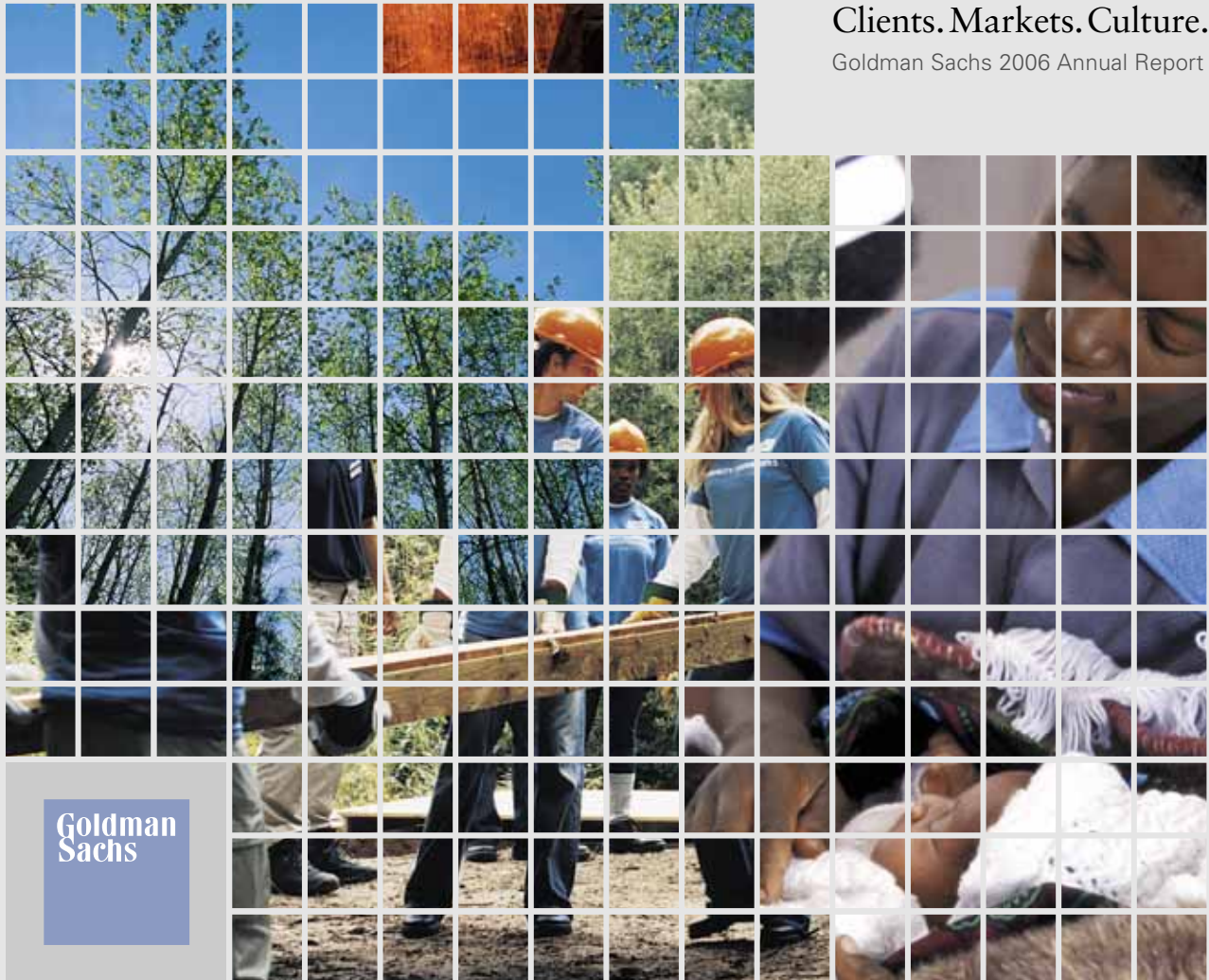


Clients. Markets. Culture.

Goldman Sachs 2006 Annual Report



Goldman Sachs

## Financial Highlights

	AS OF OR FOR THE YEAR ENDED NOVEMBER		
	2006	2005	2004
(\$ and share amounts in millions, except per share amounts)			
<b>Operating Results</b>			
Net revenues			
Investment banking	\$ 5,629	\$ 3,671	\$ 3,374
Trading and principal investments	25,562	16,818	13,728
Asset management and securities services	6,474	4,749	3,849
Total net revenues	37,665	25,238	20,951
Pre-tax earnings	14,560	8,273	6,676
Net earnings	9,537	5,626	4,553
Net earnings applicable to common shareholders	9,398	5,609	4,553
<b>Common Share Data</b>			
Diluted earnings per common share	\$ 19.69	\$ 11.21	\$ 8.92
Average diluted common shares outstanding	477.4	500.2	510.5
Dividends declared and paid per common share	\$ 1.30	\$ 1.00	\$ 1.00
Book value per common share <sup>(1)</sup>	72.62	57.02	50.77
Tangible book value per common share <sup>(2)(3)</sup>	61.47	46.76	40.91
Ending stock price	201.60	134.12	104.84
<b>Financial Condition and Other Operating Data</b>			
Total assets	\$838,201	\$706,804	\$531,379
Other secured financings (long-term)	26,134	15,669	12,087
Unsecured long-term borrowings	122,842	84,338	68,609
Total shareholders' equity	35,786	28,002	25,079
Leverage ratio <sup>(4)</sup>	23.4x	25.2x	21.2x
Adjusted leverage ratio <sup>(5)</sup>	16.1x	17.9x	15.1x
Debt to equity ratio <sup>(6)</sup>	3.4x	3.0x	2.7x
Return on average common shareholders' equity <sup>(7)</sup>	32.8%	21.8%	19.8%
Return on average tangible common shareholders' equity <sup>(8)</sup>	39.8%	26.7%	25.2%
<b>Selected Data</b>			
Total employees	26,467	23,623	21,736
Assets under management (\$ in billions)	\$ 676	\$ 532	\$ 452

<sup>(1)</sup> Book value per common share is based on common shares outstanding, including restricted stock units granted to employees with no future service requirements, of 450.1 million, 460.4 million and 494.0 million as of November 2006, November 2005 and November 2004, respectively.

<sup>(2)</sup> 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.

<sup>(3)</sup> Tangible common shareholders' equity equals total shareholders' equity less preferred stock, goodwill and identifiable intangible assets, excluding power contracts. See "Financial Information—Management's Discussion and Analysis—Equity Capital—Capital Ratios and Metrics" for further information regarding our calculation of tangible common shareholders' equity.

<sup>(4)</sup> Leverage ratio equals total assets divided by total shareholders' equity.

<sup>(5)</sup> Adjusted leverage ratio equals adjusted assets divided by tangible equity capital. See "Financial Information—Management's Discussion and Analysis—Equity Capital—Capital Ratios and Metrics" for further information regarding adjusted assets, tangible equity capital and our calculation of the adjusted leverage ratio.

<sup>(6)</sup> Debt to equity ratio equals unsecured long-term borrowings divided by total shareholders' equity.

<sup>(7)</sup> Return on average common shareholders' equity is computed by dividing net earnings applicable to common shareholders by average monthly common shareholders' equity.

<sup>(8)</sup> Return on average tangible common shareholders' equity is computed by dividing net earnings applicable to common shareholders by average monthly tangible common shareholders' equity. See "Financial Information—Management's Discussion and Analysis—Results of Operations—Financial Overview" for further information regarding our calculation of return on average tangible common shareholders' equity.

As open markets and global finance transform economies, capital markets will play an increasingly vital role in connecting capital to ideas necessary for growth. Goldman Sachs helps allocate capital and manage risk, and through this process fosters entrepreneurship and innovation, drives efficiency and encourages economic reform.

CLEARLY, IT IS OUR CLIENTS, with their aspirations and risk taking, that ultimately effect change. They build new businesses and strengthen existing ones. Others seek to enhance the performance of their portfolios and provide economic security for the future.

HOWEVER, IN TODAY'S GLOBAL MARKETS, the needs and objectives of our clients are often multifaceted and difficult to execute. Solutions to complex problems hold tremendous potential for investors, issuers and the societies they serve.

WE MUST REMAIN RESPONSIVE to the evolving needs of our clients and nimble in adapting to that change. Our culture—forged through teamwork, excellence and a passion to deliver for our clients—has instilled in our people an infectious desire to ask, “Is there a better way?” These intangibles define Goldman Sachs and the value we work to provide for our clients and shareholders.



**Gary D. Cohn,**  
President and Co-Chief Operating Officer

**Lloyd C. Blankfein,**  
Chairman and Chief Executive Officer

**Jon Winkelried,**  
President and Co-Chief Operating Officer

## Fellow Shareholders:

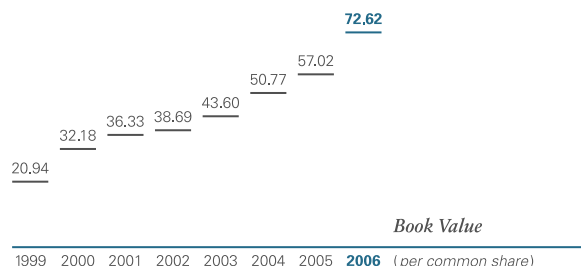
We are extraordinarily fortunate to have the opportunity to lead Goldman Sachs. Like each of our predecessors, our mandate is to preserve the legacy of the firm while remaining open to the change and innovation that best meets the needs of our clients.

Our outlook has been shaped by our having been at Goldman Sachs for an average of more than 20 years. Each of us has been responsible for a number of different regions and businesses across the firm, and, with the strong leadership in each of the firm's divisions, Goldman Sachs continues to benefit from an enduring sense of continuity. All of us at the firm are stewards of a legacy forged over 138 years that puts our clients at the center of everything we do.

These cultural attributes were at the very heart of our performance this past year. For 2006, net revenues increased 49% to \$37.7 billion and net earnings rose 70% to \$9.5 billion. Diluted earnings per common share were \$19.69, an increase of 76% from \$11.21 for the previous year. Our return on average common shareholders' equity was 32.8%. And as you can see in the chart to the right, book value per common share increased 27% in the last year, and has grown from \$20.94 at the end of our first year as a public company in 1999 to \$72.62, a compound annual rate of 19% over this period. At the same time, the firm returned over \$7.8 billion of capital to shareholders by repurchasing 50.2 million shares of our common stock in 2006.

While revenues grew 49% last year, our operating expenses increased 36%. As a result, our 39% pre-tax margin in 2006 was a record—allowing us to produce more earnings per dollar of net revenues than at any

time since we went public. We also retained a greater overall percentage of earnings than in previous years, with 43.7% of revenues being paid for compensation and related expenses.



While our business does not lend itself to predictable earnings on a quarterly basis, over the long term, we are committed to providing our shareholders with returns on equity at or near the top of our industry while continuing to grow book value and earnings per share.

In our first letter to you, we will discuss some of the underlying strengths that helped drive our results, and how they make Goldman Sachs competitive in the face of contrasting business models, structural changes and evolving client needs. We also will highlight some of the growth opportunities we see in various markets and regions and conclude with a few brief points about managing the firm in different market environments.

### The Evolving Needs of Our Clients

In recent years, the changing needs of our clients, technological advancements and the global integration of markets and economies have spurred structural changes in securities markets and, in turn, across all of our businesses.

Increasingly, clients expect firms like Goldman Sachs to commit capital on their behalf when executing transactions. This has shifted the landscape in virtually every aspect of our business. In investment banking, offering strategic advice remains at the center of what we do. Clients frequently expect our advice to be accompanied by the provision of the capital necessary to make that advice actionable. For example, Goldman Sachs was the lead advisor to Mittal Steel in its acquisition of Arcelor. We not only provided strategic advice but also a significant financing commitment—which was critical to the feasibility of the bid.

In securities sales and trading, market making has always been essential to the liquidity, efficiency and stability of financial markets. Increasingly, however, our clients look to us to execute large, complex or capital-intensive transactions on their behalf.

Our investment management clients seek advice focused on achieving the best long-term performance for their portfolios. While we must produce consistently strong results for our clients, our approach must be balanced with the right asset and risk allocation specific to each client's needs. This requires identifying and developing innovative products and strategies that seek to optimize returns, while minimizing risk.

## Redefining Our Mandate

Our focus on the needs of our clients has never wavered. The question for us remains, however, how Goldman Sachs can best meet those needs.

Today, it has become almost axiomatic that firms like Goldman Sachs can be an advisor, financier and co-investor. However, we have long believed that not only *can* Goldman Sachs fulfill these roles, but we *must* do so in order to be effective for our clients.

Guided by this client focus, we must constantly re-examine the boundaries of our businesses and identify new opportunities. This continuous review of our strategy has led us to restructure a number of businesses to better address the needs of our clients.

- **Financing Group.** We created the financing group—centralizing all financing-related advice, origination and execution within the firm. Our investment banking clients today benefit from greater connectivity within our capital markets franchise through innovative financing and risk management solutions across the equity, credit and derivatives spectrum.

- **Credit and Equity Integration.** We combined the key elements in our capital markets sales and trading operation—cash equities, credit, derivatives and convertibles—and housed them in consolidated groups so our clients' needs are served seamlessly across the entire capital structure.

- **High-Touch and Low-Touch Trading.** We recognized early on that the impact of technology and our clients' desire to execute trades through multiple channels were going to fundamentally alter the cash equities market. We restructured our equities business to respond to the priorities of our clients. We developed and built out electronic execution platforms that now trade approximately 500 million shares a day. At the same time, we refined our high-touch trading, facilitating complex client transactions through a combination of our execution capability and our willingness to assume market risk and commit capital.

- **Investing Platforms.** We built out our investing platforms and more closely coordinated their activities with investment banking. We broadened our merchant banking focus to different asset classes, closing a \$6.5 billion Infrastructure Fund and a \$5.25 billion Mezzanine Fund in the last year.

- **Alternative Assets.** As an early entrant in both the alternative asset management and prime brokerage spaces, we recognized the important role private pools of capital would play across markets. With \$145 billion of alternative assets under management, Goldman Sachs is one of the largest managers of direct hedge fund and hedge fund of fund assets as well as private equity portfolios of funds. Our securities services business, which provides financing, securities lending, fund administration and other services for many of the world's largest hedge funds, has seen its client base double and balances triple in size in the last five years. The development of these businesses has helped make us more effective advisors and investment managers.

## Clients and Culture

When we began to implement these changes, we did so at a time when we already had a strong franchise across many of our businesses. Change, understandably, seemed unduly risky to many.

Two hallmarks of the firm gave us the confidence to initiate these changes. First, staying close to clients has allowed Goldman Sachs to identify and anticipate opportunities at an early stage. Our proximity to clients allows us to understand early on what is required to meet their changing needs. And we have learned the value in being willing to embrace the risk of altering our model to supply that response.

Today, we hold leading positions in M&A advisory and underwriting, maintain significant market share in the equity, fixed income, currency and commodity markets, and have one of the largest, best-performing investment management platforms in the world. Clients have never been more important to Goldman Sachs and Goldman Sachs has never been better positioned or capable of meeting the varying needs of our clients.

The second factor that has defined our response to change is our culture. We strongly believe that the shared values embodied in our people are our most powerful competitive advantage.

Our emphasis on teamwork is not an abstract goal, but a living, breathing reality. It allows us to complement an individual's skills and expertise with his or her colleagues to provide exceptional client service across different parts of the firm and components of a client's transaction. This teamwork is ingrained in Goldman Sachs. Our people approach their responsibilities through the lens of a partnership. They feel ownership of the entire firm, not just of their division or region. On a daily basis, this translates into a real sense of collaboration.

Our focus on people begins with recruiting the right individuals one-by-one to Goldman Sachs. We then help develop their careers with regular and specific feedback and opportunities to work in different parts of Goldman Sachs. We believe this effort has paid off with high levels of retention and deep experience across the firm, despite the intense competition for talent in our industry.

Our industry and the firm's work environment are fertile ground for innovation. We reward people who develop new ideas and new ways of serving our clients. Whether it is anticipating change in equity market structure, identifying opportunities in distressed investing, exploring alternative energy solutions or recognizing the important roles private pools of capital would play, our people have searched out and been receptive to new ideas and market opportunities.

## Growth Opportunities

While we have been fortunate in identifying and acting on many opportunities in recent years, we see certain areas today where the firm has been uneven in its response. One area that we believe needs increased focus is our strategy in new and developing markets, particularly India, Russia, Brazil and the Middle East.

Certainly, the strength of our franchise in China continues to benefit from our continuous involvement in the country since the early 1990s. Two years ago, we established Goldman Sachs Gao Hua Securities Company Limited, our joint venture in China, in conjunction with the creation of a domestic securities company, Beijing Gao Hua Securities Company Limited. This unique structure gives us the ability to operate in the domestic Chinese markets. This past year, we made an important strategic investment in Industrial and Commercial Bank of China Limited (ICBC), China's largest commercial bank. We did so through a strategic cooperation agreement in which we committed to advise ICBC on important risk management, infrastructure and business development issues. Equally critical, ICBC will help us identify new clients and opportunities in one of the most significant markets we are operating in today.

While we believe we have a strong presence in China, we need to establish a more meaningful presence in India, Russia, Brazil and the Middle East. In India, we are establishing, through Goldman Sachs India, a deeper investment banking and securities business. We have strong relationships with many of the largest corporations in India, but the country's rapid growth and strong talent pool merit a much more dedicated on-the-ground presence.

Russia, with an increasing number of companies focused on international growth, represents strong investment banking, sales and trading and private banking opportunities. We recently opened an office in Moscow and have professionals focused on serving clients in each of these divisions.

In Brazil, we were recently granted a local foreign exchange license and are moving aggressively to build a significant sales and trading operation. At the same time, we have new leadership in place in our Investment Banking division in São Paulo and are intent on further strengthening our relationships in Brazil and across Latin America.

In the Middle East, Goldman Sachs is opening offices in the Arabian Gulf to work more closely with our investment banking and private wealth management clients.

We see other areas across the firm where we believe there is strong growth potential. These include widening our investment banking footprint to work with a broader circle of corporate clients. Many smaller companies in the so-called middle market may benefit from our strategic advice, financing know-how and capital even more than larger companies.

We also see opportunities in advising governments and investors on the sale and purchase of public infrastructure assets like airports, shipping ports, toll roads and bridges. In the insurance sector, the management of certain assets, such as variable annuities, allows us to extend our core competency in risk management and our trading expertise. We also are building a private banking capability within our private wealth management business as part of our strategy to provide a full range of services to our clients.

### **A Tradition of Service**

This past year, Goldman Sachs lost an individual who deeply embodied our culture and spirit.

