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 May 27, 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 June 24, 2005 there were 464,987,710 shares of the registrant's common stock outstanding.

THE GOLDMAN SACHS GROUP, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE FISCAL QUARTER ENDED MAY 27, 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 May		Six Months Ended May	
	2005	2004	2005	2004
	(in millions, except per share amounts)			
Revenues				
Investment banking	$ 796	$ 928	$ 1,669	$ 1,682
Trading and principal investments	2,562	3,409	6,703	7,228
Asset management and securities services	724	629	1,498	1,416
Interest income	4,867	2,710	9,043	5,255
Total revenues	8,949	7,676	18,913	15,581
Interest expense	4,022	2,038	7,471	3,911
Cost of power generation	121	127	231	231
Revenues, net of interest expense and cost of power generation	4,806	5,511	11,211	11,439
Operating expenses				
Compensation and benefits	2,403	2,771	5,606	5,766
Brokerage, clearing and exchange fees	274	252	526	485
Market development	94	76	176	138
Communications and technology	123	120	241	232
Depreciation and amortization	128	121	246	256
Amortization of identifiable intangible assets	31	31	62	63
Occupancy	186	156	334	326
Professional fees	109	85	205	146
Other expenses	214	159	426	358
Total non-compensation expenses	1,159	1,000	2,216	2,004
Total operating expenses	3,562	3,771	7,822	7,770
Pre-tax earnings	1,244	1,740	3,389	3,669
Provision for taxes	379	553	1,012	1,189
Net earnings	865	1,187	2,377	2,480
Preferred stock dividend	—	—	—	—
Net earnings applicable to common shareholders	$ 865	$1,187	$ 2,377	$ 2,480
Earnings per common share				
Basic	$ 1.78	$ 2.43	$ 4.85	$ 5.06
Diluted	1.71	2.31	4.65	4.81
Dividends declared per common share	$ 0.25	$ 0.25	$ 0.50	$ 0.50
Average common shares outstanding				
Basic	485.4	487.9	489.8	490.0
Diluted	506.2	513.5	510.7	515.3

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	
	May 2005	November 2004
	(in millions, except share and per share amounts)	
Assets		
Cash and cash equivalents	$ 8,042	$ 4,365
Cash and securities segregated in compliance with U.S. federal and other regulations	47,232	48,179
Receivables from brokers, dealers and clearing organizations	16,097	14,458
Receivables from customers and counterparties	42,272	38,087
Securities borrowed	176,315	155,086
Securities purchased under agreements to resell	77,097	44,257
Financial instruments owned, at fair value	207,921	183,880
Financial instruments owned and pledged as collateral, at fair value	30,776	27,924
Total financial instruments owned, at fair value	238,697	211,804
Other assets	18,720	15,143
Total assets	$624,472	$531,379
Liabilities and shareholders' equity		
Secured short-term borrowings	$ 8,753	$ 8,558
Unsecured short-term borrowings	45,043	46,401
Total short-term borrowings, including the current portion of long-term borrowings	53,796	54,959
Payables to brokers, dealers and clearing organizations	7,668	8,000
Payables to customers and counterparties	173,233	153,221
Securities loaned	19,709	19,394
Securities sold under agreements to repurchase	95,770	47,573
Financial instruments sold, but not yet purchased, at fair value	142,386	132,097
Other liabilities and accrued expenses	10,386	10,360
Secured long-term borrowings	13,443	12,087
Unsecured long-term borrowings	81,686	68,609
Total long-term borrowings	95,129	80,696
Total liabilities	598,077	506,300
Commitments, contingencies and guarantees		
Shareholders' equity		
Preferred stock, par value $0.01 per share; 150,000,000 shares authorized, 30,000 shares issued and outstanding as of May 2005 with liquidation preference of $25,000 per share	750	—
Common stock, par value $0.01 per share; 4,000,000,000 shares authorized, 567,199,823 and 554,063,234 shares issued as of May 2005 and November 2004, respectively, and 467,123,412 and 480,959,660 shares outstanding as of May 2005 and November 2004, respectively	6	6
Restricted stock units and employee stock options	2,218	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	16,592	15,501
Retained earnings	16,093	13,970
Unearned compensation	(51)	(117)
Accumulated other comprehensive (loss)/income	(2)	11
Treasury stock, at cost, par value $0.01 per share; 100,076,411 and 73,103,574 shares as of May 2005 and November 2004, respectively	(9,211)	(6,305)
Total shareholders' equity	26,395	25,079
Total liabilities and shareholders' equity	$624,472	$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 May 2005	Period Ended November 2004
	(in millions, except per share amounts)	
Preferred stock, par value $0.01 per share		
Balance, beginning of year	$ —	$ —
Issued	750	—
Balance, end of period	750	—
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	649	1,050
Delivered	(422)	(1,948)
Forfeited	(16)	(62)
Options exercised	(6)	(11)
Balance, end of period	2,218	2,013
Additional paid-in capital		
Balance, beginning of year	15,501	13,562
Issuance of common stock	938	1,609
Preferred stock issuance costs	(12)	—
Excess net tax benefit related to delivery of stock-based awards	165	330
Balance, end of period	16,592	15,501
Retained earnings		
Balance, beginning of year	13,970	9,914
Net earnings	2,377	4,553
Dividends declared	(254)	(497)
Balance, end of period	16,093	13,970
Unearned compensation		
Balance, beginning of year	(117)	(339)
Restricted stock units forfeited	1	11
Amortization of restricted stock units	65	211
Balance, end of period	(51)	(117)
Accumulated other comprehensive income		
Balance, beginning of year	11	6
Currency translation adjustment, net of tax	(17)	5
Cash flow hedging activity, net of tax	4	—
Balance, end of period	(2)	11
Treasury stock, at cost, par value $0.01 per share		
Balance, beginning of year	(6,305)	(4,500)
Repurchased	(2,906)	(1,805)
Balance, end of period	(9,211)	(6,305)
Total shareholders' equity	$26,395	$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)

	Six Months Ended May	
	2005	**2004**
	(in millions)	
Cash flows from operating activities		
Net earnings	$ 2,377	$ 2,480
Noncash items included in net earnings		
Depreciation and amortization	335	369
Amortization of identifiable intangible assets	93	63
Stock-based compensation	420	280
Changes in operating assets and liabilities		
Cash and securities segregated in compliance with U.S. federal and other regulations	982	(20,767)
Net receivables from brokers, dealers and clearing organizations	(1,971)	720
Net payables to customers and counterparties	15,847	28,704
Securities borrowed, net of securities loaned	(20,914)	(5,865)
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell	15,535	(6,592)
Financial instruments owned, at fair value	(28,759)	(21,634)
Financial instruments sold, but not yet purchased, at fair value	10,289	8,824
Other, net	(1,697)	1,159
Net cash used for operating activities	(7,463)	(12,259)
Cash flows from investing activities		
Purchase of property, leasehold improvements and equipment	(639)	(341)
Proceeds from sales of property, leasehold improvements and equipment	28	—
Business combinations, net of cash acquired	(438)	(94)
Net cash used for investing activities	(1,049)	(435)
Cash flows from financing activities		
Short-term borrowings, net	(1,168)	(1,946)
Issuance of long-term borrowings	25,603	22,013
Repayment of long-term borrowings, including the current portion of long-term borrowings	(11,194)	(5,824)
Derivative contracts with a financing element, net	695	238
Common stock repurchased	(2,906)	(835)
Dividends paid	(254)	(248)
Proceeds from issuance of preferred stock, net of issuance costs	738	—
Proceeds from issuance of common stock	675	250
Net cash provided by financing activities	12,189	13,648
Net increase in cash and cash equivalents	3,677	954
Cash and cash equivalents, beginning of year	4,365	7,087
Cash and cash equivalents, end of period	$ 8,042	$ 8,041

SUPPLEMENTAL DISCLOSURES:

Cash payments for interest, net of capitalized interest, were $7.31 billion and $3.72 billion during the six months ended May 2005 and May 2004, respectively.

Cash payments for income taxes, net of refunds, were $1.36 billion and $639 million during the six months ended May 2005 and May 2004, respectively.

Noncash activities:

During the six months ended May 2005 and May 2004, the firm assumed $758 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 May		Six Months Ended May	
	2005	2004	2005	2004
	(in millions)			
Net earnings	$865	$1,187	$2,377	$2,480
Currency translation adjustment, net of tax	(17)	(13)	(17)	10
Cash flow hedging activity, net of tax	4	—	4	—
Comprehensive income	$852	$1,174	$2,364	$2,490

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

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 Financial Accounting Standards Board (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 May 2005 and May 2004 refer to the firm's fiscal periods ended, or the dates, as the context requires, May 27, 2005 and May 28, 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 are reflected net of 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 plants 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 May		Six Months Ended May	
	2005	2004	2005	2004
	(in millions)			
Revenues [(1)]	$115	$124	$245	$240
Cost of power generation	121	127	231	231

(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. Equity awards granted to employees who have satisfied the retirement eligibility criteria are expensed over the stated service period for the award. In the event a retirement-eligible employee retires, any unamortized grant date value is immediately expensed. Employees who meet the retirement criteria are subject to a non-compete agreement from the date of retirement through the date that shares underlying the awards are delivered. A reduction to compensation expense is recorded upon forfeiture related to employees who meet the retirement criteria and violate their non-compete agreements.

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 common share (EPS) as set forth below:

	Three Months Ended May		Six Months Ended May	
	2005	2004	2005	2004
	(in millions, except per share amounts)			
Net earnings applicable to common shareholders, as reported	$ 865	$1,187	$2,377	$2,480
Add: Stock-based employee compensation expense, net of related tax effects, included in reported net earnings	130	77	271	181
Deduct: Stock-based employee compensation expense, net of related tax effects, determined under the fair-value method for all awards	(143)	(114)	(296)	(266)
Pro forma net earnings applicable to common shareholders	$ 852	$1,150	$2,352	$2,395
EPS, as reported				
Basic	$1.78	$ 2.43	$ 4.85	$ 5.06
Diluted	1.71	2.31	4.65	4.81
Pro forma EPS				
Basic	$1.76	$ 2.36	$ 4.80	$ 4.89
Diluted	1.68	2.24	4.61	4.65

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 1, 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 Common Share

Basic EPS is calculated by dividing net earnings applicable to common shareholders 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, SFAS No. 123-R, "Share-Based Payment." SFAS No. 123-R establishes standards for accounting for transactions in which an entity exchanges its equity instruments for goods and services. SFAS No. 123-R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. On April 14, 2005, the U.S. Securities and Exchange Commission (SEC) announced new rules that require companies to implement SFAS No. 123-R by the start of their fiscal year beginning after June 15, 2005. SFAS No. 123-R generally requires the immediate expensing of equity-based awards granted to retirement-eligible employees. Awards granted subject to a substantive non-compete agreement are generally expensed over the non-compete period. Management is currently evaluating the effect of adoption of SFAS No. 123-R on the firm's financial condition, results of operations and 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			
	May 2005		November 2004	
	Assets	Liabilities	Assets	Liabilities
	(in millions)			
Commercial paper, certificates of deposit, time deposits and other money market instruments	$ 8,346 [1]	$ —	$ 7,386 [1]	$ —
U.S. government, federal agency and sovereign obligations	55,006	53,179	46,777	40,866
Corporate and other debt obligations				
Mortgage whole loans and collateralized debt obligations	27,544	587	18,346	671
Investment-grade corporate bonds	10,859	4,204	11,783	5,163
Bank loans	10,763	1,464	8,900	428
High-yield securities	7,971	1,870	6,057	1,725
Preferred stock	5,070	107	4,792	109
Other	805	202	885	248
	63,012	8,434	50,763	8,344
Equities and convertible debentures	47,022	25,830	42,263	18,766
State, municipal and provincial obligations	2,038	—	1,308	—
Derivative contracts	62,267 [2]	54,373 [3]	62,495 [2]	64,001 [3]
Physical commodities	1,006	570	812	120
Total	$238,697	$142,386	$211,804	$132,097

[1] Includes $6.10 billion and $5.04 billion, as of May 2005 and November 2004, respectively, of money market instruments held by William Street Funding Corporation to support the William Street credit extension program.

