,662	$62,495	$64,001

Securitization Activities

The firm securitizes commercial and residential mortgages, home equity loans, government and corporate bonds, and other types of financial assets. The firm acts as underwriter of the beneficial interests that are sold to investors. The firm derecognizes financial assets transferred in securitizations provided it has relinquished control over such assets. Transferred assets are accounted for at fair value prior to securitization. Net revenues related to these underwriting activities are recognized in connection with the sales of the underlying beneficial interests to investors.

The firm may retain interests in securitized financial assets. Retained interests are accounted for at fair value and included in ''Total financial instruments owned, at fair value'' in the condensed consolidated statements of financial condition.

During the three months ended February 2005 and February 2004, the firm securitized $15.24 billion and $13.85 billion, respectively, of financial assets, including $6.98 billion and $3.96 billion, respectively, of agency mortgage-backed securities. Cash flows received on retained interests and other securitization cash flows were approximately $208 million and $230 million for the three months ended February 2005 and February 2004, respectively.

As of February 2005 and November 2004, the firm held $4.64 billion and $4.33 billion of retained interests, respectively, including $4.49 billion and $4.11 billion, respectively, held in QSPEs. The fair value of retained interests valued using quoted market prices in active markets was $1.04 billion and $949 million as of February 2005 and November 2004, respectively.

The following table sets forth the weighted average key economic assumptions used in measuring the fair value of $3.60 billion and $3.38 billion, respectively, as of February 2005 and November 2004, of retained interests for which fair value is based on alternative pricing sources with reasonable, little or no price transparency and the sensitivity of those fair values to immediate adverse changes of 10% and 20% in those assumptions:

	As of February 2005		As of November 2004	
	Type of Retained Interests		Type of Retained Interests	
	Mortgage-Backed	Corporate Debt and Other [3]	Mortgage-Backed	Corporate Debt and Other [3]
	($ in millions)			
Fair value of retained interests	$2,108	$1,495	$1,798	$1,578
Weighted average life (years)	5.3	3.7	4.2	3.7
Annual constant prepayment rate	22.3%	N/A	21.5%	N/A
Impact of 10% adverse change	$ (13)	$ —	$ (6)	$ —
Impact of 20% adverse change	(26)	—	(10)	—
Annual credit losses [1]	4.8%	3.5%	4.0%	4.1%
Impact of 10% adverse change [2]	$ (10)	$ —	$ (10)	$ (1)
Impact of 20% adverse change [2]	(19)	(1)	(14)	(2)
Annual discount rate	9.0%	4.9%	8.5%	4.9%
Impact of 10% adverse change	$ (41)	$ (20)	$ (39)	$ (24)
Impact of 20% adverse change	(79)	(39)	(75)	(48)

(1) Annual percentage credit loss is based only on positions in which expected credit loss is a key assumption in the determination of fair values.

(2) The impacts of adverse change take into account credit mitigants incorporated in the retained interests, including over-collateralization and subordination provisions.

(3) Includes retained interests in bonds and other types of financial assets that are not subject to prepayment risk.

The preceding table does not give effect to the offsetting benefit of other financial instruments that are held to hedge risks inherent in these retained interests. Changes in fair value based on a 10% adverse variation in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value is not usually linear. In addition, the impact of a change in a particular assumption is calculated independently of changes in any other assumption. In practice, simultaneous changes in assumptions might magnify or counteract the sensitivities disclosed above.

In addition to the retained interests described above, the firm also held interests in residential mortgage QSPEs, primarily agency mortgage-backed securities, purchased in connection with secondary market-making activities. These purchased interests approximated $5 billion as of both February 2005 and November 2004.

In connection with the issuance of asset-repackaged notes to investors, the firm had derivative receivables from QSPEs, to which the firm has transferred assets, with a fair value of $115 million and $126 million as of February 2005 and November 2004, respectively. These receivables are collateralized by a first-priority interest in the assets held by each QSPE.

Variable Interest Entities (VIEs)

The firm, in the ordinary course of its business, retains interests in VIEs in connection with its securitization activities. The firm also purchases and sells variable interests in VIEs, primarily mortgage-backed and asset-backed interests, in connection with its market-making activities and makes investments in and loans to VIEs that hold performing and nonperforming debt, real estate, power-related and other assets. In addition, the firm utilizes VIEs to provide investors with credit-linked and asset-repackaged notes designed to meet their objectives.

VIEs generally purchase assets by issuing debt and equity instruments and through other contractual arrangements. In certain instances, the firm has provided guarantees to certain VIEs or holders of variable interests in these VIEs. In such cases, the maximum exposure to loss included in the tables set forth below is the notional amount of such guarantees. Such amounts do not represent anticipated losses in connection with these guarantees. The firm's variable interests in these VIEs include senior and subordinated debt; limited and general partnership interests; preferred and common stock; interest rate, foreign currency, equity, commodity and credit derivatives; guarantees; and residual interests in mortgage-backed and asset-backed securitization vehicles. Group Inc. generally is not directly or indirectly obligated to repay the debt and equity instruments and contractual arrangements entered into by these VIEs.

The following table sets forth the firm's total assets and maximum exposure to loss associated with its significant variable interests in consolidated VIEs where the firm does not hold a majority voting interest:

	As of	
	February 2005	November 2004
	(in millions)	
VIE assets [1]	$5,111	$5,197
Maximum exposure to loss	1,403	782

(1) Consolidated VIE assets include assets financed by nonrecourse short-term and long-term debt. Nonrecourse debt is debt that Group Inc. is not directly or indirectly obligated to repay.

The following tables set forth the total assets in nonconsolidated VIEs in which the firm holds significant variable interests and the firm's maximum exposure to loss associated with these interests:

	As of February 2005					
		Maximum Exposure to Loss				
	VIE Assets	Purchased Interests	Guarantees	Derivatives	Loans and Investments	Total
	(in millions)					
Mortgage-backed	$13,711	$209	$147	$ —	$ 968	$1,324
Asset repackagings and credit linked notes	6,225	12	—	748	231	991
Power-related	7,537	—	52	—	1,232	1,284
Other asset-backed	10,425	24	183	41	886	1,134
Total	$37,898	$245	$382	$789	$3,317	$4,733

	As of November 2004					
		Maximum Exposure to Loss				
	VIE Assets	Purchased Interests	Guarantees	Derivatives	Loans and Investments	Total
	(in millions)					
Mortgage-backed	$ 9,921	$153	$100	$ —	$ 992	$1,245
Asset repackagings and credit linked notes	5,138	16	—	341	180	537
Power-related	5,340	—	52	—	571	623
Other asset-backed	8,295	—	177	38	914	1,129
Total	$28,694	$169	$329	$379	$2,657	$3,534

Secured Borrowing and Lending Activities

The firm obtains secured short-term financing principally through the use of repurchase agreements, securities lending agreements and other financings. In these transactions, the firm receives cash or securities in exchange for other securities, including U.S. government, federal agency and sovereign obligations, corporate debt and other debt obligations, equities and convertibles, letters of credit and other assets.

The firm obtains securities as collateral principally through the use of resale agreements, securities borrowing agreements, derivative transactions, customer margin loans and other secured borrowing activities to finance inventory positions, to meet customers' needs and to satisfy settlement requirements. In many cases, the firm is permitted to sell or repledge securities held as collateral. These securities may be used to secure repurchase agreements, enter into securities lending or derivative transactions, or cover short positions. As of February 2005 and November 2004, the fair value of securities received as collateral by the firm that it was permitted to sell or repledge was $560.96 billion and $511.98 billion, respectively, of which the firm sold or repledged $479.40 billion and $451.79 billion, respectively.

The firm also pledges securities it owns. Counterparties may or may not have the right to sell or repledge the securities. Securities owned and pledged to counterparties that have the right to sell or repledge are reported as ''Financial instruments owned and pledged as collateral, at fair value'' and were $29.19 billion and $27.92 billion as of February 2005 and November 2004, respectively. Securities owned and pledged in connection with repurchase and securities lending agreements to counterparties that did not have the right to sell or repledge are included in ''Financial instruments owned, at fair value'' and were $61.58 billion and $46.86 billion as of February 2005 and November 2004, respectively.

In addition to repurchase and securities lending agreements, the firm also pledges securities and other assets it owns to counterparties that do not have the right to sell or repledge, in order to collateralize secured short-term and long-term borrowings. In connection with these transactions, the firm pledged assets of $21.08 billion and $22.81 billion as collateral as of February 2005 and November 2004, respectively. See Note 4 and Note 5 for further information regarding the firm's secured short-term and long-term borrowings.

Note 4. Short-Term Borrowings

The firm obtains secured and unsecured short-term borrowings primarily through issuance of promissory notes, commercial paper and bank loans. As of February 2005 and November 2004, secured short-term borrowings were $5.81 billion and $8.56 billion, respectively. Unsecured short-term borrowings were $43.04 billion and $46.40 billion as of February 2005 and November 2004, respectively. Short-term borrowings also include the portion of long-term borrowings maturing within one year and certain long-term borrowings that may be redeemable within one year at the option of the holder. The carrying value of these short-term obligations approximates fair value due to their short-term nature.

Short-term borrowings are set forth below:

	As of	
	February 2005	November 2004
	(in millions)	
Promissory notes	$18,461	$19,513
Commercial paper	5,139	4,355
Bank loans and other	9,468	13,474
Current portion of long-term borrowings	15,786	17,617
Total [(1)]	$48,854	$54,959

(1) As of February 2005 and November 2004, the weighted average interest rates for short-term borrowings, including commercial paper, were 3.09% and 2.73%, respectively. The weighted average interest rates, after giving effect to hedging activities, were 2.80% and 2.30% as of February 2005 and November 2004, respectively.

Note 5. Long-Term Borrowings

The firm obtains secured and unsecured long-term borrowings, which consist principally of senior borrowings with maturities extending to 2034. As of February 2005 and November 2004, secured long-term borrowings were $13.26 billion and $12.09 billion, respectively. Unsecured long-term borrowings were $82.32 billion and $68.61 billion as of February 2005 and November 2004, respectively.

Long-term borrowings are set forth below:

	As of	
	February 2005	November 2004
	(in millions)	
Fixed rate obligations [1]		
U.S. dollar	$34,218	$32,078
Non-U.S. dollar	17,168	12,553
Floating rate obligations [2]		
U.S. dollar	30,895	26,033
Non-U.S. dollar	13,296	10,032
Total	$95,577	$80,696

(1) As of February 2005 and November 2004, interest rates on U.S. dollar fixed rate obligations ranged from 1.23% to 12.00% and from 2.85% to 12.00%, respectively. The rate of 1.23% relates to tax-exempt debt assumed in the acquisition of power plants and related businesses from National Energy & Gas Transmission, Inc. (NEGT). As of both February 2005 and November 2004, interest rates on non-U.S. dollar fixed rate obligations ranged from 0.70% to 8.88%, respectively.

(2) Floating interest rates generally are based on LIBOR, the U.S. Treasury bill rate or the federal funds rate. Certain equity-linked and indexed instruments are included in floating rate obligations.

Nonrecourse debt is debt that Group Inc. is not directly or indirectly obligated to repay. Long-term borrowings include nonrecourse debt issued by the following subsidiaries:

	As of	
	February 2005	November 2004
	(in millions)	
William Street Funding Corporation	$ 6,256	$ 5,144
Variable interest entities	4,683	4,546
Other subsidiaries [1]	2,352	2,364
Total	$13,291	$12,054

(1) Includes $1.20 billion and $978 million of nonrecourse debt issued by the firm's consolidated power plant operations as of February 2005 and November 2004, respectively.

Long-term borrowings by fiscal maturity date are set forth below:

	As of					
	February 2005 [1] [2]			November 2004 [1] [2]		
	U.S. Dollar	Non-U.S. Dollar	Total	U.S. Dollar	Non-U.S. Dollar	Total
	(in millions)					
2006	$12,042	$ 2,583	$14,625	$10,691	$ 2,616	$13,307
2007	9,219	847	10,066	7,116	948	8,064
2008	4,227	3,090	7,317	4,626	3,179	7,805
2009	8,959	4,502	13,461	9,061	4,116	13,177
2010-thereafter	30,666	19,442	50,108	26,617	11,726	38,343
Total	$65,113	$30,464	$95,577	$58,111	$22,585	$80,696

[1] Long-term borrowings maturing within one year and certain long-term borrowings that may be redeemable within one year at the option of the holder are included as short-term borrowings in the condensed consolidated statements of financial condition.

[2] Long-term borrowings repayable at the option of the firm are reflected at their contractual maturity dates. Certain long-term borrowings that may be redeemable prior to maturity at the option of the holder are reflected at the dates such options become exercisable.

The firm enters into derivative contracts, such as interest rate futures contracts, interest rate swap agreements, currency swap agreements and equity-linked contracts, to effectively convert a substantial portion of its long-term borrowings into U.S. dollar-based floating rate obligations. Accordingly, the aggregate carrying value of these long-term borrowings and related hedges approximates fair value.

The effective weighted average interest rates for long-term borrowings, after hedging activities, are set forth below:

	As of			
	February 2005		November 2004	
	Amount	Rate	Amount	Rate
	($ in millions)			
Fixed rate obligations	$ 2,338	6.84%	$ 2,383	6.56%
Floating rate obligations	93,239	3.00	78,313	2.48
Total	$95,577	3.10	$80,696	2.60

Deferrable Interest Junior Subordinated Debentures

In February 2004, Goldman Sachs Capital I (the Trust), a wholly owned Delaware statutory trust, was formed by the firm for the exclusive purposes of (i) issuing $2.75 billion of guaranteed preferred beneficial interests and $85 million of common beneficial interests in the Trust, (ii) investing the proceeds from the sale to purchase junior subordinated debentures from Group Inc. and (iii) engaging in only those other activities necessary or incidental to these purposes. The preferred beneficial interests were purchased by third parties, and, as of February 2005, the firm held all of the common beneficial interests.

The Trust is a wholly owned finance subsidiary of the firm for legal and regulatory purposes. However, for accounting purposes, under FIN No. 46-R, the Trust is not a consolidated subsidiary of the firm because the firm's ownership of the common beneficial interest is not considered at risk, since the Trust's principal asset is the $2.84 billion of junior subordinated debentures issued by the firm. The firm pays interest semiannually on these debentures at an annual rate of 6.345% and the debentures mature on February 15, 2034. The coupon rate and payment dates applicable to the beneficial interests are the same as the interest rate and payment dates applicable to the debentures. See Note 6 for further information regarding the firm's guarantee of the preferred beneficial interests issued by the Trust.

The firm has the right, from time to time, to defer payment of interest on the junior subordinated debentures, and, therefore, cause payment of dividends on the Trust's preferred beneficial interests to be deferred, in each case for up to ten consecutive semiannual periods, and during any such extension period Group Inc. will not be permitted to, among other things, pay dividends on or make certain repurchases of its common stock. The Trust is not permitted to pay any distributions on the common beneficial interests held by the firm unless all dividends payable on the preferred beneficial interests have been paid in full.

Note 6. Commitments, Contingencies and Guarantees

Commitments

The firm had commitments to enter into forward secured financing transactions, including certain repurchase and resale agreements and secured borrowing and lending arrangements, of $40.11 billion and $48.32 billion as of February 2005 and November 2004, respectively.

In connection with its lending activities, the firm had outstanding commitments of $28.44 billion and $27.72 billion as of February 2005 and November 2004, respectively. The firm's commitments to extend credit are agreements to lend to counterparties that have fixed termination dates and are contingent on all conditions to borrowing set forth in the contract having been met. Since these commitments may expire unused, the total commitment amount does not necessarily reflect the actual future cash flow requirements.

As of February 2005 and November 2004, $9.95 billion and $9.40 billion, respectively, of the firm's outstanding commitments to extend credit have been issued through the William Street credit extension program. These commitments were primarily issued through William Street Commitment Corporation (Commitment Corp), a consolidated wholly owned subsidiary of Group Inc. Another consolidated wholly owned subsidiary, William Street Funding Corporation (Funding Corp), was formed to raise funding to support the William Street credit extension program. Commitment Corp and Funding Corp are each separate corporate entities, with assets and liabilities that are legally separated from the other assets and liabilities of the firm. Accordingly, the assets of Commitment Corp and of Funding Corp will not be available to their respective shareholders until the claims of their respective creditors have been paid. In addition, no affiliate of either Commitment Corp or Funding Corp, except in limited cases as expressly agreed in writing, is responsible for any obligation of either entity. Substantially all of the credit risk associated with these commitments has been covered by credit loss protection provided to the firm by SMFG. The firm has also hedged the credit risk of certain non-William Street commitments using a variety of other financial instruments.