In August, John L. Weinberg, Senior Chairman and former Senior Partner, passed away. During his more than 56 years with Goldman Sachs, John built many of the firm's most enduring client relationships and, through his leadership, helped elevate the firm's global stature. John's commitment to service and ideals bigger than one person infused his sense of obligation to the firm and its culture. He was a visionary, and while this description can often be overstated, it does not do justice to the confidence he inspired, the clarity in thinking he expressed and the integrity he exhibited throughout his career.

John was a crucial link in a virtuous cycle of people helping those they work with, caring not only about their division, but also about the firm by serving on various firmwide committees or task forces and extending that ethic to their communities and countries.

The culture of service that John personified has continually evolved and, today, is represented in his successors.

Hank Paulson, who had served as Goldman Sachs' Chairman and CEO for the last seven years, was nominated and confirmed as the United States' 74th Secretary of the Treasury. Each of us is indebted to Hank in our own way but all of us miss his tireless passion, sage counsel and innate leadership. He led Goldman Sachs through both exhilarating and difficult times. In the wake of the bursting of the technology bubble, Hank forced the firm and many in the industry to ask uncomfortable questions. And he held himself to that same scrutiny.

Like his four immediate predecessors, Hank wanted to help make a difference through government service. We are proud of him and wish him every success. In many ways, however, Hank's decision is not unique. Our people, from those junior to those senior, are passionate about effecting change either through the firm or in their personal lives.

This past year, we celebrated Community TeamWorks' 10th anniversary. In that time, the people of Goldman Sachs have volunteered with over 830 community partners in 9,400 projects to help over 600,000 people in need. Every day between April and August of each year, people across the firm come together to spend time with a child or senior, help to build affordable housing, teach young people in schools, clean up parks or work for their communities in countless other ways.

While the combined effect of this volunteerism is possible to quantify in numbers, it is impossible to quantify in terms of the impact it has on Goldman Sachs. It reinforces the sense of obligation we all share not only to one another but also to the well-being of our communities. We don't require that any of our people participate in Community TeamWorks, but approximately 18,000 people in the firm volunteered to do so in 2006.

We are also proud that Goldman Sachs received a public service distinction for an action that came directly out of our business. In November, the firm accepted the Secretary of State's Award for Corporate Excellence for the donation of 680,000 acres of ecologically precious land in Tierra del Fuego, Chile. In 2002, we purchased a portfolio of distressed debt, which included notes secured by this environmentally significant forestland. We determined that this unique tract of land could and should be preserved. With the Wildlife Conservation Society (WCS), we announced a partnership to protect much of the wilderness at the southernmost edge of South America. Through this unprecedented private/public alliance, Goldman Sachs and the WCS are working with Chilean conservationists and other partners to establish a world-class nature reserve that preserves and protects this extraordinary land.

Over the last two years, the firm assisted six European governments in developing the International Finance Facility for Immunisation (IFFIm), which came to fruition this past year. This innovative structure will provide a steady stream of immunization funds for programs in 70 developing countries by issuing debt in capital markets backed by multiyear grants from sovereign donor governments. These funds are projected



to help save the lives of five million children in the next ten years. IFFIm is an important example of the power of capital markets to address some of society's most important issues.

This is particularly true in the area of the environment. In the last year, we have expanded our trading activities in the carbon emissions market to include trading and investing in project-based emission reduction credits and pricing emission risk, in addition to the trading of carbon credits. Innovative trading in these new markets can be a source of meaningful action to address global climate change.

Lastly, given the integration of markets and economies, improvements in transportation and communication networks and the development of capital markets around the world, Goldman Sachs is well positioned to be a catalyst for financial progress, innovation and economic growth.

We are proud to be able to work with many countries, both with developed and emerging markets, as they restructure and reform their economies and financial systems. We believe strongly that Goldman Sachs, through the skill and know-how of its people, is contributing to the development of vibrant and dynamic markets that can efficiently allocate capital to their most productive use. Such markets are a vital precursor to sustainable economic growth and security, as millions of people are experiencing the benefits of market development around the world.

### Managing Through Different Markets

The broader business environment has been very favorable for the past several years, and thus far in 2007, the financial and economic outlook across the global economy has remained generally positive. However, we are always cognizant that conditions can change quickly and in unforeseen ways. We continually remind ourselves that the recent pace of revenue growth simply is not sustainable. As a firm that operates in the center of the global economy, we have been able to grow at a multiple of GDP growth and are directly and significantly affected by the macro-economic environment.

It is difficult to regard 2006 as anything but an exceptional year for Goldman Sachs. One of the worst things we could do, as a firm and as individuals, is to begin to believe that the laws of economics don't apply to us—that somehow markets aren't cyclical. We also need to be mindful that our financial performance is very much a product of the opportunities the market environment and our clients make available to us.

No matter the conditions, our job is to perform well relative to our competitors and the opportunities at hand. But in absolute terms, we plan for markets and conditions that won't always be as favorable as those in recent years. We know that managing the firm in unfavorable environments is very different from managing it in good times. But two indelible mandates will remain: commitment to our clients and to our culture.

All of us at Goldman Sachs are fortunate to work in a dynamic industry with clients who expect and demand a great deal. There is no substitute for being held in high regard by our clients, having a clear understanding of our role in their larger success and keeping our perspective no matter the business environment.

We are excited and proud to lead the remarkable people of Goldman Sachs, and through their talent, expertise and client focus will work to build on the firm's strong legacy.



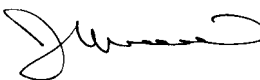
LLOYD C. BLANKFEIN

Chairman and Chief Executive Officer



GARY D. COHN

President and Co-Chief Operating Officer



JON WINKELRIED

President and Co-Chief Operating Officer



***Tokyo Cross-Divisional Client Teams***

Cross-divisional client teams in Tokyo draw upon professionals from Investment Banking; Investment Management; Equities; Fixed Income, Currency and Commodities; Human Capital Management and Operations to service financial institutions.  
*Pictured at Roppongi Hills, Tokyo.*

**STANDING, FROM LEFT TO RIGHT:**

Yoshihiko Tanio, Fixed Income, Currency and Commodities; Ichiro Amano, Equities; Chiho Adachi, Equities; Koichiro Abe, Fixed Income, Currency and Commodities.

**SEATED, FROM LEFT TO RIGHT:**

Norihiko Ishihara, Investment Banking; Yotaro Agari, Investment Banking; Tetsuji Fuwa, Investment Banking.

I.

## Clients

CLIENTS ARE AT THE CORE of our daily activities, our business strategy and our culture. How our people engage with clients has changed as the markets evolve and clients see their needs changing. Clients continue to select Goldman Sachs for advice, execution and capital for significant strategic opportunities.

Increasingly, we work with clients on a wider basis. They may ask us to create a specialized product, finance a transaction or take part in one as a principal.

Our flexibility in working with clients according to their individual needs is an important factor in our efforts to grow our franchise through strong client relationships, innovative services and new markets.



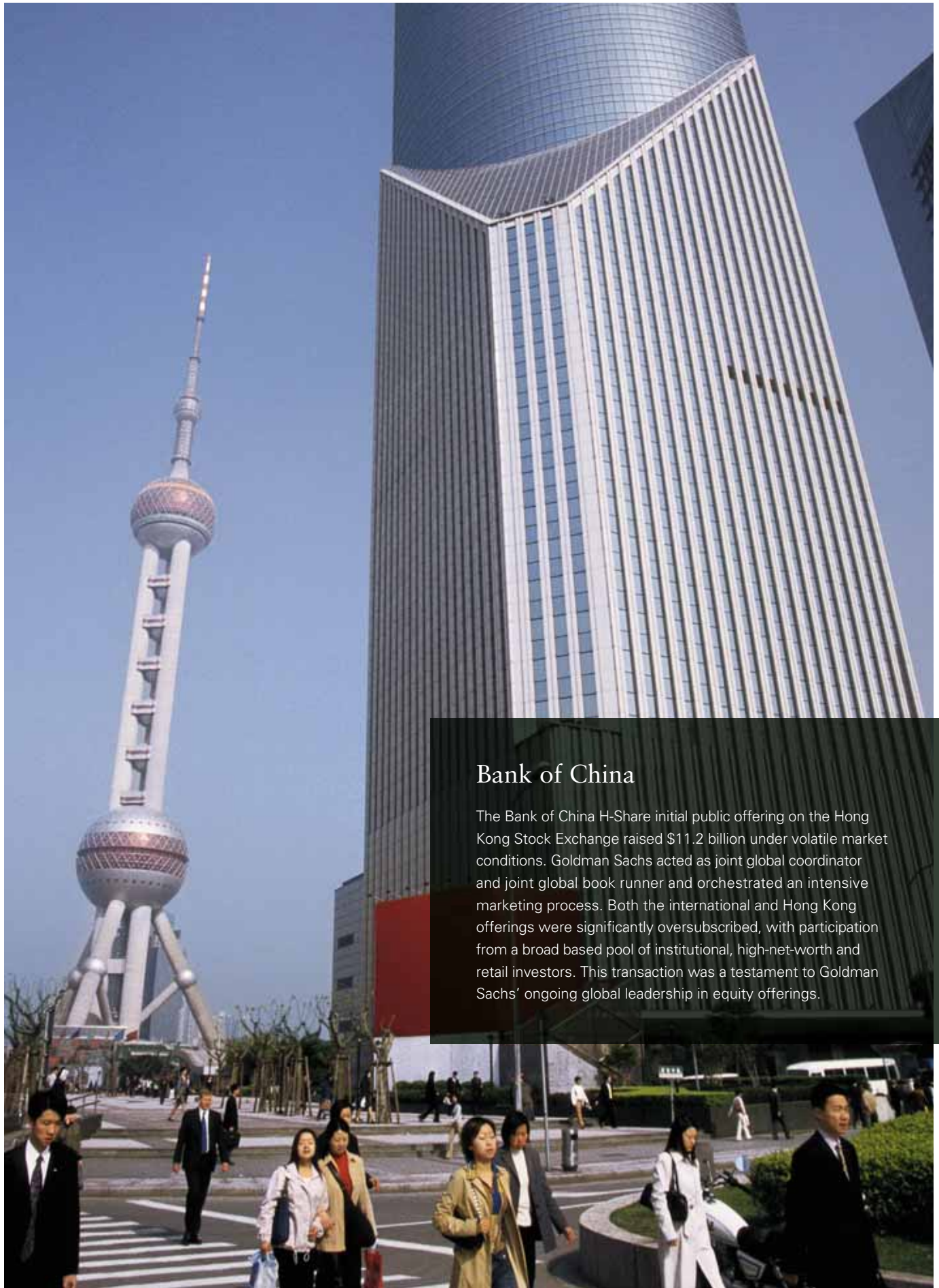
STANDING, FROM LEFT TO RIGHT:  
Hiroko Shinoda, Investment Management; Aki Asami, Investment Banking;  
Hiroyuki Tomokiyo, Fixed Income, Currency and Commodities; Toshiyuki Ohashi, Investment Banking.

SEATED, FROM LEFT TO RIGHT:  
Takeshi Fukuhara, Operations; Kumiko Ishige, Human Capital Management.

## Mittal Steel

Mittal Steel's \$34 billion acquisition of Arcelor was a signature cross-border M&A transaction in 2006. Our client's goal was to combine two leading steel companies to achieve unprecedented scale and global presence. Our team acted as Mittal Steel's lead M&A advisor on this complex and public cash and share offer. The largest ever in the steel industry, the offer was launched simultaneously in five jurisdictions including the U.S. Goldman Sachs jointly led the loan financing for the acquisition, provided credit rating advisory services and assisted Mittal Steel's communications with investors and proxy advisory firms.





## Bank of China

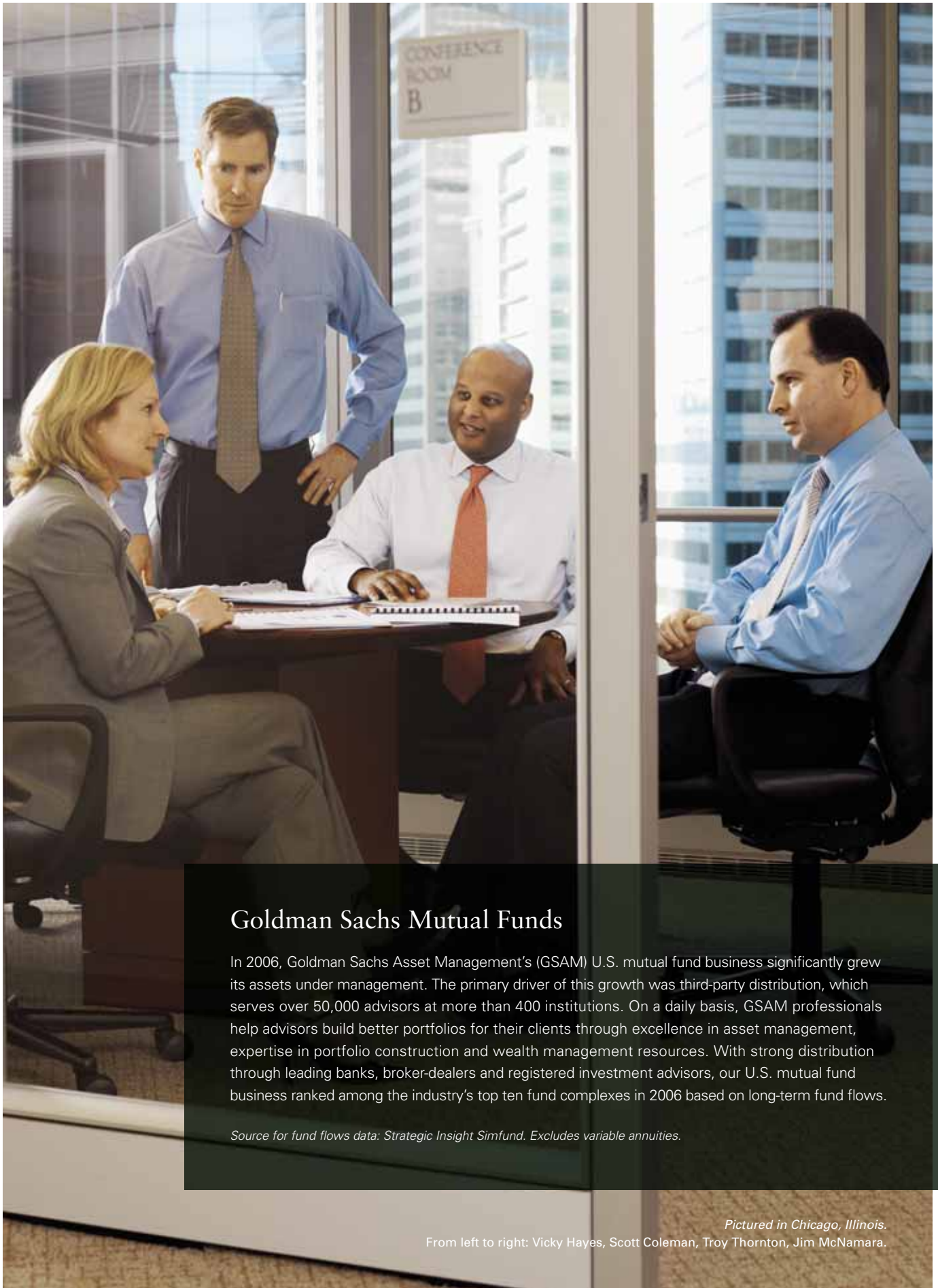
The Bank of China H-Share initial public offering on the Hong Kong Stock Exchange raised \$11.2 billion under volatile market conditions. Goldman Sachs acted as joint global coordinator and joint global book runner and orchestrated an intensive marketing process. Both the international and Hong Kong offerings were significantly oversubscribed, with participation from a broad based pool of institutional, high-net-worth and retail investors. This transaction was a testament to Goldman Sachs' ongoing global leadership in equity offerings.



## KarstadtQuelle

Europe's largest department store and mail order group, KarstadtQuelle, joined with an affiliate of Goldman Sachs' Whitehall Fund in a real estate joint venture transaction that allowed KarstadtQuelle to regain its financial flexibility and to focus again on its core business. One of the largest real estate transactions in Europe, the new joint venture holds a portfolio of over 150 real estate properties that KarstadtQuelle sold and is leasing back on long-term contracts. KarstadtQuelle is receiving a total cash payment of up to €3.7 billion and is expecting additional payments through value appreciation of its 49% stake in the joint venture. Goldman Sachs underwrote non-recourse senior and mezzanine financing and advised on the acquisition. Through a combination of our real estate, financing and structuring expertise, Goldman Sachs was able to provide KarstadtQuelle with an attractive way to redeem nearly all its outstanding debt and provided a significant contribution to its restructuring.





## Goldman Sachs Mutual Funds

In 2006, Goldman Sachs Asset Management's (GSAM) U.S. mutual fund business significantly grew its assets under management. The primary driver of this growth was third-party distribution, which serves over 50,000 advisors at more than 400 institutions. On a daily basis, GSAM professionals help advisors build better portfolios for their clients through excellence in asset management, expertise in portfolio construction and wealth management resources. With strong distribution through leading banks, broker-dealers and registered investment advisors, our U.S. mutual fund business ranked among the industry's top ten fund complexes in 2006 based on long-term fund flows.

*Source for fund flows data: Strategic Insight Simfund. Excludes variable annuities.*

*Pictured in Chicago, Illinois.*

*From left to right: Vicky Hayes, Scott Coleman, Troy Thornton, Jim McNamara.*





***Urban Investment Group***

Our Urban Investment Group invests as a long-term capital partner in a wide range of minority-led ventures and urban real estate projects. Pictured at *The Kalahari*, a mixed-use development project in New York City.

STANDING, FROM LEFT TO RIGHT:  
Michael D. Trovini, Lindsay Greene, Martin E. Chavez, Stuart M. Rothenberg, Margaret Warden.

SEATED, FROM LEFT TO RIGHT:  
Amber McCants, Todd D. Stern, Alicia K. Glen.

II.

## Markets

THE CAPITAL MARKETS are one of the world's great sources of creative energy and potential. Broadening participation in the capital markets stimulates growth, enhances financial stability and generates efficiencies for all participants. Goldman Sachs has specific views on how the needs of our clients are helping to shape the evolution of the markets. We have structured our business to reflect those views, and have taken direct action to help governments, corporations and investors tap the markets to address some of their most significant challenges.



STANDING, FROM LEFT TO RIGHT:  
Richard A. Friedman, Kevin M. Jordan, Margaret Chinwe Anadu, Thomas A. Kalvik, Precious Williams.

SEATED, FROM LEFT TO RIGHT:  
Osei A. Van Horne, Carrie L. Van Syckel, William G. Gonzalez.