[2] Reflected net of cash received pursuant to credit support agreements of $20.46 billion and $18.65 billion as of May 2005 and November 2004, respectively.

[3] Reflected net of cash paid pursuant to credit support agreements of $16.85 billion and $5.45 billion as of May 2005 and November 2004, respectively.

Derivative Activities

Derivative contracts are instruments, such as futures, forwards, swaps or option contracts, that 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., London Inter-Bank Offer Rate (LIBOR)) on its fixed rate long-term borrowings. The firm also applies cash flow hedge accounting to derivative contracts that hedge changes in interest rates associated with floating rate long-term borrowings at its power plant operations.

Fair values of the firm's derivative contracts are reflected net of 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			
	May 2005		November 2004	
	Assets	Liabilities	Assets	Liabilities
	(in millions)			
Forward settlement contracts	$11,241	$13,179	$13,137	$14,578
Swap agreements	35,727	23,079	34,727	30,836
Option contracts	15,299	18,115	14,631	18,587
Total	$62,267	$54,373	$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 six months ended May 2005 and May 2004, the firm securitized $37.94 billion and $28.63 billion, respectively, of financial assets, including $11.00 billion and $11.03 billion, respectively, of agency mortgage-backed securities. Cash flows received on retained interests and other securitization cash flows were approximately $394 million and $515 million for the six months ended May 2005 and May 2004, respectively.

As of May 2005 and November 2004, the firm held $5.35 billion and $4.33 billion of retained interests, respectively, including $5.02 billion and $4.11 billion, respectively, in QSPEs. The fair value of retained interests valued using quoted market prices in active markets was $606 million and $949 million as of May 2005 and November 2004, respectively.

The following table sets forth the weighted average key economic assumptions used in measuring the fair value of $4.74 billion and $3.38 billion, respectively, as of May 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 May 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	$3,090	$1,653	$1,798	$1,578
Weighted average life (years)	6.6	3.6	4.2	3.7
Annual constant prepayment rate	19.1%	N/A	21.5%	N/A
Impact of 10% adverse change	$ (16)	$ —	$ (6)	$ —
Impact of 20% adverse change	(29)	—	(10)	—
Annual credit losses [1]	4.5%	3.4%	4.0%	4.1%
Impact of 10% adverse change [2]	$ (9)	$ (3)	$ (10)	$ (1)
Impact of 20% adverse change [2]	(14)	(3)	(14)	(2)
Annual discount rate	7.5%	5.0%	8.5%	4.9%
Impact of 10% adverse change	$ (78)	$ (17)	$ (39)	$ (24)
Impact of 20% adverse change	(153)	(30)	(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 impact of adverse change takes 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 May 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 had transferred assets, with a fair value of $113 million and $126 million as of May 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	
	May 2005	November 2004
	(in millions)	
VIE assets [(1)]	$5,097	$5,197
Maximum exposure to loss	1,597	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 May 2005					
		Maximum Exposure to Loss				
	VIE Assets	Purchased Interests	Guarantees	Derivatives	Loans and Investments	Total
			(in millions)			
Mortgage-backed	$ 7,255	$ 22	$141	$ —	$1,075	$1,238
Asset repackagings and credit-linked notes	11,469	390	—	1,007	405	1,802
Power-related	7,451	—	37	—	983	1,020
Other asset-backed	10,495	13	162	45	771	991
Total	$36,670	$425	$340	$1,052	$3,234	$5,051

	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 customer 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 May 2005 and November 2004, the fair value of securities received as collateral by the firm that it was permitted to sell or repledge was $578.40 billion and $511.98 billion, respectively, of which the firm sold or repledged $493.30 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'' in the condensed consolidated statements of financial condition and were $30.78 billion and

$27.92 billion as of May 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'' in the condensed consolidated statements of financial condition and were $68.09 billion and $46.86 billion as of May 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 $26.31 billion and $22.81 billion as collateral as of May 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 May 2005 and November 2004, secured short-term borrowings were $8.75 billion and $8.56 billion, respectively. Unsecured short-term borrowings were $45.05 billion and $46.40 billion as of May 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	
	May 2005	November 2004
	(in millions)	
Promissory notes	$18,192	$19,513
Commercial paper	4,385	4,355
Bank loans and other	13,422	13,474
Current portion of long-term borrowings	17,797	17,617
Total [1]	$53,796	$54,959

[1] As of May 2005 and November 2004, the weighted average interest rate for short-term borrowings, including commercial paper, was 3.40% and 2.73%, respectively. The weighted average interest rate, after giving effect to hedging activities, was 3.18% and 2.30% as of May 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 2035. As of May 2005 and November 2004, secured long-term borrowings were $13.44 billion and $12.09 billion, respectively. Unsecured long-term borrowings were $81.69 billion and $68.61 billion as of May 2005 and November 2004, respectively.

Long-term borrowings are set forth below:

	As of May 2005	As of November 2004
	(in millions)	
Fixed rate obligations [1]		
U.S. dollar	$33,975	$32,078
Non-U.S. dollar	17,322	12,553
Floating rate obligations [2]		
U.S. dollar	28,974	26,033
Non-U.S. dollar	14,858	10,032
Total	$95,129	$80,696

(1) As of both May 2005 and November 2004, interest rates on U.S. dollar fixed rate obligations ranged from 2.85% to 12.00%. As of May 2005 and November 2004, interest rates on non-U.S. dollar fixed rate obligations ranged from 0.08% to 8.88% and from 0.70% to 8.88%, respectively.

(2) Floating interest rates generally are based on LIBOR 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 May 2005	As of November 2004
	(in millions)	
William Street Funding Corporation	$ 5,123	$ 5,144
Variable interest entities	5,368	4,546
Other subsidiaries [1]	2,841	2,364
Total	$13,332	$12,054

(1) Includes $1.83 billion and $978 million of nonrecourse debt issued by the firm's consolidated power plant operations as of May 2005 and November 2004, respectively.

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

	As of					
	May 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	$ 7,147	$ 1,918	$ 9,065	$10,691	$ 2,616	$13,307
2007	9,385	1,103	10,488	7,116	948	8,064
2008	4,548	2,943	7,491	4,626	3,179	7,805
2009	9,350	4,192	13,542	9,061	4,116	13,177
2010-thereafter	32,519	22,024	54,543	26,617	11,726	38,343
Total	$62,949	$32,180	$95,129	$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			
	May 2005		November 2004	
	Amount	Rate	Amount	Rate
	($ in millions)			
Fixed rate obligations	$ 2,090	7.85%	$ 2,383	6.56%
Floating rate obligations	93,039	3.56	78,313	2.48
Total	$95,129	3.65	$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 May 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 $31.22 billion and $48.32 billion as of May 2005 and November 2004, respectively.

In connection with its lending activities, the firm had outstanding commitments of $36.55 billion and $27.72 billion as of May 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 May 2005 and November 2004, $11.68 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 $9.64 billion and $11.15 billion as of May 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 $4.20 billion and $1.04 billion in corporate and real estate investment funds as of May 2005 and November 2004, respectively.

The firm had construction-related commitments of $46 million and $107 million as of May 2005 and November 2004, respectively, and other purchase commitments of $493 million and $242 million as of May 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	$ 187
2006	375
2007	332
2008	312
2009	313
2010-thereafter	1,945
Total	$3,464

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, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." 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 tables 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 connection with 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 the 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 tables set forth certain information about the firm's derivative contracts that meet the definition of a guarantee and certain other guarantees as of May 2005 and November 2004:

	As of May 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]	$9,046	$174,710	$249,649	$178,344	$340,002	$942,705
Securities lending indemnifications [2]	—	17,392	—	—	—	17,392
Guarantees of trust preferred beneficial interest [3]	—	87	349	349	7,025	7,810
Guarantee of the collection of contractual cash flows	6	18	141	30	24	213
Merchant banking fund-related commitments	—	19	55	8	5	87
Letters of credit and other guarantees	90	359	163	9	82	613

(1) The carrying value of $9.05 billion excludes the effect of a legal right of setoff that may exist under an enforceable netting agreement.

(2) Collateral held by the lenders in connection with securities lending indemnifications was $18.06 billion as of May 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 by the lenders 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 May 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 May 2005 and November 2004.

Note 7. Shareholders' Equity

On June 15, 2005, the Board of Directors of Group Inc. (the Board) declared a dividend of $0.25 per common share to be paid on August 25, 2005, to common shareholders of record on July 26, 2005.

On April 25, 2005, the firm issued 30,000 shares of perpetual Floating Rate Non-Cumulative Preferred Stock, Series A (Series A Preferred Stock), par value $0.01, out of a total of 50,000 shares of Series A Preferred Stock authorized for issuance. Each share of Series A Preferred Stock has a liquidation preference of $25,000 and is represented by 1,000 depositary shares. The Series A Preferred Stock is redeemable at the firm's option starting on April 25, 2010 at a redemption price equal to $25,000 per share plus declared and unpaid dividends. The redemption value of the Series A Preferred Stock is $750 million. The Series A Preferred Stock has a preference over the firm's common stock for the payment of dividends (as described in the terms of the Series A Preferred Stock). Any dividends declared on the preferred stock will be payable quarterly in arrears at an annual rate equal to the greater of (i) 0.75% above three-month LIBOR on the related LIBOR determination date or (ii) 3.75%. On June 15, 2005, the Board declared a dividend of $290.58 per share of Series A Preferred Stock (equivalent to $0.29 per depositary share) to be paid on August 10, 2005 to preferred shareholders of record on July 26, 2005.

During the three and six months ended May 2005, the firm repurchased 15.5 million shares and 27.0 million shares of the firm's common stock, respectively. The average price paid per share for repurchased shares was $108.34 and $107.74 for the three and six months ended May 2005, respectively. In addition, to satisfy minimum statutory employee tax withholding requirements related to the delivery of shares underlying restricted stock units, the firm cancelled 1.6 million restricted stock units at an average price of $104.71 per unit during the first half 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 May 2005, the remaining share authorization under the firm's repurchase program was 19.5 million shares.