The firm provides letters of credit issued by various banks to counterparties in lieu of securities or cash to satisfy various collateral and margin deposit requirements. Letters of credit outstanding were $9.95 billion and $11.15 billion as of February 2005 and November 2004, respectively.

The firm acts as an investor in merchant banking transactions, which includes making long-term investments in equity and debt securities in privately negotiated transactions, corporate acquisitions and real estate transactions. In connection with these activities, the firm had commitments to invest up to $979 million and $1.04 billion in corporate and real estate investment funds as of February 2005 and November 2004, respectively.

The firm had construction-related commitments of $120 million and $107 million as of February 2005 and November 2004, respectively, and other purchase commitments of $270 million and $242 million as of February 2005 and November 2004, respectively.

The firm has contractual obligations under long-term noncancelable lease agreements, principally for office space, expiring on various dates through 2029. Certain agreements are subject to periodic escalation provisions for increases in real estate taxes and other charges. Future minimum rental payments, net of minimum sublease rentals, are set forth below:

	(in millions)
Minimum rental payments	
Remainder of 2005	$ 268
2006	359
2007	319
2008	300
2009	302
2010-thereafter	1,910
Total	$3,458

Contingencies

The firm is involved in a number of judicial, regulatory and arbitration proceedings concerning matters arising in connection with the conduct of its businesses. Management believes, based on currently available information, that the results of such proceedings, in the aggregate, will not have a material adverse effect on the firm's financial condition, but may be material to the firm's operating results for any particular period, depending, in part, upon the operating results for such period. Given the inherent difficulty of predicting the outcome of the firm's litigation matters, particularly in cases in which claimants seek substantial or indeterminate damages, the firm cannot estimate losses or ranges of losses for cases where there is only a reasonable possibility that a loss may have been incurred.

Guarantees

The firm enters into various derivative contracts that meet the definition of a guarantee under FIN No. 45. Such derivative contracts include credit default swaps, written equity and commodity put options, written currency contracts and interest rate caps, floors and swaptions. FIN No. 45 does not require disclosures about derivative contracts if such contracts may be cash settled and the firm has no basis to conclude it is probable that the counterparties held, at inception, the underlying instruments related to the derivative contracts. The firm has concluded that these conditions have been met, for certain large, internationally active commercial and investment bank end users and certain other users. Accordingly, the firm has not included such contracts in the table below.

The firm, in its capacity as an agency lender, occasionally indemnifies securities lending customers against losses incurred in the event that borrowers do not return securities and the collateral held is insufficient to cover the market value of the securities borrowed. In relation to certain asset sales and securitization transactions, the firm guarantees the collection of contractual cash flows. In connection with its merchant banking activities, the firm may issue loan guarantees to secure financing and to obtain preferential terms. In addition, the firm provides letters of credit and other guarantees, on a limited basis, to enable clients to enhance their credit standing and complete transactions.

In connection with the firm's establishment of the Trust, Group Inc. effectively provided for the full and unconditional guarantee of the beneficial interests in the Trust held by third parties. Timely payment by Group Inc. of interest on the junior subordinated debentures and other amounts due and performance of its other obligations under the transaction documents will be sufficient to cover payments due by the Trust on its beneficial interests. As a result, management believes that it is unlikely the firm will have to make payments related to the Trust other than those required under the junior subordinated debentures and in connection with certain expenses incurred by the Trust.

The following table sets forth certain information about the firm's derivative contracts that meet the definition of a guarantee and certain other guarantees as of February 2005 and November 2004:

	As of February 2005					
		Maximum Payout/Notional Amount by Period of Expiration [4]				
	Carrying Value	Remainder of 2005	2006-2007	2008-2009	2010-Thereafter	Total
		(in millions)				
Derivatives [1]	$4,833	$174,901	$254,924	$201,694	$289,192	$920,711
Securities lending indemnifications [2]	—	14,859	—	—	—	14,859
Guarantees of trust preferred beneficial interest [3]	—	87	349	349	7,025	7,810
Guarantee of the collection of contractual cash flows	16	47	159	57	27	290
Merchant banking fund-related commitments	—	27	60	8	8	103
Letters of credit and other guarantees	18	364	169	9	80	622

(1) The carrying value of $4.83 billion excludes the effect of a legal right of setoff that may exist under an enforceable netting agreement.

(2) Collateral held in connection with securities lending indemnifications was $15.41 billion as of February 2005.

(3) Includes the guarantee of all payments scheduled to be made over the life of the Trust, which could be shortened in the event the firm redeemed the junior subordinated debentures issued to fund the Trust (see Note 5 for further information regarding the Trust).

(4) Such amounts do not represent the anticipated losses in connection with these contracts.

	As of November 2004					
		Maximum Payout/Notional Amount by Period of Expiration [4]				
	Carrying Value	2005	2006-2007	2008-2009	2010-Thereafter	Total
			(in millions)			
Derivatives [1]	$6,752	$269,246	$96,829	$175,910	$349,789	$891,774
Securities lending indemnifications [2]	—	14,737	—	—	—	14,737
Guarantees of trust preferred beneficial interest [3]	—	174	349	349	7,025	7,897
Guarantee of the collection of contractual cash flows	16	47	162	57	20	286
Merchant banking fund-related commitments	—	19	41	—	5	65
Letters of credit and other guarantees	44	93	123	9	80	305

(1) The carrying value of $6.75 billion excludes the effect of a legal right of setoff that may exist under an enforceable netting agreement.

(2) Collateral held in connection with securities lending indemnifications was $15.28 billion as of November 2004.

(3) Includes the guarantee of all payments scheduled to be made over the life of the Trust, which could be shortened in the event the firm redeemed the junior subordinated debentures issued to fund the Trust (see Note 5 for further information regarding the Trust).

(4) Such amounts do not represent the anticipated losses in connection with these contracts.

In the normal course of its business, the firm indemnifies and guarantees certain service providers, such as clearing and custody agents, trustees and administrators, against specified potential losses in connection with their acting as an agent of, or providing services to, the firm or its affiliates. The firm also indemnifies some clients against potential losses incurred in the event specified third-party service providers, including subcustodians and third-party brokers, improperly execute transactions. In addition, the firm is a member of payment, clearing and settlement networks as well as securities exchanges around the world that may require the firm to meet the obligations of such networks and exchanges in the event of member defaults. In connection with its prime brokerage and clearing businesses, the firm may agree to clear and settle on behalf of its clients the transactions entered into by them with other brokerage firms. The firm's obligations in respect of such transactions are secured by the assets in the client's account as well as any proceeds received from the transactions cleared and settled by the firm on behalf of the client. In connection with joint venture investments, the firm may issue loan guarantees under which it may be liable in the event of fraud, misappropriation, environmental liabilities and certain other matters involving the borrower. The firm is unable to develop an estimate of the maximum payout under these guarantees and indemnifications. However, management believes that it is unlikely the firm will have to make material payments under these arrangements, and no liabilities related to these guarantees and indemnifications have been recognized in the condensed consolidated statements of financial condition as of February 2005 and November 2004.

The firm provides representations and warranties to counterparties in connection with a variety of commercial transactions and occasionally indemnifies them against potential losses caused by the breach of those representations and warranties. The firm may also provide indemnifications protecting against changes in or adverse application of certain U.S. tax laws in connection with ordinary-course transactions such as securities issuances, borrowings or derivatives. In addition, the firm may provide indemnifications to some counterparties to protect them in the event additional taxes are owed or payments are withheld, due either to a change in or an adverse application of certain non-U.S. tax laws. These indemnifications generally are standard contractual terms and are entered into in the normal course of business. Generally, there are no stated or notional amounts included in these indemnifications, and the contingencies triggering the obligation to indemnify are not expected to occur. The firm is unable to develop an estimate of the maximum payout under these guarantees. However, management believes that it is unlikely the firm will have to make material payments under these arrangements, and no liabilities related to these arrangements have been recognized in the condensed consolidated statements of financial condition as of February 2005 and November 2004.

Note 7. Shareholders' Equity

On March 16, 2005, the Board of Directors of Group Inc. (the Board) declared a dividend of $0.25 per share to be paid on May 26, 2005, to common shareholders of record on April 26, 2005.

During the three months ended February 2005, the firm repurchased 11.5 million shares of the firm's common stock. The average price paid per share for repurchased shares was $106.91 for the three months ended February 2005. In addition, to satisfy minimum statutory employee tax withholding requirements related to the delivery of shares underlying restricted stock units, the firm cancelled 1.5 million restricted stock units at an average price of $104.62 per unit in the first quarter of 2005. On January 25, 2005, the Board authorized the repurchase of an additional 40.0 million shares of common stock pursuant to the firm's existing share repurchase program. As of February 2005, the remaining share authorization under the firm's repurchase program was 35.0 million shares.

Note 8. Earnings Per Share

The computations of basic and diluted EPS are set forth below:

	Three Months Ended February	
	2005	2004
	(in millions, except per share amounts)	
Numerator for basic and diluted EPS — earnings available to common shareholders	$1,512	$1,293
Denominator for basic EPS — weighted average number of common shares	494.3	492.0
Effect of dilutive securities		
Restricted stock units	7.8	11.2
Stock options	13.0	13.9
Dilutive potential common shares	20.8	25.1
Denominator for diluted EPS — weighted average number of common shares and dilutive potential common shares [1]	515.1	517.1
Basic EPS	$ 3.06	$ 2.63
Diluted EPS	2.94	2.50

[1] The diluted EPS computations do not include the antidilutive effect of the following options:

	Three Months Ended February	
	2005	2004
	(in millions)	
Number of antidilutive options, end of period	1	1

Note 9. Goodwill and Identifiable Intangible Assets

Goodwill

As of both February 2005 and November 2004, goodwill of $3.07 billion and $3.18 billion, respectively, was included in "Other assets" in the condensed consolidated statements of financial condition.

Identifiable Intangible Assets

The following table sets forth the gross carrying amount, accumulated amortization and net carrying amount of identifiable intangible assets:

		As of February 2005	As of November 2004
		(in millions)	
Power contracts [1]	Gross carrying amount	$ 959	$ —
	Accumulated amortization	(6)	—
	Net carrying amount	$ 953	$ —
Customer lists [2]	Gross carrying amount	$1,021	$1,021
	Accumulated amortization	(206)	(193)
	Net carrying amount	$ 815	$ 828
New York Stock Exchange (NYSE) specialist rights	Gross carrying amount	$ 714	$ 714
	Accumulated amortization	(115)	(107)
	Net carrying amount	$ 599	$ 607
Exchange-traded fund (ETF) and option specialist rights	Gross carrying amount	$ 145	$ 145
	Accumulated amortization	(25)	(24)
	Net carrying amount	$ 120	$ 121
Other [3]	Gross carrying amount	$ 298	$ 298
	Accumulated amortization	(174)	(165)
	Net carrying amount	$ 124	$ 133
Total	Gross carrying amount	$3,137	$2,178
	Accumulated amortization	(526)	(489)
	Net carrying amount	$2,611	$1,689

(1) Primarily relates to above-market power contracts acquired in the firm's combinations with Cogentrix Energy, Inc. and NEGT. The firm completed its purchase price allocation for Cogentrix Energy, Inc. and closed on its acquisition of NEGT during the first quarter of fiscal 2005. Substantially all of these power contracts have been pledged as collateral to counterparties in connection with certain of the firm's secured short-term and long-term borrowings.

(2) Primarily includes the firm's clearance and execution and NASDAQ customer lists acquired in the firm's combination with SLK LLC (SLK) and financial counseling customer lists acquired in the firm's combination with The Ayco Company, L.P.

(3) Primarily includes technology-related assets acquired in the firm's combination with SLK.

Identifiable intangible assets are amortized over their estimated useful lives. The weighted average remaining life of the firm's identifiable intangibles is approximately 17 years. There were no identifiable intangible assets that were considered to be indefinite-lived and, therefore, not subject to amortization.

Note 10. Other Assets and Other Liabilities

Other assets are generally less liquid, nonfinancial assets. The following table sets forth the firm's other assets by type:

	As of	
	February 2005	November 2004
	(in millions)	
Goodwill and identifiable intangible assets [1]	$ 5,680	$ 4,871
Property, leasehold improvements and equipment [2]	4,472	4,083
Equity-method investments and joint ventures	2,310	2,447
Miscellaneous receivables and other	4,235	3,742
Total	$16,697	$15,143

(1) See Note 9 for further information regarding the firm's goodwill and identifiable intangible assets.

(2) Net of accumulated depreciation and amortization of $4.38 billion and $4.23 billion for February 2005 and November 2004, respectively.

Other liabilities and accrued expenses primarily includes compensation and benefits, minority interest in certain consolidated entities, litigation liabilities, tax-related payables, deferred revenue and other payables. The following table sets forth the firm's other liabilities and accrued expenses by type:

	As of	
	February 2005	November 2004
	(in millions)	
Compensation and benefits	$2,928	$ 5,571
Minority interest	1,972	1,809
Accrued expenses and other payables	3,321	2,980
Total	$8,221	$10,360

Note 11. Employee Benefit Plans

The firm sponsors various pension plans and certain other postretirement benefit plans, primarily healthcare and life insurance, which cover most employees worldwide. The firm also provides certain benefits to former or inactive employees prior to retirement.

Defined Benefit Pension Plans and Postretirement Plans

The firm maintains a defined benefit pension plan for substantially all U.S. employees. As of November 2004, this plan has been closed to new participants and no further benefits will be accrued to existing participants. Employees of certain non-U.S. subsidiaries participate in various local defined benefit plans. These plans generally provide benefits based on years of credited service and a percentage of the employee's eligible compensation. In addition, the firm has unfunded postretirement benefit plans that provide medical and life insurance for eligible retirees, employees and dependents in the United States.

The components of pension expense/(income) and postretirement expense are set forth below:

	Three Months Ended February 2005	Three Months Ended February 2004
	(in millions)	
U.S. pension		
Service cost	$ —	$ 3
Interest cost	5	5
Expected return on plan assets	(7)	(6)
Net amortization	2	1
Total	$ —	$ 3
Non-U.S. pension		
Service cost	$ 11	$12
Interest cost	5	4
Expected return on plan assets	(6)	(5)
Net amortization	3	3
Other [1]	(17)	—
Total	$ (4)	$14
Postretirement		
Service cost	$ 3	$ 2
Interest cost	3	3
Expected return on plan assets	—	—
Net amortization	1	2
Total	$ 7	$ 7

[1] Represents a benefit in the first quarter of fiscal 2005 as a result of the termination of a Japanese pension plan.

The firm will contribute a minimum of $5 million to its pension plans and $7 million to its postretirement plans in fiscal 2005.

Note 12. Regulated Subsidiaries

The firm's principal U.S. and international regulated subsidiaries include Goldman, Sachs & Co. (GS&Co.) and Goldman Sachs Execution & Clearing, L.P.[1] (GSEC) in New York, Goldman Sachs International (GSI) in London and Goldman Sachs (Japan) Ltd. (GSJL) in Tokyo.

GS&Co. and GSEC are registered U.S. broker-dealers and futures commission merchants subject to Rule 15c3-1 of the U.S. Securities and Exchange Commission (SEC) and Rule 1.17 of the Commodity Futures Trading Commission, which specify uniform minimum net capital requirements, as defined, for their registrants. They have elected to compute their net capital in accordance with the ''Alternative Net Capital Requirement'' as permitted by Rule 15c3-1. As of February 2005, GS&Co. had regulatory net capital, as defined, of $4.73 billion, which exceeded the amount required by $3.55 billion. As of February 2005, GSEC had regulatory net capital, as defined, of $1.32 billion, which exceeded the amount required by $1.28 billion.

[1] The firm renamed Spear, Leeds & Kellogg, L.P., Goldman Sachs Execution & Clearing, L.P., effective January 14, 2005.