## Environmental Markets

While we aggressively manage our own environmental footprint, we are also establishing a leading position in understanding the many ways environmental concerns are affecting global markets. Our equity research teams have established a rigorous approach to evaluating the environmental, social and governance (ESG) risks for industry sectors and individual companies. We have delivered on our 2005 pledge to invest over \$1 billion in alternative energy projects across a range of technologies including wind, photovoltaics, solar and geothermal. We have been trading carbon credits in the European carbon emissions market since its inception and, in the last year, have expanded our activities to include trading and investing in project-based emission reduction credits and pricing emission risk. Finally, our newly created Center for Environmental Markets has made leadership grants to support a series of market-based research initiatives.

Mr. Zhou Yueqiu, ICBC General Manager of the Custody Service Department speaking with Jerry Corrigan, Goldman Sachs Managing Director, at a best-practices exchange in New York City.

## Industrial and Commercial Bank of China Limited

Goldman Sachs has been deeply involved in helping China develop successful capital markets and reform its financial sector. In January 2006, Goldman Sachs and Industrial and Commercial Bank of China Limited (ICBC), China's largest banking institution, signed a strategic cooperation agreement under which Goldman Sachs is assisting ICBC management across a range of strategic and operational initiatives. The firm is providing expertise and exchanging ideas on best-practices for issues such as governance, corporate and investment banking, nonperforming loans disposal and risk, treasury and asset management. In connection with this agreement, Goldman Sachs made a significant investment in ICBC, reinforcing our long-term commitment to China.



## Electronic Trading

Goldman Sachs is a leader in helping clients navigate the structural changes in the equity markets. Many early and significant investments in electronic trading capabilities are paying off, such as our award-winning REDIPlus® platform that offers clients the ability to electronically execute transactions involving equities, options, futures, foreign exchange and entire portfolios—frequently using GSAT® algorithms—in the U.S., Europe and Asia. Our SIGMA X crossing network represents a significant liquidity pool, allowing clients to transact with over one billion shares per day. While the majority of our customer share volume is now handled electronically, the traditional “high-touch” capabilities of capital commitment and risk management skills demanded by more complex trades still drive a significant portion of our Equities business. Offering clients both these “high-touch” and “low-touch” capabilities is critical to our strategy.





## BRICs

Since Goldman Sachs introduced the concept of BRICs in a 2001 research report titled "Building Better Global Economic BRICs," this innovative approach to analyzing emerging markets has become part of the common language of the global capital markets. As economies, the BRICs nations (Brazil, Russia, India and China) are proving their importance to the global economy. By the end of 2006, the collective size of the BRICs economies had risen above 11% of world GDP. As an investment tool, the BRICs analysis is helping clients manage their portfolios and serving as the foundation for new investment funds including our own BRIC fund from Goldman Sachs Asset Management. Our commitment to the BRICs economies is further reflected in our significant investments in new offices in Moscow and Mumbai as well as ongoing investment in our businesses in China and Brazil.

Countries scaled to 2006 GDP in descending order.



***Capital and Commitments Committees***

We reinforce our cultural standards for integrity with rigorous processes through which our Capital Committee reviews principal commitments of the firm's capital and our Commitments Committee reviews the firm's underwriting and distribution activities. *Representatives pictured in Jersey City, New Jersey.*

**STANDING, FROM LEFT TO RIGHT:**

Tim Freshwater, Hong Kong; David Viniar, New York; Edward C. Forst, New York; Christopher A. Cole, New York; Frances R. Bermanzohn, New York.

**SEATED, FROM LEFT TO RIGHT:**

Mark G. A. Machin, Hong Kong; Glenn P. Earle, London.



III.

## Culture

OUR CULTURE IS INTEGRAL to our business strategy. We take active steps to reinforce it and keep it relevant to clients, new recruits and the current generation of Goldman Sachs people. Our culture is at work as Goldman Sachs teams tackle multifaceted client objectives. It is continually renewed as the firm's senior-most executives invest significant amounts of time recruiting new talent into our organization. Our culture is strengthened in communities around the world where Goldman Sachs individuals come together to volunteer their time and expertise. Finally, and sadly, it is reaffirmed when we come together as a community to mourn the passing of one of our own.



STANDING, FROM LEFT TO RIGHT:  
Kevin W. Kennedy, New York; Eric S. Dobkin, New York; Howard A. Silverstein, New York;  
Michael S. Sherwood, London; E. Gerald Corrigan, New York.

SEATED, FROM LEFT TO RIGHT:  
David J. Mastrocola, New York; Robert J. Markwick, London.



## IFFIm

Every year, 27 million infants around the world are not vaccinated against the most common childhood diseases. Childhood immunization provides tremendous benefit at very low cost. Six European governments determined to use the power of the capital markets to accelerate the funding they pledge for immunization programs. A small team at Goldman Sachs dedicated two years to this initiative and worked with the initial sovereign sponsors, the World Bank and other development organizations to turn the idea into a reality. The result is the International Finance Facility for Immunisation (IFFIm), which is financing immunization programs in 70 of the world's poorest countries. IFFIm launched its first \$1 billion bond in November 2006, with Goldman Sachs acting as lead manager. Through immunization programs operated by the GAVI Alliance, it is projected that, in total, the money IFFIm raises will help protect more than 500 million children over the next decade—saving an estimated ten million lives over time.





## CTW 10th Anniversary

The Charitable Services Group helps our people fulfill the firm's commitment to assist our communities through financial support, volunteer activities and collaborations with nonprofit organizations. Consistent with all of our programs, we take a strong client service approach with our nonprofit partners, helping them build capacity and develop programs that address community needs while best using our people's skills. Our Community TeamWorks program is in its tenth year of helping over 600 nonprofit organizations around the world tap the talents and energy of approximately 18,000 Goldman Sachs volunteers. We also coordinate participation in local activities like the Corporate Challenge, New York Cares Day, Change for Charity and Gulf Coast Volunteering.

Goldman Sachs volunteers, as part of their Community TeamWorks project, worked to clear a haven for wildlife that was not accessible to the public for over 50 years.



## Talent

Our ability to attract and retain talented people is the foundation of what we do for clients and shareholders. We make an unusual effort to identify people with the talent and drive to succeed in life and in business. Our senior executive team is deeply engaged in on-campus recruiting. Our investments in career development are significant and ongoing, designed to help our professionals grow personally and professionally over the course of their careers. We truly believe that Goldman Sachs provides an unsurpassed platform for people who want to take their talents to the next level.

Edith Cooper, Managing Director, addresses a group of students at Georgetown University, Washington, D.C.

## A Tradition of Service

This year we lost a friend and leader who devoted his life to service—first in the United States Marine Corps during two wars, and then to Goldman Sachs and its clients. At his memorial service, friends remembered John L. Weinberg:

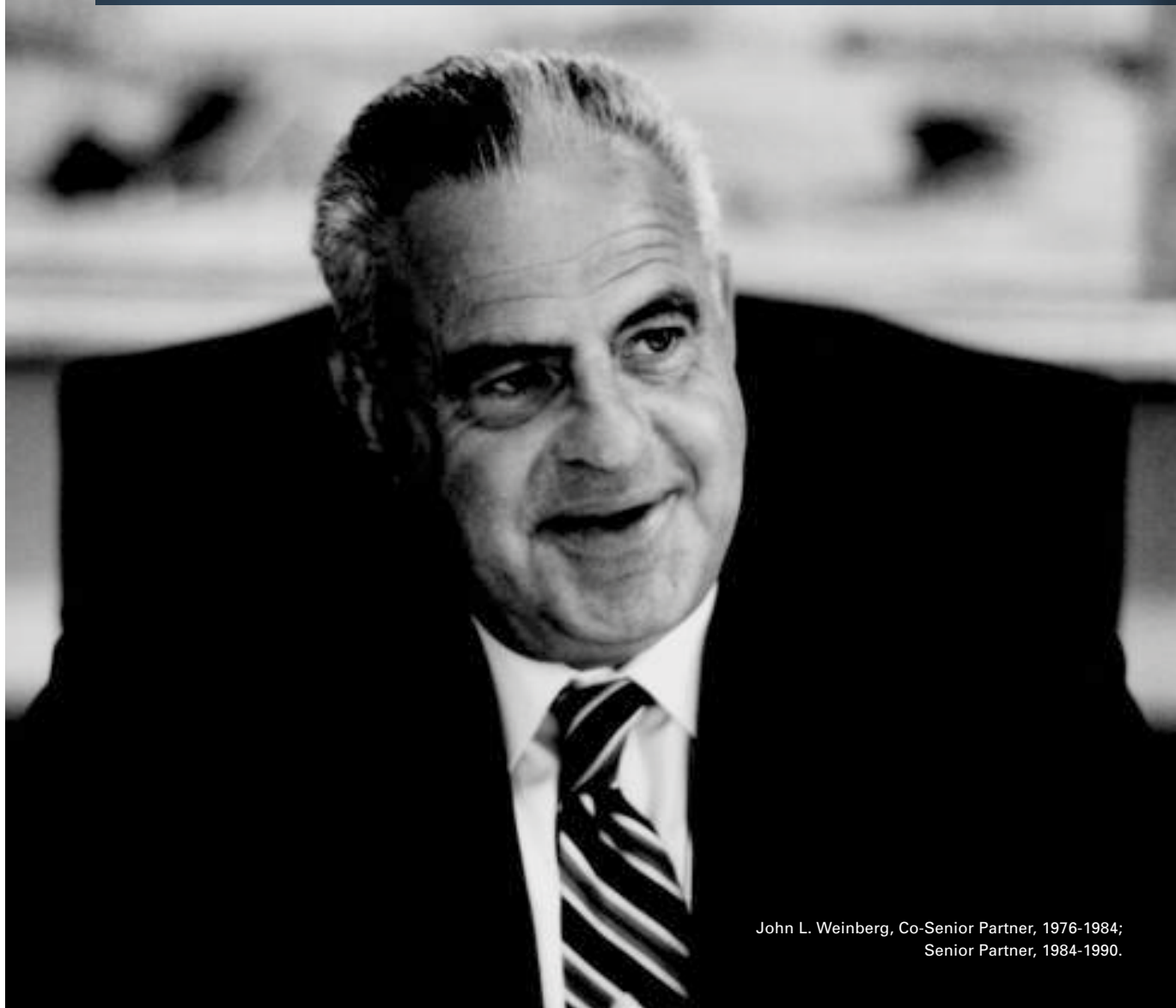
"John would pump up the weak and deflate the mighty. He would remind us that trees don't grow to the sky."  
—Lloyd C. Blankfein, Chairman and CEO, 2006–Present

"John was a keeper of our culture. He embodied it. He was totally and completely authentic. He could not abide arrogance."  
—Henry M. Paulson, Jr., Chairman and CEO, 1999–2006

"When we were reminiscing about our dealings with John, it seemed that everyone had the same thing to say: authentic, wise, real—that's what John was."  
—Jack F. Welch, Jr., Chairman and CEO, GE, 1981–2001

"Having two chairmen was so unusual that Marvin Bower at McKinsey, who always liked new ideas, told us it couldn't work, but he would be happy to help us fix it. A year later, we gave him a free lunch and told him it didn't need fixing."  
—John C. Whitehead, Co-Senior Partner, 1976–1984

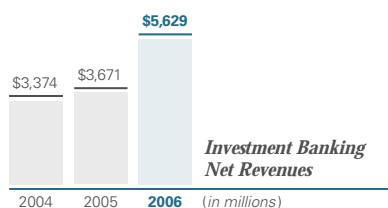
"President Clinton told me about a backwoods character from Arkansas who had more financial sense than all the sophisticates I knew. I told him about a backwoods character from Greenwich, Connecticut whom I would face off against his man anytime."  
—Robert E. Rubin, Co-Senior Partner, 1990–1991



John L. Weinberg, Co-Senior Partner, 1976-1984;  
Senior Partner, 1984-1990.

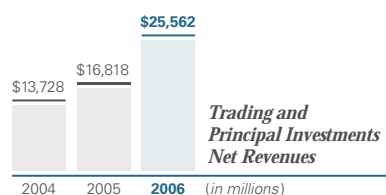
Goldman Sachs is a leading global investment banking, securities and investment management firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments and high-net-worth individuals.

Our activities are divided into three segments:



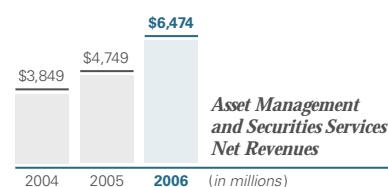
### Investment Banking

We provide a broad range of investment banking services to a diverse group of corporations, financial institutions, investment funds, governments and individuals.



### Trading and Principal Investments

We facilitate client transactions with a diverse group of corporations, financial institutions, investment funds, governments and individuals and take proprietary positions through market making in, trading of and investing in fixed income and equity products, currencies, commodities and derivatives on these products. In addition, we engage in specialist and market-making activities on equities and options exchanges and we clear client transactions on major stock, options and futures exchanges worldwide. In connection with our merchant banking and other investing activities, we make principal investments directly and through funds that we raise and manage.



### Asset Management and Securities Services

We provide investment advisory and financial planning services and offer investment products (primarily through separate accounts and funds) across all major asset classes to a diverse group of institutions and individuals worldwide and provide prime brokerage services, financing services and securities lending services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and to high-net-worth individuals worldwide.

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# Management's Discussion and Analysis

## 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, investment funds, governments and individuals.
- **Trading and Principal Investments**— We facilitate client transactions with a diverse group of corporations, financial institutions, investment funds, governments and individuals and take proprietary positions through market making in, trading of and investing in fixed income and equity products, currencies, commodities and derivatives on these products. In addition, we engage in specialist and market-making activities on equities and options exchanges and we clear client transactions on major stock, options and futures exchanges worldwide. In connection with our merchant banking and other investing activities, we make principal investments directly and through funds that we raise and manage.
- **Asset Management and Securities Services**— We provide investment advisory and financial planning services and offer investment products (primarily through separate accounts and funds) across all major asset classes to a diverse group of institutions and individuals worldwide and provide prime brokerage services, financing services and securities lending services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and to high-net-worth individuals worldwide.

Unless specifically stated otherwise, all references to 2006, 2005 and 2004 refer to our fiscal years ended, or the dates, as the context requires, November 24, 2006, November 25, 2005 and November 26, 2004, respectively.

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. 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 24, 2006.

In this discussion, we have included statements that may constitute “forward-looking statements” within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not historical facts but instead represent only our beliefs regarding future events, many of which, by their nature, are inherently uncertain and outside our control. These statements may relate to our future plans and objectives, among other things. By identifying these statements for you in this manner, we are alerting you to the possibility that our actual results may differ, possibly materially, from the anticipated results indicated in these forward-looking statements. Important factors that could cause our results to differ, possibly materially, from those indicated in the forward-looking statements include, among others, those discussed below under “—Certain Risk Factors That May Affect Our Business” as well as “Risk Factors” in Part I, Item 1A of the Annual Report on Form 10-K and “Cautionary Statement Pursuant to the Private Securities Litigation Reform Act of 1995” in Part I, Item 1 of the Annual Report on Form 10-K.

# Management's Discussion and Analysis

## EXECUTIVE OVERVIEW

Our diluted earnings per common share were \$19.69 for 2006, compared with \$11.21 for 2005. Return on average tangible common shareholders' equity<sup>(1)</sup> was 39.8% and return on average common shareholders' equity was 32.8%. Excluding non-cash expenses of \$637 million related to the accounting for certain share-based awards under SFAS No. 123-R<sup>(2)</sup>, diluted earnings per common share for the year were \$20.57<sup>(2)</sup>, return on average tangible common shareholders' equity<sup>(1)</sup> was 41.8%<sup>(2)</sup> and return on average common shareholders' equity was 34.4%<sup>(2)</sup>.

In 2006, we generated record diluted earnings per common share, which exceeded the prior year record results by 76%. Each of our three segments achieved record results. The increase in Trading and Principal Investments reflected significantly higher net revenues in Fixed Income, Currency and Commodities (FICC), Equities and Principal Investments. The increase in FICC reflected particularly strong performances across all major businesses. During 2006, FICC operated in an environment characterized by strong customer-driven activity and favorable market opportunities. The increase in Equities primarily reflected significantly higher net revenues in our customer franchise business. During 2006, Equities operated in a favorable environment characterized by strong customer-driven activity, generally higher equity prices and favorable market opportunities,

although volatility levels were generally low. In FICC and Equities, as a result of the favorable trading and investing opportunities for our clients and ourselves, we increased our market risk, particularly in equity products, to capitalize on these opportunities. We grew our balance sheet as needed to support these opportunities as well as to support increased activity in Securities Services. The increase in Principal Investments reflected a significant gain related to our investment in the ordinary shares of Industrial and Commercial Bank of China Limited (ICBC) and higher gains and overrides from other principal investments, partially offset by a smaller, but still significant, gain related to our investment in the convertible preferred stock of Sumitomo Mitsui Financial Group, Inc. (SMFG). The increase in Investment Banking was due to significantly higher net revenues in Underwriting and Financial Advisory, as we benefited from strong client activity levels, reflecting favorable equity and financing markets, strong CEO confidence and growth in financial sponsor activity. The increase in Asset Management and Securities Services was primarily due to higher assets under management and significantly higher incentive fees, as well as significantly higher global customer balances in Securities Services. Assets under management increased \$144 billion or 27% to a record \$676 billion, including net asset inflows of \$94 billion during 2006.

<sup>(1)</sup> Return on average tangible common shareholders' equity is computed by dividing 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 return on average tangible common shareholders' equity.

<sup>(2)</sup> Statement of Financial Accounting Standards (SFAS) No. 123-R, "Share-Based Payment," focuses primarily on accounting for transactions in which an entity obtains employee services in exchange for share-based payments. In the first quarter of 2006, we adopted SFAS No. 123-R, which requires that share-based awards held by employees that were retirement-eligible, including those subject to non-compete agreements, be expensed in the year of grant. In addition to expensing current year awards, prior year awards must continue to be amortized over the relevant service period. Therefore, our compensation and benefits expenses in 2006 included (and, to a lesser extent, 2007 and 2008 will include) both amortization of prior year share-based awards held by employees that were retirement-eligible on the date of adoption of SFAS No. 123-R and new awards granted to those employees. We believe that presenting our results excluding the impact of the continued amortization of these prior year share-based awards increases the comparability of period-to-period operating results and allows for a more meaningful representation of the relationship of current period compensation to net revenues.