As of May 2005, accumulated other comprehensive loss/income in the condensed consolidated statements of financial condition consisted of a loss of $6 million, net of tax, related to currency translation adjustment and a gain of $4 million, net of tax, related to cash flow hedging activity. As of November 2004, accumulated other comprehensive income consisted of a gain of $11 million, net of tax, related to currency translation adjustment.

Note 8. Earnings Per Common Share

The computations of basic and diluted earnings per common share are set forth below:

	Three Months Ended May		Six Months Ended May	
	2005	2004	2005	2004
	(in millions, except per share amounts)			
Numerator for basic and diluted EPS — earnings applicable to common shareholders	$ 865	$1,187	$2,377	$2,480
Denominator for basic EPS — weighted average number of common shares	485.4	487.9	489.8	490.0
Effect of dilutive securities				
Restricted stock units	9.2	12.3	8.5	11.7
Stock options	11.6	13.3	12.4	13.6
Dilutive potential common shares	20.8	25.6	20.9	25.3
Denominator for diluted EPS — weighted average number of common shares and dilutive potential common shares (1)	506.2	513.5	510.7	515.3
Basic EPS	$ 1.78	$ 2.43	$ 4.85	$ 5.06
Diluted EPS	1.71	2.31	4.65	4.81

(1) The diluted EPS computations do not include the antidilutive effect of the following options:

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

Note 9. Goodwill and Identifiable Intangible Assets

Goodwill

As of May 2005 and November 2004, goodwill of $3.09 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	
		May 2005	November 2004
		(in millions)	
Power contracts [1]	Gross carrying amount	$1,063	$ —
	Accumulated amortization	(31)	—
	Net carrying amount	$1,032	$ —
Customer lists [2]	Gross carrying amount	$1,021	$1,021
	Accumulated amortization	(218)	(193)
	Net carrying amount	$ 803	$ 828
New York Stock Exchange (NYSE) specialist rights	Gross carrying amount	$ 714	$ 714
	Accumulated amortization	(122)	(107)
	Net carrying amount	$ 592	$ 607
Exchange-traded fund (ETF) and option specialist rights	Gross carrying amount	$ 145	$ 145
	Accumulated amortization	(26)	(24)
	Net carrying amount	$ 119	$ 121
Other [3]	Gross carrying amount	$ 310	$ 298
	Accumulated amortization	(185)	(165)
	Net carrying amount	$ 125	$ 133
Total	Gross carrying amount	$3,253	$2,178
	Accumulated amortization	(582)	(489)
	Net carrying amount	$2,671	$1,689

(1) Primarily relates to above-market power contracts acquired in the firm's combinations with Cogentrix Energy, Inc. and National Energy & Gas Transmission, Inc. (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. The firm recorded purchase price allocation adjustments for NEGT during the second 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

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

	As of May 2005	As of November 2004
	(in millions)	
Goodwill and identifiable intangible assets [1]	$ 5,756	$ 4,871
Property, leasehold improvements and equipment [2]	4,934	4,083
Equity-method investments and joint ventures	2,545	2,447
Income tax related assets	1,736	777
Miscellaneous receivables and other	3,749	2,965
Total	$18,720	$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 $4.52 billion and $4.23 billion for May 2005 and November 2004, respectively.

Other Liabilities

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 May 2005	As of November 2004
	(in millions)	
Compensation and benefits	$ 4,014	$ 5,571
Minority interest	2,594	1,809
Accrued expenses and other payables	3,778	2,980
Total	$10,386	$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 May		Six Months Ended May	
	2005	2004	2005	2004
	(in millions)			
U.S. pension				
Service cost	$—	$ 3	$ —	$ 6
Interest cost	5	5	10	10
Expected return on plan assets	(6)	(6)	(13)	(12)
Net amortization	1	1	3	2
Total	$—	$ 3	$ —	$ 6
Non-U.S. pension				
Service cost	$12	$12	$ 23	$ 24
Interest cost	5	4	10	8
Expected return on plan assets	(6)	(5)	(12)	(10)
Net amortization	3	3	6	6
Other [1]	—	—	(17)	—
Total	$14	$14	$ 10	$ 28
Postretirement				
Service cost	$ 4	$ 2	$ 7	$ 4
Interest cost	3	3	6	6
Net amortization	1	2	2	4
Total	$ 8	$ 7	$ 15	$ 14

(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 is regulated by the SEC as a consolidated supervised entity (CSE). As such, it is subject to group-wide supervision and examination by the SEC and, accordingly, is subject to minimum capital requirements on a consolidated basis. As of May 2005, the firm was in compliance with the CSE capital requirements.

The firm's principal U.S. regulated subsidiaries include Goldman, Sachs & Co. (GS&Co.) and Goldman Sachs Execution & Clearing, L.P. (GSEC). GS&Co. and GSEC are registered U.S. broker-dealers and futures commission merchants subject to Rule 15c3-1 of the SEC and Rule 1.17 of the Commodity Futures Trading Commission, which specify uniform minimum net capital requirements, as defined, for their registrants. GS&Co. and GSEC have elected to compute their minimum capital requirements in accordance with the ''Alternative Minimum Net Capital Requirement'' as permitted under Rule 15c3-1. As of May 2005, GS&Co. and GSEC had net capital in excess of their minimum capital requirements. In addition to its alternative minimum net capital requirements, GS&Co. is also required to hold tentative net capital in excess of $1 billion and net capital in excess of $500 million in accordance with the market and credit risk standards of Appendix E of Rule 15c3-1. GS&Co. is also required to notify the SEC in the event that its tentative net capital is less than $5 billion. As of

May 2005, GS&Co. had tentative net capital and net capital in excess of both the minimum and the notification requirements.

The firm's principal international regulated subsidiaries include Goldman Sachs International (GSI) and Goldman Sachs (Japan) Ltd (GSJL). 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 May 2005, GSI and GSJL were in compliance with their local capital and 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 May 2005, these subsidiaries were in compliance with their local capital adequacy requirements.

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 May 2005	As of or for the Three Months Ended May 2004	As of or for the Six Months Ended May 2005	As of or for the Six Months Ended May 2004
		(in millions)			
Investment Banking	Net revenues	$ 815	$ 953	$ 1,708	$ 1,716
	Operating expenses	718	775	1,505	1,468
	Pre-tax earnings	$ 97	$ 178	$ 203	$ 248
	Segment assets	$ 3,205	$ 4,536	$ 3,205	$ 4,536
Trading and Principal Investments	Net revenues	$ 2,813	$ 3,627	$ 7,196	$ 7,749
	Operating expenses	2,065	2,350	4,794	4,878
	Pre-tax earnings	$ 748	$ 1,277	$ 2,402	$ 2,871
	Segment assets	$445,541	$301,339	$445,541	$301,339
Asset Management and Securities Services	Net revenues	$ 1,178	$ 931	$ 2,307	$ 1,974
	Operating expenses	787	641	1,500	1,338
	Pre-tax earnings	$ 391	$ 290	$ 807	$ 636
	Segment assets	$175,471	$161,302	$175,471	$161,302
Total	Net revenues	$ 4,806	$ 5,511	$ 11,211	$ 11,439
	Operating expenses [(1)]	3,562	3,771	7,822	7,770
	Pre-tax earnings	$ 1,244	$ 1,740	$ 3,389	$ 3,669
	Total assets [(2)]	$624,472	$467,921	$624,472	$467,921

(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 $5 million and $26 million for the three months and six months ended May 2004, respectively, and (ii) a change in net provisions for a number of litigation and regulatory proceedings of $(8) million for the three months ended May 2005 and $23 million and $60 million for the six months ended May 2005 and May 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 May 27, 2005, the related condensed consolidated statements of earnings for the three and six months ended May 27, 2005 and May 28, 2004, the condensed consolidated statement of changes in shareholders' equity for the six months ended May 27, 2005, the condensed consolidated statements of cash flows for the six months ended May 27, 2005 and May 28, 2004, and the condensed consolidated statements of comprehensive income for the three and six months ended May 27, 2005 and May 28, 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
June 21, 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 May 2005 and May 2004 refer to our fiscal periods ended, or the dates, as the context requires, May 27, 2005 and May 28, 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 common share were $1.71 for the second quarter of 2005, a 26% decrease compared with the same period last year. Annualized return on average tangible common shareholders' equity was 17.2% [1] and annualized return on average common shareholders' equity was 13.4%. The decrease in our second quarter results reflected lower net revenues in Trading and Principal Investments and Investment Banking, partially offset by growth in Asset Management and Securities Services. The decrease in Trading and Principal Investments reflected significantly lower net revenues in Principal Investments, as the gain related to our investment in the convertible preferred stock of Sumitomo Mitsui Financial Group, Inc. (SMFG) was significantly lower compared with the large gain in the second quarter of 2004. In addition, net revenues in Fixed Income, Currency and Commodities (FICC) were lower compared with the same prior year period. During the second quarter, trading conditions in FICC were less favorable than more recent quarters, as

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

markets generally lacked direction, credit markets weakened and the U.S. yield curve continued to flatten. Although Equities operated in an environment characterized by generally declining equity prices and continued low market volatility during the quarter, net revenues in Equities were slightly higher compared with the second quarter of 2004. Net revenues in Investment Banking decreased compared with the second quarter of 2004, reflecting lower net revenues in Financial Advisory and equity underwriting, partially offset by higher net revenues in debt underwriting. Asset Management and Securities Services net revenues increased compared with the second quarter of 2004, primarily reflecting continued growth in our prime brokerage business as well as higher assets under management.

Our diluted earnings per common share were $4.65 for the six months ended May 2005, a 3% decrease compared with the same period last year. Annualized return on average tangible common shareholders' equity was 23.5% [1] and annualized return on average common shareholders' equity was 18.5%. Our results in the first half of 2005 reflected lower net revenues in Trading and Principal Investments, partially offset by higher net revenues in Asset Management and Securities Services. Net revenues in Investment Banking were essentially unchanged. The decrease in Trading and Principal Investments reflected significantly lower net revenues in Principal Investments, as the gain related to our investment in the convertible preferred stock of SMFG was significantly lower compared with the large gain in the first half of 2004. Net revenues in Equities were slightly lower, primarily reflecting lower net revenues in convertibles and, to a lesser extent, shares, partially offset by higher net revenues in equity derivatives. Net revenues in FICC were essentially unchanged compared with the strong first half of 2004, reflecting higher net revenues in commodities, offset by lower net revenues in interest rate products, currencies and, to a lesser extent, mortgages. Asset Management and Securities Services net revenues increased compared with the first half of 2004, primarily reflecting strong growth in our prime brokerage business, as well as higher assets under management, partially offset by lower incentive fees. Net revenues in Investment Banking reflected higher net revenues in debt underwriting, offset by lower net revenues in equity underwriting and Financial Advisory.