GSI, a registered U.K. broker-dealer, is subject to the capital requirements of the Financial Services Authority, and GSJL, a Tokyo-based broker-dealer, is subject to the capital requirements of the Financial Services Agency. As of February 2005, GSI and GSJL were in compliance with their local capital adequacy requirements.

Certain other subsidiaries of the firm are also subject to capital adequacy requirements promulgated by authorities of the countries in which they operate. As of February 2005, these subsidiaries were in compliance with their local capital adequacy requirements.

On March 23, 2005, the SEC approved an application by the firm to become a consolidated supervised entity (CSE). As a CSE, the firm is subject to group-wide supervision and examination by the SEC, and accordingly, is subject to minimum capital requirements on a consolidated basis.

Note 13. Business Segments

In reporting to management, the firm's operating results are categorized into the following three segments: Investment Banking, Trading and Principal Investments, and Asset Management and Securities Services.

Basis of Presentation

In reporting segments, certain of the firm's business lines have been aggregated where they have similar economic characteristics and are similar in each of the following areas: (i) the nature of the services they provide, (ii) their methods of distribution, (iii) the types of clients they serve and (iv) the regulatory environments in which they operate.

The cost drivers of the firm taken as a whole — compensation, headcount and levels of business activity — are broadly similar in each of the firm's business segments. Compensation expenses within the firm's business segments reflect, among other factors, the overall performance of the firm as well as performance of individual business units. Consequently, pre-tax margins in one segment of the firm's business may be significantly affected by the performance of the firm's other business segments. The timing and magnitude of changes in the firm's bonus accruals can have a significant effect on segment results in a given period.

Segment Operating Results

Management believes that the following information provides a reasonable representation of each segment's contribution to consolidated pre-tax earnings and total assets:

		As of or for the Three Months Ended February	
		2005	2004
		(in millions)	
Investment Banking	Net revenues	$ 893	$ 763
	Operating expenses	787	693
	Pre-tax earnings	$ 106	$ 70
	Segment assets	$ 3,051	$ 5,872
Trading and Principal Investments	Net revenues	$ 4,383	$ 4,122
	Operating expenses	2,729	2,528
	Pre-tax earnings	$ 1,654	$ 1,594
	Segment assets	$413,570	$281,774
Asset Management and Securities Services	Net revenues	$ 1,129	$ 1,043
	Operating expenses	713	697
	Pre-tax earnings	$ 416	$ 346
	Segment assets	$179,276	$154,919
Total	Net revenues	$ 6,405	$ 5,928
	Operating expenses [1]	4,260	3,999
	Pre-tax earnings	$ 2,145	$ 1,929
	Total assets [2]	$596,149	$443,285

(1) Includes the following expenses that have not been allocated to the firm's segments: (i) the amortization of employee initial public offering awards, net of forfeitures, of $21 million for the three months ended February 2004, and (ii) net provisions for a number of litigation and regulatory proceedings of $31 million and $60 million for the three months ended February 2005 and February 2004, respectively.

(2) Includes certain assets that management believes are not allocable to a particular segment.

Report of Independent Registered Public Accounting Firm

To the Directors and Shareholders of
The Goldman Sachs Group, Inc.:

We have reviewed the accompanying condensed consolidated statement of financial condition of The Goldman Sachs Group, Inc. and subsidiaries (the Company) at February 25, 2005, the related condensed consolidated statements of earnings for the three months ended February 25, 2005 and February 27, 2004, the condensed consolidated statement of changes in shareholders' equity for the three months ended February 25, 2005, the condensed consolidated statements of cash flows for the three months ended February 25, 2005 and February 27, 2004, and the condensed consolidated statements of comprehensive income for the three months ended February 25, 2005 and February 27, 2004. These condensed consolidated interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial condition at November 26, 2004, the related consolidated statements of earnings, changes in shareholders' equity, cash flows and comprehensive income for the year then ended, management's assessment of the effectiveness of the Company's internal control over financial reporting as of November 26, 2004 and the effectiveness of the Company's internal control over financial reporting as of November 26, 2004; and in our report dated February 4, 2005, we expressed an unqualified opinion thereon. The consolidated financial statements and management's assessment of the effectiveness of internal control over financial reporting referred to above are not presented herein. In our opinion, the information set forth in the accompanying condensed consolidated statement of financial condition as of November 26, 2004, and the condensed consolidated statement of changes in shareholders' equity for the year ended November 26, 2004 is fairly stated, in all material respects, in relation to the consolidated financial statements from which it has been derived.

/s/ PricewaterhouseCoopers LLP

New York, New York
March 22, 2005

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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Introduction

Goldman Sachs is a leading global investment banking, securities and investment management firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments and high-net-worth individuals.

Our activities are divided into three segments:

- **Investment Banking.** We provide a broad range of investment banking services to a diverse group of corporations, financial institutions, governments and individuals.
- **Trading and Principal Investments.** We facilitate customer transactions with a diverse group of corporations, financial institutions, governments and individuals and take proprietary positions through market making in, and trading of, fixed income and equity products, currencies, commodities and derivatives on such products. In addition, we engage in floor-based and electronic market making as a specialist on U.S. equities and options exchanges and we clear customer transactions on major stock, options and futures exchanges worldwide. In connection with our merchant banking and other investment activities, we make principal investments directly and through funds that we raise and manage.
- **Asset Management and Securities Services.** We offer a broad array of investment strategies, advice and planning across all major asset classes to a diverse group of institutions and individuals worldwide, and provide prime brokerage, financing services and securities lending services to mutual funds, pension funds, hedge funds, foundations and high-net-worth individuals worldwide.

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended November 26, 2004. References herein to the Annual Report on Form 10-K are to our Annual Report on Form 10-K for the fiscal year ended November 26, 2004.

Unless specifically stated otherwise, all references to February 2005 and February 2004 refer to our fiscal periods ended, or the dates, as the context requires, February 25, 2005 and February 27, 2004, respectively. All references to November 2004, unless specifically stated otherwise, refer to our fiscal year ended, or the date, as the context requires, November 26, 2004.

When we use the terms ''Goldman Sachs,'' ''we,'' ''us'' and ''our,'' we mean The Goldman Sachs Group, Inc. (Group Inc.), a Delaware corporation, and its consolidated subsidiaries.

Executive Overview

Our diluted earnings per share were $2.94 for the first quarter of 2005, an 18% increase compared with the same period last year. Annualized return on average tangible shareholders' equity was 29.6% [1] and annualized return on average shareholders' equity was 23.5%. Our first quarter results reflected strong performances in each of our three segments. The increase in Trading and Principal Investments reflected significantly higher net revenues in Fixed Income, Currency and Commodities (FICC), as all major businesses performed well. Net revenues in Equities were lower compared with the first quarter of 2004, but the business performed well as its results were significantly higher than more recent quarters. The increase in Investment Banking net revenues compared with the first quarter of 2004 primarily reflected significantly higher net revenues from debt underwriting. The increase in Asset Management and Securities Services net revenues reflected significantly higher customer balances in securities lending and margin lending. In Asset

(1) Annualized return on average tangible shareholders' equity is computed by dividing annualized net earnings by average monthly tangible shareholders' equity. See ''— Results of Operations — Financial Overview'' below for further information regarding our calculation of annualized return on average tangible shareholders' equity.

Management, although incentive fees declined, net revenues were only slightly lower, as assets under management increased 17% from the first quarter of 2004.

Our operating results in the first quarter of 2005 continued to reflect improvement in economic conditions, as well as a number of trends that have emerged in recent years. We continued to see solid trading and investing opportunities for our clients and ourselves, and consequently, we maintained our market risk at levels generally consistent with 2004 to capitalize on these opportunities. In Investment Banking, although industry-wide completed mergers and acquisitions and equity underwriting volumes decreased compared with the most recent quarter, corporate activity continued to recover as our Investment Banking results reflected our second best quarterly performance in the last two years, particularly due to improvement in high-yield and bank loan activity. In the regulatory environment, financial services firms continued to be under intense scrutiny, with the volume and amount of claims against financial institutions and other related costs remaining significant. Given the range of litigation and investigations presently under way, our litigation expenses can be expected to remain high.

Though our operating results were strong in the first quarter of 2005, our business, by its nature, does not produce predictable earnings. Our results in any given period can be materially affected by conditions in global financial markets and economic conditions generally. For a further discussion of these trends and other factors affecting our businesses, see ''Business — Certain Factors That May Affect Our Business'' in Part I, Item 1 of the Annual Report on Form 10-K.

Business Environment

During the first quarter, global growth remained strong, though the balance of growth was stronger in the U.S. and China, and softer in Japan and Europe. Declining geopolitical uncertainty and ongoing signs of economic growth contributed to generally higher equity prices. In the fixed income markets, long-term bond yields ended the quarter essentially unchanged after initially falling, and yield curves, particularly in the U.S., continued to flatten, while corporate credit spreads remained tight. Industry-wide announced mergers and acquisitions improved significantly during the quarter and debt origination volumes remained strong, but industry-wide equity underwriting volumes declined.

In the United States, the economy showed steady growth during the quarter, helped by robust growth in capital expenditures and continued growth in consumer spending. The labor market showed clearer signs of recovery through the quarter, while measures of core inflation generally firmed. As a result, the U.S. Federal Reserve raised its federal funds rate target by 50 basis points during the quarter. Long-term yields, however, remained at relatively low levels as the 10-year U.S. Treasury note yield ended the quarter at 4.27%. The Dow Jones Industrial Average and the S&P 500 Index increased 3% and 2%, respectively, while the NASDAQ Composite Index declined 2%.

In Europe, real gross domestic product growth remained quite weak as domestic demand and industrial production growth remained soft. With growth still modest and inflation well contained, the European Central Bank left rates unchanged. Long-term yields also ended the quarter essentially unchanged from levels at the beginning of the quarter. The U.K. economy continued to grow at a healthy pace on the back of steady domestic demand growth. The Bank of England left interest rates unchanged during the quarter. Despite modest economic growth, continental European equity markets generally rose during the quarter, as did the U.K. equity market.

In Japan, in the beginning of our fiscal quarter, domestic demand growth remained soft and net exports continued to restrain economic growth, but continued labor market improvement and signs of improved capital expenditures appeared consistent with somewhat firmer economic growth later in our fiscal quarter. These signs of improvement were reflected in the Nikkei 225 Index, which increased 8% during the quarter. In the rest of Asia, although the pace of economic growth appeared to slow from 2004 levels, it remained strong as export growth across the region, particularly China, remained solid. Several regional equity markets, including Korea, Taiwan and Singapore, rose strongly during the quarter.

Critical Accounting Policies

Fair Value

"Total financial instruments owned, at fair value" and "Financial instruments sold, but not yet purchased, at fair value" in the condensed consolidated statements of financial condition consist of financial instruments carried at fair value or amounts that approximate fair value, with related unrealized gains or losses recognized in our results of operations. The use of fair value to measure these financial instruments, with related unrealized gains and losses recognized immediately in our results of operations, is fundamental to our financial statements and is our most critical accounting policy. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

In determining fair value, we separate our financial instruments into three categories — cash (i.e., nonderivative) trading instruments, derivative contracts and principal investments, as set forth in the following table:

Financial Instruments by Category
(in millions)

	As of February 2005		As of November 2004	
	Financial Instruments Owned, At Fair Value	Financial Instruments Sold, But Not Yet Purchased, At Fair Value	Financial Instruments Owned, At Fair Value	Financial Instruments Sold, But Not Yet Purchased, At Fair Value
Cash trading instruments	$158,074	$ 73,831	$143,376	$ 68,096
Derivative contracts	58,691	51,662	62,495	64,001
Principal investments	4,744 (1)	63 (2)	4,654 (1)	—
Total	$221,509	$125,556	$210,525	$132,097

(1) Excludes assets of $1.28 billion in consolidated employee-owned merchant banking funds as of February 2005 and November 2004.

(2) Represents an economic hedge on the unrestricted common stock underlying our investment in the convertible preferred stock of Sumitomo Mitsui Financial Group, Inc. (SMFG). For a further discussion of our investment in SMFG, see "— Principal Investments" below.

Cash Trading Instruments. Fair values of our cash trading instruments are generally obtained from quoted market prices in active markets, broker or dealer price quotations, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued in this manner include U.S. government and agency securities, other sovereign government obligations, liquid mortgage products, investment-grade corporate bonds, listed equities, money market securities, state, municipal and provincial obligations, and physical commodities.

Certain cash trading instruments trade infrequently and, therefore, have little or no price transparency. Such instruments may include certain high-yield debt, corporate bank loans, mortgage whole loans and distressed debt. We value these instruments using methodologies such as the present value of known or estimated cash flows and generally do not adjust underlying valuation assumptions unless there is substantive evidence supporting a change in the value of the underlying instrument or valuation assumptions (such as similar market transactions, changes in financial ratios and changes in credit ratings of the underlying companies).

The following table sets forth the valuation of our cash trading instruments by level of price transparency:

Cash Trading Instruments by Price Transparency
(in millions)

	As of February 2005		As of November 2004	
	Financial Instruments Owned, At Fair Value	**Financial Instruments Sold, But Not Yet Purchased, At Fair Value**	**Financial Instruments Owned, At Fair Value**	**Financial Instruments Sold, But Not Yet Purchased, At Fair Value**
Quoted prices or alternative pricing sources with reasonable price transparency	$140,760	$73,610	$130,908	$67,948
Little or no price transparency	17,314	221	12,468	148
Total	$158,074	$73,831	$143,376	$68,096

Cash trading instruments we own (long positions) are marked to bid prices and instruments we have sold but not yet purchased (short positions) are marked to offer prices. If liquidating a position is reasonably expected to affect its prevailing market price, our valuation is adjusted generally based on market evidence or predetermined policies. In certain circumstances, such as for highly illiquid positions, management's estimates are used to determine this adjustment.

Derivative Contracts. Derivative contracts consist of exchange-traded and over-the-counter (OTC) derivatives. The following table sets forth the fair value of our exchange-traded and OTC derivative assets and liabilities:

Derivative Assets and Liabilities
(in millions)

	As of February 2005		As of November 2004	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Exchange-traded derivatives	$ 5,883	$ 5,304	$ 5,464	$ 5,905
OTC derivatives	52,808	46,358	57,031	58,096
Total [1]	$58,691	$51,662	$62,495	$64,001

(1) The fair values of our derivative assets and liabilities include cash we have paid and received (for example, option premiums or cash paid or received pursuant to credit support agreements) and may change significantly from period to period based on, among other factors, changes in our trading positions and market movements.

Fair values of our exchange-traded derivatives are generally determined from quoted market prices. OTC derivatives are valued using valuation models. We use a variety of valuation models including the present value of known or estimated cash flows, option-pricing models and option-adjusted spread models. The valuation models that we use to derive the fair values of our OTC derivatives require inputs including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. The selection of a model to value an OTC derivative depends upon the contractual terms of, and specific risks inherent in, the instrument as well as the availability of pricing information in the market. We generally use similar models to value similar instruments. Where possible, we verify the values produced by our pricing models to market transactions. For OTC derivatives that trade in liquid markets, such as generic forwards, swaps and options, model selection does not involve significant judgment because market prices are readily available. For OTC derivatives that trade in less liquid markets, model selection requires more judgment because such instruments tend to be more complex and pricing information is less available in the market. As markets continue to develop and more pricing information becomes available, we continue to review and refine the models that we use.

At the inception of an OTC derivative contract (day one), we value the contract at the model value if we can verify all of the significant model inputs to observable market data and verify the model to market transactions. When appropriate, valuations are adjusted to reflect various factors such as liquidity, bid/offer and credit considerations. These adjustments are generally based on market evidence or predetermined policies. In certain circumstances, such as for highly illiquid positions, management's estimates are used to determine these adjustments.

Where we cannot verify all of the significant model inputs to observable market data and verify the model to market transactions, we value the contract at the transaction price at inception and, consequently, record no day one gain or loss in accordance with Emerging Issues Task Force (EITF) Issue No. 02-3, ''Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities.''

Following day one, we adjust the inputs to our valuation models only to the extent that changes in such inputs can be verified by similar market transactions, third-party pricing services and/or broker quotes or can be derived from other substantive evidence such as empirical market data. In circumstances where we cannot verify the model to market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value.