The following tables set forth a reconciliation of diluted earnings per common share, common shareholders' equity and net earnings applicable to common shareholders, as reported, to these items excluding the impact of the continued amortization of these prior year share-based awards held by employees that were retirement-eligible on the date of adoption of SFAS No. 123-R:

	YEAR ENDED NOVEMBER 2006
Diluted earnings per common share	\$19.69
Impact of the continued amortization of prior year share-based awards, net of tax	0.88
Diluted earnings per common share, excluding the impact of the continued amortization of prior year share-based awards	\$20.57

<i>(in millions)</i>	AVERAGE FOR THE YEAR ENDED NOVEMBER 2006
Total shareholders' equity	\$31,048
Preferred stock	(2,400)
Common shareholders' equity	28,648
Impact of the continued amortization of prior year share-based awards, net of tax	(122)
Common shareholders' equity, excluding the impact of the continued amortization of prior year share-based awards	28,526
Goodwill and identifiable intangible assets, excluding power contracts (see footnote 1 above)	(5,013)
Tangible common shareholders' equity (see footnote 1 above), excluding the impact of the continued amortization of prior year share-based awards	\$23,513

<i>(in millions)</i>	YEAR ENDED NOVEMBER 2006
Net earnings applicable to common shareholders	\$9,398
Impact of the continued amortization of prior year share-based awards, net of tax	421
Net earnings applicable to common shareholders, excluding the impact of the continued amortization of prior year share-based awards	\$9,819

## Management's Discussion and Analysis

Looking forward to 2007, our investment banking backlog at the end of 2006 was at its highest level since 2000<sup>(1)</sup>. In addition to potential growth in the businesses and geographic areas in which we currently operate, the expansion of the economies of China, India, Russia and Brazil, as well as those of the Middle East offer new opportunities for us to increase our presence in those markets. In Investment Banking, there is growth potential to broaden our client base by providing strategic and financing advice and capital to middle-market companies. We also see opportunities to advise governments and investors on the sale and purchase of public infrastructure assets. In addition, we are building a private banking capability as part of our strategy to provide a full range of services to our private wealth management clients.

Though we generated record operating results in 2006, 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 the factors that may affect our future operating results, see “—Certain Risk Factors That May Affect Our Business” below as well as “Risk Factors” in Part I, Item 1A of the Annual Report on Form 10-K.

<sup>(1)</sup> 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.

### BUSINESS ENVIRONMENT

As an investment banking, securities and investment management firm, our businesses are materially affected by conditions in the financial markets and economic conditions generally, both in the United States and elsewhere around the world. A favorable business environment is generally characterized by, among other factors, high global gross domestic product growth, stable geopolitical conditions, transparent and efficient capital markets, low inflation, high business and investor confidence and strong business earnings. These factors provide a positive climate for our investment banking activities, for many of our trading businesses and for wealth creation, which contributes to growth in our asset management business. Although global short-term interest rates rose to modest levels and yield curves continued to flatten in 2006, economic conditions remained favorable, as global equity prices generally rose, core inflation was broadly contained and corporate activity strengthened. For a further discussion of how market conditions can affect our businesses, see “—Certain Risk Factors That May Affect Our Business” below as well as “Risk Factors” in Part I, Item 1A of the Annual Report on Form 10-K. A further discussion of the business environment in 2006 is set forth below.

**Global**—After solid economic growth in 2005, the global economy grew at a strong pace in 2006, particularly during the first half of the year. However, during the second half of the year, economic growth in the United States and Japan showed some signs of deceleration, while the pace of growth in the Eurozone economy appeared to strengthen. Corporate activity was very strong, as mergers and acquisitions and equity and debt underwriting volumes increased significantly compared with 2005. The U.S. Federal Reserve continued to raise rates in the first half of the year, increasing its federal funds target rate by a total of 125 basis points. Despite the increase in short-term rates, fixed income markets were favorable as long-term bond yields remained low and the credit environment remained strong. Oil prices remained high throughout the year, despite declining during our fourth quarter, but this did not appear to materially affect consumer spending or global growth. In the currency markets, the U.S. dollar weakened against most major currencies, as well as against such emerging market currencies as the Brazilian real, Chinese yuan and Korean won.

**United States**—The U.S. economy grew at a strong pace during the year as financial conditions remained supportive of economic activity. Real gross domestic product rose by 3.4% in the 2006 calendar year, driven principally by strength in the industrial sector, solid consumer expenditure growth and a strong labor market. This growth occurred despite a decline in the housing market and residential investment. After slowing modestly in the beginning of 2006, the rate of inflation increased, particularly in the second quarter, as energy prices rose significantly. Measures of core inflation also accelerated, although they eased towards the end of the calendar year. In response to the strong economic growth and rising inflation, the U.S. Federal Reserve raised its federal funds target rate by 25 basis points in each of its meetings in 2006 through June, bringing the rate to 5.25%. However, the Federal Reserve kept rates unchanged for the remainder of the year as the pace of growth moderated, reflecting a decline in the U.S. housing market and the delayed effects of higher interest rates and energy prices. Despite the rise in short-term interest rates, the 10-year U.S. Treasury note yield ended the year only 12 basis points higher at 4.55%. The Dow Jones Industrial Average, S&P 500 Index and NASDAQ Composite Index increased by 12%, 10% and 9%, respectively, during our fiscal year.

**Europe**—The pace of economic growth in Europe accelerated as real gross domestic product in the Eurozone economy grew by approximately 2.7% in the 2006 calendar year. Despite a higher Euro, economic conditions in the Eurozone countries improved throughout the year, and consumer sentiment began to improve as a result of lower unemployment levels and higher domestic demand. After leaving rates unchanged for over two

## Management's Discussion and Analysis

years, the European Central Bank raised interest rates by a total of 125 basis points during our 2006 fiscal year, bringing its policy rate to 3.25%. In the United Kingdom, real gross domestic product growth accelerated to approximately 2.7% in the 2006 calendar year, primarily reflecting strong investment spending. The Bank of England increased interest rates by 50 basis points to 5.00%, after having reduced rates by 25 basis points in 2005. Long-term bond yields in both the Eurozone and the United Kingdom ended our fiscal year modestly higher. Reflecting the improvement in economic growth, European equity markets increased significantly during our fiscal year.

**Asia**—Japan's economy grew at a relatively strong pace for the second year in a row, with real gross domestic product increasing by approximately 2.2% in the 2006 calendar year. The recovery in private investment and domestic demand continued to drive much of the improvement in the first part of the year, while exports drove real gross domestic product growth toward the end of the calendar year. The unemployment rate fell to 4.2% in 2006 from 4.4% in calendar 2005. The Bank of Japan ended its zero interest rate policy, which had been in place since early 2001, and raised the target overnight call rate by 25 basis points during our fiscal year. The yield on 10-year Japanese government bonds increased slightly, ending our fiscal year up 17 basis points. Despite slightly higher short- and long-term interest rates, financial conditions remained supportive of economic activity. The yen appreciated slightly against the U.S. dollar, but declined against most other major currencies, while the Nikkei 225 Index increased 6% during our fiscal year.

Elsewhere in Asia, China's real gross domestic product growth remained robust, with growth particularly reliant on net exports, as demonstrated by China's large current account surplus. China continued to allow its currency to appreciate modestly, with evidence of acceleration during the second half of the calendar year, ending our fiscal year nearly 3% higher against the U.S. dollar. Other currencies in the region also strengthened against the U.S. dollar, including the Korean won, Philippine peso and the Taiwan dollar. Growth in India also remained strong, which, together with China, supported growth throughout the region. Equity markets across the region generally rose, with markets in China, India, Hong Kong, South Korea and Taiwan all posting significant gains during our fiscal year.

### CERTAIN RISK FACTORS

#### THAT MAY AFFECT OUR BUSINESS

We face a variety of risks that are substantial and inherent in our businesses, including market, liquidity, credit, operational, legal and regulatory risks. For a discussion of how management seeks to manage some of these risks, see “—Risk Management” below. A summary of the more important factors that could affect our business follows below. For a further discussion of these and other important factors that could affect our business, see “Risk Factors” in Part I, Item 1A of the Annual Report on Form 10-K.

**Market Conditions and Market Risk**—Our businesses are materially affected by conditions in the global financial markets and economic conditions generally, and these conditions may change suddenly and dramatically. A favorable business environment is generally characterized by, among other factors, high global gross domestic product growth, stable geopolitical conditions, transparent and efficient capital markets, low inflation, high business and investor confidence and strong business earnings. Unfavorable or uncertain economic and market conditions, which can be caused by outbreaks of hostilities or other geopolitical instability, declines in business confidence, increases in inflation, corporate, political or other scandals that reduce investor confidence in capital markets, natural disasters or pandemics or a combination of these or other factors, have adversely affected, and may in the future adversely affect, our business and profitability in many ways, including the following:

- We have been operating in a low interest rate market for the past several years. Increasing or high interest rates and/or widening credit spreads, especially if such changes are rapid, may create a less favorable environment for certain of our businesses.
- We have been committing increasing amounts of capital in many of our businesses and generally maintain large trading, specialist and investing positions. Market fluctuations and volatility may adversely affect the value of those positions, including, but not limited to, our interest rate and credit products, currency, commodity and equity positions and our merchant banking investments, or may reduce our willingness to enter into new transactions. From time to time, we have incurred significant trading losses in periods of market turbulence. Conversely, certain of our trading businesses depend on market volatility to provide trading and arbitrage opportunities, and decreases in volatility may reduce these opportunities and adversely affect the results of these businesses.

## Management's Discussion and Analysis

- Industry-wide declines in the size and number of underwritings and mergers and acquisitions may have an adverse effect on our revenues and, because we may be unable to reduce expenses correspondingly, our profit margins. In particular, because a significant portion of our investment banking revenues are derived from our participation in large transactions, a decrease in the number of large transactions due to uncertain or unfavorable market conditions may adversely affect our investment banking business.
- Pricing and other competitive pressures have continued, even as the volume and number of investment banking transactions have increased. In addition, the trend in the underwriting business toward multiple book runners and co-managers handling transactions, where previously there would have been a single book runner, has adversely affected our business and reduced our revenues.
- Reductions in the level of the equity markets or increases in interest rates tend to reduce the value of our clients' portfolios, which in turn may reduce the fees we earn for managing assets. Increases in interest rates or attractive conditions in other investments could cause our clients to transfer their assets out of our funds or other products. Even in the absence of uncertain or unfavorable economic or market conditions, investment performance by our asset management business below the performance of benchmarks or competitors could result in a decline in assets under management and in the incentive and management fees we receive as well as reputational damage that might make it more difficult to attract new investors.
- Concentration of risk increases the potential for significant losses in our market-making, proprietary trading and investing, block trading, merchant banking, underwriting and lending businesses. This risk may increase to the extent we expand our proprietary trading and investing businesses or commit capital to facilitate customer-driven business. For example, in recent years large blocks of securities have increasingly been sold in block trades rather than on a marketed basis, which increases the risk that Goldman Sachs may be unable to resell the purchased securities at favorable prices and may incur significant losses as a result. Moreover, because of concentration of risk, we may suffer losses even when economic and market conditions are generally favorable for others in the industry. 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.
- The volume of transactions that we execute for our clients and as a specialist or market maker may decline, which would reduce the revenues we receive from commissions and spreads. In addition, competitive pressures and other industry factors, including the increasing use by our clients of low-cost electronic trading, could cause a reduction in commissions and spreads. In our specialist businesses, we are obligated by stock exchange rules to maintain an orderly market, including by purchasing shares in a declining market. This may result in trading losses and an increased need for liquidity. Weakness in global equity markets and the trading of securities in multiple markets and on multiple exchanges could adversely impact our trading businesses and impair the value of our goodwill and identifiable intangible assets. In addition, competitive pressures have been particularly intense in the context of block trades. For a further discussion of our goodwill and identifiable intangible assets, see “—Critical Accounting Policies—Goodwill and Identifiable Intangible Assets” below.
- While we employ a broad and diversified set of risk monitoring and risk mitigation techniques, those techniques and the judgments that accompany their application cannot anticipate every economic and financial outcome or the specifics and timing of such outcomes. Thus, we may, in the course of our activities, incur losses.
- Market volatility has been relatively low in recent years. An increase in volatility would increase our measured risk, which might cause us to reduce our proprietary positions or to reduce certain of our business activities. In such circumstances, we may not be able to reduce our positions or our exposure in a timely, cost-effective way or in a manner sufficient to offset the increase in measured risk.

**Liquidity Risk**—Liquidity is essential to our businesses. Our liquidity could be impaired by an inability to access secured and/or unsecured debt markets, an inability to access funds from our subsidiaries, an inability to sell assets or unforeseen outflows of cash or collateral. This situation may arise due to circumstances that we are unable to control, such as a general market disruption or an operational problem that affects third parties or us. The financial instruments that we hold and the contracts to which we are a party are increasingly complex, as we employ structured products to benefit our clients and ourselves, and these complex structured products often do not have readily available markets to access in times of liquidity stress. Growth of our proprietary investing activities may lead to situations where the holdings from these activities represent a significant portion of specific markets, which could restrict liquidity for our positions. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time.

## Management's Discussion and Analysis

Our credit ratings are important to our liquidity. A reduction in our credit ratings could adversely affect our liquidity and competitive position, increase our borrowing costs, limit our access to the capital markets or trigger our obligations under certain bilateral provisions in some of our trading and collateralized financing contracts. Under these provisions, counterparties could be permitted to terminate contracts with Goldman Sachs or require us to post additional collateral. Termination of our trading and collateralized financing contracts could cause us to sustain losses and impair our liquidity by requiring us to find other sources of financing or to make significant cash payments or securities movements. For a discussion of the potential impact on Goldman Sachs of a reduction in our credit ratings, see “—Liquidity and Funding Risk—Credit Ratings” below.

**Credit Risk**—We are exposed to the risk that third parties that owe us money, securities or other assets will not perform their obligations. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons. We are also subject to the risk that our rights against third parties may not be enforceable in all circumstances. In addition, a deterioration in the credit quality of third parties whose securities or obligations we hold could result in losses and/or adversely affect our ability to rehypothecate or otherwise use those securities or obligations for liquidity purposes. A significant downgrade in the credit ratings of our counterparties could also have a negative impact on our results. The amount and duration of our credit exposures have been increasing over the past several years, as has the breadth of the entities to which we have credit exposures. As a clearing member firm, we finance our client positions, and we could be held responsible for the defaults or misconduct of our clients. In addition, we have experienced, due to competitive factors, pressure to extend and price credit at levels that may not always fully compensate us for the risks we take. In particular, corporate clients sometimes seek to require credit commitments from us in connection with investment banking and other assignments. Although we regularly review credit exposures to specific clients and counterparties and to specific industries, countries and regions that we believe may present credit concerns, default risk may arise from events or circumstances that are difficult to detect or foresee, particularly as new business initiatives lead us to transact with a broader array of clients, with new asset classes and in new markets. In addition, concerns about, or a default by, one institution could lead to significant liquidity problems, losses or defaults by other institutions, which in turn could adversely affect Goldman Sachs.

**Operational Risk**—Shortcomings or failures in our internal processes, people or systems, or external events could lead to impairment of our liquidity, financial loss, disruption of our businesses, liability to clients, regulatory intervention or reputational damage. For example, our businesses are highly dependent on our ability to process, on a daily basis, a large number of transactions across numerous and diverse markets in many currencies. The transactions we process have become increasingly complex and often must adhere to client-specific guidelines, as well as legal and regulatory standards. Despite the contingency plans and facilities we have in place, our ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports our businesses and the communities in which we are located. This may include a disruption involving electrical, communications, transportation or other services used by Goldman Sachs or third parties with which we conduct business.

**Legal and Regulatory Risk**—We are subject to extensive and evolving regulation in jurisdictions around the world. Substantial legal liability or a significant regulatory action against Goldman Sachs could have material adverse financial effects or cause significant reputational harm to Goldman Sachs, which in turn could seriously harm our business prospects. Firms in the financial services industry have been operating in a difficult regulatory environment. We face significant legal risks in our businesses, and the volume of claims and amount of damages and penalties claimed in litigation and regulatory proceedings against financial institutions remain high. For a discussion of how we account for our legal and regulatory exposures, see “—Use of Estimates” below.

### CRITICAL ACCOUNTING POLICIES

#### **Fair Value**

The use of fair value to measure our financial instruments, with related unrealized gains or losses generally 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.

## Management's Discussion and Analysis

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

### Financial Instruments by Category

(in millions)	AS OF NOVEMBER			
	2006		2005	
	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	\$247,031 <sup>(1)</sup>	\$ 87,244	\$210,042	\$ 89,735
Derivative contracts	67,543	65,496	58,532	57,829
Principal investments	13,962 <sup>(2)</sup>	3,065 <sup>(3)</sup>	6,526 <sup>(2)</sup>	1,507 <sup>(3)</sup>
Total	\$328,536	\$155,805	\$275,100	\$149,071

<sup>(1)</sup> Includes securities held by our bank and insurance subsidiaries, which are accounted for as "available-for-sale" (AFS) under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The following table sets forth the types of AFS securities and their maturity profile:

(in millions)	AS OF NOVEMBER 2006				
	UNDER ONE YEAR	1-5 YEARS	5-10 YEARS	10 YEARS OR GREATER	TOTAL
Mortgage-backed and other federal agency securities	\$2,374	\$1,031	\$146	\$111	\$3,662
Investment-grade corporate bonds	23	1,403	42	51	1,519
Collateralized debt obligations	192	4,199	—	121	4,512
Other debt securities	115	31	52	54	252
Total	\$2,704	\$6,664	\$240	\$337	\$9,945

<sup>(2)</sup> Excludes assets related to consolidated merchant banking funds of \$6.03 billion and \$1.93 billion as of November 2006 and November 2005, respectively, for which Goldman Sachs is not at risk.

<sup>(3)</sup> Represents an economic hedge on 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**—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 NOVEMBER			
	2006		2005	
	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	\$231,012	\$87,110	\$198,233	\$89,565
Little or no price transparency	16,019	134	11,809	170
Total	\$247,031	\$87,244	\$210,042	\$89,735

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 and high-yield corporate bonds, listed equities, money market securities, state, municipal and provincial obligations, and physical commodities.

Certain cash trading instruments trade infrequently and have little or no price transparency. Such instruments include certain corporate bank loans, mortgage whole loans and distressed debt. We value these instruments initially at cost and generally do not adjust valuations 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 or changes in the credit ratings of the underlying companies). Where there is evidence supporting a change in the value, we use valuation methodologies such as the present value of known or estimated cash flows.

## Management's Discussion and Analysis

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. In certain circumstances, such as for positions that are illiquid or have transfer restrictions, the fair value reflects liquidity valuation adjustments based on market evidence or predetermined policies.

For certain highly illiquid positions, management's estimates are used to determine these liquidity valuation adjustments. See "—Recent Accounting Developments" below for a discussion of the impact of SFAS No. 157, "Fair Value Measurements" on the valuation of financial instruments.