Our operating results in the first half of 2005 continued to reflect generally favorable economic conditions. However, during the second quarter, market conditions for our Trading and Principal Investments businesses were less favorable than the first quarter. The environment in FICC in the first quarter was characterized by strong customer-driven activity, volatile commodity markets and narrow credit spreads, but conditions became less favorable in the second quarter, as markets generally lacked direction, credit markets weakened and the U.S. yield curve continued to flatten. Conditions were also less favorable in the equity markets in the second quarter, as equity prices generally declined and volatility levels remained low. In Investment Banking, although our debt underwriting results were strong during the first half of 2005, our Financial Advisory and equity underwriting businesses were impacted by declines in completed mergers and acquisitions and equity underwriting volumes. In Asset Management and Securities Services, we continued to see strong client activity throughout the first half of 2005, as reflected by the growth in our prime brokerage business and growth in our assets under management. With respect to 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 half 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

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

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

Early in our second fiscal quarter, concerns about the global economic outlook increased as economic data released in March suggested a possible slowdown, particularly in the U.S. These concerns contributed to uncertainty in the capital markets, as reflected in the global equity markets, which generally declined in March. Later in the quarter, although conditions in the U.S. appeared to improve, the major global equity markets generally remained lower. In the fixed income markets, trading conditions became more challenging than in recent quarters, as the U.S. yield curve continued to flatten and corporate credit spreads widened, before generally reversing direction near the end of our fiscal quarter. In addition, corporate activity, as measured by industry-wide announced mergers and acquisitions and equity and equity-related underwriting volumes, declined during the quarter.

In the United States, the pace of economic growth appeared to slow during our fiscal quarter, as industrial production and capital expenditures softened, particularly in March. Despite these factors, measures of core inflation remained firm, reflecting the pass-through of earlier commodity price pressures and an increase in unit labor cost inflation. As a result, the U.S. Federal Reserve continued to raise its federal funds rate target during the quarter, increasing the benchmark rate by 50 basis points to 3.00%. However, long-term yields declined during the quarter (after increasing in March), as the 10-year U.S. Treasury note yield ended the quarter at 4.08%. The Dow Jones Industrial Average and the S&P 500 Index declined 3% and 1%, respectively, while the NASDAQ Composite Index increased 1%.

In Europe, economic growth weakened further, as domestic demand and industrial production remained soft. In addition, the weak labor market continued to weigh on consumer confidence and spending. The European Central Bank left rates unchanged during the quarter. The U.K. economy showed continued growth, albeit at a more moderate pace as compared with the prior quarter. The Bank of England also left interest rates unchanged during the quarter. Despite modest economic growth, continental European equity markets ended the quarter slightly higher, while the FTSE 100 Index was essentially unchanged. Long-term yields in both continental Europe and the U.K. declined during the quarter.

In Japan, the economy continued to improve, although at a slower pace than the first quarter, as stronger industrial production, a recovery in the labor market and an improvement in consumption led to growth in domestic demand. Despite this improvement, the Nikkei 225 Index declined 4% during the quarter, reflecting, in part, concerns about the global economic outlook. Economic growth in China remained steady, supported by solid domestic demand and export growth. In the rest of Asia, certain economies were negatively impacted by slowing exports to China. These concerns affected regional equity markets, including Hong Kong, Korea, and Taiwan, all of which declined 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 May 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	$169,936	$ 87,147	$143,376	$ 68,096
Derivative contracts	62,267	54,373	62,495	64,001
Principal investments	4,847 [1]	866 [2]	4,654 [1]	—
Total	$237,050	$142,386	$210,525	$132,097

(1) Excludes assets of $1.65 billion and $1.28 billion in consolidated employee-owned merchant banking funds as of May 2005 and November 2004, respectively.

(2) Represents an economic hedge on the majority of the unrestricted shares of common stock underlying our investment in the convertible preferred stock of 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 May 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	$153,753	$86,963	$130,908	$67,948
Little or no price transparency	16,183	184	12,468	148
Total	$169,936	$87,147	$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 May 2005		As of November 2004	
	Assets	Liabilities	Assets	Liabilities
Exchange-traded derivatives	$ 6,695	$ 6,069	$ 5,464	$ 5,905
OTC derivatives	55,572	48,304	57,031	58,096
Total (1)	$62,267 (2)	$54,373 (3)	$62,495 (2)	$64,001 (3)

(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.

(2) Reflected net of cash received pursuant to credit support agreements of $20.46 billion and $18.65 billion as of May 2005 and November 2004, respectively.

(3) Reflected net of cash paid pursuant to credit support agreements of $16.85 billion and $5.45 billion as of May 2005 and November 2004, respectively.

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 May 2005					
Assets						
Contract Type	**0 - 6 Months**	**6 - 12 Months**	**1 - 5 Years**	**5 - 10 Years**	**10 Years or Greater**	**Total**
Interest rates	$ 2,173	$ 612	$ 5,658	$ 5,528	$13,247	$27,218
Currencies	5,363	1,001	2,198	1,776	946	11,284
Commodities	2,170	2,794	5,804	1,311	145	12,224
Equities	1,609	833	1,317	971	116	4,846
Total	$11,315	$5,240	$14,977	$ 9,586	$14,454	$55,572
Liabilities						
Contract Type	**0 - 6 Months**	**6 - 12 Months**	**1 - 5 Years**	**5 - 10 Years**	**10 Years or Greater**	**Total**
Interest rates	$ 1,670	$ 702	$ 6,028	$ 4,926	$ 5,115	$18,441
Currencies	5,321	1,411	3,085	486	1,075	11,378
Commodities	2,598	3,126	5,446	1,583	160	12,913
Equities	1,476	940	1,231	1,650	275	5,572
Total	$11,065	$6,179	$15,790	$ 8,645	$ 6,625	$48,304

	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 May 2005			As of November 2004		
	Corporate	Real Estate	Total	Corporate	Real Estate	Total
Private	$1,195	$692	$1,887	$ 935	$769	$1,704
Public	298	25	323	343	51	394
Subtotal (1)	1,493	717	2,210	1,278	820	2,098
SMFG convertible preferred stock (2)	2,637	—	2,637 (3)	2,556	—	2,556
Total	$4,130	$717	$4,847	$3,834	$820	$4,654

(1) Excludes assets of $1.65 billion and $1.28 billion in consolidated employee-owned merchant banking funds as of May 2005 and November 2004, respectively.

(2) 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.

(3) Excludes an economic hedge on the unrestricted shares of common stock underlying our investment in the convertible preferred stock of SMFG. As of May 27, 2005, the fair value of this hedge was $866 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 second quarter, the fair value of our investment (excluding the economic hedge on unrestricted shares of common stock underlying our investment) was essentially unchanged (expressed in Japanese yen). This primarily reflects the impact of the passage of time in respect of the transfer restrictions on the underlying common stock, offset by a decrease 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 May 27, 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 that include 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	
	May 2005	November 2004
Investment Banking		
Financial Advisory	$ —	$ —
Underwriting	125	125
Trading and Principal Investments		
FICC [(1)]	38	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)]	$3,085	$3,182

(1) The decline in goodwill from November 2004 to May 2005 primarily 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 May 2005		As of November 2004
	Carrying Value	**Range of Remaining Useful Lives (in years)**	**Carrying Value**
Power contracts [1]	$1,032	2 – 33	$ —
Customer lists [2]	803	6 – 19	828
New York Stock Exchange (NYSE) specialist rights	592	22 – 25	607
Exchange-traded fund (ETF) and option specialist rights	119	22	121
Other [3]	125	2 – 7	133
Total	$2,671		$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 fiscal 2005. We recorded purchase price allocation adjustments for NEGT during the second quarter of fiscal 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 that could adversely affect our 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, in Part II, Item 1 of our Quarterly Report on Form 10-Q for the quarter ended February 25, 2005 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 May		Six Months Ended May	
	2005	2004	2005	2004
Net revenues	$4,806	$5,511	$11,211	$11,439
Pre-tax earnings	1,244	1,740	3,389	3,669
Net earnings	865	1,187	2,377	2,480
Net earnings applicable to common shareholders	865	1,187	2,377	2,480
Diluted earnings per common share	1.71	2.31	4.65	4.81
Annualized return on average common shareholders' equity (1)	13.4%	20.9%	18.5%	22.2%
Annualized return on average tangible common shareholders' equity (2)	17.2%	26.7%	23.5%	28.5%

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

(2) Tangible common shareholders' equity equals total shareholders' equity less preferred stock less goodwill and identifiable intangible assets. We believe that annualized return on average tangible common shareholders' equity is a meaningful measure of performance because it excludes the portion of our common 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 common shareholders' equity is computed by dividing annualized net earnings applicable to common shareholders by average monthly tangible common shareholders' equity.

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

	Average for the			
	Three Months Ended May		Six Months Ended May	
	2005	2004	2005	2004
	(in millions)			
Total shareholders' equity	$26,226	$22,703	$25,967	$22,351
Deduct: Preferred stock	(375)	—	(214)	—
Common shareholders' equity	25,851	22,703	25,753	22,351
Deduct: Goodwill and identifiable intangible assets	(5,685)	(4,932)	(5,482)	(4,949)
Tangible common shareholders' equity	$20,166	$17,771	$20,271	$17,402

Net Revenues

Three Months Ended May 2005 versus May 2004. Our net revenues were $4.81 billion in the second quarter of 2005, a decrease of 13% compared with the second quarter of 2004, reflecting lower net revenues in Trading and Principal Investments and Investment Banking, partially offset by growth in Asset Management and Securities Services. The decrease in Trading and Principal Investments reflected significantly lower net revenues in Principal Investments, as the gain related to our investment in the convertible preferred stock of SMFG was significantly lower compared with the large gain in the second quarter of 2004. In addition, net revenues in FICC were lower compared with the same prior year period. During the second quarter, trading conditions in FICC were less favorable than more recent quarters, as markets generally lacked direction, credit markets weakened and the U.S. yield curve continued to flatten. Although Equities operated in an environment characterized by generally declining equity prices and continued low market volatility during the quarter, net revenues in Equities were slightly higher compared with the second quarter of 2004. Net revenues in Investment Banking decreased compared with the second quarter of 2004, reflecting lower net revenues in Financial Advisory and equity underwriting, partially offset by higher net revenues in debt underwriting. Asset Management and Securities Services net revenues increased compared with the second quarter of 2004, primarily reflecting continued growth in our prime brokerage business as well as higher assets under management.

Six Months Ended May 2005 versus May 2004. Our net revenues were $11.21 billion in the first half of 2005, a decrease of 2% compared with the same period last year, reflecting lower net revenues in Trading and Principal Investments, partially offset by higher net revenues in Asset Management and Securities Services. Net revenues in Investment Banking were essentially unchanged. The decrease in Trading and Principal Investments reflected significantly lower net revenues in Principal Investments, as the gain related to our investment in the convertible preferred stock of SMFG was significantly lower compared with the large gain in the first half of 2004. Net revenues in Equities were slightly lower, primarily reflecting lower net revenues in convertibles and, to a lesser extent, shares, partially offset by higher net revenues in equity derivatives. Net revenues in FICC were essentially unchanged compared with the strong first half of 2004, reflecting higher net revenues in commodities offset by lower net revenues in interest rate products, currencies and, to a lesser extent, mortgages. Asset Management and Securities Services net revenues increased compared with the first half of 2004, primarily reflecting strong growth in our prime brokerage business, as well as higher assets under management, partially offset by lower incentive fees. Net revenues in Investment Banking reflected higher net revenues in debt underwriting, offset by lower net revenues in equity underwriting and Financial Advisory.