The following tables set forth the fair values of our OTC derivative assets and liabilities by product and by remaining contractual maturity:

OTC Derivatives
(in millions)

	As of February 2005					
Assets						
Contract Type	**0 - 6 Months**	**6 - 12 Months**	**1 - 5 Years**	**5 - 10 Years**	**10 Years or Greater**	**Total**
Interest rates	$ 1,085	$ 456	$ 6,058	$ 4,441	$12,636	$24,676
Currencies	5,367	970	3,281	2,005	1,082	12,705
Commodities	2,138	3,171	4,256	1,370	64	10,999
Equities	1,894	814	537	919	264	4,428
Total	$10,484	$5,411	$14,132	$ 8,735	$14,046	$52,808
Liabilities						
Contract Type	**0 - 6 Months**	**6 - 12 Months**	**1 - 5 Years**	**5 - 10 Years**	**10 Years or Greater**	**Total**
Interest rates	$ 1,399	$ 558	$ 6,151	$ 5,139	$ 5,356	$18,603
Currencies	4,297	1,370	3,937	659	1,121	11,384
Commodities	2,403	2,594	4,201	1,224	105	10,527
Equities	1,825	937	1,047	1,609	426	5,844
Total	$ 9,924	$5,459	$15,336	$ 8,631	$ 7,008	$46,358

	As of November 2004					
Assets						
Contract Type	**0 - 6 Months**	**6 - 12 Months**	**1 - 5 Years**	**5 - 10 Years**	**10 Years or Greater**	**Total**
Interest rates	$ 1,475	$ 451	$ 5,682	$ 4,250	$12,743	$24,601
Currencies	9,570	1,499	3,670	2,320	1,198	18,257
Commodities	2,943	1,164	5,581	1,108	160	10,956
Equities	1,311	813	457	634	2	3,217
Total	$15,299	$3,927	$15,390	$ 8,312	$14,103	$57,031
Liabilities						
Contract Type	**0 - 6 Months**	**6 - 12 Months**	**1 - 5 Years**	**5 - 10 Years**	**10 Years or Greater**	**Total**
Interest rates	$ 1,854	$ 789	$ 7,366	$ 7,136	$ 5,658	$22,803
Currencies	9,577	1,580	4,456	2,755	1,184	19,552
Commodities	3,791	1,425	4,522	814	107	10,659
Equities	1,409	1,304	1,114	1,084	171	5,082
Total	$16,631	$5,098	$17,458	$11,789	$ 7,120	$58,096

We enter into certain OTC option transactions that provide us or our counterparties with the right to extend the maturity of the underlying contract. The fair value of these option contracts is not material to the aggregate fair value of our OTC derivative portfolio. In the tables above, for option contracts that require settlement by delivery of an underlying derivative instrument, the classification of the remaining contractual maturity is generally based upon the maturity date of the underlying derivative instrument. In those instances when the underlying instrument does not have a maturity date or either counterparty has the right to settle in cash, the remaining contractual maturity date is generally based upon the option expiration date.

Price transparency for OTC derivative model inputs varies depending on, among other factors, product type, maturity and the complexity of the contract. Price transparency for interest rate and currency contracts varies by the underlying currencies, with the currencies of the leading industrialized nations having the most price transparency. Price transparency for commodity contracts varies by type of underlying commodity. Price transparency for equity contracts varies by market, with the equity markets of the leading industrialized nations having the most price transparency. Price transparency is inherently more limited for more complex structures because they often combine one or more product types, requiring additional inputs such as correlations and volatilities.

Principal Investments. In valuing our corporate and real estate principal investments, we separate our portfolio into investments in private companies, investments in public companies (excluding our investment in the convertible preferred stock of SMFG) and our investment in SMFG.

The following table sets forth the carrying value of our principal investments portfolio:

Principal Investments
(in millions)

	As of February 2005			As of November 2004		
	Corporate	Real Estate	Total	Corporate	Real Estate	Total
Private	$ 988	$754	$1,742	$ 935	$769	$1,704
Public	294	27	321	343	51	394
Subtotal	1,282	781	2,063	1,278	820	2,098
SMFG convertible preferred stock [1]	2,681	—	2,681 [3]	2,556	—	2,556
Total [2]	$3,963	$781	$4,744	$3,834	$820	$4,654

(1) The fair value of our Japanese yen-denominated investment in SMFG convertible preferred stock includes the effect of foreign exchange revaluation. We hedge our economic exposure to exchange rate movements on our investment in SMFG by borrowing Japanese yen. Foreign exchange revaluation on the investment and the related borrowing are generally equal and offsetting. For example, if the Japanese yen appreciates against the U.S. dollar, the U.S. dollar carrying value of our SMFG investment will increase and the U.S. dollar carrying value of the related borrowing will also increase by an amount that is generally equal and offsetting.

(2) Excludes assets of $1.28 billion in consolidated employee-owned merchant banking funds as of February 2005 and November 2004.

(3) Excludes an economic hedge on the unrestricted shares of common stock underlying our investment in the convertible preferred stock of SMFG. As of February 25, 2005, the fair value of this hedge was $63 million and is reflected in ''Financial instruments sold, but not yet purchased, at fair value'' in the condensed consolidated statements of financial condition. For a further discussion of the restrictions on our ability to hedge or sell the common stock underlying our investment in SMFG, see below.

Our private principal investments, by their nature, have little or no price transparency. Such investments are initially carried at cost as an approximation of fair value. Adjustments to carrying value are made if there are third-party transactions evidencing a change in value. Downward adjustments are also made, in the absence of third-party transactions, if we determine that the expected realizable value of the investment is less than the carrying value. In reaching that determination, we consider many factors, including, but not limited to, the operating cash flows and financial performance of the companies or properties relative to budgets or projections, trends within sectors and/or regions, underlying business models, expected exit timing and strategy, and any specific rights or terms associated with the investment, such as conversion features and liquidation preferences.

Our public principal investments, which tend to be large, concentrated holdings that result from initial public offerings or other corporate transactions, are valued using quoted market prices discounted for restrictions on sale. If liquidating a position is reasonably expected to affect market prices, valuations are adjusted accordingly based on predetermined written policies.

Our investment in the convertible preferred stock of SMFG is carried at fair value, which is derived from a model that incorporates SMFG's common stock price and credit spreads, the impact of nontransferability and illiquidity and downside protection on the conversion strike price. The fair value of our investment is particularly sensitive to movements in the SMFG common stock price. As a result of transfer restrictions and the downside protection on the conversion strike price, the relationship between changes in the fair value of our investment and changes in SMFG's common stock price is nonlinear. During the first quarter, the fair value of our investment increased 8% (expressed in Japanese yen), primarily due to the passage of time in respect of the transfer restrictions on the underlying common stock and an increase in the SMFG common stock price.

Our convertible preferred investment is generally nontransferable. Restrictions on our ability to hedge or sell one-third of the common stock underlying our investment in SMFG lapsed in February 2005. As of April 5, 2005, we had hedged a majority of these unrestricted shares. Restrictions on our ability to hedge or sell the remaining shares of common stock underlying our investment in SMFG will lapse in equal installments on February 7, 2006 and February 7, 2007. The current conversion price of our SMFG preferred stock into shares of SMFG common stock is ¥322,300, but this price is subject to downward adjustment if the price of SMFG common stock at the time of conversion is less than the conversion price (subject to a floor of ¥106,300).

Controls Over Valuation of Financial Instruments. Proper controls, independent of the trading and principal investing functions, are fundamental to ensuring that our financial instruments are appropriately and consistently valued and that fair value measurements are reliable. This is particularly important in valuing instruments with lower levels of price transparency.

We employ an oversight structure that includes appropriate segregation of duties. Senior management, independent of the trading functions, is responsible for the oversight of control and valuation policies and procedures and reporting the results of such work to the Audit Committee. We seek to maintain the necessary resources, with the appropriate experience and training, to ensure that control and independent price verification functions are performed to the highest standards. In addition, we employ procedures for the approval of new transaction types and markets, independent price verification, review of daily profit and loss, and review of valuation models by personnel with appropriate technical knowledge of relevant products and markets. More specifically, as it relates to cash trading instruments with little or no price transparency, we employ, where possible, procedures including comparisons to similar observable positions, analysis of actual to projected cash flows, comparisons to subsequent sales and discussions with senior business leaders. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Risk Management" in Part II, Item 7 of the Annual Report on Form 10-K for a further discussion on how we manage the risks inherent in our trading and principal investing businesses.

Goodwill and Identifiable Intangible Assets

As a result of our business combinations, principally with SLK LLC (SLK) in fiscal 2000, we have acquired goodwill and identifiable intangible assets. Goodwill is the cost of acquired companies in excess of the fair value of net assets, including identifiable intangible assets, at the acquisition date.

Goodwill. We test the goodwill in each of our operating segments for impairment at least annually in accordance with Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," by comparing the estimated fair value of each operating segment with its estimated net book value. We derive the fair value of each of our operating segments primarily based on price-earnings multiples. We derive the net book value of our operating segments by estimating the amount of shareholders' equity required to support the assets of each operating segment. Our last annual impairment test was performed during our fiscal 2004 fourth quarter and no impairment was identified.

The following table sets forth the carrying value of our goodwill by operating segment:

Goodwill by Operating Segment
(in millions)

	As of	
	February 2005	**November 2004**
Investment Banking		
Financial Advisory	$ —	$ —
Underwriting	125	125
Trading and Principal Investments		
FICC [(1)]	22	135
Equities [(2)]	2,382	2,382
Principal Investments	—	—
Asset Management and Securities Services		
Asset Management [(3)]	423	423
Securities Services	117	117
Total [(1)]	$3,069	$3,182

(1) The decline in goodwill from November 2004 to February 2005 reflects the sale of SLK's fixed income business in January 2005.

(2) Primarily related to our combinations with SLK and The Hull Group.

(3) Primarily related to our combination with The Ayco Company, L.P. (Ayco).

Identifiable Intangible Assets. We amortize our identifiable intangible assets over their estimated useful lives in accordance with SFAS No. 142, and test for potential impairment whenever events or changes in circumstances suggest that an asset's or asset group's carrying value may not be fully recoverable in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." An impairment loss, calculated as the difference between the estimated fair value and the carrying value of an asset or asset group, is recognized if the sum of the estimated undiscounted cash flows relating to the asset or asset group is less than the corresponding carrying value.

The following table sets forth the carrying value and range of remaining useful lives of our identifiable intangible assets by major asset class:

Identifiable Intangible Assets by Asset Class
($ in millions)

	As of February 2005		As of November 2004
	Carrying Value	Range of Remaining Useful Lives (in years)	Carrying Value
Power contracts [1]	$ 953	2 – 33	$ —
Customer lists [2]	815	7 – 19	828
New York Stock Exchange (NYSE) specialist rights	599	23 – 25	607
Exchange-traded fund (ETF) and option specialist rights	120	23	121
Other [3]	124	3 – 8	133
Total	$2,611		$1,689

(1) Primarily relates to above-market power contracts acquired in our combinations with Cogentrix Energy, Inc. (Cogentrix) and National Energy & Gas Transmission, Inc. (NEGT). We completed our purchase price allocation for Cogentrix and closed on our acquisition of NEGT during the first quarter of 2005. Substantially all of these power contracts have been pledged as collateral to counterparties in connection with certain of our secured short-term and long-term borrowings.

(2) Primarily includes our clearance and execution and NASDAQ customer lists acquired in our combination with SLK and financial counseling customer lists acquired in our combination with Ayco.

(3) Primarily includes technology-related assets acquired in our combination with SLK.

A prolonged period of weakness in global equity markets and the trading of securities in multiple markets and on multiple exchanges could adversely impact our businesses and impair the value of our goodwill and/or identifiable intangible assets. In addition, certain events could indicate a potential impairment of the associated identifiable intangible assets, including, among other events, an announced restructuring by the NYSE or any other exchange on which we hold specialist rights, an adverse action or assessment by a regulator, a default event under a power contract, or physical damage or other adverse events impacting the underlying power generation facilities.

Use of Estimates

The use of generally accepted accounting principles requires management to make certain estimates. In addition to the estimates we make in connection with fair value measurements and the accounting for goodwill and identifiable intangible assets, the use of estimates is also important in determining compensation and benefits expenses for interim periods and in determining provisions for potential losses that may arise from litigation and regulatory proceedings and tax audits.

A substantial portion of our compensation and benefits expenses represents discretionary bonuses, generally determined and paid at year end. We target compensation and benefits at 50% (plus or minus a few percentage points) of consolidated net revenues and, accordingly, we believe the most appropriate way to allocate estimated annual discretionary bonuses between interim periods is in proportion to net revenues earned in such periods. Consequently, at the end of each interim period, we estimate the annual ratio of compensation and benefits expense to net revenues and accrue to that ratio on a year-to-date basis.

We estimate and provide for potential losses that may arise out of litigation and regulatory proceedings and tax audits to the extent that such losses are probable and can be estimated, in accordance with SFAS No. 5, "Accounting for Contingencies." Significant judgment is required in making these estimates and our final liabilities may ultimately be materially different. Our total liability in respect of litigation and regulatory proceedings is determined on a case-by-case basis and represents an estimate of probable losses after considering, among other factors, the progress of each case, our experience and the experience of others in similar cases, and the opinions and views of legal counsel. Given the inherent difficulty of predicting the outcome of our litigation matters, particularly in cases in which claimants seek substantial or indeterminate damages, we cannot estimate losses or ranges of losses for cases where there is only a reasonable possibility that a loss may have been incurred. See "Legal Proceedings" in Part I, Item 3 of the Annual Report on Form 10-K and in Part II, Item 1 of this Quarterly Report on Form 10-Q for information on our judicial, regulatory and arbitration proceedings.

Results of Operations

The composition of our net revenues has varied over time as financial markets and the scope of our operations have changed. The composition of net revenues can also vary over the shorter term due to fluctuations in U.S. and global economic and market conditions. For a further discussion of the impact of economic and market conditions on our results of operations, see "— Business Environment" above, and "Business — Certain Factors That May Affect Our Business" in Part I, Item 1 of the Annual Report on Form 10-K.

Financial Overview

The following table sets forth an overview of our financial results:

Financial Overview
($ in millions, except per share amounts)

	Three Months Ended February	
	2005	2004
Net revenues	$6,405	$5,928
Pre-tax earnings	2,145	1,929
Net earnings	1,512	1,293
Diluted earnings per share	2.94	2.50
Annualized return on average shareholders' equity [1]	23.5%	23.5%
Annualized return on average tangible shareholders' equity [2]	29.6%	30.4%

(1) Annualized return on average shareholders' equity is computed by dividing annualized net earnings by average monthly shareholders' equity.

(2) Tangible shareholders' equity equals total shareholders' equity less goodwill and identifiable intangible assets. We believe that annualized return on average tangible shareholders' equity is a meaningful measure of performance because it excludes the portion of our shareholders' equity attributable to goodwill and identifiable intangible assets. As a result, this calculation measures corporate performance in a manner that treats underlying businesses consistently, whether they were acquired or developed internally. Annualized return on average tangible shareholders' equity is computed by dividing annualized net earnings by average monthly tangible shareholders' equity.

The following table sets forth the reconciliation of average shareholders' equity to average tangible shareholders' equity:

	Three Months Ended February	
	2005	2004
	(in millions)	
Average shareholders' equity	$25,735	$21,970
Deduct: Average goodwill and identifiable intangible assets	(5,329)	(4,966)
Average tangible shareholders' equity	$20,406	$17,004

Net Revenues

Three Months Ended February 2005 versus February 2004. Our net revenues were $6.41 billion in the first quarter of 2005, an increase of 8% compared with the first quarter of 2004, reflecting strong performances in each of our three segments. The increase in Trading and Principal Investments reflected significantly higher net revenues in FICC, as all major businesses performed well. Net revenues in Equities were lower compared with the first quarter of 2004, but the business performed well as its results were significantly higher than more recent quarters. The increase in Investment Banking net revenues compared with the first quarter of 2004 primarily reflected significantly higher net revenues from debt underwriting. The increase in Asset Management and Securities Services net revenues reflected significantly higher customer balances in securities lending and margin lending. In Asset Management, although incentive fees declined, net revenues were only slightly lower, as assets under management increased 17% from the first quarter of 2004.