**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 NOVEMBER			
	2006		2005	
	ASSETS	LIABILITIES	ASSETS	LIABILITIES
Exchange-traded derivatives	\$14,407	\$13,851	\$10,869	\$ 9,083
OTC derivatives	53,136	51,645	47,663	48,746
Total	\$67,543 <sup>(1)</sup>	\$65,496 <sup>(2)</sup>	\$58,532 <sup>(1)</sup>	\$57,829 <sup>(2)</sup>

<sup>(1)</sup>Net of cash received pursuant to credit support agreements of \$24.06 billion and \$22.61 billion as of November 2006 and November 2005, respectively.

<sup>(2)</sup>Net of cash paid pursuant to credit support agreements of \$16.00 billion and \$16.10 billion as of November 2006 and November 2005, 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 and option-pricing 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 these markets. 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. 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 spreads 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 these 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. See "—Recent Accounting Developments" below for a discussion of the impact of SFAS No. 157 on the valuation of financial instruments.



## Management's Discussion and Analysis

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 NOVEMBER 2006						
ASSETS	0-6 MONTHS	6-12 MONTHS	1-5 YEARS	5-10 YEARS	10 YEARS OR GREATER	TOTAL
Contract Type						
Interest rates <sup>(1)</sup>	\$ 2,432	\$1,706	\$ 5,617	\$ 5,217	\$6,201	\$21,173
Currencies	5,578	943	3,103	1,669	966	12,259
Commodities	3,892	1,215	5,836	1,258	231	12,432
Equities	1,430	1,134	1,329	2,144	1,235	7,272
<b>Total</b>	<b>\$13,332</b>	<b>\$4,998</b>	<b>\$15,885</b>	<b>\$10,288</b>	<b>\$8,633</b>	<b>\$53,136</b>
LIABILITIES						
LIABILITIES	0-6 MONTHS	6-12 MONTHS	1-5 YEARS	5-10 YEARS	10 YEARS OR GREATER	TOTAL
Contract Type						
Interest rates <sup>(1)</sup>	\$ 2,807	\$1,242	\$ 6,064	\$3,582	\$5,138	\$18,833
Currencies	6,859	1,290	2,582	494	634	11,859
Commodities	3,078	658	4,253	1,643	273	9,905
Equities	3,235	1,682	2,615	3,239	277	11,048
<b>Total</b>	<b>\$15,979</b>	<b>\$4,872</b>	<b>\$15,514</b>	<b>\$8,958</b>	<b>\$6,322</b>	<b>\$51,645</b>

AS OF NOVEMBER 2005						
ASSETS	0-6 MONTHS	6-12 MONTHS	1-5 YEARS	5-10 YEARS	10 YEARS OR GREATER	TOTAL
Contract Type						
Interest rates <sup>(1)</sup>	\$ 1,898	\$ 467	\$ 4,634	\$5,310	\$5,221	\$17,530
Currencies	5,825	1,031	1,843	919	1,046	10,664
Commodities	3,772	1,369	8,130	1,374	120	14,765
Equities	1,168	1,171	832	1,403	130	4,704
<b>Total</b>	<b>\$12,663</b>	<b>\$4,038</b>	<b>\$15,439</b>	<b>\$9,006</b>	<b>\$6,517</b>	<b>\$47,663</b>
LIABILITIES						
LIABILITIES	0-6 MONTHS	6-12 MONTHS	1-5 YEARS	5-10 YEARS	10 YEARS OR GREATER	TOTAL
Contract Type						
Interest rates <sup>(1)</sup>	\$ 1,956	\$ 590	\$ 5,327	\$3,142	\$4,970	\$15,985
Currencies	6,295	575	3,978	436	924	12,208
Commodities	3,852	2,080	5,904	1,865	162	13,863
Equities	1,308	1,068	2,079	1,993	242	6,690
<b>Total</b>	<b>\$13,411</b>	<b>\$4,313</b>	<b>\$17,288</b>	<b>\$7,436</b>	<b>\$6,298</b>	<b>\$48,746</b>

<sup>(1)</sup>Includes credit-related derivatives.

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 remaining contractual maturity is generally classified based upon the maturity date of the underlying derivative instrument. In those instances where the underlying instrument does not have a maturity date or either counterparty has the right to settle in cash, the remaining contractual maturity is generally based upon the option expiration date.

## Management's Discussion and Analysis

**Principal Investments**—The following table sets forth the carrying value of the investments included within the Principal Investments component of our Trading and Principal Investments segment. These investments consist of private investments, investments in the convertible preferred stock of SMFG and the ordinary shares of ICBC, and other public investments:

### Principal Investments

(in millions)	AS OF NOVEMBER					
	2006			2005		
	CORPORATE	REAL ESTATE	TOTAL	CORPORATE	REAL ESTATE	TOTAL
Private	\$ 2,741	\$555	\$ 3,296	\$1,538	\$716	\$2,254
Public	934	33	967	185	29	214
Subtotal <sup>(1)</sup>	3,675	588	4,263	1,723	745	2,468
SMFG convertible preferred stock <sup>(2)(3)</sup>	4,505	—	4,505	4,058	—	4,058
ICBC ordinary shares <sup>(4)</sup>	5,194	—	5,194	—	—	—
Total	\$13,374	\$588	\$13,962	\$5,781	\$745	\$6,526

<sup>(1)</sup> Excludes assets related to consolidated merchant banking funds of \$6.03 billion and \$1.93 billion as of November 2006 and November 2005, respectively, for which Goldman Sachs is not at risk.

<sup>(2)</sup> The fair value of our Japanese yen-denominated investment in the convertible preferred stock of SMFG includes the effect of foreign exchange revaluation. We mitigate 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.

<sup>(3)</sup> Excludes an economic hedge on the unrestricted shares of common stock underlying our investment in the convertible preferred stock of SMFG. The fair value of this hedge was \$3.07 billion and \$1.51 billion as of November 2006 and November 2005, respectively, and is reflected in "Financial instruments sold, but not yet purchased, at fair value" in the 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.

<sup>(4)</sup> Includes interests of \$3.28 billion as of November 2006 held by investment funds managed by Goldman Sachs. The fair value of our investment in the ordinary shares of ICBC, which trade on The Stock Exchange of Hong Kong, includes the effect of foreign exchange revaluation.

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. See "—Recent Accounting Developments" below for a discussion of the impact of SFAS No. 157 on the valuation of financial instruments.

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 less a liquidity valuation adjustment 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 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 would be nonlinear for a significant decline in the SMFG common stock price. During the year, the fair value of our investment (excluding the economic hedge on the unrestricted shares of common stock) increased 8% (expressed in Japanese yen), reflecting the impact of passage of time in respect of the transfer restrictions on the underlying common stock.

Our investment in the convertible preferred stock of SMFG is generally nontransferable without the consent of SMFG, but is freely convertible into SMFG common stock. As of November 2006, we had hedged two-thirds of the common stock underlying our investment in SMFG. Restrictions on our ability to hedge or sell the remaining shares will lapse on February 7, 2007. As of November 2006, the conversion price was ¥318,800, 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 ¥105,100).

## Management's Discussion and Analysis

Our investment in the ordinary shares of ICBC is carried at fair value using quoted market prices less a liquidity valuation adjustment. The ordinary shares acquired from ICBC are subject to transfer restrictions that, among other things, prohibit any sale, disposition or other transfer until April 28, 2009. From April 28, 2009 to October 20, 2009, we may transfer up to 50% of the aggregate ordinary shares of ICBC that we owned as of October 20, 2006. We may transfer the remaining shares after October 20, 2009. A portion of our interest is held by investment funds managed by Goldman Sachs.

**Controls Over Valuation of Financial Instruments**—A control infrastructure, independent of the trading and investing functions, is fundamental to ensuring that our financial instruments are appropriately 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 for reporting the results of these policies to our Audit Committee. We seek to maintain the necessary resources to ensure that control functions are performed to the highest standards. We employ procedures for the approval of new transaction types and markets, price verification, review of daily profit and loss, and review of valuation models by personnel with appropriate technical knowledge of relevant products and markets. These procedures are performed by personnel independent of the revenue-producing units. For trading and principal investments with little or no price transparency, we employ, where possible, procedures that include comparisons with similar observable positions, analysis of actual to projected cash flows, comparisons with subsequent sales and discussions with senior business leaders. For a further discussion of how we manage the risks inherent in our trading and principal investing businesses, see “—Risk Management” below.

### Goodwill and Identifiable Intangible Assets

As a result of our acquisitions, principally SLK LLC (SLK) in 2000, The Ayco Company, L.P. (Ayco) in 2003, Cogentrix Energy, Inc. (Cogentrix) in 2004, National Energy & Gas Transmission, Inc. (NEGT) in 2005 and the acquisition of the variable annuity and variable life insurance business of The Hanover Insurance Group, Inc. (formerly Allmerica Financial Corporation) in 2006, 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 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 activities of each operating segment. Our last annual impairment test was performed during our 2006 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 NOVEMBER	
	2006	2005
Investment Banking		
Financial Advisory	\$ —	\$ —
Underwriting	125	125
Trading and Principal Investments		
FICC	136	91
Equities <sup>(1)</sup>	2,381	2,390
Principal Investments	4	1
Asset Management and Securities Services		
Asset Management <sup>(2)</sup>	421	424
Securities Services	117	117
<b>Total</b>	<b>\$3,184</b>	<b>\$3,148</b>

<sup>(1)</sup> Primarily related to SLK.

<sup>(2)</sup> Primarily related to 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.

## Management's Discussion and Analysis

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

	AS OF NOVEMBER		2005
	2006		
	CARRYING VALUE	RANGE OF REMAINING USEFUL LIVES (IN YEARS)	CARRYING VALUE
(\$ in millions)			
Customer lists <sup>(1)</sup>	\$ 737	5 – 19	\$ 777
Power contracts <sup>(2)</sup>	667	2 – 22	481
New York Stock Exchange (NYSE) specialist rights	542	15 <sup>(5)</sup>	580
Insurance-related assets <sup>(3)</sup>	362	7	—
Exchange-traded fund (ETF) specialist rights	105	21	111
Other <sup>(4)</sup>	89	1 – 7	106
Total	\$2,502		\$2,055

<sup>(1)</sup> Primarily includes our clearance and execution and NASDAQ customer lists related to SLK and financial counseling customer lists related to Ayco.

<sup>(2)</sup> Primarily relates to above-market power contracts of consolidated power generation facilities related to Cogentrix and NEG. Substantially all of these power contracts have been pledged to counterparties in connection with our secured financings. The increase in the carrying value of power contracts in 2006 was due to a restructuring of certain contracts, which resulted in the consolidation of the associated power generation facilities that had been previously accounted for under the equity method.

<sup>(3)</sup> Consists of the value of business acquired (VOBA) and deferred acquisition costs (DAC). VOBA represents the present value of estimated future gross profits of the variable annuity and variable life insurance business acquired in 2006. DAC results from commissions paid by Goldman Sachs to the primary insurer (ceding company) on life and annuity reinsurance agreements as compensation to place the business with us and to cover the ceding company's acquisition expenses. VOBA and DAC are amortized over the estimated life of the underlying contracts based on estimated gross profits, and amortization is adjusted based on actual experience. The seven year useful life represents the weighted average remaining amortization period of the underlying contracts (certain of which extend for approximately 30 years).

<sup>(4)</sup> Primarily includes technology-related and other assets related to SLK.

<sup>(5)</sup> During the first quarter of 2006, we reduced the estimated useful lives of our NYSE specialist rights from 22-24 years to 16 years. This change was due to higher than expected attrition in acquired NYSE specialist rights, primarily from mergers and delistings.

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 our identifiable intangible assets, including (i) changes in market structure that could adversely affect our specialist businesses, (ii) an adverse action or assessment by a regulator, (iii) a default event under a power contract or physical damage or other adverse events impacting the underlying power generation facilities, or (iv) adverse actual experience on the contracts in our variable annuity and variable life insurance business.

### 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 provisions for potential losses that may arise from litigation and regulatory proceedings and tax audits.

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 or proceeding, our experience and the experience of others in similar cases or proceedings, and the opinions and views of legal counsel. Given the inherent difficulty of predicting the outcome of our litigation and regulatory matters, particularly in cases or proceedings in which substantial or indeterminate damages or fines are sought, we cannot estimate losses or ranges of losses for cases or proceedings where there is only a reasonable possibility that a loss may be incurred. See "—Legal Proceedings" in Part I, Item 3 of the Annual Report on Form 10-K, for information on our judicial, regulatory and arbitration proceedings.

# Management's Discussion and Analysis

## 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 “—Certain Risk Factors That May Affect Our Business” above, and “Risk Factors” in Part I, Item 1A 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)	YEAR ENDED NOVEMBER		
	2006	2005	2004
Net revenues <sup>(1)</sup>	<b>\$37,665</b>	\$25,238	\$20,951
Pre-tax earnings	<b>14,560</b>	8,273	6,676
Net earnings	<b>9,537</b>	5,626	4,553
Net earnings applicable to common shareholders	<b>9,398</b>	5,609	4,553
Diluted earnings per common share	<b>19.69</b>	11.21	8.92
Return on average common shareholders' equity <sup>(2)</sup>	<b>32.8%</b>	21.8%	19.8%
Return on average tangible common shareholders' equity <sup>(3)</sup>	<b>39.8%</b>	26.7%	25.2%

<sup>(1)</sup> Beginning in the fourth quarter of 2006, “Cost of power generation” in the consolidated statements of earnings was reclassified to operating expenses. “Cost of power generation” was previously reported as a reduction to revenues. Prior periods have been reclassified to conform to the current presentation, with no impact to our reported net earnings.

<sup>(2)</sup> Return on average common shareholders' equity is computed by dividing net earnings applicable to common shareholders by average monthly common shareholders' equity.

<sup>(3)</sup> Tangible common shareholders' equity equals total shareholders' equity less preferred stock, goodwill and identifiable intangible assets, excluding power contracts. In 2006, we amended our calculation of tangible common shareholders' equity. We no longer deduct identifiable intangible assets associated with power contracts from total shareholders' equity because, unlike other intangible assets, less than 50% of these assets are supported by common shareholders' equity. Prior periods have been adjusted to conform to the current presentation.

We believe that return on average tangible common shareholders' equity is meaningful because it measures the performance of businesses consistently, whether they were acquired or developed internally. Return on average tangible common shareholders' equity is computed by dividing net earnings applicable to common shareholders by average monthly tangible common shareholders' equity.

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

(\$ in millions)	AVERAGE FOR THE YEAR ENDED NOVEMBER		
	2006	2005	2004
Total shareholders' equity	<b>\$31,048</b>	\$26,264	\$22,975
Preferred stock	<b>(2,400)</b>	(538)	—
Common shareholders' equity	<b>\$28,648</b>	\$25,726	\$22,975
Goodwill and identifiable intangible assets, excluding power contracts	<b>(5,013)</b>	(4,737)	(4,918)
Tangible common shareholders' equity	<b>\$23,635</b>	\$20,989	\$18,057

# Management's Discussion and Analysis

## Net Revenues

**2006 Versus 2005**—Our net revenues were \$37.67 billion in 2006, an increase of 49% compared with 2005, reflecting significantly higher net revenues in Trading and Principal Investments, Investment Banking, and Asset Management and Securities Services. The increase in Trading and Principal Investments reflected significantly higher net revenues in FICC, Equities and Principal Investments. The increase in FICC reflected particularly strong performances across all major businesses. During 2006, FICC operated in an environment characterized by strong customer-driven activity and favorable market opportunities. In addition, corporate credit spreads tightened, the yield curve flattened and volatility levels were generally low in interest rate and currency markets. The increase in Equities primarily reflected significantly higher net revenues in our customer franchise business. During 2006, Equities operated in a favorable environment characterized by strong customer-driven activity, generally higher equity prices and favorable market opportunities, although volatility levels were generally low. The increase in Principal Investments reflected a significant gain related to our investment in the ordinary shares of ICBC and higher gains and overrides from other principal investments, partially offset by a smaller, but still significant, gain related to our investment in the convertible preferred stock of SMFG. The increase in Investment Banking was due to significantly higher net revenues in Underwriting and Financial Advisory, as we benefited from strong client activity levels, reflecting favorable equity and financing markets, strong CEO confidence and growth in financial sponsor activity. The increase in Asset Management and Securities Services was primarily due to higher assets under management and significantly higher incentive fees, as well as significantly higher global customer balances in Securities Services. Assets under management increased \$144 billion or 27% to a record \$676 billion, including net asset inflows of \$94 billion during 2006.

**2005 Versus 2004**—Our net revenues were \$25.24 billion in 2005, an increase of 20% compared with 2004, reflecting strong growth in Trading and Principal Investments and Asset Management and Securities Services as well as higher net revenues in Investment Banking. The increase in Trading and Principal Investments reflected significantly higher net revenues in FICC, as all major businesses performed well. During 2005, FICC operated in an environment generally characterized by strong customer-driven activity, tight, but volatile, credit spreads, higher energy prices and a flatter yield curve. Net revenues in Equities also improved significantly compared with the prior year, reflecting strong performance across the business. Equities operated in an environment characterized by generally higher

equity prices, improved customer-driven activity and continued low levels of market volatility. Net revenues in our Principal Investments business also increased significantly, primarily reflecting a gain on our investment in the convertible preferred stock of SMFG as well as gains from real estate principal investments. The strong net revenue growth in Asset Management and Securities Services primarily reflected higher assets under management and higher customer balances in Securities Services. The increase in Investment Banking net revenues was due to significantly higher net revenues in debt underwriting and improved results in Financial Advisory, primarily reflecting an increase in industry-wide corporate activity, partially offset by lower net revenues in equity underwriting.

## 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 which are significantly impacted by, among other factors, the level of net revenues, prevailing labor markets, business mix and the structure of our share-based compensation programs. For 2006, our ratio of compensation and benefits to net revenues was 43.7%. Excluding non-cash expenses of \$637 million related to the continued amortization of prior year share-based awards held by employees that were retirement-eligible on the date of adoption of SFAS No. 123-R, our ratio of compensation and benefits to net revenues was 42.0%<sup>(1)</sup>.