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 May		Six Months Ended May	
	2005	2004	2005	2004
Compensation and benefits [1]	$ 2,403	$ 2,771	$5,606	$5,766
Brokerage, clearing and exchange fees	274	252	526	485
Market development	94	76	176	138
Communications and technology	123	120	241	232
Depreciation and amortization	128	121	246	256
Amortization of identifiable intangible assets	31	31	62	63
Occupancy	186	156	334	326
Professional fees	109	85	205	146
Other expenses	214	159	426	358
Total non-compensation expenses	1,159	1,000	2,216	2,004
Total operating expenses	$ 3,562	$ 3,771	$7,822	$7,770
Employees at period end [2] [3]	20,888	19,533		

(1) Includes the amortization of employee initial public offering and acquisition awards of $5 million and $15 million for the three months ended May 2005 and May 2004, respectively, and $11 million and $46 million for the six months ended May 2005 and May 2004, respectively.

(2) Excludes 1,130 and 1,037 employees as of May 2005 and May 2004, respectively, of Goldman Sachs' consolidated property management and loan servicing subsidiaries. Compensation and benefits includes $41 million and $36 million for the three months ended May 2005 and May 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.

(3) Excludes 6,626 and 284 employees as of May 2005 and May 2004, respectively, of consolidated entities held for investment purposes. Compensation and benefits includes $17 million and $3 million for the three months ended May 2005 and May 2004, respectively, attributable to these consolidated entities. Consolidated entities held for investment purposes include entities that are held strictly for capital appreciation, have a defined exit strategy and are engaged in activities which are not closely related to our principal businesses.

The following table sets forth non-compensation expenses of consolidated entities held for investment purposes and the remaining non-compensation expenses by line item:

Non-Compensation Expenses
(in millions)

	Three Months Ended May		Six Months Ended May	
	2005	2004	2005	2004
Non-compensation expenses of consolidated investments [1]	$ 49	$ 2	$ 64	$ 8
Non-compensation expenses excluding consolidated investments				
Brokerage, clearing and exchange fees	274	252	526	485
Market development	90	76	172	138
Communications and technology	123	120	241	232
Depreciation and amortization	124	121	240	256
Amortization of identifiable intangible assets	31	31	62	63
Occupancy	174	156	322	326
Professional fees	108	85	204	146
Other expenses	186	157	385	350
Subtotal	1,110	998	2,152	1,996
Total non-compensation expenses, as reported	$1,159	$1,000	$2,216	$2,004

(1) Consolidated entities held for investment purposes include entities that are held strictly for capital appreciation, have a defined exit strategy and are engaged in activities which are not closely related to our principal businesses. For example, these investments include consolidated entities that hold real estate assets such as golf courses and hotels in Asia, but exclude investments in entities which primarily hold financial assets. We believe that it is meaningful to review non-compensation expenses excluding expenses related to these consolidated entities in order to evaluate trends in non-compensation expenses for our principal business activities. Revenues related to such entities are included in ''Trading and principal investments'' in the condensed consolidated statements of earnings.

Three Months Ended May 2005 versus May 2004. Operating expenses were $3.56 billion, 6% lower than the second quarter of 2004. Compensation and benefits expenses were $2.40 billion, 13% lower than the second quarter of 2004, commensurate with lower net revenues. The ratio of compensation and benefits to net revenues was 50.0% for the quarter, consistent with last year's second quarter. [1] Employment levels were essentially unchanged during the quarter.

Non-compensation expenses were $1.16 billion, 16% higher than the second quarter of 2004. Other expenses increased primarily due to higher expenses of consolidated entities held for investment purposes and higher levels of business activity. Occupancy expenses were higher and included $16 million of real estate exit costs associated with the relocation of office space. Professional fees were higher reflecting increased consulting and legal fees. Brokerage, clearing and exchange fees increased, reflecting higher transaction volumes in certain of our businesses. Market development costs also increased, primarily due to higher levels of business activity. Excluding non-compensation expenses related to consolidated entities held for investment purposes, non-compensation expenses were 11% higher than the second quarter of 2004. See ''— Capital and Funding — Contractual Obligations and Contingent Commitments'' below for a discussion of our excess office space.

(1) For the three and six months ended May 2004, the ratio of compensation and benefits to net revenues, including the amortization of employee initial public offering and acquisition awards, was 50.3% and 50.4%, respectively.

Six Months Ended May 2005 versus May 2004. Operating expenses were $7.82 billion for the first half of 2005, a 1% increase from the same period last year. Compensation and benefits expenses were $5.61 billion, a 3% decrease from the same period last year, commensurate with lower net revenues. The ratio of compensation and benefits to net revenues was 50.0% for the six months ended May 2005, consistent with the same period last year.[1]

Non-compensation expenses were $2.22 billion, 11% higher than the first half of 2004. Other expenses included net provisions for litigation and regulatory proceedings of $23 million for the first half of 2005 compared with $60 million for the same period last year. Excluding these provisions, other expenses increased $105 million, primarily due to higher levels of business activity and higher expenses of consolidated entities held for investment purposes. Professional fees also increased, primarily reflecting higher consulting and legal fees. Brokerage, clearing and exchange fees and market development costs were also higher, primarily reflecting higher levels of business activity. Excluding non-compensation expenses related to consolidated entities held for investment purposes, non-compensation expenses were 8% higher than the first half of 2004.

Provision for Taxes

The provision for taxes for the three and six months ended May 2005 was $379 million and $1.01 billion, respectively. The effective income tax rate for the first half of 2005 was 29.9%, up from 29.5% for the first quarter of 2005. Excluding the impact of audit settlements in 2005, the effective income tax rate for the first half of 2005 would have been 33.1%, down from 33.3% for the first quarter of 2005 and up from 31.8% for fiscal year 2004. The increase in the effective tax rate for the first half of 2005 compared with fiscal year 2004 was primarily due to lower tax credits and increased state and local taxes in 2005.

[1] For the three and six months ended May 2004, the ratio of compensation and benefits to net revenues, including the amortization of employee initial public offering and acquisition awards, was 50.3% and 50.4%, respectively.

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 May		Six Months Ended May	
		2005	2004	2005	2004
Investment Banking	Net revenues	$ 815	$ 953	$ 1,708	$ 1,716
	Operating expenses	718	775	1,505	1,468
	Pre-tax earnings	$ 97	$ 178	$ 203	$ 248
Trading and Principal Investments	Net revenues	$2,813	$3,627	$ 7,196	$ 7,749
	Operating expenses	2,065	2,350	4,794	4,878
	Pre-tax earnings	$ 748	$1,277	$ 2,402	$ 2,871
Asset Management and Securities Services	Net revenues	$1,178	$ 931	$ 2,307	$ 1,974
	Operating expenses	787	641	1,500	1,338
	Pre-tax earnings	$ 391	$ 290	$ 807	$ 636
Total	Net revenues	$4,806	$5,511	$11,211	$11,439
	Operating expenses [1]	3,562	3,771	7,822	7,770
	Pre-tax earnings	$1,244	$1,740	$ 3,389	$ 3,669

[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 $5 million and $26 million for the three and six months ended May 2004, respectively, and (ii) a change in net provisions for a number of litigation and regulatory proceedings of $(8) million for the three months ended May 2005, and $23 million and $60 million for the six months ended May 2005 and May 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 May 2005	Three Months Ended May 2004	Six Months Ended May 2005	Six Months Ended May 2004
Financial Advisory	$386	$513	$ 800	$ 872
Equity underwriting	114	213	300	432
Debt underwriting	315	227	608	412
Total Underwriting	429	440	908	844
Total net revenues	815	953	1,708	1,716
Operating expenses	718	775	1,505	1,468
Pre-tax earnings	$ 97	$178	$ 203	$ 248

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

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

	Three Months Ended May 2005	Three Months Ended May 2004	Six Months Ended May 2005	Six Months Ended May 2004
Announced mergers and acquisitions	$137	$ 99	$407	$229
Completed mergers and acquisitions	100	165	214	253
Equity and equity-related offerings [(2)]	9	17	20	30
Debt offerings [(3)]	56	58	130	125

(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 May 2005 versus May 2004. Net revenues in Investment Banking of $815 million for the second quarter of 2005 decreased 14% compared with the second quarter of 2004. Net revenues in Financial Advisory of $386 million decreased 25% compared with the second quarter of 2004, reflecting a decrease in completed mergers and acquisitions. Net revenues in our Underwriting business of $429 million decreased 3% compared with the second quarter of 2004, reflecting lower net revenues in equity underwriting, primarily due to a decrease in industry-wide equity and equity-related offerings, partially offset by higher net revenues in debt underwriting, primarily due to an increase in bank loan and mortgage activity. Our investment banking backlog increased during the quarter. [(1)]

Operating expenses of $718 million decreased 7% compared with the second quarter of 2004, primarily due to decreased compensation and benefits expenses resulting from a lower accrual of discretionary compensation. Pre-tax earnings of $97 million decreased 46% compared with the second quarter of 2004.

(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.

Six Months Ended May 2005 versus May 2004. Net revenues in Investment Banking of $1.71 billion for the first half of 2005 were essentially unchanged compared with the same period last year. Net revenues in Financial Advisory of $800 million decreased 8% compared with the same period last year, reflecting a decrease in completed mergers and acquisitions. Net revenues in our Underwriting business of $908 million increased 8% compared with the same period last year, reflecting higher net revenues in debt underwriting, due to an increase in bank loan and mortgage activity, partially offset by lower net revenues in equity underwriting (particularly in convertible offerings), reflecting a decrease in industry-wide equity and equity-related offerings.

Operating expenses of $1.51 billion for the first half of 2005 increased 3% compared with the same period last year, primarily due to increased other expenses driven by higher levels of business activity. In addition, market development costs increased, primarily reflecting higher levels of business activity, and professional fees were higher, primarily due to increased consulting fees. These increases were partially offset by lower compensation and benefits expenses, primarily resulting from a lower accrual of discretionary compensation. Pre-tax earnings of $203 million decreased 18% compared with the same period last year.

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 gains or losses related to 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.

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 May		Six Months Ended May	
	2005	2004	2005	2004
FICC	$1,519	$1,892	$4,008	$3,995
Equities trading	372	351	1,201	1,297
Equities commissions	733	727	1,454	1,441
Total Equities	1,105	1,078	2,655	2,738
SMFG	73	561	254	762
Gross gains	157	177	334	440
Gross losses	(50)	(112)	(79)	(273)
Net other corporate and real estate investments	107	65	255	167
Overrides	9	31	24	87
Total Principal Investments	189	657	533	1,016
Total net revenues	2,813	3,627	7,196	7,749
Operating expenses	2,065	2,350	4,794	4,878
Pre-tax earnings	$ 748	$1,277	$2,402	$2,871

Three Months Ended May 2005 versus May 2004. Net revenues in Trading and Principal Investments of $2.81 billion for the second quarter of 2005 decreased 22% compared with the second quarter of 2004. Net revenues in FICC of $1.52 billion decreased 20% compared with the second quarter of 2004, primarily due to lower net revenues in credit products, interest rate products and commodities. In addition, mortgages performed well, although net revenues were lower compared with the second quarter of 2004, while net revenues in currencies improved. During the second quarter, trading conditions were less favorable than more recent quarters, as markets generally lacked direction. In addition, credit markets weakened and the U.S. yield curve continued to flatten. Net revenues in Equities of $1.11 billion increased 3% compared with the second quarter of 2004, primarily reflecting higher net revenues in our principal strategies business, partially offset by lower net revenues in our customer franchise businesses, particularly in convertibles. During the quarter, the business operated in an environment characterized by generally lower equity prices and continued low market volatility. Principal Investments recorded net revenues of $189 million, primarily due to $107 million in gains from corporate and real estate principal investments and a $73 million gain related to our investment in the convertible preferred stock of SMFG.