Operating Expenses

Our operating expenses are primarily influenced by compensation, headcount and levels of business activity. A substantial portion of our compensation expense represents discretionary bonuses, with our overall compensation and benefits expenses generally targeted at 50% (plus or minus a few percentage points) of consolidated net revenues. In addition to the level of net revenues, our compensation expense in any given year is also influenced by, among other factors, prevailing labor markets, business mix and the structure of our equity-based compensation programs. See "— Use of Estimates" above for more information on our ratio of compensation and benefits expense to net revenues.

The following table sets forth our operating expenses and number of employees:

Operating Expenses and Employees
($ in millions)

	Three Months Ended February	
	2005	**2004**
Compensation and benefits [1]	$ 3,203	$ 2,995
Non-compensation expenses	1,057	1,004
Total operating expenses	$ 4,260	$ 3,999
Employees at period end [2]	20,678	19,285

(1) Compensation and benefits expenses include the amortization of employee initial public offering and acquisition awards of $6 million and $31 million for the three months ended February 2005 and February 2004, respectively.

(2) Excludes 1,138 and 1,216 employees as of February 2005 and February 2004, respectively, of Goldman Sachs' consolidated property management and loan servicing subsidiaries. Compensation and benefits expenses include $42 million and $51 million for the three months ended February 2005 and February 2004, respectively, attributable to these subsidiaries, the majority of which is reimbursed to Goldman Sachs by the investment funds for which these companies manage properties and perform loan servicing. Such reimbursements are recorded in net revenues. Both periods exclude employees of certain consolidated entities that are held for investment purposes only.

Three Months Ended February 2005 versus February 2004. Operating expenses were $4.26 billion, 7% higher than the first quarter of 2004. Compensation and benefits expenses were $3.20 billion, 7% higher than the first quarter of 2004, commensurate with higher net revenues. The ratio of compensation and benefits to net revenues was 50.0% for the quarter, consistent with last year's first quarter. [3] Employment levels were essentially unchanged during the quarter.

(3) For the three months ended February 2004, the ratio of compensation and benefits to net revenues, including the amortization of employee initial public offering and acquisition awards, was 50.5%.

Non-compensation expenses were $1.06 billion, 5% higher than the first quarter of 2004. Professional fees were higher, reflecting increased legal and consulting fees. Market development expenses and brokerage, clearing and exchange fees also increased, primarily reflecting higher levels of business activity. Other expenses included net provisions for litigation and regulatory proceedings of $31 million for the first quarter of 2005 compared with $60 million for the first quarter of 2004. Excluding these provisions, other expenses increased $42 million, primarily due to higher levels of business activity and higher expenses from consolidated entities held for investment purposes. These increases were partially offset by lower occupancy and depreciation and amortization expenses, as the first quarter of 2004 included exit costs of $35 million associated with reductions in our global office space. See "— Capital and Funding — Contractual Obligations and Contingent Commitments" below for a discussion of our excess office space.

Provision for Taxes

The provision for taxes for the quarter ended February 2005 was $633 million. The effective income tax rate for the first quarter of 2005 was 29.5%, down from 31.8% for fiscal year 2004 due to an $80 million net benefit from various audit settlements. Excluding the effect of audit settlements, the effective income tax rate for the first quarter of 2005 would have been 33.3%, up from fiscal year 2004, primarily due to higher tax credits in 2004 and increased state and local taxes in 2005.

Segment Operating Results

The following table sets forth the net revenues, operating expenses and pre-tax earnings of our segments:

Segment Operating Results
(in millions)

		Three Months Ended February	
		2005	2004
Investment Banking	Net revenues	$ 893	$ 763
	Operating expenses	787	693
	Pre-tax earnings	$ 106	$ 70
Trading and Principal Investments	Net revenues	$4,383	$4,122
	Operating expenses	2,729	2,528
	Pre-tax earnings	$1,654	$1,594
Asset Management and Securities Services	Net revenues	$1,129	$1,043
	Operating expenses	713	697
	Pre-tax earnings	$ 416	$ 346
Total	Net revenues	$6,405	$5,928
	Operating expenses [1]	4,260	3,999
	Pre-tax earnings	$2,145	$1,929

[1] Includes the following expenses that have not been allocated to our segments: (i) the amortization of employee initial public offering awards, net of forfeitures, of $21 million for the three months ended February 2004 and (ii) net provisions for a number of litigation and regulatory proceedings of $31 million and $60 million for the three months ended February 2005 and February 2004, respectively.

Net revenues in our segments include allocations of interest income and interest expense to specific securities, commodities and other positions in relation to the cash generated by, or funding requirements of, such underlying positions.

The cost drivers of Goldman Sachs taken as a whole — compensation, headcount and levels of business activity — are broadly similar in each of our business segments. Compensation expenses within our segments reflect, among other factors, the overall performance of Goldman Sachs as well as the performance of individual business units. Consequently, pre-tax margins in one segment of our business may be significantly affected by the performance of our other business segments. The timing and magnitude of changes in our bonus accruals can have a significant effect on segment results in a given period. A discussion of segment operating results follows.

Investment Banking

Our Investment Banking segment is divided into two components:

- **Financial Advisory.** Financial Advisory includes advisory assignments with respect to mergers and acquisitions, divestitures, corporate defense activities, restructurings and spin-offs.

- **Underwriting.** Underwriting includes public offerings and private placements of equity, equity-related and debt instruments.

The following table sets forth the operating results of our Investment Banking segment:

Investment Banking Operating Results
(in millions)

	Three Months Ended February	
	2005	**2004**
Financial Advisory	$414	$359
Equity underwriting	186	219
Debt underwriting	293	185
Total Underwriting	479	404
Total net revenues	893	763
Operating expenses	787	693
Pre-tax earnings	$106	$ 70

The following table sets forth our financial advisory and underwriting transaction volumes:

Goldman Sachs Global Investment Banking Volumes [1]
(in billions)

	Three Months Ended February	
	2005	**2004**
Announced mergers and acquisitions	$270	$129
Completed mergers and acquisitions	104	88
Equity and equity-related offerings [2]	10	13
Debt offerings [3]	75	67

(1) Source: Thomson Financial. Announced and completed mergers and acquisitions volumes are based on full credit to each of the advisors in a transaction. Equity and equity-related offerings and debt offerings are based on full credit for single book managers and equal credit for joint book managers. Transaction volumes may not be indicative of net revenues in a given period.

(2) Includes public common stock offerings and convertible offerings.

(3) Includes non-convertible preferred stock, mortgage-backed securities, asset-backed securities and taxable municipal debt. Includes publicly registered and Rule 144A issues.

Three Months Ended February 2005 versus February 2004. Net revenues in Investment Banking of $893 million for the first quarter of 2005 increased 17% compared with the first quarter of 2004. Net revenues in Financial Advisory of $414 million increased 15% compared with the first quarter of 2004, primarily reflecting an increase in activity. Net revenues in our Underwriting business of $479 million increased 19% compared with the first quarter of 2004, reflecting significantly higher net revenues in debt underwriting, primarily due to increased high-yield and bank loan activity, partially offset by lower net revenues in equity underwriting, particularly from convertible issuances. Our investment banking backlog increased during the quarter. [1]

Operating expenses of $787 million increased 14% compared with the first quarter of 2004, primarily due to increased compensation and benefits expenses. Pre-tax earnings of $106 million increased 51% compared with the first quarter of 2004.

Trading and Principal Investments

Our Trading and Principal Investments segment is divided into three components:

- **FICC.** We make markets in and trade interest rate and credit products, mortgage-backed securities and loans, currencies and commodities, structure and enter into a wide variety of derivative transactions, and engage in proprietary trading.
- **Equities.** We make markets in, act as a specialist for, and trade equities and equity-related products, structure and enter into equity derivative transactions, and engage in proprietary trading. We also execute and clear customer transactions on major stock, options and futures exchanges worldwide.
- **Principal Investments.** Principal Investments primarily represents net revenues from our merchant banking investments, including the increased share of the income and gains derived from our merchant banking funds when the return on a fund's investments exceeds certain threshold returns (merchant banking overrides), as well as unrealized gains or losses from our investment in the convertible preferred stock of SMFG.

Substantially all of our inventory is marked-to-market daily and, therefore, its value and our net revenues are subject to fluctuations based on market movements. In addition, net revenues derived from our principal investments in privately held concerns and in real estate may fluctuate significantly depending on the revaluation or sale of these investments in any given period. We also regularly enter into large transactions as part of our trading businesses. The number and size of such transactions may affect our results of operations in a given period.

Net revenues from Principal Investments do not include management fees generated from our merchant banking funds. These management fees are included in the net revenues of the Asset Management and Securities Services segment.

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(1) Our investment banking backlog represents an estimate of our future net revenues from investment banking transactions where we believe that future revenue realization is more likely than not.

The following table sets forth the operating results of our Trading and Principal Investments segment:

Trading and Principal Investments Operating Results
(in millions)

	Three Months Ended February	
	2005	2004
FICC	$2,489	$2,103
Equities trading	829	946
Equities commissions	721	714
Total Equities	1,550	1,660
SMFG	181	201
Gross gains	177	263
Gross losses	(29)	(161)
Net other corporate and real estate investments	148	102
Overrides	15	56
Total Principal Investments	344	359
Total net revenues	4,383	4,122
Operating expenses	2,729	2,528
Pre-tax earnings	$1,654	$1,594

Three Months Ended February 2005 versus February 2004. Net revenues in Trading and Principal Investments of $4.38 billion for the first quarter of 2005 increased 6% compared with the first quarter of 2004. Net revenues in FICC of $2.49 billion increased 18% compared with the first quarter of 2004, as all major businesses performed well. The increase was driven by significantly higher net revenues in commodities and in credit products (including distressed investing), partially offset by lower net revenues in currencies as compared with a strong first quarter of 2004. Net revenues in interest rate products and mortgages were essentially unchanged compared with the first quarter of 2004. During the quarter, FICC operated in an environment generally characterized by strong customer-driven activity, continued volatility in commodity markets, a flattening yield curve and narrow credit spreads. Net revenues in Equities of $1.55 billion decreased 7% compared with the first quarter of 2004. Our principal strategies business performed well, but net revenues were lower compared with a particularly strong first quarter of 2004. Net revenues in our global equities products group were essentially unchanged compared with a strong first quarter of 2004, reflecting higher net revenues in derivatives, offset by lower net revenues in shares and convertibles. During the quarter, the business operated in an environment characterized by solid customer-driven activity, generally higher equity prices and continued low volatility levels. Principal Investments recorded net revenues of $344 million, primarily due to an unrealized gain related to our investment in the convertible preferred stock of SMFG of $181 million (net of foreign exchange revaluation on the Japanese yen-denominated borrowing funding this investment), as well as gains from other corporate and real estate principal investments.

Operating expenses of $2.73 billion increased 8% compared with the first quarter of 2004, primarily due to increased compensation and benefits expenses primarily resulting from higher discretionary compensation. Brokerage, clearing and exchange fees also increased, reflecting higher transaction volumes in certain of our businesses. In addition, other expenses increased, primarily reflecting higher expenses from consolidated entities held for investment purposes and increased levels of business activity, and professional fees were higher, primarily due to increased legal and consulting fees. Pre-tax earnings of $1.65 billion increased 4% compared with the first quarter of 2004.

Asset Management and Securities Services

Our Asset Management and Securities Services segment is divided into two components:

- **Asset Management.** Asset Management provides investment advisory and financial planning services to a diverse group of institutions and individuals worldwide and primarily generates revenues in the form of management and incentive fees.
- **Securities Services.** Securities Services provides prime brokerage, financing services and securities lending services to mutual funds, pension funds, hedge funds, foundations and high-net-worth individuals worldwide, and generates revenues primarily in the form of interest rate spreads or fees.

The following table sets forth the operating results of our Asset Management and Securities Services segment:

Asset Management and Securities Services Operating Results
(in millions)

	Three Months Ended February	
	2005	2004
Asset Management	$ 749	$ 761
Securities Services	380	282
Total net revenues	1,129	1,043
Operating expenses	713	697
Pre-tax earnings	$ 416	$ 346

Assets under management typically generate fees as a percentage of asset value or based on investment performance. Assets under management include our mutual funds, alternative investment funds, separately managed accounts for institutional and individual investors and our merchant banking funds. Substantially all assets under management are valued as of calendar month end.

The following table sets forth our assets under management by asset class:

Assets Under Management by Asset Class
(in billions)

	As of February 28, 2005	As of February 29, 2004	As of November 30,	
			2004	2003
Money markets	$ 99	$ 93	$ 90	$ 89
Fixed income and currency	145	123	139	115
Equity [(1)]	136	113	126	98
Alternative investments [(2)]	102	83	97	71
Total	$482	$412	$452	$373

(1) Includes both our fundamental equity and quantitative equity strategies.

(2) Includes other quantitative and/or non-traditional investment strategies (e.g., hedge funds), merchant banking funds and vehicles where we contract with subadvisors for our clients.

The following table sets forth a summary of the changes in our assets under management:

Changes in Assets Under Management
(in billions)

	Three Months Ended	
	February 28, 2005	February 29, 2004
Balance, beginning of period	$452	$373
Net asset inflows/(outflows)		
Money markets	9	4
Fixed income and currency	6	3
Equity	8	7
Alternative investments	4	10
Total net asset inflows/(outflows)	27	24
Net market appreciation/(depreciation)	3	15
Balance, end of period	$482	$412

Three Months Ended February 2005 versus February 2004. Net revenues in Asset Management and Securities Services of $1.13 billion for the first quarter of 2005 increased 8% compared with the first quarter of 2004. Asset Management net revenues of $749 million decreased 2% compared with a particularly strong first quarter of 2004. This reflected higher management fees, driven by growth in assets under management, offset by lower incentive fees. During the quarter, assets under management increased 7%, reflecting net asset inflows of $27 billion across all asset classes, as well as market appreciation of $3 billion, primarily in equity and alternative investment assets. Securities Services net revenues of $380 million increased 35% compared with the first quarter of 2004, primarily due to significantly higher customer balances in securities lending and margin lending.

Operating expenses of $713 million increased 2% compared with the first quarter of 2004, primarily due to increased compensation and benefits expenses. Professional fees also increased, principally reflecting higher legal fees. Pre-tax earnings of $416 million increased 20% compared with the first quarter of 2004.

Capital and Funding

Capital

The amount of capital we hold is principally determined by subsidiary capital requirements, regulatory and rating agency guidelines, and our overall risk profile, which is largely driven by the size and composition of our trading and investment positions. Goldman Sachs' total capital (shareholders' equity and long-term borrowings) increased 15% to $121.66 billion as of February 2005 compared with $105.78 billion as of November 2004. See ''— Liquidity Risk — Cash Flows'' below for a discussion of how we deployed capital raised as part of our financing activities.

The increase in total capital resulted primarily from an increase in long-term borrowings to $95.58 billion as of February 2005 from $80.70 billion as of November 2004. The weighted average maturity of our long-term borrowings as of February 2005 was approximately 7 years. We swap a substantial portion of our long-term borrowings into U.S. dollar obligations with short-term floating interest rates in order to minimize our exposure to interest rates and foreign exchange movements. See Note 5 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for further information regarding our long-term borrowings.

Over the past several years, our ratio of long-term borrowings to shareholders' equity has been increasing. The growth in our long-term borrowings has been driven primarily by (i) our ability to replace a portion of our short-term borrowings with long-term borrowings and pre-fund near-term refinancing requirements, in light of the favorable debt financing environment, and (ii) the need to increase total capital in response to opportunities in our trading and investing businesses.

Shareholders' equity increased by 4% to $26.08 billion as of February 2005 from $25.08 billion as of November 2004. During the three months ended February 2005, we repurchased 11.5 million shares of our common stock at an average price of $106.91 per share. In addition, to satisfy minimum statutory employee tax withholding requirements related to the delivery of shares underlying restricted stock units, we cancelled 1.5 million restricted stock units at an average price of $104.62 per unit in the first quarter of 2005.

Our repurchase program is intended to substantially offset increases in share count over time resulting from employee equity-based compensation and to help maintain our shareholders' equity at appropriate levels. The repurchase program has been effected primarily through regular open-market purchases, the sizes of which have been and will continue to be influenced by, among other factors, prevailing prices and market conditions. On January 25, 2005, the Board of Directors of Goldman Sachs authorized the repurchase of an additional 40.0 million shares of common stock. As of February 2005, the remaining share authorization under our repurchase program was 35.0 million shares. For additional information on our repurchase program, see Part II, Item 2 "Unregistered Sales of Equity Securities and Use of Proceeds" included in this Quarterly Report on Form 10-Q.