<sup>(1)</sup> Our ratio of compensation and benefits to net revenues, excluding the impact of the continued amortization of these share-based awards, is computed by dividing compensation and benefits, excluding the impact of the continued amortization of these prior year share-based awards held by employees that were retirement-eligible on the date of adoption of SFAS No. 123-R, by net revenues. We believe that presenting the ratio of compensation and benefits to net revenues excluding the impact of the continued amortization of these awards enhances the comparability of period-to-period compensation and benefits and allows for a more meaningful representation of the relationship of current period compensation to net revenues. The following table sets forth the reconciliation of the ratio of compensation and benefits to net revenues, as reported, to the ratio of compensation and benefits to net revenues excluding the impact of the continued amortization of these prior year share-based awards:

	YEAR ENDED NOVEMBER 2006
(\$ in millions)	
Compensation and benefits	\$16,457
Impact of the continued amortization of prior year share-based awards	(637)
Compensation and benefits, excluding the impact of the continued amortization of prior year share-based awards	\$15,820
Net revenues	\$37,665
Ratio of compensation and benefits to net revenues, excluding the impact of the continued amortization of prior year share-based awards	42.0%

## Management's Discussion and Analysis

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

### *Operating Expenses and Employees*

(\$ in millions)	YEAR ENDED NOVEMBER		
	2006	2005	2004
Compensation and benefits <sup>(1) (2)</sup>	<b>\$16,457</b>	\$11,758	\$ 9,681
Brokerage, clearing, exchange and distribution fees <sup>(3)</sup>	<b>1,985</b>	1,416	1,172
Market development	<b>492</b>	378	374
Communications and technology	<b>544</b>	490	461
Depreciation and amortization	<b>521</b>	501	499
Amortization of identifiable intangible assets	<b>173</b>	124	125
Occupancy	<b>850</b>	728	646
Professional fees	<b>545</b>	475	338
Cost of power generation <sup>(2)</sup>	<b>406</b>	386	372
Other expenses <sup>(3)</sup>	<b>1,132</b>	709	607
Total non-compensation expenses	<b>6,648</b>	5,207	4,594
Total operating expenses	<b>\$23,105</b>	\$16,965	\$14,275
Employees at year end <sup>(4) (5)</sup>	<b>26,467</b>	23,623	21,736

<sup>(1)</sup> Compensation and benefits includes \$259 million, \$137 million and \$19 million for the years ended November 2006, November 2005 and November 2004, respectively, attributable to consolidated entities held for investment purposes. Consolidated entities held for investment purposes are entities that are held strictly for capital appreciation, have a defined exit strategy and are engaged in activities that are not closely related to our principal businesses.

<sup>(2)</sup> Beginning in the fourth quarter of 2006, "Cost of power generation" in the consolidated statements of earnings was reclassified to operating expenses. "Cost of power generation" was previously reported as a reduction to revenues. Compensation and benefits includes direct employee costs associated with our consolidated power generation facilities and cost of power generation includes the other direct costs associated with these power generation facilities and related contractual assets. Prior periods have been reclassified to conform to the current presentation, with no impact to our reported net earnings. This reclassification increased operating expenses as follows:

(in millions)	YEAR ENDED NOVEMBER		
	2006	2005	2004
Compensation and benefits	<b>\$ 78</b>	\$ 70	\$ 29
Cost of power generation	<b>406</b>	386	372
Total	<b>\$484</b>	\$456	\$401

<sup>(3)</sup> Beginning in the fourth quarter of 2006, third party research and brokerage fees and asset management sales and distribution fees were reclassified from "Other expenses" to "Brokerage, clearing, exchange and distribution fees" in the consolidated statements of earnings. Prior periods have been reclassified to conform to the current presentation.

<sup>(4)</sup> Excludes 3,868, 7,382 and 485 employees as of November 2006, November 2005 and November 2004, respectively, of consolidated entities held for investment purposes (see footnote 1 above).

<sup>(5)</sup> Includes 1,326 employees as of November 2006 of Goldman Sachs' consolidated property management and loan servicing subsidiaries. November 2005 and November 2004 have been adjusted to conform to the current presentation and include 1,198 and 1,014 employees, respectively.

## Management's Discussion and Analysis

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

### Non-Compensation Expenses

(in millions)	YEAR ENDED NOVEMBER		
	2006	2005	2004
Non-compensation expenses of consolidated investments <sup>(1)</sup>	\$ 501	\$ 265	\$ 21
Non-compensation expenses excluding consolidated investments			
Brokerage, clearing, exchange and distribution fees <sup>(2)</sup>	1,985	1,416	1,172
Market development	461	361	374
Communications and technology	537	487	461
Depreciation and amortization	444	467	499
Amortization of identifiable intangible assets	169	124	125
Occupancy	738	674	646
Professional fees	534	468	338
Cost of power generation <sup>(3)</sup>	406	386	372
Other expenses <sup>(2)</sup>	873	559	586
Subtotal	6,147	4,942	4,573
Total non-compensation expenses, as reported	\$6,648	\$5,207	\$4,594

<sup>(1)</sup> Consolidated entities held for investment purposes are entities that are held strictly for capital appreciation, have a defined exit strategy and are engaged in activities that 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 that 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 related to our principal business activities. Revenues related to such entities are included in "Trading and principal investments" in the consolidated statements of earnings.

<sup>(2)</sup> Beginning in the fourth quarter of 2006, third party research and brokerage fees and asset management sales and distribution fees were reclassified from "Other expenses" to "Brokerage, clearing, exchange and distribution fees" in the consolidated statements of earnings. Prior periods have been reclassified to conform to the current presentation.

<sup>(3)</sup> Beginning in the fourth quarter of 2006, "Cost of power generation" in the consolidated statements of earnings was reclassified to operating expenses. "Cost of power generation" was previously reported as a reduction to revenues. Prior periods have been reclassified to conform to the current presentation, with no impact to our reported net earnings.

**2006 Versus 2005**—Operating expenses were \$23.11 billion for 2006, 36% higher than 2005. Compensation and benefits expenses of \$16.46 billion increased 40% compared with 2005, primarily reflecting increased discretionary compensation due to higher net revenues, and increased levels of employment. The ratio of compensation and benefits to net revenues for 2006 was 43.7%<sup>(1)</sup> compared with 46.6%<sup>(1)</sup> for 2005. This lower ratio primarily reflected our strong net revenues in 2006. Employment levels increased 12% compared with November 2005.

In the first quarter of 2006, we adopted SFAS No. 123-R, which requires that share-based awards granted to retirement-eligible employees be expensed in the year of grant. In addition to expensing current year awards, prior year awards must continue to be amortized over the relevant service period. Therefore, our compensation and benefits in 2006 included (and, to a lesser extent, 2007 and 2008 will include) both amortization of prior year share-based awards held by employees that were retirement-eligible on the date of adoption of SFAS No. 123-R and new awards granted to those employees.

Compensation and benefits expenses in 2006 included \$637 million in continued amortization of prior year awards held by employees that were retirement-eligible on the date of adoption of SFAS

No. 123-R. This amount represents the majority of the expense to be recognized with respect to these awards.

Non-compensation expenses of \$6.65 billion for 2006 increased 28% compared with 2005. Excluding non-compensation expenses related to consolidated entities held for investment purposes, non-compensation expenses were 24% higher than 2005, primarily due to higher brokerage, clearing, exchange and distribution fees in Equities and FICC, and increased other expenses, primarily due to costs related to our insurance business, which was acquired in 2006. In addition, market development costs and professional fees were higher, reflecting increased levels of business activity, and occupancy expenses increased, primarily reflecting new office space and higher facility expenses.

**2005 Versus 2004**—Operating expenses were \$16.97 billion for 2005, 19% above 2004. Compensation and benefits expenses of \$11.76 billion increased 21% compared with 2004, resulting from higher discretionary compensation, reflecting higher net revenues, and increased levels of employment. The ratio of compensation and benefits to net revenues for 2005 was 46.6%<sup>(1)</sup> compared with 46.2%<sup>(1)</sup> for 2004. Employment levels increased 9% compared with November 2004.

<sup>(1)</sup> The effect of the cost of power generation reclassification on the ratio of compensation and benefits to net revenues was to decrease the ratio by approximately 30 basis points, 60 basis points and 50 basis points for 2006, 2005 and 2004, respectively.



## Management's Discussion and Analysis

Non-compensation expenses of \$5.21 billion for 2005 increased 13% compared with 2004. Excluding non-compensation expenses related to consolidated entities held for investment purposes, non-compensation expenses were 8% higher than 2004, primarily due to higher brokerage, clearing, exchange and distribution fees, reflecting higher transaction volumes in FICC and Equities, and increased professional fees, reflecting higher legal and consulting fees.

Non-compensation expenses in 2005 included \$37 million of net provisions for litigation and regulatory proceedings (included in other expenses) and \$36 million of real estate costs associated with the relocation of office space (included in occupancy). Non-compensation expenses in 2004 included \$103 million of net provisions for litigation and regulatory proceedings, \$62 million in connection with the establishment of our joint venture in China (included in market development) and \$41 million of real estate exit costs associated with reductions in our office space (included in occupancy and depreciation and amortization).

### Provision for Taxes

The effective income tax rate was 34.5% for 2006, up from 32.0% for 2005. The increase in the effective income tax rate for

2006 compared with 2005 was primarily related to a reduction in the impact of permanent benefits due to higher levels of earnings in 2006 and audit settlements in 2005. The effective income tax rate for 2005 was 32.0% compared with 31.8% for 2004. Excluding the impact of audit settlements in 2005, the effective income tax rate for 2005 would have been 33.3%<sup>(1)</sup>. Excluding the impact of audit settlements, the increase in the effective income tax rate for 2005 compared with 2004 was primarily due to a lower benefit from tax credits in 2005.

Our effective income tax rate can vary from period to period depending on, among other factors, the geographic and business mix of our earnings, the level of our tax credits and the effect of tax audits. Certain of these and other factors, including our history of pre-tax earnings, are taken into account in assessing our ability to realize our net deferred tax assets. See Note 14 to the consolidated financial statements for further information regarding our provision for taxes.

<sup>(1)</sup>The effective income tax rate excluding the impact of audit settlements is calculated by dividing the provision for taxes, adjusted to exclude the impact of audit settlements, by pre-tax earnings. The impact of audit settlements decreased the effective income tax rate by 1.3% for 2005. We believe that the effective income tax rate excluding the impact of audit settlements provides a meaningful basis for period-to-period comparisons of our effective income tax rates.

## Segment Operating Results

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

### Segment Operating Results

		YEAR ENDED NOVEMBER		
		2006	2005	2004
<i>(in millions)</i>				
Investment Banking	Net revenues	\$ 5,629	\$ 3,671	\$ 3,374
	Operating expenses	4,062	3,258	2,973
	Pre-tax earnings	\$ 1,567	\$ 413	\$ 401
Trading and Principal Investments	Net revenues <sup>(1)</sup>	\$25,562	\$16,818	\$13,728
	Operating expenses <sup>(1)</sup>	14,962	10,600	8,688
	Pre-tax earnings	\$10,600	\$ 6,218	\$ 5,040
Asset Management and Securities Services	Net revenues	\$ 6,474	\$ 4,749	\$ 3,849
	Operating expenses	4,036	3,070	2,430
	Pre-tax earnings	\$ 2,438	\$ 1,679	\$ 1,419
Total	Net revenues <sup>(1)</sup>	\$37,665	\$25,238	\$20,951
	Operating expenses <sup>(1)(2)</sup>	23,105	16,965	14,275
	Pre-tax earnings	\$14,560	\$ 8,273	\$ 6,676

<sup>(1)</sup>Beginning in the fourth quarter of 2006, "Cost of power generation" in the consolidated statements of earnings was reclassified to operating expenses. "Cost of power generation" was previously reported as a reduction to revenues. Prior periods have been reclassified to conform to the current presentation, with no impact to our reported pre-tax earnings.

<sup>(2)</sup>Includes the following expenses that have not been allocated to our segments: (i) net provisions for a number of litigation and regulatory proceedings of \$45 million, \$37 million and \$103 million for the years ended November 2006, November 2005 and November 2004, respectively; (ii) \$62 million in connection with the establishment of our joint venture in China for the year ended November 2004; and (iii) the amortization of employee initial public offering awards, net of forfeitures, of \$19 million for the year ended November 2004.

## Management's Discussion and Analysis

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. See Note 16 to the consolidated financial statements for further information regarding our segments.

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 and benefits 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. A discussion of segment operating results follows.

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

### *Investment Banking Operating Results*

<i>(in millions)</i>	YEAR ENDED NOVEMBER		
	2006	2005	2004
Financial Advisory	<b>\$2,580</b>	\$1,905	\$1,737
Equity underwriting	<b>1,365</b>	704	819
Debt underwriting	<b>1,684</b>	1,062	818
Total Underwriting	<b>3,049</b>	1,766	1,637
Total net revenues	<b>5,629</b>	3,671	3,374
Operating expenses	<b>4,062</b>	3,258	2,973
Pre-tax earnings	<b>\$1,567</b>	\$ 413	\$ 401

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

### *Goldman Sachs Global Investment Banking Volumes<sup>(1)</sup>*

<i>(in billions)</i>	YEAR ENDED NOVEMBER		
	2006	2005	2004
Announced mergers and acquisitions	<b>\$1,112</b>	\$807	\$395
Completed mergers and acquisitions	<b>858</b>	588	503
Equity and equity-related offerings <sup>(2)</sup>	<b>76</b>	49	54
Debt offerings <sup>(3)</sup>	<b>302</b>	270	236

<sup>(1)</sup>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.

<sup>(2)</sup>Includes public common stock offerings, convertible offerings, rights offerings and Rule 144A issues.

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

## Management's Discussion and Analysis

**2006 Versus 2005**—Net revenues in Investment Banking of \$5.63 billion for 2006 increased 53% compared with 2005. Net revenues in Financial Advisory of \$2.58 billion increased 35% compared with 2005, primarily reflecting strong growth in industry-wide completed mergers and acquisitions. Net revenues in our Underwriting business of \$3.05 billion increased 73% compared with 2005. Net revenues were significantly higher in equity underwriting, reflecting increased client activity. Net revenues were also significantly higher in debt underwriting, primarily due to a significant increase in leveraged finance activity and, to a lesser extent, an increase in investment-grade activity. Our investment banking backlog at the end of 2006 was at its highest level since 2000.<sup>(1)</sup>

Operating expenses of \$4.06 billion for 2006 increased 25% compared with 2005, substantially all of which was due to increased compensation and benefits expenses resulting from higher levels of discretionary compensation. Pre-tax earnings were \$1.57 billion in 2006 compared with \$413 million in 2005.

**2005 Versus 2004**—Net revenues in Investment Banking of \$3.67 billion for 2005 increased 9% compared with 2004. Net revenues in Financial Advisory of \$1.91 billion increased 10% compared with 2004, primarily reflecting an increase in industry-wide completed mergers and acquisitions. Net revenues in our Underwriting business of \$1.77 billion increased 8% compared with 2004, reflecting higher net revenues in debt underwriting, primarily due to an increase in leveraged finance and mortgage activity, partially offset by lower net revenues in equity underwriting. Our investment banking backlog at the end of 2005 was significantly higher than at the end of 2004.<sup>(1)</sup>

Operating expenses of \$3.26 billion for 2005 increased 10% compared with 2004, primarily due to increased compensation and benefits expenses resulting from higher levels of discretionary compensation and increased amortization expense related to prior year equity awards. In addition, professional fees were higher, principally due to increased legal and consulting fees. Pre-tax earnings of \$413 million in 2005 increased 3% compared with 2004.

<sup>(1)</sup> 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.

### 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-related securities and loan products, currencies and commodities, structure and enter into a wide variety of derivative transactions and engage in proprietary trading and investing.
- **Equities**—We make markets in, trade and act as a specialist for equities and equity-related products, structure and enter into equity derivative transactions and engage in proprietary trading and insurance activities. We also execute and clear client transactions on major stock, options and futures exchanges worldwide.
- **Principal Investments**—We make real estate and corporate principal investments, including our investments in the convertible preferred stock of SMFG and the ordinary shares of ICBC. We generate net revenues from returns on these investments and from the increased share of the income and gains derived from our merchant banking funds when the return on a fund's investments, over the life of the fund, exceeds certain threshold returns (overrides).

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.

## Management's Discussion and Analysis

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

### *Trading and Principal Investments Operating Results*

(in millions)	YEAR ENDED NOVEMBER		
	2006	2005	2004
FICC <sup>(1)</sup>	<b>\$14,262</b>	\$ 8,940	\$ 7,723
Equities trading	<b>4,965</b>	2,675	1,969
Equities commissions	<b>3,518</b>	2,975	2,704
Total Equities	<b>8,483</b>	5,650	4,673
SMFG	<b>527</b>	1,475	771
ICBC	<b>937</b>	—	—
Gross gains	<b>1,534</b>	767	855
Gross losses <sup>(2)</sup>	<b>(585)</b>	(198)	(399)
Net other corporate and real estate investments	<b>949</b>	569	456
Overrides	<b>404</b>	184	105
Total Principal Investments	<b>2,817</b>	2,228	1,332
Total net revenues <sup>(1)</sup>	<b>25,562</b>	16,818	13,728
Operating expenses <sup>(1)</sup>	<b>14,962</b>	10,600	8,688
Pre-tax earnings	<b>\$10,600</b>	\$ 6,218	\$ 5,040

<sup>(1)</sup> Beginning in the fourth quarter of 2006, "Cost of power generation" in the consolidated statements of earnings was reclassified to operating expenses. "Cost of power generation" was previously reported as a reduction to revenues. Prior periods have been reclassified to conform to the current presentation, with no impact to our reported pre-tax earnings.

<sup>(2)</sup> A substantial portion relates to interest expense on our principal investments.

**2006 Versus 2005**—Net revenues in Trading and Principal Investments of \$25.56 billion for 2006 increased 52% compared with 2005. Net revenues in FICC of \$14.26 billion increased 60% compared with 2005, primarily due to significantly higher net revenues in credit products (which includes distressed investing) and commodities. In addition, net revenues were higher in interest rate products, currencies and mortgages. During 2006, the business operated in an environment characterized by strong customer-driven activity and favorable market opportunities. In addition, corporate credit spreads tightened, the yield curve flattened and volatility levels were generally low in interest rate and currency markets. Net revenues in Equities of \$8.48 billion increased 50% compared with 2005, primarily reflecting significantly higher net revenues in derivatives, across all regions, as well as higher net revenues in shares. The increase also reflected the contribution from our insurance business, which was acquired in 2006. In addition, principal strategies performed well, although net revenues were lower than a particularly strong 2005. During 2006, Equities operated in a favorable environment characterized by strong customer-driven activity, generally higher equity prices and favorable market opportunities,

although volatility levels were generally low. Principal Investments recorded net revenues of \$2.82 billion, reflecting a \$937 million gain related to our investment in the ordinary shares of ICBC, a \$527 million gain related to our investment in the convertible preferred stock of SMFG and \$1.35 billion in gains and overrides from other principal investments.