Operating expenses of $2.07 billion decreased 12% compared with the second quarter of 2004, primarily due to decreased compensation and benefits expenses resulting from a lower accrual of discretionary compensation. This decrease was partially offset by higher other expenses, primarily reflecting higher expenses of consolidated entities held for investment purposes and increased levels of business activity. In addition, brokerage, clearing and exchange fees increased primarily due to higher transaction volumes in certain of our businesses, and occupancy expenses were higher. Professional fees also increased, primarily due to higher consulting fees. Excluding operating expenses related to consolidated entities held for investment purposes, operating expenses were 15% lower than the second quarter of 2004. Pre-tax earnings of $748 million decreased 41% compared with the second quarter of 2004.

Six Months Ended May 2005 versus May 2004. Net revenues in Trading and Principal Investments of $7.20 billion for the first half of 2005 decreased 7% compared with the same period last year. Net revenues in FICC of $4.01 billion were essentially unchanged compared with the strong first half of 2004. Higher net revenues in commodities were offset by lower net revenues in interest rate products, currencies and, to a lesser extent, mortgages. Net revenues in credit products were essentially unchanged compared with the first half of 2004. The environment for FICC during the first quarter was generally favorable, reflecting strong customer-driven activity, volatile commodity markets and narrow credit spreads; however, conditions became less favorable in the second quarter as markets generally lacked direction, the U.S. yield curve continued to flatten and credit markets weakened, although credit spreads tightened towards the end of the quarter. Net revenues in Equities of $2.66 billion for the first half of 2005 decreased 3% compared with the same period last year, primarily reflecting lower net revenues in convertibles and, to a lesser extent, shares, partially offset by higher net revenues in equity derivatives. Principal strategies performed well as net revenues were essentially unchanged compared with the first half of 2004. During the first half of the year, the business operated in an environment characterized by low market volatility. In addition, equity prices were generally higher in the first quarter but lower in the second quarter. Principal Investments recorded net revenues of $533 million, primarily due to $255 million in gains from corporate and real estate principal investments and a $254 million gain related to our investment in the convertible preferred stock of SMFG.

Operating expenses of $4.79 billion for the first half of 2005 decreased 2% compared with the same period last year, primarily due to decreased compensation and benefits expenses resulting from a lower accrual of discretionary compensation. This decrease was partially offset by higher other expenses, primarily reflecting higher expenses of consolidated entities held for investment purposes and increased levels of business activity. In addition, brokerage, clearing and exchange fees were higher primarily reflecting increased transaction volumes in certain of our businesses, and professional fees increased, primarily due to increased consulting and legal fees. Market development costs also increased, driven by higher levels of business activity. Excluding operating expenses related to consolidated entities held for investment purposes, operating expenses were 3% lower than the first half of 2004. Pre-tax earnings of $2.40 billion decreased 16% compared with the same period last year.

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 May		Six Months Ended May	
	2005	2004	2005	2004
Asset Management	$ 689	$601	$1,438	$1,362
Securities Services	489	330	869	612
Total net revenues	1,178	931	2,307	1,974
Operating expenses	787	641	1,500	1,338
Pre-tax earnings	$ 391	$290	$ 807	$ 636

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 May 31,		As of November 30,	
	2005	2004	2004	2003
Money markets	$ 98	$ 92	$ 90	$ 89
Fixed income and currency	153	123	139	115
Equity (1)	135	114	126	98
Alternative investments (2)	104	86	97	71
Total	$490	$415	$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 May 31,		Six Months Ended May 31,	
	2005	2004	2005	2004
Balance, beginning of period	$482	$412	$452	$373
Net asset inflows/(outflows)				
Money markets	(1)	(1)	8	3
Fixed income and currency	6	2	12	5
Equity	2	3	10	10
Alternative investments	3	5	7	15
Total net asset inflows/(outflows)	10	9	37	33
Net market appreciation/(depreciation)	(2)	(6)	1	9
Balance, end of period	$490	$415	$490	$415

Three Months Ended May 2005 versus May 2004. Net revenues in Asset Management and Securities Services of $1.18 billion for the second quarter of 2005 increased 27% compared with the second quarter of 2004. Asset Management net revenues of $689 million increased 15% compared with the second quarter of 2004, reflecting higher management fees, driven by growth in assets under management, partially offset by lower incentive fees. During the quarter, assets under management increased 2%, reflecting net asset inflows of $10 billion, primarily in fixed income, alternative investment and equity assets, partially offset by market depreciation of $2 billion, primarily in equity assets. Securities Services net revenues of $489 million increased 48% compared with the second quarter of 2004, as our prime brokerage business continued to perform well, reflecting higher global customer balances in securities lending and margin lending as well as higher activity levels in Europe.

Operating expenses of $787 million increased 23% compared with the second quarter of 2004, primarily due to increased compensation and benefits expenses. Pre-tax earnings of $391 million increased 35% compared with the second quarter of 2004.

Six Months Ended May 2005 versus May 2004. Net revenues in Asset Management and Securities Services of $2.31 billion for the first half of 2005 increased 17% compared with the same period last year. Asset Management net revenues of $1.44 billion increased 6% compared with the same period last year, reflecting significantly higher management fees, driven by growth in assets under management, partially offset by lower incentive fees. During the first half of 2005, assets under management increased 8% to $490 billion, reflecting net asset inflows of $37 billion across all asset classes, as well as market appreciation of $1 billion. Securities Services net revenues of $869 million increased 42% compared with the same period last year, as our prime brokerage business performed well, reflecting higher global customer balances in securities lending and margin lending as well as higher activity levels in Europe during the second quarter of 2005.

Operating expenses of $1.50 billion for the first half of 2005 increased 12% compared with the same period last year, primarily due to increased compensation and benefits expenses. Pre-tax earnings of $807 million increased 27% compared with the same period last year.

Capital and Funding

Capital

The amount of capital we hold is principally determined by regulatory capital requirements, rating agency guidelines, subsidiary capital requirements and our overall risk profile, which is largely driven by the size and composition of our trading and investment positions. Goldman Sachs' total capital (total shareholders' equity and long-term borrowings) increased 15% to $121.53 billion as of May 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 $95.13 billion as of May 2005 from $80.70 billion as of November 2004. The weighted average maturity of our long-term borrowings as of May 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 total 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.

Total shareholders' equity increased by 5% to $26.40 billion (common equity of $25.65 billion and preferred stock of $750 million) as of May 2005 from $25.08 billion as of November 2004. On April 25, 2005, Goldman Sachs issued 30,000 shares of perpetual Floating Rate Non-Cumulative Preferred Stock, Series A (Series A Preferred Stock), par value of $0.01, out of a total of 50,000 shares of Series A Preferred Stock authorized for issuance. Each share of Series A Preferred Stock has a liquidation preference of $25,000 and is represented by 1,000 depositary shares. The Series A Preferred Stock is redeemable at our option starting on April 25, 2010 at a redemption price equal to $25,000 per share plus declared and unpaid dividends. The redemption value of the Series A Preferred Stock is $750 million. The Series A Preferred Stock has a preference over our common stock for the payment of dividends (as described in the terms of the Series A Preferred Stock).

During the three and six months ended May 2005, we repurchased 15.5 million shares and 27.0 million shares of our common stock, respectively. The average price paid per share for repurchased shares was $108.34 and $107.74 for the second quarter and the first six months of 2005, respectively. In addition, to satisfy minimum statutory employee tax withholding requirements related to the delivery of shares underlying restricted stock units, we cancelled 1.6 million restricted stock units at an average price of $104.71 per unit during the first half 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 total 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. As of May 2005, the remaining share authorization under our repurchase program was 19.5 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 common share:

	As of	
	May 2005	November 2004
	($ in millions, except per share amounts)	
Total assets	$624,472	$531,379
Adjusted assets [(1)]	406,085	347,082
Total shareholders' equity	26,395	25,079
Tangible equity capital [(2)]	23,389	22,958
Leverage ratio [(3)]	23.7x	21.2x
Adjusted leverage ratio [(4)]	17.4x	15.1x
Debt to equity ratio [(5)]	3.6x	3.2x
Common shareholders' equity	$ 25,645	$ 25,079
Tangible common shareholders' equity [(6)]	19,889	20,208
Book value per common share [(7)]	$ 53.46	$ 50.77
Tangible book value per common share [(8)]	41.46	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	
		May 2005	November 2004
		(in millions)	
Total assets		$ 624,472	$ 531,379
Deduct:	Securities purchased under agreements to resell	(77,097)	(44,257)
	Securities borrowed	(176,315)	(155,086)
Add:	Financial instruments sold, but not yet purchased, at fair value	142,386	132,097
	Less derivative short positions	(54,373)	(64,001)
	Subtotal	88,013	68,096
Deduct:	Cash and securities segregated in compliance with U.S. federal and other regulations	(47,232)	(48,179)
	Goodwill and identifiable intangible assets	(5,756)	(4,871)
Adjusted assets		$ 406,085	$ 347,082

[(2)] Tangible equity capital equals total shareholders' equity and junior subordinated debt issued to a trust less goodwill and identifiable intangible assets. 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 total shareholders' equity to tangible equity capital:

	As of	
	May 2005	November 2004
	(in millions)	
Total shareholders' equity	$26,395	$25,079
Add: Junior subordinated debt issued to a trust	2,750	2,750
Deduct: Goodwill and identifiable intangible assets	(5,756)	(4,871)
Tangible equity capital	$23,389	$22,958

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

(6) Tangible common shareholders' equity equals total shareholders' equity less preferred stock less goodwill and identifiable intangible assets. The following table sets forth a reconciliation of total shareholders' equity to tangible common shareholders' equity:

	As of	
	May 2005	November 2004
	(in millions)	
Total shareholders' equity	$26,395	$25,079
Deduct: Preferred stock	(750)	—
Common shareholders' equity	$25,645	$25,079
Deduct: Goodwill and identifiable intangible assets	(5,756)	(4,871)
Tangible common shareholders' equity	$19,889	$20,208

(7) Book value per common share is based on common shares outstanding, including restricted stock units granted to employees with no future service requirements, of 479.7 million as of May 2005 and 494.0 million as of November 2004.

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

Consolidated Supervised Entity

Goldman Sachs is regulated by the U.S. Securities and Exchange Commission (SEC) as a consolidated supervised entity (CSE). As such, 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. As of May 2005, Goldman Sachs was in compliance with the CSE capital requirements.