The following table sets forth information on our assets, shareholders' equity, leverage ratios and book value per share:

	As of	
	February 2005	**November 2004**
	($ in millions, except per share amounts)	
Total assets	$596,149	$531,379
Adjusted assets [(1)]	372,792	347,082
Shareholders' equity	26,075	25,079
Tangible shareholders' equity [(2)]	20,395	20,208
Tangible equity capital [(2)]	23,145	22,958
Leverage ratio [(3)]	22.9x	21.2x
Adjusted leverage ratio [(4)]	16.1x	15.1x
Debt to equity ratio [(5)]	3.7x	3.2x
Book value per share [(6)]	$ 53.15	$ 50.77
Tangible book value per share [(7)]	41.57	40.91

(1) Adjusted assets excludes (i) low-risk collateralized assets generally associated with our matched book and securities lending businesses (which we calculate by adding our securities purchased under agreements to resell and securities borrowed, and then subtracting our nonderivative short positions), (ii) cash and securities we segregate in compliance with regulations and (iii) goodwill and identifiable intangible assets.

The following table sets forth a reconciliation of total assets to adjusted assets:

		As of	
		February 2005	November 2004
		(in millions)	
Total assets		$ 596,149	$ 531,379
Deduct:	Securities purchased under agreements to resell	(66,007)	(44,257)
	Securities borrowed	(180,362)	(155,086)
Add:	Financial instruments sold, but not yet purchased, at fair value	125,556	132,097
	Less derivative short positions	(51,662)	(64,001)
	Subtotal	73,894	68,096
Deduct:	Cash and securities segregated in compliance with U.S. federal and other regulations	(45,202)	(48,179)
	Goodwill and identifiable intangible assets	(5,680)	(4,871)
Adjusted assets		$ 372,792	$ 347,082

(2) Tangible shareholders' equity equals total shareholders' equity less goodwill and identifiable intangible assets. Tangible equity capital includes tangible shareholders' equity and junior subordinated debt issued to a trust. We consider junior subordinated debt issued to a trust to be a component of our tangible equity capital base due to the inherent characteristics of these securities, including the long-term nature of the securities, our ability to defer coupon interest for up to ten consecutive semiannual periods and the subordinated nature of the obligations in our capital structure.

The following table sets forth a reconciliation of shareholders' equity to tangible shareholders' equity and tangible equity capital:

		As of	
		February 2005	November 2004
		(in millions)	
Shareholders' equity		$26,075	$25,079
Deduct:	Goodwill and identifiable intangible assets	(5,680)	(4,871)
Tangible shareholders' equity		$20,395	$20,208
Add:	Junior subordinated debt issued to a trust	2,750	2,750
Tangible equity capital		$23,145	$22,958

(3) Leverage ratio equals total assets divided by shareholders' equity.

(4) Adjusted leverage ratio equals adjusted assets divided by tangible equity capital. We believe that the adjusted leverage ratio is a more meaningful measure of our capital adequacy because it excludes certain low-risk collateralized assets that are generally supported with little or no capital and reflects the tangible equity capital deployed in our businesses.

(5) Debt to equity ratio equals long-term borrowings divided by shareholders' equity.

(6) Book value per share is based on common shares outstanding, including restricted stock units granted to employees with no future service requirements, of 490.6 million as of February 2005 and 494.0 million as of November 2004.

(7) Tangible book value per share is computed by dividing tangible shareholders' equity by the number of common shares outstanding, including restricted stock units granted to employees with no future service requirements.

Consolidated Supervised Entity

On March 23, 2005, the U.S. Securities and Exchange Commission (SEC) approved an application by Goldman Sachs to become a consolidated supervised entity (CSE). As a CSE, Goldman Sachs is subject to group-wide supervision and examination by the SEC and, accordingly, is subject to minimum capital requirements on a consolidated basis.

Short-Term Borrowings

Goldman Sachs obtains secured and unsecured short-term borrowings primarily through issuance of promissory notes, commercial paper and bank loans. Short-term borrowings also include the portion of long-term borrowings maturing within one year and certain long-term borrowings that may be redeemable within one year at the option of the holder.

The following table sets forth our short-term borrowings by product:

Short-Term Borrowings
(in millions)

	As of	
	February 2005	November 2004
Promissory notes	$18,461	$19,513
Commercial paper	5,139	4,355
Bank loans and other	9,468	13,474
Current portion of long-term borrowings	15,786	17,617
Total	$48,854	$54,959

Our liquidity depends to an important degree on our ability to refinance these borrowings on a continuous basis. Investors who hold our outstanding promissory notes (short-term unsecured debt that is nontransferable and in which Goldman Sachs does not make a market) and commercial paper have no obligation to purchase new instruments when the outstanding instruments mature.

The following table sets forth our secured and unsecured short-term borrowings:

	As of	
	February 2005	November 2004
	(in millions)	
Secured short-term borrowings	$ 5,815	$ 8,558
Unsecured short-term borrowings	43,039	46,401
Total short-term borrowings	$48,854	$54,959

Our secured short-term borrowings provide Goldman Sachs with a more stable source of liquidity, as these borrowings are less sensitive to changes in our credit ratings than our unsecured short-term borrowings, due to the underlying collateral. See "— Liquidity Risk" below for a discussion of the principal liquidity policies we have in place to manage the liquidity risk associated with our short-term borrowings. For a discussion of factors that could impair our ability to access the capital markets, see "Business — Certain Factors That May Affect Our Business" in Part I, Item 1 of the Annual Report on Form 10-K. See Note 4 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for further information regarding our short-term borrowings.

Credit Ratings

We rely upon the short-term and long-term debt capital markets to fund a significant portion of our day-to-day operations. The cost and availability of debt financing is influenced by our credit ratings. Credit ratings are important when we are competing in certain markets and when we seek to engage in longer term transactions, including OTC derivatives. We believe our credit ratings are primarily based on the credit rating agencies' assessment of our liquidity, market and credit risk management practices, the level and variability of our earnings, our franchise, reputation and management, our capital base, our corporate governance and the external operating environment. For a discussion of the risks associated with a reduction in our credit ratings, see "Business — Certain Factors That May Affect Our Business" in Part I, Item 1 of the Annual Report on Form 10-K.

The following table sets forth our unsecured credit ratings as of February 2005:

	Short-Term Debt	Long-Term Debt
Dominion Bond Rating Service Limited	R-1 (middle)	A (high)
Fitch, Inc.	F1+	AA–
Moody's Investors Service	P-1	Aa3
Standard & Poor's	A-1	A+

As of February 2005, collateral or termination payments pursuant to bilateral agreements with certain counterparties of approximately $242 million could have been required in the event of a one-level reduction in our long-term credit ratings. In evaluating our liquidity requirements, we consider additional collateral or termination payments that could be required in the event of further reductions in our long-term credit ratings, as well as collateral that has not been called by counterparties, but is available to them. For a further discussion of our excess liquidity policies, see "— Liquidity Risk — Excess Liquidity — Maintenance of a Pool of Highly Liquid Securities" below.

Contractual Obligations and Contingent Commitments

Goldman Sachs has contractual obligations to make future payments under long-term debt and long-term noncancelable lease agreements and has contingent commitments under a variety of commercial arrangements.

The following table sets forth our contractual obligations as of February 2005:

Contractual Obligations
(in millions)

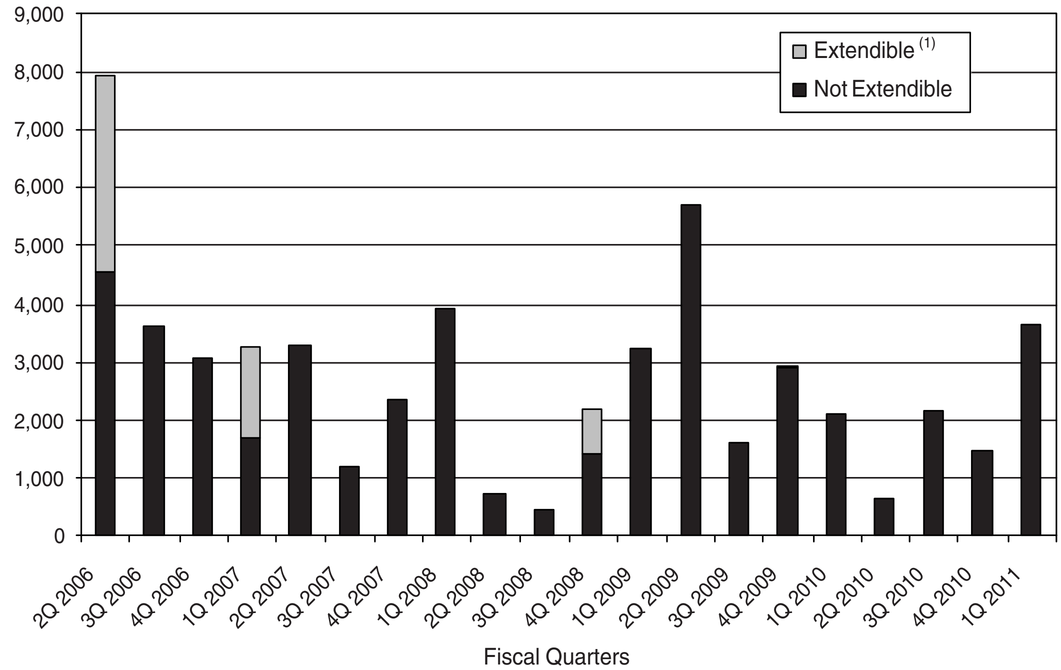
	Remainder of 2005	2006-2007	2008-2009	2010-Thereafter	Total
Long-term borrowings by contract maturity [1] [2]	$ —	$24,691	$20,778	$50,108	$95,577
Minimum rental payments	268	678	602	1,910	3,458

(1) Long-term borrowings maturing within one year and certain long-term borrowings that may be redeemable within one year at the option of the holder are included as short-term borrowings in the condensed consolidated statements of financial condition.

(2) Long-term borrowings repayable at the option of Goldman Sachs are reflected at their contractual maturity dates. Certain long-term borrowings that may be redeemable prior to maturity at the option of the holder are reflected at the dates such options become exercisable.

Our long-term borrowings include extendible debt that has an initial maturity of one year or greater. Extendible debt is debt that allows the holder the right to extend the maturity date at predetermined periods during the contractual life of the instrument. The following table sets forth our quarterly long-term borrowings maturity profile through the first fiscal quarter of 2011:

Long-Term Borrowings Maturity Profile
($ in millions)



(1) Extendible debt is categorized in the maturity profile at the earliest possible maturity date even though the debt can be extended.

As of February 2005, our long-term borrowings were $95.58 billion and consisted principally of senior borrowings with maturities extending to 2034. These long-term borrowings consisted of $13.26 billion in secured long-term borrowings and $82.32 billion in unsecured long-term borrowings. As of February 2005, long-term borrowings included nonrecourse debt of $13.29 billion, consisting of $6.26 billion issued by William Street Funding Corporation (a wholly owned subsidiary of Group Inc. formed to raise funding to support loan commitments made by another wholly owned William Street entity to investment-grade clients), $1.20 billion issued by our consolidated power plant operations and $5.83 billion issued by other consolidated entities. Nonrecourse debt is debt that Group Inc. is not directly or indirectly obligated to repay. See Note 5 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for further information regarding our long-term borrowings.

As of February 2005, our future minimum rental payments, net of minimum sublease rentals, under noncancelable leases were $3.46 billion. These lease commitments, principally for office space, expire on various dates through 2029. Certain agreements are subject to periodic escalation provisions for increases in real estate taxes and other charges.

Our occupancy expenses include costs associated with office space held in excess of our current requirements. This excess space, the cost of which is charged to earnings as incurred, is being held for potential growth or to replace currently occupied space that we may exit in the future. We continually evaluate our current and future space capacity in relation to current and projected staffing levels. In the first quarter of 2005, we did not incur any exit costs. However, we may incur exit costs in 2005 and thereafter to the extent we (i) further reduce our capacity or (ii) commit to new properties in the locations in which we operate and, consequently, dispose of existing space that had been held for potential growth. Such exit costs may be material to our results of operations in a given period.

The following table sets forth our contingent commitments as of February 2005:

Contingent Commitments
(in millions)

	Commitment Amount by Period of Expiration				
	Remainder of 2005	2006-2007	2008-2009	2010-Thereafter	Total
Commitments to extend credit	$ 5,397	$8,004	$7,166	$7,874	$28,441
Commitments under letters of credit issued by banks to counterparties	9,843	92	1	12	9,948
Other commercial commitments [1]	488	441	6	434	1,369
Total	$15,728	$8,537	$7,173	$8,320	$39,758

[1] Includes our corporate and real estate investment fund commitments, construction-related obligations and other purchase commitments.

Our commitments to extend credit are agreements to lend to counterparties that have fixed termination dates and are contingent on all conditions to borrowing set forth in the contract having been met. Since these commitments may expire unused, the total commitment amount does not necessarily reflect the actual future cash flow requirements. As of February 2005, $9.95 billion of our outstanding commitments to extend credit have been issued through the William Street credit extension program. Substantially all of the credit risk associated with these commitments has been covered by credit loss protection provided by SMFG. We have also hedged the credit risk of certain non-William Street commitments using a variety of other financial instruments.

As of February 2005, we had commitments to enter into forward secured financing transactions, including certain repurchase and resale agreements and secured borrowing and lending arrangements, of $40.11 billion.

See Note 6 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for further information regarding our commitments, contingencies and guarantees.

Liquidity Risk

Liquidity is of critical importance to companies in the financial services sector. Most failures of financial institutions have occurred in large part due to insufficient liquidity resulting from adverse circumstances. Accordingly, Goldman Sachs has in place a comprehensive set of liquidity and funding policies that are intended to maintain significant flexibility to address both firm-specific and broader industry or market liquidity events. Our principal objective is to be able to fund Goldman Sachs and to enable our core businesses to continue to generate revenue even under adverse circumstances.

Management has implemented a number of policies according to the following liquidity risk management framework:

- Excess Liquidity — maintain substantial excess liquidity to meet a broad range of potential cash outflows in a stressed environment including financing obligations.

- Asset-Liability Management — ensure we fund our assets with the appropriate financing.
- Intercompany Funding — maintain parent company liquidity and manage the distribution of liquidity across the group structure.
- Crisis Planning — ensure all funding and liquidity management is based on stress-scenario planning and feeds into our liquidity crisis plan.

Excess Liquidity

Maintenance of a Pool of Highly Liquid Securities. Our most important liquidity policy is to pre-fund what we estimate will be our likely cash needs during a liquidity crisis and hold such excess liquidity in the form of unencumbered, highly liquid securities that may be sold or pledged to provide same-day liquidity. This ''Global Core Excess'' liquidity is intended to allow us to meet immediate obligations without needing to sell other assets or depend on additional funding from credit-sensitive markets. We believe that this pre-funded pool of excess liquidity provides us with a resilient source of funds and gives us significant flexibility in managing through a difficult funding environment. Our Global Core Excess reflects the following principles:

- Focus must be maintained on all potential cash and collateral outflows, not just disruptions to financing flows. Goldman Sachs' businesses are diverse, and its cash needs are driven by many factors, including market movements, collateral requirements and client commitments, all of which can change dramatically in a difficult funding environment.
- During a liquidity crisis, credit-sensitive funding, including unsecured debt and some types of secured financing agreements, may be unavailable and the terms or availability of other types of secured financing may change.
- As a result of our policy to pre-fund liquidity that we estimate may be needed in a crisis, we hold more unencumbered securities and larger unsecured debt balances than our businesses would otherwise require. We believe that our liquidity is stronger with greater balances of highly liquid unencumbered securities, even though it increases our unsecured liabilities.
- The first days or weeks of a liquidity crisis are the most critical to a company's survival.

The loan value (the estimated amount of cash that would be advanced by counterparties against these securities) of our Global Core Excess averaged $43.65 billion in the first quarter of 2005 and $41.99 billion in the fiscal year 2004.