Operating expenses of \$14.96 billion for 2006 increased 41% compared with 2005, due to increased compensation and benefits expenses, primarily resulting from higher levels of discretionary compensation due to higher net revenues and increased levels of employment, as well as higher non-compensation expenses. Excluding non-compensation expenses related to consolidated entities held for investment purposes, the increase in non-compensation expenses was primarily due to higher brokerage, clearing, exchange and distribution fees, in Equities and FICC, and increased other expenses, primarily due to costs related to our insurance business, which was acquired in 2006, and higher levels of business activity. In addition, professional fees were higher, due to increased legal and consulting fees. Pre-tax earnings of \$10.60 billion in 2006 increased 70% compared with 2005.

## Management's Discussion and Analysis

**2005 Versus 2004**—Net revenues in Trading and Principal Investments of \$16.82 billion for 2005 increased 23% compared with 2004. Net revenues in FICC of \$8.94 billion increased 16% compared with 2004, primarily reflecting significantly higher net revenues in credit products (which includes distressed investing) and, to a lesser extent, interest rate products and currencies. Net revenues in commodities and mortgages were strong, but essentially unchanged compared with 2004. During 2005, FICC operated in an environment generally characterized by strong customer-driven activity, tight, but volatile, credit spreads, higher energy prices and a flatter yield curve. Net revenues in Equities of \$5.65 billion increased 21% compared with 2004, reflecting significantly higher net revenues in our customer franchise and principal strategies businesses. The increase in our customer franchise business reflected improved results in derivatives and shares, particularly in Europe and Asia, as well as in convertibles. In addition, results in principal strategies reflected strength across all regions. During 2005, Equities operated in an environment characterized by generally higher equity prices, improved customer-driven activity and continued low levels of market volatility. Principal Investments recorded net revenues of \$2.23 billion, due to a \$1.48 billion gain related to our investment in the convertible preferred stock of SMFG and \$753 million in gains and overrides from other corporate and, to a lesser extent, real estate principal investments.

Operating expenses of \$10.60 billion for 2005 increased 22% compared with 2004, primarily due to increased compensation and benefits expenses, reflecting higher discretionary compensation and increased levels of employment and, to a lesser extent, higher non-compensation expenses related to consolidated entities held for investment purposes. Excluding non-compensation expenses related to consolidated entities held for investment purposes, the increase in non-compensation expenses was primarily attributable to higher brokerage, clearing, exchange

and distribution fees, principally due to increased transaction volumes in FICC and Equities, and higher professional fees, due to increased legal and consulting fees. Pre-tax earnings of \$6.22 billion in 2005 increased 23% compared with 2004.

### Asset Management and Securities Services

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

- **Asset Management**—Asset Management provides investment advisory and financial planning services and offers investment products (primarily through separate accounts and funds) across all major asset classes 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 services, financing services and securities lending services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and to high-net-worth individuals worldwide, and generates revenues primarily in the form of interest rate spreads or fees.

Assets under management typically generate fees as a percentage of asset value. In certain circumstances, we are also entitled to receive incentive fees based on a percentage of a fund's return or when the return on assets under management exceeds specified benchmark returns or other performance targets. Incentive fees are recognized when the performance period ends and they are no longer subject to adjustment. We have numerous incentive fee arrangements, many of which have annual performance periods that end on December 31. For that reason, incentive fees have been seasonally weighted to our first quarter. Based on investment performance in calendar 2006, our incentive fees will be significantly lower in fiscal 2007 than they were in fiscal 2006.

## Management's Discussion and Analysis

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)	YEAR ENDED NOVEMBER		
	2006	2005	2004
Management and other fees	<b>\$3,332</b>	\$2,629	\$2,219
Incentive fees	<b>962</b>	327	334
Total Asset Management	<b>4,294</b>	2,956	2,553
Securities Services	<b>2,180</b>	1,793	1,296
Total net revenues	<b>6,474</b>	4,749	3,849
Operating expenses	<b>4,036</b>	3,070	2,430
Pre-tax earnings	<b>\$2,438</b>	\$1,679	\$1,419

Assets under management include our mutual funds, alternative investment funds and separately managed accounts for institutional and individual investors. 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<sup>(1)</sup>*

(in billions)	AS OF NOVEMBER 30		
	2006	2005	2004
Alternative investments <sup>(2)</sup>	<b>\$145</b>	\$110	\$ 95
Equity	<b>215</b>	167	133
Fixed income	<b>198</b>	154	134
Total non-money market assets	<b>558</b>	431	362
Money markets	<b>118</b>	101	90
Total assets under management	<b>\$676</b>	\$532	\$452

<sup>(1)</sup> In the first quarter of 2006, we changed the methodology for classifying certain non-money market assets. The changes were made primarily to reclassify certain assets allocated to external investment managers out of alternative investment assets and to reclassify currency funds into alternative investment assets. The changes did not impact total assets under management and prior periods have been reclassified to conform to the current presentation.

<sup>(2)</sup> Primarily includes hedge funds, private equity, real estate, currencies, commodities and asset allocation strategies.

## Management's Discussion and Analysis

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

### Changes in Assets Under Management

(in billions)	YEAR ENDED NOVEMBER 30		
	2006	2005	2004
Balance, beginning of year	<b>\$532</b>	\$452	\$373
Net asset inflows/(outflows)			
Alternative investments	<b>32</b>	11	27
Equity	<b>16</b>	25	13
Fixed income	<b>29</b>	16	11
Total non-money market net asset inflows/(outflows)	<b>77</b>	52	51
Money markets	<b>17<sup>(1)</sup></b>	11	1
Total net asset inflows/(outflows)	<b>94<sup>(2)</sup></b>	63	52
Net market appreciation/(depreciation)	<b>50</b>	17	27
Balance, end of year	<b>\$676</b>	\$532	\$452

<sup>(1)</sup> Net of \$8 billion transferred from assets under management to interest-bearing deposits at Goldman Sachs Bank USA, a wholly owned subsidiary of Group Inc. These deposits are not included in assets under management.

<sup>(2)</sup> Includes \$3 billion of net asset inflows in connection with our December 30, 2005 acquisition of the variable annuity and variable life insurance business of The Hanover Insurance Group, Inc.

**2006 Versus 2005**—Net revenues in Asset Management and Securities Services of \$6.47 billion for 2006 increased 36% compared with 2005. Asset Management net revenues of \$4.29 billion increased 45% compared with 2005, reflecting significantly higher management and other fees, principally due to strong growth in assets under management, and significantly higher incentive fees. During the year, assets under management increased \$144 billion or 27% to \$676 billion, reflecting non-money market net asset inflows of \$77 billion, spread across all asset classes, money market net asset inflows of \$17 billion<sup>(1)</sup>, and market appreciation of \$50 billion, primarily in equity and fixed income assets. Securities Services net revenues of \$2.18 billion increased 22% compared with 2005, as our prime brokerage business continued to generate strong results, primarily reflecting significantly higher global customer balances in securities lending and margin lending.

Operating expenses of \$4.04 billion for 2006 increased 31% compared with 2005, primarily due to increased compensation and benefits expenses, resulting from higher levels of discretionary compensation due to higher net revenues, and increased levels of employment. Non-compensation expenses also increased, primarily due to higher distribution fees (included in brokerage, clearing, exchange and distribution fees). In addition, market development costs were higher, reflecting increased levels of business activity. Pre-tax earnings of \$2.44 billion increased 45% compared with 2005.

<sup>(1)</sup> Net of \$8 billion transferred from assets under management to interest-bearing deposits at Goldman Sachs Bank USA, a wholly owned subsidiary of Group Inc. These deposits are not included in assets under management.

**2005 Versus 2004**—Net revenues in Asset Management and Securities Services of \$4.75 billion for 2005 increased 23% compared with 2004. Asset Management net revenues of \$2.96 billion increased 16% compared with 2004, primarily due to higher management fees, driven by growth in assets under management. During 2005, assets under management increased 18% to \$532 billion, reflecting net asset inflows of \$63 billion across all asset classes as well as market appreciation of \$17 billion, primarily in equity assets. Securities Services net revenues of \$1.79 billion for 2005 increased 38% compared with 2004, primarily reflecting significantly higher global customer balances in securities lending and margin lending.

Operating expenses of \$3.07 billion for 2005 increased 26% compared with 2004, primarily due to increased compensation and benefits expenses resulting from higher discretionary compensation and increased levels of employment. Other expenses also increased and professional fees were higher, principally due to increased consulting and legal fees. Pre-tax earnings of \$1.68 billion increased 18% compared with 2004.

### Geographic Data

For a summary of the net revenues and pre-tax earnings of Goldman Sachs by geographic region, see Note 16 to the consolidated financial statements.

# Management's Discussion and Analysis

## OFF-BALANCE-SHEET ARRANGEMENTS

We have various types of off-balance-sheet arrangements that we enter into in the ordinary course of business. Our involvement in these arrangements can take many different forms, including purchasing or retaining residual and other interests in mortgage-backed and other asset-backed securitization vehicles; holding senior and subordinated debt, interests in limited and general partnerships, and preferred and common stock in other non-consolidated vehicles; entering into interest rate, foreign currency, equity, commodity and credit derivatives, including total return swaps; entering into operating leases; and providing guarantees, indemnifications, loan commitments, letters of credit, representations and warranties.

We enter into these arrangements for a variety of business purposes, primarily related to the securitization of commercial and residential mortgages, home equity and auto loans, government and corporate bonds, and other types of financial assets. Other reasons for entering into these arrangements include underwriting

client securitization transactions; providing secondary market liquidity; making investments in performing and nonperforming debt, equity, real estate and other assets; providing investors with credit-linked and asset-repackaged notes; and receiving or providing letters of credit to satisfy margin requirements and to facilitate the clearance and settlement process.

We engage in transactions with variable interest entities (VIEs) and qualifying special-purpose entities (QSPEs). Such vehicles are critical to the functioning of several significant investor markets, including the mortgage-backed and other asset-backed securities markets, since they provide market liquidity to financial assets by offering investors access to specific cash flows and risks created through the securitization process. Our financial interests in, and derivative transactions with, such nonconsolidated entities are accounted for at fair value, in the same manner as our other financial instruments, except in cases where we apply the equity method of accounting.

The following table sets forth where a discussion of these and other off-balance-sheet arrangements may be found in this Annual Report:

TYPE OF OFF-BALANCE-SHEET ARRANGEMENT	DISCLOSURE IN ANNUAL REPORT
Retained interests or contingent interests in assets transferred by us to nonconsolidated entities	See Note 3 to the consolidated financial statements.
Leases, letters of credit, and loans and other commitments	See “—Contractual Obligations and Commitments” below and Note 6 to the consolidated financial statements.
Guarantees	See Note 6 to the consolidated financial statements.
Other obligations, including contingent obligations, arising out of variable interests we have in nonconsolidated entities	See Note 3 to the consolidated financial statements.
Derivative contracts	See “—Critical Accounting Policies” above and “—Risk Management” below and Note 3 to the consolidated financial statements.

In addition, see Note 2 to the consolidated financial statements for a discussion of our consolidation policies.



# Management's Discussion and Analysis

## EQUITY CAPITAL

The level and composition of our equity capital are principally determined by our consolidated regulatory capital requirements, subsidiary capital requirements and rating agency guidelines. The equity capital we hold may also be influenced by the business environment, conditions in the financial markets and an assessment of potential future losses during an extremely adverse business and market environment. As of November 2006, our total shareholders' equity was \$35.79 billion (consisting of common shareholders' equity of \$32.69 billion and preferred stock of \$3.10 billion) compared with total shareholders' equity of \$28.00 billion as of November 2005 (consisting of common shareholders' equity of \$26.25 billion and preferred stock of \$1.75 billion). In addition to total shareholders' equity, we consider the \$2.75 billion of junior subordinated debt issued to a trust (see below) part of our equity capital, as it qualifies as capital for regulatory and certain rating agency purposes.

### Consolidated Regulatory Capital Requirements

During 2005, Goldman Sachs became 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 to minimum capital adequacy standards on a consolidated basis. Minimum capital adequacy standards are principally driven by the amount of our market risk, credit risk and operational risk as calculated by methodologies approved by the SEC. Eligible sources of regulatory capital include common equity and certain types of preferred stock, debt and hybrid instruments, including our junior subordinated debt issued to a trust. The recognition of preferred stock, debt and hybrid instruments as regulatory capital is subject to limitations. Goldman Sachs was in compliance with the CSE capital adequacy standards as of November 2006 and November 2005.

### Subsidiary Capital Requirements

Many of our principal subsidiaries are subject to separate regulation and capital requirements in the United States and/or elsewhere. Goldman, Sachs & Co. and Goldman Sachs Execution & Clearing, L.P. are registered U.S. broker-dealers and futures commissions merchants, and their primary regulators include the SEC, the Commodity Futures Trading Commission, the Chicago Board of Trade, the NYSE, the National Association of Securities Dealers, Inc. and the National Futures Association. Goldman Sachs International, our regulated U.K. broker-dealer, is subject to regulation primarily by the U.K.'s Financial

Services Authority. Goldman Sachs Japan Co., Ltd. (GSJCL), our regulated Japanese broker-dealer, is subject to regulation by Japan's Financial Services Agency. Prior to October 1, 2006, Goldman Sachs (Japan) Ltd. (GSJL), the predecessor to GSJCL, was our primary regulated subsidiary based in Japan. Several other subsidiaries of Goldman Sachs are regulated by securities, investment advisory, banking, and other regulators and authorities around the world, such as the Federal Financial Supervisory Authority (BaFin) and the Bundesbank in Germany, Banque de France and the Autorité des Marchés Financiers in France, Banca d'Italia and the Commissione Nazionale per le Società e la Borsa (CONSOB) in Italy, the Swiss Federal Banking Commission, the Securities and Futures Commission in Hong Kong, the Monetary Authority of Singapore and the China Securities Regulatory Commission. Goldman Sachs Bank USA (GS Bank), a wholly owned industrial bank, is regulated by the Federal Deposit Insurance Corporation and the State of Utah Department of Financial Institutions and is subject to minimum capital requirements. As of November 2006 and November 2005, these subsidiaries were in compliance with their local capital requirements.

As discussed above, many of our subsidiaries are subject to regulatory capital requirements in jurisdictions throughout the world. Subsidiaries not subject to separate regulation may hold capital to satisfy local tax guidelines, rating agency requirements or internal policies, including policies concerning the minimum amount of capital a subsidiary should hold based upon its underlying risk. For a discussion of our potential inability to access funds from our subsidiaries, see "—Liquidity and Funding Risk—Conservative Liability Structure" below.

Equity investments in subsidiaries are generally funded with parent company equity capital. As of November 2006, Group Inc.'s equity investment in subsidiaries was \$32.58 billion compared with its total shareholders' equity of \$35.79 billion.

Our capital invested in non-U.S. subsidiaries is generally exposed to foreign exchange risk, substantially all of which is managed primarily through the use of derivative contracts. In addition, we generally manage the non-trading exposure to foreign exchange risk that arises from transactions denominated in currencies other than the transacting entity's functional currency.

See Note 15 to the consolidated financial statements for further information regarding our regulated subsidiaries.

## Management's Discussion and Analysis

### Rating Agency Guidelines

The credit rating agencies assign credit ratings to the obligations of The Goldman Sachs Group, Inc., which directly issues or guarantees substantially all of Goldman Sachs' senior unsecured obligations. The level and composition of our equity capital are among the many factors considered in determining our credit ratings. Each agency has its own definition of eligible capital and methodology for evaluating capital adequacy, and assessments are generally based on a combination of factors rather than a single calculation. See “—Liquidity and Funding Risk—Credit Ratings” below for further information regarding our credit ratings.

### Equity Capital Management

Our objective is to maintain a sufficient level and optimize the composition of our equity capital. We manage our capital through repurchases of our common stock and issuances of preferred stock, junior subordinated debt issued to a trust and subordinated debt.

**Share Repurchase Program**—We use our share repurchase program to help maintain the appropriate level of common equity and to

substantially offset increases in share count over time resulting from employee share-based compensation. The repurchase program is effected primarily through regular open-market purchases and is influenced by our overall capital position (the comparison of our capital requirements to our available capital), general market conditions and the prevailing price and trading volumes of our common stock.

The following table sets forth the level of share repurchases for the years ended November 2006 and November 2005:

(in millions, except per share amounts)	AS OF NOVEMBER	
	2006	2005
Number of shares repurchased	50.23	63.73
Total cost	\$ 7,817	\$ 7,108
Average cost per share	\$155.64	\$111.57

As of November 2006, we were authorized to repurchase up to 52.6 million additional shares of common stock pursuant to our repurchase program. For additional information on our repurchase program, see “—Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities” in Part II, Item 5 of the Annual Report on Form 10-K.

**Preferred Stock**—During 2006, Goldman Sachs issued 54,000 shares of perpetual Floating Rate Non-Cumulative Preferred Stock, Series D. As of November 2006, Goldman Sachs had 124,000 shares of perpetual non-cumulative preferred stock outstanding in four series as set forth in the following table:

### Preferred Stock by Series

SERIES	SHARES ISSUED	SHARES AUTHORIZED	DIVIDEND RATE	EARLIEST REDEMPTION DATE	REDEMPTION VALUE (IN MILLIONS)
A	30,000	50,000	3 month LIBOR + 0.75%, with floor of 3.75% per annum	April 25, 2010	\$ 750
B	32,000	50,000	6.20% per annum	October 31, 2010	800
C	8,000	25,000	3 month LIBOR + 0.75%, with floor of 4% per annum	October 31, 2010	200
D	54,000	60,000	3 month LIBOR + 0.67%, with floor of 4% per annum	May 24, 2011	1,350
	124,000	185,000			\$3,100

Each share of preferred stock has a par value of \$0.01, has a liquidation preference of \$25,000, is represented by 1,000 depositary shares and is redeemable at our option at a redemption price equal to \$25,000 plus declared and unpaid dividends. Dividends on each series of preferred stock, if declared, are payable quarterly in arrears. Our ability to declare or pay dividends on, or purchase, redeem or otherwise acquire, our common stock is subject to certain restrictions in the event that we fail to pay or set aside full dividends on our preferred stock for the latest completed dividend period. All preferred stock also has a preference over our common stock upon liquidation.

**Junior Subordinated Debt Issued to a Trust**—As of November 2006, we had outstanding junior subordinated debt issued to a trust of \$2.75 billion, included in “Unsecured long-term borrowings” on the consolidated statements of financial condition. 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, are such that they qualify as regulatory capital for CSE purposes, and thus, are part of our equity capital.

## Management's Discussion and Analysis

**Subordinated Debt**—Although not part of our shareholders' equity, subordinated debt may be used to meet a portion of our consolidated minimum capital requirements as a CSE. As of November 2006, we had outstanding subordinated debt of \$4.67 billion.