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	
	May 2005	November 2004
Promissory notes	$18,192	$19,513
Commercial paper	4,385	4,355
Bank loans and other	13,422	13,474
Current portion of long-term borrowings	17,797	17,617
Total	$53,796	$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	
	May 2005	November 2004
	(in millions)	
Secured short-term borrowings	$ 8,753	$ 8,558
Unsecured short-term borrowings	45,043	46,401
Total short-term borrowings	$53,796	$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 May 2005:

	Short-Term Debt	Long-Term Debt	Preferred Stock
Dominion Bond Rating Service Limited	R-1 (middle)	A (high)	Not applicable
Fitch, Inc.	F1+	AA–	A+
Moody's Investors Service	P-1	Aa3	A2
Standard & Poor's	A-1	A+	A–

As of May 2005, collateral or termination payments pursuant to bilateral agreements with certain counterparties of approximately $334 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 May 2005:

Contractual Obligations
(in millions)

	Remainder of 2005	2006-2007	2008-2009	2010-Thereafter	Total
Long-term borrowings by contract maturity [1] [2]	$ —	$19,553	$21,033	$54,543	$95,129
Minimum rental payments	187	707	625	1,945	3,464

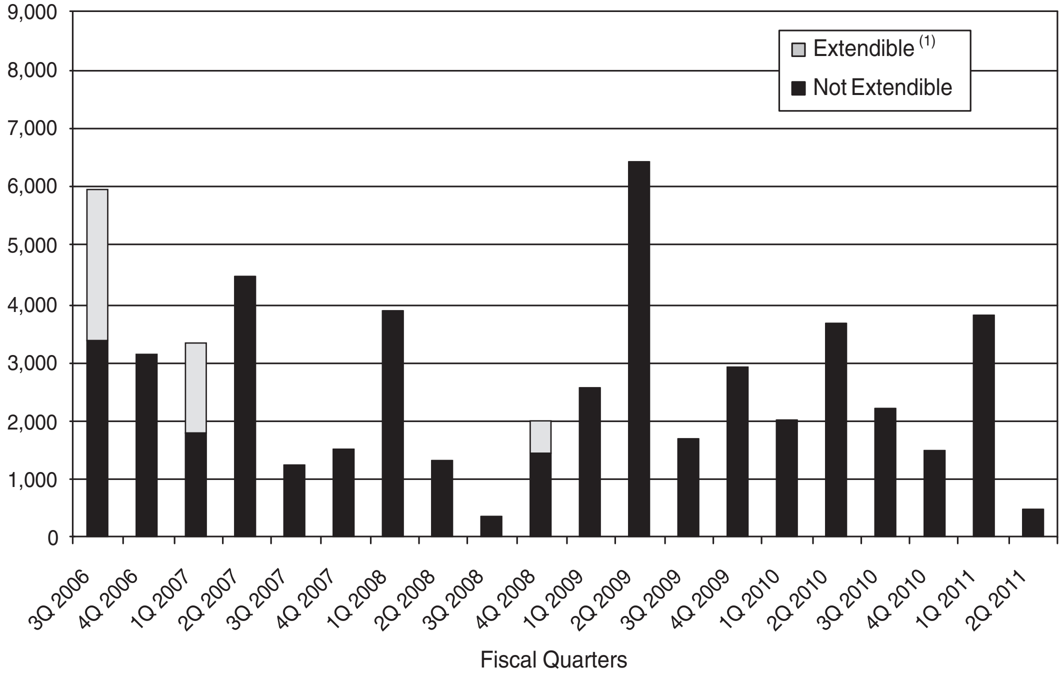
(1) Long-term borrowings maturing within one year and certain long-term borrowings that may be redeemable within one year at the option of the holder are included as short-term borrowings in the condensed consolidated statements of financial condition.

(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 if the earliest maturity is one year or greater from the end of our current quarter. 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 second 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 May 2005, our long-term borrowings were $95.13 billion and consisted principally of senior borrowings with maturities extending to 2035. These long-term borrowings consisted of $13.44 billion in secured long-term borrowings and $81.69 billion in unsecured long-term borrowings. As of May 2005, long-term borrowings included nonrecourse debt of $13.33 billion, consisting of $5.12 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), $1.83 billion issued by our consolidated power plant operations and $6.38 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 May 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 second quarter of 2005, we incurred exit costs of $16 million included in occupancy expenses, associated with the relocation of office space. We may incur additional 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 May 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	$ 8,414	$11,486	$6,316	$10,333	$36,549
Commitments under letters of credit issued by banks to counterparties	9,122	503	—	11	9,636
Other commercial commitments [1]	587	450	907	2,790	4,734
Total	$18,123	$12,439	$7,223	$13,134	$50,919

(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 May 2005, $11.68 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 May 2005, we had commitments to enter into forward secured financing transactions, including certain repurchase and resale agreements and secured borrowing and lending arrangements, of $31.22 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 $48.76 billion in the second quarter of 2005, $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 May 2005	Fiscal Year Ended November 2004
	(in millions)	
U.S. dollar-denominated	$37,438	$33,858
Non-U.S. dollar-denominated	11,317	8,135
Total Global Core Excess	$48,755	$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 $126.74 billion, $117.04 billion and $100.51 billion in the second quarter of 2005, first quarter of 2005 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 both been, on average, 13% lower than amounts that would have been observed, based on a weekly average, over that period. These differences, however, have not resulted in material changes

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

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	
	May 2005	November 2004
	(in millions)	
Mortgage whole loans and collateralized debt obligations [(1)]	$27,544	$18,346
Bank loans [(2)]	10,763	8,900
High-yield securities	7,971	6,057
Emerging market debt securities	1,725	1,653
SMFG convertible preferred stock	2,637	2,556
Other corporate principal investments [(3)]	1,493	1,278
Real estate principal investments [(3)]	717	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 $1.65 billion and $1.28 billion in consolidated employee-owned merchant banking funds as of May 2005 and November 2004, respectively.

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 total 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 $121.53 billion and $105.78 billion as of May 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 May 2005, Group Inc.'s equity investment in subsidiaries was $24.08 billion compared with its total shareholders' equity of $26.40 billion.

Group Inc. has provided substantial amounts of equity and subordinated indebtedness, directly or indirectly, to its regulated subsidiaries; for example, as of May 2005, Group Inc. had $16.78 billion of such equity and subordinated indebtedness invested in Goldman, Sachs & Co., its principal U.S. regulated broker-dealer, $13.98 billion invested in Goldman Sachs International, a registered U.K. broker-dealer, $2.67 billion invested in Goldman Sachs Execution & Clearing, L.P., a U.S. regulated broker-dealer, and $2.09 billion invested in Goldman Sachs (Japan) Ltd., a Tokyo-based broker-dealer. Group Inc. also had $45.78 billion of unsubordinated loans to these entities as of May 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. 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.

Six Months Ended May 2005. Our cash and cash equivalents increased by $3.68 billion to $8.04 billion as of May 2005. We raised $12.19 billion in net cash from financing activities, primarily in long-term debt, in light of the favorable debt financing environment, as well as from the issuance of preferred stock, partially offset by common stock repurchases. We used net cash of $8.51 billion in our operating and investing activities, primarily to capitalize on trading and investing opportunities for ourselves and our clients.

Six Months Ended May 2004. Our cash and cash equivalents increased by $954 million to $8.04 billion as of May 2004. We raised $13.65 billion in net cash from financing activities, primarily in long-term debt, in part to capitalize on favorable market conditions. We used net cash of $12.69 billion in our operating and investing activities, primarily to capitalize on opportunities in our trading and principal 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 establishes standards for accounting for transactions in which an entity exchanges its equity instruments for goods and services. SFAS No. 123-R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. On April 14, 2005, the SEC announced new rules that require companies to implement SFAS No. 123-R by the start of their fiscal year beginning after June 15, 2005. SFAS No. 123-R generally requires the immediate expensing of equity-based awards granted to retirement-eligible employees. Awards granted subject to a substantive non-compete agreement are generally expensed over the non-compete period. We are currently evaluating the effect of adoption of SFAS No. 123-R on our financial condition, results of operations and 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 table sets forth the daily trading VaR:

Daily VaR [1]
(in millions)

Risk Categories	Average for the Three Months Ended May 2005	Average for the Three Months Ended May 2004	Average for the Six Months Ended May 2005	Average for the Six Months Ended May 2004	As of May 2005	As of February 2005	Three Months Ended May 2005 High	Three Months Ended May 2005 Low
Interest rates	$ 33	$ 37	$ 32	$ 37	$ 31	$ 31	$44	$28
Equity prices	26	37	28	37	32	30	34	21
Currency rates	19	20	17	22	19	15	31	13
Commodity prices	24	15	26	15	18	24	34	16
Diversification effect [2]	(42)	(40)	(41)	(41)	(41)	(38)		
Total	$ 60	$ 69	$ 62	$ 70	$ 59	$ 62	72	51

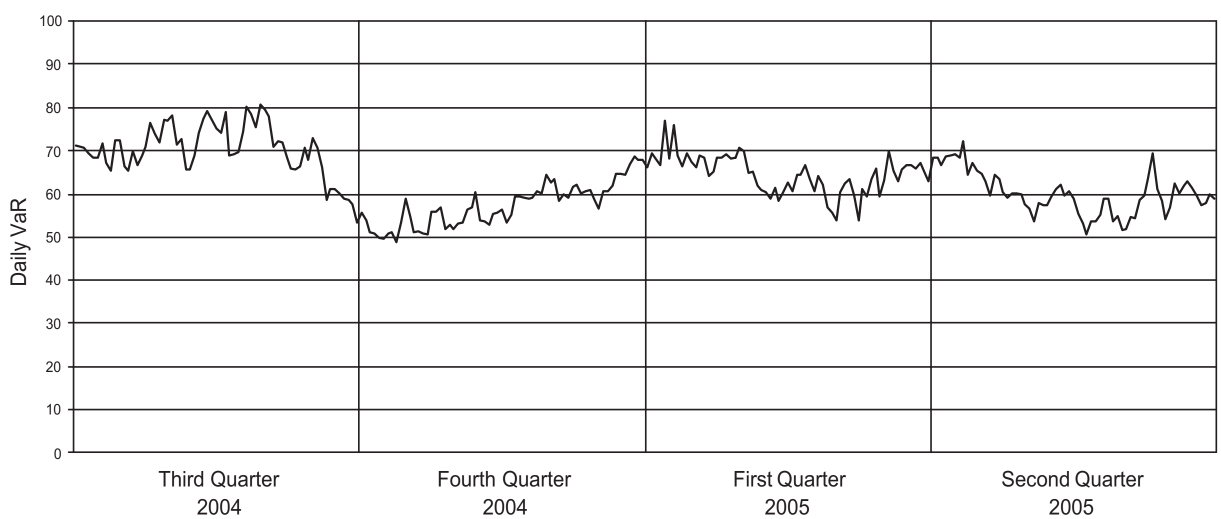
(1) During the second quarter of 2004, we began to exclude from our calculation distressed asset portfolios in FICC that cannot be properly measured in VaR. The effect of excluding these portfolios was not material to prior periods and, accordingly, such periods have not been adjusted. For a further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

(2) Equals the difference between total 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.

Our average daily VaR decreased to $60 million during the second quarter of 2005 from $69 million during the second quarter of 2004. The decrease was primarily due to lower levels of exposure to equity prices and interest rates, partially offset by increased levels of exposure to commodity prices.