The following table sets forth the average loan value of our Global Core Excess:

	Three Months Ended February 2005	Fiscal Year Ended November 2004
	(in millions)	
U.S. dollar-denominated	$32,175	$33,858
Non-U.S. dollar-denominated	11,474	8,135
Total Global Core Excess	$43,649	$41,993

The U.S. dollar-denominated excess includes only overnight cash deposits and unencumbered U.S. government and agency securities and highly liquid mortgage securities, all of which are Federal Reserve repo-eligible. Our non-U.S. dollar-denominated excess includes only unencumbered French, German, United Kingdom and Japanese government bonds and Euro, British pound and Japanese yen overnight cash deposits. We strictly limit our Global Core Excess to this narrowly defined list of securities and cash which we believe are highly liquid, even in a difficult funding environment.

The majority of our Global Core Excess is structured such that it is available to meet the liquidity requirements of our parent company, Group Inc., and all of its subsidiaries. The remainder is held in our principal non-U.S. operating entities, primarily to better match the currency and timing requirements for those entities' potential liquidity obligations.

The size of our Global Core Excess is determined by an internal liquidity model together with a qualitative assessment of the condition of the financial markets and of Goldman Sachs. Our liquidity model identifies and estimates cash and collateral outflows over a short-term horizon in a liquidity crisis, including, but not limited to:

- upcoming maturities of unsecured debt and letters of credit;
- potential buybacks of a portion of our outstanding negotiable unsecured debt;
- adverse changes in the terms or availability of secured funding;
- derivatives and other margin and collateral outflows, including those due to market moves or increased requirements;
- additional collateral that could be called in the event of a downgrade in our credit ratings;
- draws on our unfunded commitments not supported by William Street Funding Corporation [(1)]; and
- upcoming cash outflows, such as tax and other large payments.

Other Unencumbered Assets. In addition to our Global Core Excess described above, we have a significant amount of other unencumbered securities as a result of our business activities. These assets, which are located in the United States, Europe and Asia, include other government bonds, high-grade money market securities, corporate bonds and marginable equities. We do not include these securities in our Global Core Excess.

We maintain Global Core Excess and other unencumbered assets in an amount that, if pledged or sold, would provide the funds necessary to replace at least 110% of our unsecured obligations that are scheduled to mature (or where holders have the option to redeem) within the next twelve months. This implies that we could fund our positions on a secured basis for one year in the event we were unable to issue new unsecured debt or liquidate assets. We assume conservative loan values that are based on stress-scenario borrowing capacity and we review these assumptions asset-by-asset at least annually. The estimated aggregate loan value of our Global Core Excess and our other unencumbered assets averaged $117.04 billion, $111.68 billion and $100.51 billion in the first quarter of 2005, fourth quarter of 2004 and in the fiscal year 2004, respectively.

Asset-Liability Management

Asset Quality and Balance Sheet Composition. We seek to maintain a highly liquid balance sheet and substantially all of our inventory is marked-to-market daily. Our balance sheet fluctuates significantly between financial statement dates and is lower at fiscal period end than would be observed on an average basis. We require certain of our businesses to reduce balance sheet usage on a quarterly basis to demonstrate compliance with limits set by management, thereby providing a disincentive to committing our capital over longer periods of time. These balance sheet reductions are generally achieved during the last several weeks of each fiscal quarter through ordinary-course, open-market transactions in the most liquid portions of our balance sheet, principally U.S. government and agency securities, securities of foreign sovereigns, and mortgage and money market instruments, as well as through the roll-off of repurchase agreements and certain collateralized financing arrangements. Accordingly, over the last six quarters, our total assets and adjusted assets at quarter end have been, on average, 15% lower and 14% lower, respectively, than amounts that would have been observed, based on a weekly average, over that period. These differences, however, have not resulted

[(1)] The Global Core Excess excludes liquid assets held separately to support the William Street credit extension program.

in material changes to our credit risk, market risk or liquidity position because they are generally in highly liquid assets that are typically financed on a secured basis.

Certain financial instruments may be more difficult to fund on a secured basis during times of market stress and, accordingly, we generally hold higher levels of capital for these assets than more liquid types of financial instruments.

The table below sets forth our aggregate holdings in these categories of financial instruments:

	As of	
	February 2005	November 2004
	(in millions)	
Mortgage whole loans and collateralized debt obligations [(1)]	$25,095	$18,346
Bank loans [(2)]	9,727	8,900
High-yield securities	6,815	6,057
Emerging market debt securities	1,447	1,653
SMFG convertible preferred stock	2,681	2,556
Other corporate principal investments [(3)]	1,282	1,278
Real estate principal investments [(3)]	781	820

(1) Includes certain mortgage-backed interests held in qualifying special-purpose entities. See Note 3 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for further information regarding our securitization activities.

(2) Includes both funded commitments and inventory held in connection with our trading and lending activities.

(3) Excludes assets of $1.28 billion in consolidated employee-owned merchant banking funds as of February 2005 and November 2004.

A large proportion of these assets are continually funded on a secured basis through normal secured funding markets and nonrecourse funding. We focus on developing capacity for funding these assets on a term secured basis in order to ensure that these assets maintain a certain amount of loan value in periods of market stress.

See Note 3 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for further information regarding the financial instruments we hold.

Appropriate Financing of Asset Base. We seek to manage the maturity profile of our funding base such that we should be able to liquidate our assets prior to our liabilities coming due, even in times of prolonged or severe liquidity stress. We generally do not rely on immediate sales of assets (other than our Global Core Excess) to maintain liquidity in a distressed environment. However, we recognize that orderly asset sales may be prudent and necessary in a persistent liquidity crisis.

In order to avoid reliance on asset sales, we ensure that we have sufficient total capital (long-term borrowings plus shareholders' equity) to fund our balance sheet for at least one year. We therefore seek to maintain total capital in excess of the aggregate of the following long-term financing requirements:

- the portion of financial instruments owned that we believe could not be funded on a secured basis in periods of market stress, assuming conservative loan values;
- goodwill and identifiable intangible assets, property, leasehold improvements and equipment, and other illiquid assets;
- derivatives and other margin and collateral requirements;
- anticipated draws on our unfunded commitments; and
- capital or other forms of financing in our regulated subsidiaries that is in excess of their long-term financing requirements. See "— Intercompany Funding" below for further discussion on how we fund our subsidiaries.

Our total capital of $121.66 billion and $105.78 billion as of February 2005 and November 2004, respectively, exceeded the aggregate of these requirements.

Conservative Liability Structure. We structure our liabilities conservatively to minimize refinancing and buy-back risk. For example, we emphasize the use of promissory notes over commercial paper in order to improve the stability of our short-term unsecured financing base. We have also created internal guidelines regarding the principal amount of debt maturing on any one day or during any single week or year and have average maturity targets for our unsecured debt programs.

We seek to maintain broad and diversified funding sources globally for both secured and unsecured funding. We have imposed various internal guidelines, including the amount of our commercial paper that can be owned and letters of credit that can be issued by any single investor or group of investors. We benefit from distributing our debt issuances through our own sales force to a large, diverse global creditor base and we believe that our relationships with our creditors are critical to our liquidity.

We access funding in a variety of markets in the United States, Europe and Asia. We issue debt through syndicated U.S. registered offerings, U.S. registered and 144A medium-term notes programs, offshore medium-term notes offerings and other bond offerings, U.S. and non-U.S. commercial paper and promissory note issuances, and other methods. We make extensive use of the repurchase agreement and securities lending markets and arrange for letters of credit to be issued on our behalf.

Additionally, senior unsecured debt issued by Group Inc. does not contain provisions that would, based solely upon an adverse change in our credit ratings, financial ratios, earnings, cash flows or our stock price, trigger a requirement for an early payment, collateral support, change in terms, acceleration of maturity or the creation of an additional financial obligation.

Intercompany Funding

Subsidiary Funding Policies. Substantially all of our unsecured funding is raised by our parent company, Group Inc. The parent company then lends the necessary funds to its subsidiaries, some of which are regulated, to meet their asset financing and capital requirements. In addition, the parent company provides its regulated subsidiaries the necessary capital to meet their regulatory requirements. The benefits of this strategy include enhanced control and greater flexibility to meet the funding requirements of our subsidiaries.

Our intercompany funding policies are predicated on our assumption that, unless legally provided for, funds or securities are not freely available from a subsidiary to its parent company or other subsidiaries. In particular, many of our subsidiaries are subject to laws that authorize regulatory bodies to block or limit the flow of funds from those subsidiaries to Group Inc. Regulatory action of that kind could impede access to funds that Group Inc. needs to make payments on obligations, including debt obligations. As such, we assume that capital or other financing provided to our regulated subsidiaries is not available to our parent company or other subsidiaries. In addition, we assume that the Global Core Excess held in our principal non-U.S. operating entities will not be available to our parent company or other subsidiaries and therefore is available only to meet the potential liquidity requirements of those entities.

We also manage our intercompany exposure by requiring senior and subordinated intercompany loans to have maturities equal to or shorter than the maturities of the aggregate borrowings of the parent company. This policy ensures that the subsidiaries' obligations to the parent company will generally mature in advance of the parent company's third-party borrowings. In addition, many of our subsidiaries and affiliates pledge collateral at loan value to the parent company to cover their intercompany borrowings (other than subordinated debt) in order to mitigate parent company liquidity risk.

Equity investments in subsidiaries are generally funded with parent company equity capital. As of February 2005, Group Inc.'s equity investment in subsidiaries was $24.23 billion compared with its shareholders' equity of $26.08 billion.

Group Inc. has provided substantial amounts of equity and subordinated indebtedness, directly or indirectly, to its regulated subsidiaries; for example, as of February 2005, Group Inc. had $16.81 billion of such equity and subordinated indebtedness invested in Goldman, Sachs & Co., its principal U.S. regulated broker-dealer, $13.04 billion invested in Goldman Sachs International, a registered U.K. broker-dealer, $2.78 billion invested in Goldman Sachs Execution & Clearing, L.P., a U.S. regulated broker-dealer, and $2.05 billion invested in Goldman Sachs (Japan) Ltd., a Tokyo-based broker-dealer. Group Inc. also had $43.03 billion of unsubordinated loans to these entities as of February 2005, as well as significant amounts of capital invested in and loans to its other regulated subsidiaries.

Subsidiary Foreign Exchange Policies. Our capital invested in non-U.S. subsidiaries is generally exposed to foreign exchange risk, substantially all of which is hedged. "Currency translation adjustment, net of tax" in the condensed consolidated statements of comprehensive income decreased from the first quarter of 2004, primarily due to an expansion of our policy for hedging our net investment in non-U.S. subsidiaries. In addition, we generally hedge the nontrading exposure to foreign exchange risk that arises from transactions denominated in currencies other than the transacting entity's functional currency.

Crisis Planning

In order to be prepared for a liquidity event, or a period of market stress, we base our liquidity risk management framework and our resulting funding and liquidity policies on conservative stress-scenario planning.

In addition, we maintain a Liquidity Crisis Plan that specifies an approach for analyzing and responding to a liquidity-threatening event. The Plan provides the framework to estimate the likely impact of a liquidity event on Goldman Sachs based on some of the risks identified above and outlines which and to what extent liquidity maintenance activities should be implemented based on the severity of the event. It also lists the crisis management team and internal and external parties to be contacted to ensure effective distribution of information.

Cash Flows

As a global financial institution, our cash flows are complex and interrelated and bear little relation to our net earnings and net assets and, consequently, we believe that traditional cash flow analysis is less meaningful in evaluating our liquidity position than the excess liquidity and asset-liability management policies described above. Cash flow analysis may, however, be helpful in highlighting certain macro trends and strategic initiatives in our business.

Three Months Ended February 2005. Our cash and cash equivalents increased by $1.17 billion to $5.53 billion at the end of the first quarter of 2005. We raised $7.90 billion in net cash from financing activities, primarily in long-term debt, in light of the favorable debt financing environment. We used net cash of $6.73 billion in our operating and investing activities, primarily to capitalize on trading and investing opportunities for ourselves and our clients and to repurchase our common stock.

Three Months Ended February 2004. Our cash and cash equivalents as of February 2004 were essentially unchanged compared with November 2003. We raised $15.15 billion in net cash from financing activities, in part to capitalize on the favorable interest rate environment. We used $15.29 billion in our operating and investing activities, primarily to capitalize on opportunities in our trading and investing businesses.

Recent Accounting Developments

In December 2004, the Financial Accounting Standards Board (FASB) issued a revision to SFAS No. 123, "Accounting for Stock-Based Compensation," SFAS No. 123-R, "Share-Based Payment." SFAS No. 123-R focuses primarily on transactions in which an entity exchanges its equity instruments for employee services and generally establishes standards for the accounting for transactions in which an entity obtains goods or services in share-based payment transactions. SFAS No. 123-R is effective for our fourth quarter of fiscal 2005. We are currently evaluating the effect of adoption of SFAS No. 123-R, but do not expect adoption to have a material effect on our financial condition, results of operations or cash flows.

Cautionary Statement Pursuant to The Private Securities Litigation Reform Act of 1995

We have included in Parts I and II of this Quarterly Report on Form 10-Q, and from time to time our management may make, statements which may constitute "forward-looking statements" within the meaning of the safe harbor provisions of The Private Securities Litigation Reform Act of 1995. These forward-looking statements are not historical facts but instead represent only our belief regarding future events, many of which, by their nature, are inherently uncertain and outside of our control. It is possible that our actual results may differ, possibly materially, from the anticipated results indicated in these forward-looking statements. Important factors that could cause actual results to differ from those in our specific forward-looking statements include, but are not limited to, those discussed under "Business — Certain Factors That May Affect Our Business" in Part I, Item 1 of the Annual Report on Form 10-K.

Statements about our investment banking transaction backlog also may constitute forward-looking statements. Such statements are subject to the risk that the terms of these transactions may be modified or that they may not be completed at all; therefore, the net revenues that we expect to earn from these transactions may differ, possibly materially, from those currently expected. Important factors that could result in a modification of the terms of a transaction or a transaction not being completed include, in the case of underwriting transactions, a decline in general economic conditions, volatility in the securities markets generally or an adverse development with respect to the issuer of the securities and, in the case of financial advisory transactions, a decline in the securities markets, an adverse development with respect to a party to the transaction or a failure to obtain a required regulatory approval. Other important factors that could adversely affect our investment banking transactions are described under "Business — Certain Factors That May Affect Our Business" in Part I, Item 1 of the Annual Report on Form 10-K.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

In addition to applying business judgment, senior management uses a number of quantitative tools to manage our exposure to market risk. These tools include:

- risk limits based on a summary measure of market risk exposure referred to as Value-at-Risk (VaR);
- scenario analyses, stress tests and other analytical tools that measure the potential effects on our trading net revenues of various market events, including, but not limited to, a large widening of credit spreads, a substantial decline in equity markets and significant moves in selected emerging markets; and
- inventory position limits for selected business units.

See "Quantitative and Qualitative Disclosures About Market Risk" in Part II, Item 7A of the Annual Report on Form 10-K for a description of our risk management policies and procedures.

VaR

VaR is the potential loss in value of Goldman Sachs' trading positions due to adverse market movements over a defined time horizon with a specified confidence level.

For the VaR numbers reported below, a one-day time horizon and a 95% confidence level were used. This means that there is a 1 in 20 chance that daily trading net revenues will fall below the expected daily trading net revenues by an amount at least as large as the reported VaR. Thus, shortfalls from expected trading net revenues on a single trading day greater than the reported VaR would be anticipated to occur, on average, about once a month. Shortfalls on a single day can exceed reported VaR by significant amounts. Shortfalls can also accumulate over a longer time horizon such as a number of consecutive trading days.

The VaR numbers below are shown separately for interest rate, equity, currency and commodity products, as well as for our overall trading positions. The VaR numbers in each risk category include the underlying product positions and related hedges that may include positions in other product areas. For example, the hedge of a foreign exchange forward may include an interest rate futures position, and the hedge of a long corporate bond position may include a short position in the related equity.

The modeling of the risk characteristics of our trading positions involves a number of assumptions and approximations. While management believes that these assumptions and approximations are reasonable, there is no uniform industry methodology for estimating VaR, and different assumptions and/or approximations could produce materially different VaR estimates.