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

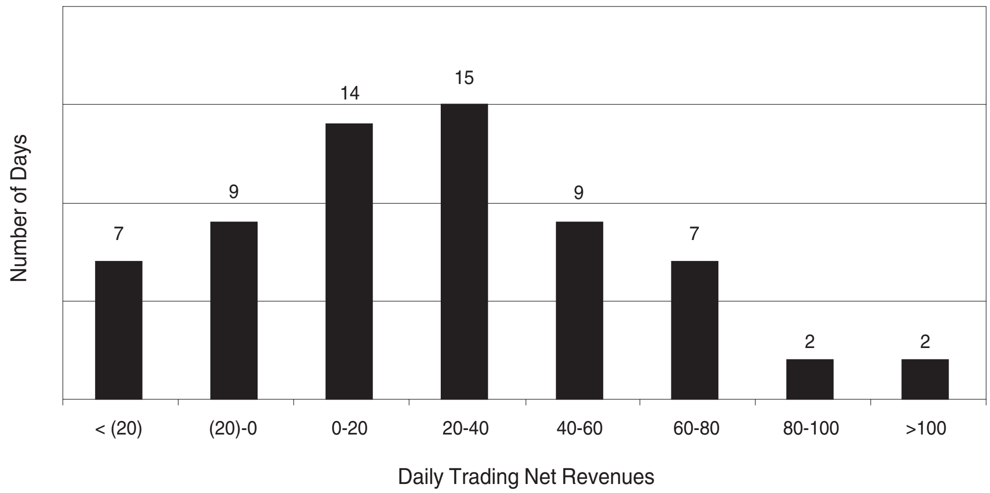
Daily VaR
($ in millions)



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 May 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 May 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 May 2005, the potential impact of a 10% decline in the asset value of these portfolios was $548 million compared with $395 million as of February 2005. This change was primarily due to increased activity in the U.S. and Asia during the quarter.

Nontrading Risk

SMFG. The market risk of our investment in the convertible preferred stock of SMFG, net of the economic hedge on unrestricted shares of common stock underlying the investment, 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 May 2005, the sensitivity of our investment to a 10% decline in the SMFG common stock price was $162 million compared with $245 million as of February 2005. The change was primarily due to the effect of hedging the majority of the unrestricted shares of common stock underlying our investment and, to a lesser extent, a decrease in the SMFG common stock price, partially offset by the passage of time in respect of the transfer restrictions on the underlying common stock. 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 May 2005, the sensitivity of our nontrading portfolio (excluding our investment in the convertible preferred stock of SMFG) to a 10% equity market decline was $142 million compared with $123 million as of February 2005, primarily reflecting new investments in our private nontrading portfolio.

Derivatives

Derivative contracts are instruments, such as futures, forwards, swaps or option contracts, that 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 are reflected net of 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 May 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	$ 3,297	$ 183	$ 3,114	7%
AA/Aa2	14,814	1,940	12,874	30
A/A2	18,354	2,407	15,947	38
BBB/Baa2	9,464	2,630	6,834	16
BB/Ba2 or lower	8,379	4,573	3,806	9
Unrated	1,264	1,102	162	—
Total	$55,572	$12,835	$42,737	100%

(1) Reflected net of 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	$ 134	$ 122	$ 1,404	$ 641	$ 813	$ 3,114
AA/Aa2	3,414	1,029	3,132	2,604	2,695	12,874
A/A2	2,284	1,417	3,157	1,197	7,892	15,947
BBB/Baa2	1,571	935	2,118	1,138	1,072	6,834
BB/Ba2 or lower	967	607	1,126	714	392	3,806
Unrated	101	1	42	17	1	162
Total	$8,471	$4,111	$10,979	$6,311	$12,865	$42,737

Contract Type	0 - 6 Months	6 - 12 Months	1 - 5 Years	5 - 10 Years	10 Years or Greater	Total [1]
Interest rates	$1,880	$ 488	$ 3,772	$3,842	$11,718	$21,700
Currencies	4,296	782	1,926	1,468	914	9,386
Commodities	1,878	2,193	4,337	846	145	9,399
Equities	417	648	944	155	88	2,252
Total	$8,471	$4,111	$10,979	$6,311	$12,865	$42,737

(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, as updated by our Quarterly Report on Form 10-Q for the quarter ended February 25, 2005.

IPO Process Matters

In the lawsuits alleging that the prospectuses for certain offerings violated the federal securities laws by failing to disclose the existence of alleged arrangements to ''tie'' allocations to higher brokerage commission rates as well as purchase orders in the aftermarket, by an order dated June 30, 2005, the U.S. Court of Appeals for the Second Circuit agreed to review the federal district court's class certification decision on an interlocutory basis.

In the lawsuit brought by an official committee of unsecured creditors on behalf of eToys, Inc., by a decision dated June 7, 2005, the New York Court of Appeals affirmed in part and reversed in part the intermediate appellate court's decision, dismissing claims for breach of contract, professional malpractice and unjust enrichment, but permitting claims for breach of fiduciary duty and fraud to continue.

The parties in the purported shareholder derivative action relating to eBay, Inc. have entered into a settlement, which was approved by the court by order dated June 29, 2005. Pursuant to the settlement terms, The Goldman Sachs Group, Inc. will contribute $395,000 to the settlement fund.

Research Independence Matters

In the action brought by the West Virginia Attorney General against various securities firms including Goldman, Sachs & Co., the West Virginia Supreme Court held argument on the appeal on June 8, 2005.

In a purported shareholder derivative action against The Goldman Sachs Group, Inc. (as nominal defendant) and its board, the plaintiffs filed an amended complaint on June 14, 2005 alleging that the firm's Board of Directors breached its fiduciary duties in connection with the firm's research and IPO allocations activities.

Enron Litigation Matters

On June 10, 2005, plaintiffs in various consolidated actions entered into a settlement with Citigroup, Inc., including with respect to claims relating to the Exchangeable Notes offering, as to which Citigroup's affiliate Salomon Smith Barney, Inc. was one of the three underwriters (together with Goldman, Sachs & Co. and Banc of America Securities LLC). The settling parties have yet to announce what portion of the settlement, as well as a prior settlement reached with Banc of America Securities LLC, will be allocated to claims relating to the Exchangeable Notes.

On June 13, 2005, the federal district court granted Goldman, Sachs & Co.'s motion for clarification and reconsideration in the action brought by several funds, and provided for further briefing on Goldman, Sachs & Co.'s motion to dismiss.

The settlement of the claims brought by Enron North America Corp. and Enron Corp. relating to trading of over-the-counter derivatives has been consummated.

In the actions seeking to recover as fraudulent transfers and/or preferences payments by Enron Corp. in repurchasing its commercial paper, by a decision dated June 15, 2005, the bankruptcy court denied the motions to dismiss.

Montana Power Litigation

By a decision dated June 10, 2005, the federal district court denied defendants' motions to dismiss the complaint filed by the creditors' committee of Touch America Holdings, Inc.

Mutual Fund Matters

On May 2, 2005, defendants moved to dismiss the putative consolidated class and derivative actions brought by purported shareholders of certain Goldman Sachs mutual funds.

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 May 27, 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 (February 26, 2005 to March 25, 2005) (1)	2,496,700	$109.57	2,496,700	32,494,542
Month #2 (March 26, 2005 to April 29, 2005)	9,962,400	$109.43	9,962,400	22,532,142
Month #3 (April 30, 2005 to May 27, 2005) (1)	3,058,363	$103.82	3,058,363	19,473,779
Total (1)	15,517,463	$108.34	15,517,463	

(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 total 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 16,580,679 shares as of June 24, 2005; the repurchase program has no set expiration or termination date.

Item 4: Submission of Matters to a Vote of Security Holders

On April 6, 2005, Group Inc. held its Annual Meeting of Shareholders at which the shareholders voted upon (i) the election of four directors to the Board of Directors for three-year terms, (ii) the ratification of the appointment of PricewaterhouseCoopers LLP as Group Inc.'s independent registered public accounting firm for the 2005 fiscal year, and (iii) amendments to Group Inc.'s Amended and Restated Certificate of Incorporation to provide for the annual election of all directors.

The shareholders elected as directors John H. Bryan, Stephen Friedman, William W. George and Henry M. Paulson, Jr. for three-year terms (which became one-year terms because the amendments to the Amended and Restated Certificate of Incorporation were approved). The other directors whose terms of office continued after the Annual Meeting are: Lloyd C. Blankfein, Lord Browne of Madingley, Claes Dahlbäck, James A. Johnson, Lois D. Juliber, Edward M. Liddy and Ruth J. Simmons. The shareholders also approved the ratification of the appointment of PricewaterhouseCoopers LLP as Group Inc.'s independent registered public accounting firm for the 2005 fiscal year as well as amendments to the Amended and Restated Certificate of Incorporation. The number of votes cast for, against or withheld and the number of abstentions with respect to each matter voted upon, as applicable, is set forth below. Broker non-votes were not applicable to any of the matters voted upon at the Annual Meeting.

	For	Against/ Withheld	Abstain
1. Election of Directors:			
John H. Bryan	412,608,088	6,166,797	*
Stephen Friedman	412,472,314	6,302,571	*
William W. George	413,334,113	5,440,772	*
Henry M. Paulson, Jr.	408,094,335	10,680,550	*
2. Ratification of the Appointment of Independent Registered Public Accounting Firm	413,302,673	2,697,100	2,775,112
3. Amendments to the Amended and Restated Certificate of Incorporation	409,606,595	6,039,397	3,128,893

* Not applicable

Item 6: Exhibits

Exhibits:

3.1	Amended and Restated Certificate of Incorporation of Group Inc. (incorporated by reference to Exhibit 3.1 to Group Inc.'s Current Report on Form 8-K, filed April 8, 2005).
3.2	Amended and Restated By-Laws of Group Inc. (incorporated by reference to Exhibit 3.2 to Group Inc.'s Current Report on Form 8-K, filed April 8, 2005).
3.3 and 4.1	Certificate of Designations of Group Inc. relating to the Series A Preferred Stock (incorporated by reference to Exhibit 3 to Group Inc.'s Registration Statement on Form 8-A, filed April 22, 2005).
4.2	Form of Certificate representing the Series A Preferred Stock (incorporated by reference to Exhibit 5 to Group Inc.'s Registration Statement on Form 8-A, filed April 22, 2005).
4.3	Deposit Agreement, dated April 14, 2005, between Group Inc. and JPMorgan Chase Bank, N.A., as Depository (incorporated by reference to Exhibit 4 to the Group Inc.'s Registration Statement on Form 8-A, filed April 22, 2005).
4.4	Form of Depository Receipt, included as Exhibit A to Exhibit 4.3 hereto (incorporated by reference to Exhibit 4 to Group Inc.'s Registration Statement on Form 8-A, filed April 22, 2005).
10.1	Letter, dated April 6, 2005, from Group Inc. to Mr. Stephen Friedman (incorporated by reference to Exhibit 10.1 of Group Inc.'s Current Report on Form 8-K, filed April 8, 2005).
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: July 1, 2005