We use historical data to estimate our VaR and, to better reflect current asset volatilities, we generally weight historical data to give greater importance to more recent observations. Given its reliance on historical data, VaR is most effective in estimating risk exposures in markets in which there are no sudden fundamental changes or shifts in market conditions. An inherent limitation of VaR is that the distribution of past changes in market risk factors may not produce accurate predictions of future market risk. Different VaR methodologies and distributional assumptions could produce a materially different VaR. Moreover, VaR calculated for a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or offset with hedges within one day. Changes in VaR between reporting periods are generally due to changes in levels of exposure, volatilities and/or correlations among asset classes.

The following tables set forth the daily trading VaR:

Daily VaR [1]
(in millions)

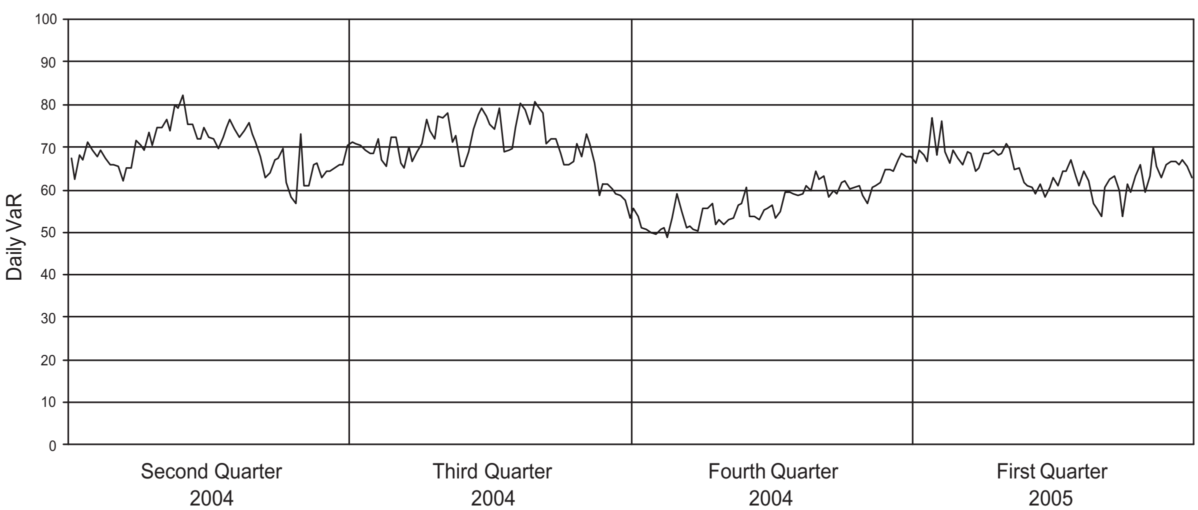
Risk Categories	Average for the Three Months Ended February 2005	Average for the Three Months Ended February 2004	As of February 2005	As of November 2004 [1]	Three Months Ended February 2005 High	Three Months Ended February 2005 Low
Interest rates	$ 32	$ 38	$ 31	$ 28	$43	$26
Equity prices	29	37	30	25	42	26
Currency rates	15	23	15	18	23	9
Commodity prices	28	15	24	35	34	21
Diversification effect [2]	(39)	(42)	(38)	(40)		
Firmwide	$ 65	$ 71	$ 62	$ 66	77	54

(1) During the second quarter of 2004, we began to exclude from our calculation distressed asset portfolios in FICC that cannot be properly measured in VaR. The effect of excluding these portfolios was not material to prior periods and, accordingly, such periods have not been adjusted. For a further discussion of the market risk associated with these portfolios, see "— Distressed Asset Portfolios" below.

(2) Equals the difference between firmwide VaR and the sum of the VaRs for the four risk categories. This effect arises because the four market risk categories are not perfectly correlated.

The following chart presents our daily trading VaR during the last four quarters:

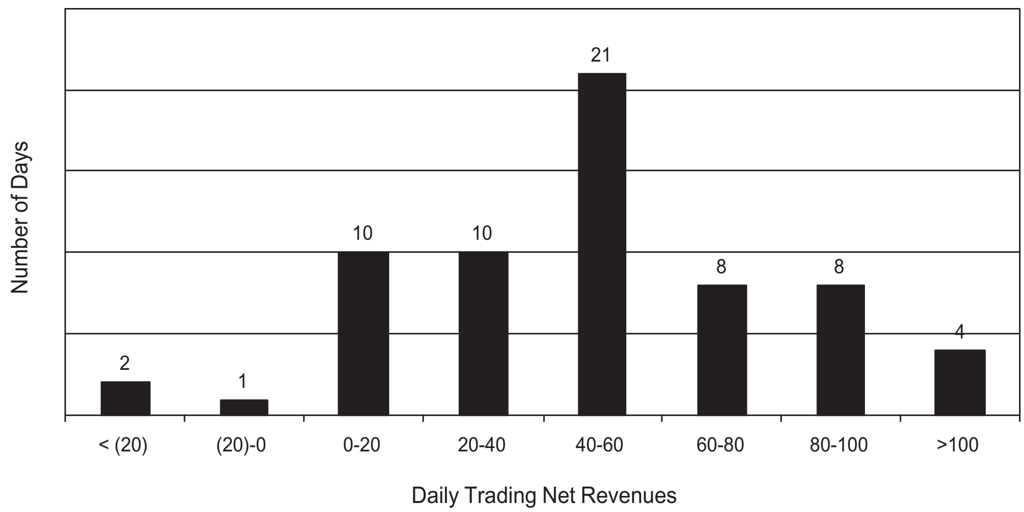
Daily VaR
($ in millions)



Trading Net Revenues Distribution

Substantially all of our inventory positions are marked-to-market on a daily basis and changes are recorded in net revenues. The following chart sets forth the frequency distribution of our daily trading net revenues for substantially all inventory positions included in VaR for the quarter ended February 2005:

Daily Trading Net Revenues
($ in millions)



As part of our overall risk control process, daily trading net revenues are compared with VaR calculated as of the end of the prior business day. Trading losses incurred on a single day did not exceed our 95% one-day VaR during the quarter ended February 2005.

Distressed Asset Portfolios

The market risk associated with distressed asset portfolios in FICC that cannot be properly measured in VaR (primarily due to inadequate historical data on the underlying assets in the aggregate) is measured based on a potential 10% decline in the asset value of such portfolios. The market values of the underlying distressed asset positions are sensitive to changes in a number of factors, including discount rates and the projected timing and amount of future cash flows. As of February 2005, the potential impact of a 10% decline in the asset value of these portfolios was $395 million compared with $416 million as of November 2004.

Nontrading Risk

SMFG. The market risk of our investment in the convertible preferred stock of SMFG is measured using a sensitivity analysis that estimates the potential reduction in our net revenues associated with a 10% decline in the SMFG common stock price. As of February 2005, the sensitivity of our investment to a 10% decline in the SMFG common stock price was $245 million compared with $236 million as of November 2004. The change is primarily due to the passage of time in respect of the transfer restrictions on the underlying common stock and an increase in the SMFG common stock price. This sensitivity should not be extrapolated to other movements in the SMFG common stock price, as the relationship between the fair value of our investment and the SMFG common stock price is nonlinear.

Other Principal Investments. The market risk for financial instruments in our nontrading portfolio, including our merchant banking investments but excluding our investment in the convertible preferred stock of SMFG, is measured using a sensitivity analysis that estimates the potential reduction in our net revenues associated with a 10% decline in equity markets. This sensitivity analysis is based on certain assumptions regarding the relationship between changes in stock price indices and changes in the fair value of the individual financial instruments in our nontrading portfolio. Different assumptions could produce materially different risk estimates. As of February 2005, the sensitivity of our nontrading portfolio (excluding our investment in the convertible preferred stock of SMFG) to a 10% equity market decline was $123 million compared with $118 million as of November 2004.

Derivatives

Derivative contracts are instruments, such as futures, forwards, swaps or option contracts, which derive their value from underlying assets, indices, reference rates or a combination of these factors. Derivative instruments may be privately negotiated contracts, which are often referred to as OTC derivatives, or they may be listed and traded on an exchange.

Substantially all of our derivative transactions are entered into for trading purposes, in order to facilitate customer transactions, to take proprietary positions or as a means of risk management. In addition to derivative transactions entered into for trading purposes, we enter into derivative contracts to hedge our net investment in non-U.S. operations and to manage the interest rate and currency exposure on our long-term borrowings and certain short-term borrowings.

Derivatives are used in many of our businesses, and we believe that the associated market risk can only be understood relative to the underlying assets or risks being hedged, or as part of a broader trading strategy. Accordingly, the market risk of derivative positions is managed with all of our other nonderivative market risk.

Fair values of our derivative contracts reflect cash paid or received pursuant to credit support agreements and are reported on a net-by-counterparty basis in our condensed consolidated statements of financial condition when management believes a legal right of setoff exists under an enforceable netting agreement. For an OTC derivative, our credit exposure is directly with our counterparty and continues until the maturity or termination of such contract.

The following table sets forth the distribution, by credit rating, of substantially all of our exposure with respect to OTC derivatives as of February 2005, after taking into consideration the effect of netting agreements. The categories shown reflect our internally determined public rating agency equivalents.

Over-the-Counter Derivative Credit Exposure
($ in millions)

Credit Rating Equivalent	Exposure (1)	Collateral Held	Exposure Net of Collateral	Percentage of Total Exposure Net of Collateral
AAA/Aaa	$ 4,321	$ 165	$ 4,156	10%
AA/Aa2	12,611	1,596	11,015	26
A/A2	17,474	1,621	15,853	37
BBB/Baa2	9,346	2,618	6,728	16
BB/Ba2 or lower	7,641	3,431	4,210	10
Unrated	1,415	1,055	360	1
Total	$52,808	$10,486	$42,322	100%

(1) Reflects cash received pursuant to credit support agreements.

The following tables set forth our OTC derivative credit exposure, net of collateral, by remaining contractual maturity:

Exposure Net of Collateral
(in millions)

Credit Rating Equivalent	0 - 6 Months	6 - 12 Months	1 - 5 Years	5 - 10 Years	10 Years or Greater	Total (1)
AAA/Aaa	$1,148	$ 332	$ 1,471	$ 526	$ 679	$ 4,156
AA/Aa2	2,315	883	2,957	2,805	2,055	11,015
A/A2	2,266	1,160	2,800	1,067	8,560	15,853
BBB/Baa2	1,494	1,247	2,166	1,078	743	6,728
BB/Ba2 or lower	1,045	653	1,572	584	356	4,210
Unrated	213	22	37	—	88	360
Total	$8,481	$4,297	$11,003	$6,060	$12,481	$42,322

Contract Type	0 - 6 Months	6 - 12 Months	1 - 5 Years	5 - 10 Years	10 Years or Greater	Total (1)
Interest rates	$ 881	$ 363	$ 4,361	$3,509	$11,742	$20,856
Currencies	4,788	855	3,084	1,840	418	10,985
Commodities	1,876	2,491	3,194	530	64	8,155
Equities	936	588	364	181	257	2,326
Total	$8,481	$4,297	$11,003	$6,060	$12,481	$42,322

(1) Where we have obtained collateral from a counterparty under a master trading agreement that covers multiple products and transactions, we have allocated the collateral ratably based on exposure before giving effect to such collateral.

Derivative transactions may also involve legal risks including, among other risks, that they are not authorized or appropriate for a counterparty, that documentation has not been properly executed or that executed agreements may not be enforceable against the counterparty. We attempt to minimize these risks by obtaining advice of counsel on the enforceability of agreements as well as on the authority of a counterparty to effect the derivative transaction.

Item 4: Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out by Goldman Sachs' management, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that these disclosure controls and procedures were effective as of the end of the period covered by this report. In addition, no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II: OTHER INFORMATION

Item 1: Legal Proceedings

The following supplements and amends our discussion set forth under "Legal Proceedings" in Part I, Item 3 of the Annual Report on Form 10-K for the fiscal year ended November 26, 2004.

IPO Process Matters

In the lawsuit alleging that the prospectuses for certain offerings violated the federal securities laws by failing to disclose the existence of "tying" arrangements, the federal district court preliminarily approved the proposed settlement between plaintiffs and the issuer defendants by a decision and order dated February 15, 2005.

In connection with the settlement of charges brought by the SEC relating to certain allocation practices, the U.S. District Court for the Southern District of New York entered a final judgment on February 7, 2005 approving the settlement and granting the permanent injunctive relief.

Research Independence Matters

In the lawsuit alleging that The Goldman Sachs Group, Inc., Goldman, Sachs & Co. and Henry M. Paulson, Jr. violated the federal securities laws in connection with the firm's research activities, the amended complaint was dismissed with leave to amend by an order dated February 17, 2005, plaintiffs filed a second amended complaint on February 25, 2005, and defendants moved to dismiss the second amended complaint on March 24, 2005.

Enron Litigation Matters

The adversary proceedings brought by Enron North America Corp. relating to termination of an agreement for the trading of over-the-counter derivatives and by Enron Corp. seeking to avoid related guarantees have been finally settled.

Worldcom Bondholders Litigation

On March 9, 2005, Goldman, Sachs & Co. and certain other underwriters in the May 2000 offering entered into a definitive settlement of the class action claims, subject to court approval. Goldman, Sachs & Co. will contribute approximately $12.5 million toward the settlement, which does not resolve pending actions brought by individual investors that opted out of the class action.

Global Crossing and Asia Global Crossing Securities Litigation

On March 1, 2005, plaintiffs entered into a definitive settlement agreement with Citigroup, Inc. and certain related parties, including as to claims asserted against such parties in respect of the various offerings in which Goldman, Sachs & Co. participated. The settlement, pursuant to which the Citigroup defendants have agreed to pay $75 million, does not resolve claims against the balance of the syndicates, including Goldman, Sachs & Co.

Treasury Matters

By an opinion and order dated March 28, 2005, the federal district court denied Goldman, Sachs & Co.'s motion to dismiss as to the federal commodities claims, granted the motion with leave to replead as to the federal antitrust claims, and dismissed the Illinois statutory and common law claims.

Item 2: Unregistered Sales of Equity Securities and Use of Proceeds

The table below sets forth the information with respect to purchases made by or on behalf of The Goldman Sachs Group, Inc. or any ''affiliated purchaser'' (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of our common stock during the three months ended February 25, 2005.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (2)
Month #1 (November 27, 2004 to December 31, 2004) (1)	1,983,500	$104.73	1,983,500	4,409,094
Month #2 (January 1, 2005 to January 28, 2005)	4,450,694 (3)	$104.28	4,396,672	40,012,422
Month #3 (January 29, 2005 to February 25, 2005) (1)	5,021,180	$110.10	5,021,180	34,991,242
Total (1)	11,455,374	$106.91	11,401,352	

(1) As a matter of policy, Goldman Sachs did not repurchase shares of its common stock as part of the repurchase program during a standard self-imposed ''black-out'' period from the last two weeks of each fiscal quarter through the date of the earnings release for such quarter.

(2) On March 21, 2000, we announced that our board of directors had approved a repurchase program, pursuant to which up to 15 million shares of our common stock may be repurchased. This repurchase program was increased by an aggregate of 100 million shares by resolutions of our board of directors adopted on June 18, 2001, March 18, 2002, November 20, 2002, January 30, 2004 and January 25, 2005. The repurchase program is intended to substantially offset increases in share count over time resulting from employee equity-based compensation and to help maintain our shareholders' equity at appropriate levels. The repurchase program is being effected from time to time, depending on market conditions and other factors, through open market purchases and privately negotiated transactions. Taking into account the increased authorization, the total remaining authorization under the repurchase program was 30,047,242 shares as of April 1, 2005; the repurchase program has no set expiration or termination date.

(3) Includes repurchases of 54,022 shares withheld to satisfy employee income taxes on equity-based awards issued at the time of our initial public offering that were delivered to employees during the period.

Item 6: Exhibits

Exhibits:

- 12.1 Statement re: computation of ratios of earnings to fixed charges.
- 15.1 Letter re: Unaudited Interim Financial Information.
- 31.1 Rule 13a-14(a) Certifications.
- 32.1 Section 1350 Certifications.

SIGNATURES

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

THE GOLDMAN SACHS GROUP, INC.

By: /s/ DAVID A. VINIAR
Name: David A. Viniar
Title: Chief Financial Officer

By: /s/ SARAH E. SMITH
Name: Sarah E. Smith
Title: Principal Accounting Officer

Date: April 5, 2005