### Capital Ratios and Metrics

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

(\$ in millions, except per share amounts)	AS OF NOVEMBER	
	2006	2005
Total assets	<b>\$838,201</b>	\$706,804
Adjusted assets <sup>(1)</sup>	<b>541,033</b>	466,500
Total shareholders' equity	<b>35,786</b>	28,002
Tangible equity capital <sup>(2)</sup>	<b>33,517</b>	26,030
Leverage ratio <sup>(3)</sup>	<b>23.4x</b>	25.2x
Adjusted leverage ratio <sup>(4)</sup>	<b>16.1x</b>	17.9x
Debt to equity ratio <sup>(5)</sup>	<b>3.4x</b>	3.0x
Common shareholders' equity	<b>32,686</b>	26,252
Tangible common shareholders' equity <sup>(6)</sup>	<b>27,667</b>	21,530
Book value per common share <sup>(7)</sup>	<b>\$ 72.62</b>	\$ 57.02
Tangible book value per common share <sup>(8)</sup>	<b>61.47</b>	46.76

<sup>(1)</sup> 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 borrowed and financial instruments purchased under agreements to resell, and then subtracting our nonderivative short positions), (ii) cash and securities we segregate for regulatory and other purposes and (iii) goodwill and identifiable intangible assets, excluding power contracts. In 2006, we amended our calculation of adjusted assets. We no longer deduct identifiable intangible assets associated with power contracts from total assets. We amended our calculation in order to be consistent with the calculation of tangible equity capital and the adjusted leverage ratio (see footnote 2 below). Prior periods have been adjusted to conform to the current presentation.

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

(in millions)	AS OF NOVEMBER	
	2006	2005
Total assets	<b>\$838,201</b>	\$706,804
Deduct: Securities borrowed	<b>(219,342)</b>	(191,800)
Financial instruments purchased under agreements to resell	<b>(82,126)</b>	(83,619)
Add: Financial instruments sold, but not yet purchased, at fair value	<b>155,805</b>	149,071
Less derivative liabilities	<b>(65,496)</b>	(57,829)
Subtotal	<b>90,309</b>	91,242
Deduct: Cash and securities segregated for regulatory and other purposes	<b>(80,990)</b>	(51,405)
Goodwill and identifiable intangible assets, excluding power contracts	<b>(5,019)</b>	(4,722)
Adjusted assets	<b>\$541,033</b>	\$466,500

<sup>(2)</sup> Tangible equity capital equals total shareholders' equity and junior subordinated debt issued to a trust less goodwill and identifiable intangible assets, excluding power contracts. In 2006, we amended our calculation of tangible equity capital. We no longer deduct identifiable intangible assets associated with power contracts from total shareholders' equity because, unlike other intangible assets, less than 50% of these assets are supported by common shareholders' equity. Prior periods have been adjusted to conform to the current presentation. 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 the reconciliation of total shareholders' equity to tangible equity capital:

(in millions)	AS OF NOVEMBER	
	2006	2005
Total shareholders' equity	<b>\$35,786</b>	\$28,002
Add: Junior subordinated debt issued to a trust	<b>2,750</b>	2,750
Deduct: Goodwill and identifiable intangible assets, excluding power contracts	<b>(5,019)</b>	(4,722)
Tangible equity capital	<b>\$33,517</b>	\$26,030

<sup>(3)</sup> Leverage ratio equals total assets divided by total shareholders' equity.

<sup>(4)</sup> 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 than the leverage ratio 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.

<sup>(5)</sup> Debt to equity ratio equals unsecured long-term borrowings divided by total shareholders' equity.

<sup>(6)</sup> Tangible common shareholders' equity equals total shareholders' equity less preferred stock, goodwill and identifiable intangible assets, excluding power contracts. In 2006, we amended our calculation of tangible common shareholders' equity. We no longer deduct identifiable intangible assets associated with power contracts from total shareholders' equity because, unlike other intangible assets, less than 50% of these assets are supported by common shareholders' equity. Prior periods have been adjusted to conform to the current presentation.

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

(in millions)	AS OF NOVEMBER	
	2006	2005
Total shareholders' equity	<b>\$35,786</b>	\$28,002
Deduct: Preferred stock	<b>(3,100)</b>	(1,750)
Common shareholders' equity	<b>32,686</b>	26,252
Deduct: Goodwill and identifiable intangible assets, excluding power contracts	<b>(5,019)</b>	(4,722)
Tangible common shareholders' equity	<b>\$27,667</b>	\$21,530

<sup>(7)</sup> Book value per common share is based on common shares outstanding, including restricted stock units granted to employees with no future service requirements, of 450.1 million and 460.4 million as of November 2006 and November 2005, respectively.

<sup>(8)</sup> 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.

## Management's Discussion and Analysis

### CONTRACTUAL OBLIGATIONS AND COMMITMENTS

Goldman Sachs has contractual obligations to make future payments related to our unsecured long-term borrowings, secured long-term financings, long-term noncancelable lease agreements and purchase obligations and has commitments under a variety of commercial arrangements.

The following table sets forth our contractual obligations by fiscal maturity date as of November 2006:

#### *Contractual Obligations*

<i>(in millions)</i>	2007	2008-2009	2010-2011	2012- THEREAFTER	TOTAL
Unsecured long-term borrowings <sup>(1)(2)(3)</sup>	\$ —	\$33,262	\$20,043	\$69,537	\$122,842
Secured long-term financings <sup>(1)(2)(4)</sup>	—	6,412	6,999	12,723	26,134
Minimum rental payments	564	758	535	2,195	4,052
Purchase obligations <sup>(5)</sup>	1,448	535	18	18	2,019

<sup>(1)</sup> Obligations maturing within one year of our financial statement date or redeemable within one year of our financial statement date at the option of the holder are excluded from this table and are treated as short-term obligations. See Note 3 to the consolidated financial statements for further information regarding our secured financings.

<sup>(2)</sup> Obligations that are repayable prior to maturity at the option of Goldman Sachs are reflected at their contractual maturity dates. Obligations that are redeemable prior to maturity at the option of the holder are reflected at the dates such options become exercisable.

<sup>(3)</sup> Includes \$7.25 billion of hybrid financial instruments accounted for at fair value under SFAS No. 155 as of November 2006.

<sup>(4)</sup> Included in "Other secured financings" in the consolidated statements of financial condition.

<sup>(5)</sup> Primarily includes construction-related obligations.

As of November 2006, our unsecured long-term borrowings were \$122.84 billion and consisted principally of senior borrowings with maturities extending to 2036. See Note 5 to the consolidated financial statements for further information regarding our unsecured long-term borrowings.

As of November 2006, our future minimum rental payments, net of minimum sublease rentals, under noncancelable leases were \$4.05 billion. These lease commitments, principally for office space, expire on various dates through 2069. Certain agreements are subject to periodic escalation provisions for increases in real estate taxes and other charges. See Note 6 to the consolidated financial statements for further information regarding our leases.

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 regularly evaluate our current and future space capacity in relation to current and projected staffing levels. We may incur exit costs in 2007 and thereafter to the extent we (i) reduce our space capacity or (ii) commit to, or occupy, new properties in the locations in which we operate and, consequently, dispose of existing space that had been held for potential growth. These exit costs may be material to our results of operations in a given period.

As of November 2006 and November 2005, we had construction-related obligations of \$1.63 billion and \$579 million, respectively, including purchase obligations of \$1.07 billion and \$481 million, respectively, related to the development of wind energy projects. Construction-related obligations also include outstanding purchase obligations of \$500 million and \$47 million as of November 2006 and November 2005, respectively, related to our new world headquarters in New York City, which is expected to cost between \$2.3 billion and \$2.5 billion.

## Management's Discussion and Analysis

The following table sets forth our commitments as of November 2006:

### Commitments

(in millions)	COMMITMENT AMOUNT BY FISCAL PERIOD OF EXPIRATION				TOTAL
	2007	2008-2009	2010-2011	2012-THEREAFTER	
Commitments to extend credit					
William Street program	\$ 1,540	\$ 2,664	\$13,442	\$ 1,185	\$ 18,831
Other commercial lending:					
Investment-grade	4,606	1,463	1,535	—	7,604
Non-investment-grade	2,437	11,999	30,415	12,166	57,017
Warehouse financing	15,488	1,538	—	—	17,026
Total commitments to extend credit	24,071	17,664	45,392	13,351	100,478
Forward starting resale and securities borrowing agreements	18,285	—	—	—	18,285
Forward starting repurchase and securities lending agreements	17,148	—	—	—	17,148
Commitments under letters of credit issued by banks to counterparties	5,714	4	1	15	5,734
Merchant banking commitments	4,058	457	487	1,353	6,355
Underwriting commitments	2,620	—	—	—	2,620
Other investment commitments	356	1,201	143	182	1,882
Total	\$72,252	\$19,326	\$46,023	\$14,901	\$152,502

Our commitments to extend credit are agreements to lend to counterparties that have fixed termination dates and are contingent on the satisfaction of all conditions to borrowing set forth in the contract. In connection with our lending activities, we had outstanding commitments to extend credit of \$100.48 billion as of November 2006 compared with \$61.12 billion as of November 2005. Since these commitments may expire unused or be reduced or cancelled at the counterparty's request, the total commitment amount does not necessarily reflect the actual future cash flow requirements. Our commercial lending commitments outside the William Street credit extension program are generally extended in connection with contingent acquisition financing and other types of corporate lending. We may seek to reduce our credit risk on these commitments by syndicating all or substantial portions of commitments to other investors. In addition, commitments that are extended for contingent acquisition financing are often short-term in nature, as borrowers often replace them with other funding sources.

Substantially all of the commitments provided under the William Street credit extension program are to investment-grade corporate borrowers. Commitments under the program are primarily extended by William Street Commitment Corporation (Commitment Corp.), a consolidated wholly owned subsidiary of Group Inc. whose assets and liabilities are legally separated from other assets and liabilities of Goldman Sachs, and, to a lesser extent, by William Street Credit Corporation, another consolidated wholly owned subsidiary of Group Inc. A majority of the commitments

extended by Commitment Corp. are supported by funding raised by William Street Funding Corporation (Funding Corp.), another consolidated wholly owned subsidiary of Group Inc. whose assets and liabilities are also legally separated from other assets and liabilities of Goldman Sachs. With respect to substantially all of the William Street commitments, SMFG provides us with credit loss protection that is generally limited to 95% of the first loss we realize on approved loan commitments, up to a maximum of \$1.00 billion. In addition, subject to the satisfaction of certain conditions, upon our request, SMFG will provide protection for 70% of the second loss on such commitments, up to a maximum of \$1.13 billion. We also use other financial instruments to mitigate credit risks related to certain William Street commitments not covered by SMFG.

Our commitments to extend credit also include financing for the warehousing of financial assets to be securitized, primarily in connection with collateralized debt obligations (CDOs) and mortgage securitizations, which are expected to be repaid from the proceeds of the related securitizations for which we may or may not act as underwriter. These arrangements are secured by the warehoused assets, primarily consisting of mortgage-backed and other asset-backed securities, residential and commercial mortgages and corporate debt instruments.

See Note 6 to the consolidated financial statements for further information regarding our commitments, contingencies and guarantees.

# Management's Discussion and Analysis

## RISK MANAGEMENT

Management believes that effective risk management is of primary importance to the success of Goldman Sachs. Accordingly, we have a comprehensive risk management process to monitor, evaluate and manage the principal risks we assume in conducting our activities. These risks include market, credit, liquidity, operational, legal and reputational exposures.

### Risk Management Structure

We seek to monitor and control our risk exposure through a variety of separate but complementary financial, credit, operational, compliance and legal reporting systems. In addition, a number of committees are responsible for monitoring risk exposures and for general oversight of our risk management process, as described further below. These committees (including their subcommittees), meet regularly and consist of senior members of both our revenue-producing units and departments that are independent of our revenue-producing units.

Segregation of duties and management oversight are fundamental elements of our risk management process. In addition to the committees described below, functions that are independent of the revenue-producing units, such as Compliance, Finance, Legal, Management Controls (Internal Audit) and Operations, perform risk management functions, which include monitoring, analyzing and evaluating risk.

**Management Committee**—All risk control functions ultimately report to our Management Committee. Through both direct and delegated authority, the Management Committee approves all of our operating activities, trading risk parameters and customer review guidelines.

**Risk Committees**—The Firmwide Risk Committee reviews the activities of existing businesses, approves new businesses and products, approves firmwide and divisional market risk limits, reviews business unit market risk limits, approves market risk limits for selected sovereign markets and business units, approves sovereign credit risk limits and credit risk limits by ratings group, and reviews scenario analyses based on abnormal or “catastrophic” market movements.

The Divisional Risk Committee sets market risk limits for our trading activities subject to overall firmwide risk limits, based on a number of measures, including Value-at-Risk (VaR), stress tests and scenario analyses. Several other committees oversee various risk, valuation, operational, credit and business practice issues related to our asset management business.

Business unit risk limits are established by the various risk committees and may be further allocated by the business unit managers to individual trading desks. Trading desk managers

have the first line of responsibility for managing risk within prescribed limits. These managers have in-depth knowledge of the primary sources of risk in their respective markets and the instruments available to hedge their exposures.

Market risk limits are monitored by the Finance Division and are reviewed regularly by the appropriate risk committee. Limit violations are reported to the appropriate risk committee and business unit managers and addressed, as necessary. Credit risk limits are also monitored by the Finance Division and reviewed by the appropriate risk committee.

**Business Practices Committee**—The Business Practices Committee assists senior management in its oversight of compliance, legal and operational risks and related reputational concerns, such as potential conflicts of interest. The Business Practices Committee also reviews Goldman Sachs' business practices, policies, and procedures for consistency with our business principles. The Business Practices Committee reviews these areas and makes recommendations for improvements as necessary to mitigate potential risks and assist in achieving adherence to our business principles.

**Firmwide Capital Committee**—The Firmwide Capital Committee reviews and approves transactions involving commitments of our capital. Such capital commitments include, but are not limited to, extensions of credit, alternative liquidity commitments, certain bond underwritings and certain distressed debt and principal finance activities. The Firmwide Capital Committee is also responsible for establishing business and reputational standards for capital commitments and ensuring that they are maintained on a global basis.

**Commitments Committee**—The Commitments Committee reviews and approves underwriting and distribution activities, primarily with respect to offerings of equity and equity-related securities, and sets and maintains policies and procedures designed to ensure that legal, reputational, regulatory and business standards are maintained in conjunction with these activities. In addition to reviewing specific transactions, the Commitments Committee periodically conducts strategic reviews of industry sectors and products and establishes policies in connection with transaction practices.

**Credit Policy Committee**—The Credit Policy Committee establishes and reviews broad credit policies and parameters that are implemented by the Credit Department.

**Finance Committee**—The Finance Committee establishes and oversees our liquidity policies, sets certain inventory position limits and has oversight responsibility for liquidity risk, the size and composition of our balance sheet and capital base, and our

## Management's Discussion and Analysis

credit ratings. The Finance Committee regularly reviews our funding position and capitalization and makes adjustments in light of current events, risks and exposures.

**New Products Committee**—The New Products Committee, under the oversight of the Firmwide Risk Committee, is responsible for reviewing and approving new products and businesses globally.

**Operational Risk Committee**—The Operational Risk Committee provides oversight of the ongoing development and implementation of our operational risk policies, framework and methodologies, and monitors the effectiveness of operational risk management.

**Structured Products Committee**—The Structured Products Committee reviews and approves structured product transactions entered into with our clients that raise legal, regulatory, tax or accounting issues or present reputational risk to Goldman Sachs.

### Market Risk

The potential for changes in the market value of our trading and investing positions is referred to as market risk. Such positions result from market-making, specialist, proprietary trading and investing, and underwriting activities.

Categories of market risk include exposures to interest rates, equity prices, currency rates and commodity prices. A description of each market risk category is set forth below:

- Interest rate risks primarily result from exposures to changes in the level, slope and curvature of the yield curve, the volatility of interest rates, mortgage prepayment speeds and credit spreads.
- Equity price risks result from exposures to changes in prices and volatilities of individual equities, equity baskets and equity indices.
- Currency rate risks result from exposures to changes in spot prices, forward prices and volatilities of currency rates.
- Commodity price risks result from exposures to changes in spot prices, forward prices and volatilities of commodities, such as electricity, natural gas, crude oil, petroleum products, and precious and base metals.

We seek to manage these risks by diversifying exposures, controlling position sizes and establishing economic hedges in

related securities or derivatives. For example, we may hedge a portfolio of common stocks by taking an offsetting position in a related equity-index futures contract. The ability to manage an exposure may, however, be limited by adverse changes in the liquidity of the security or the related hedge instrument and in the correlation of price movements between the security and related hedge instrument.

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

- risk limits based on a summary measure of market risk exposure referred to as 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.

### 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 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 standard methodology for estimating VaR, and different assumptions and/or approximations could produce materially different VaR estimates.

## Management's Discussion and Analysis

We use historical data to estimate our VaR and, to better reflect current asset volatilities, we generally weight historical data to give greater importance to more recent observations. Given its reliance on historical data, VaR is most effective in estimating risk exposures in markets in which there are no sudden fundamental changes or shifts in market conditions. An inherent limitation of VaR is that the distribution of past changes in market risk factors may not produce accurate

predictions of future market risk. Different VaR methodologies and distributional assumptions could produce a materially different VaR. Moreover, VaR calculated for a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or offset with hedges within one day. Changes in VaR between reporting periods are generally due to changes in levels of exposure, volatilities and/or correlations among asset classes.

The following tables set forth the daily VaR:

### Average Daily VaR<sup>(1)</sup>

(in millions)

RISK CATEGORIES	YEAR ENDED NOVEMBER		
	2006	2005	2004
Interest rates	\$ 49	\$ 37	\$ 36
Equity prices	72	34	32
Currency rates	21	17	20
Commodity prices	30	26	20
Diversification effect <sup>(2)</sup>	(71)	(44)	(41)
Total	\$101	\$ 70	\$ 67

<sup>(1)</sup> Beginning in the first quarter of 2006, we excluded from our calculation of VaR certain equity positions generally due to their transfer restrictions or illiquidity. The effect of excluding these positions 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 positions, see "—Other Market Risk Measures" below.

<sup>(2)</sup> 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 increased to \$101 million in 2006 from \$70 million in 2005. We increased our level of exposure across all risk categories, particularly equity prices and interest rates.

Our average daily VaR increased to \$70 million in 2005 from \$67 million in 2004. The increase was primarily due to higher levels of exposure to commodity prices, equity prices and interest rates, partially offset by reduced exposures to currency rates, as well as reduced volatilities, particularly in interest rate and equity assets.

### Daily VaR<sup>(1)</sup>

(in millions)

RISK CATEGORIES	AS OF NOVEMBER		YEAR ENDED NOVEMBER 2006	
	2006	2005	HIGH	LOW
Interest rates	\$ 51	\$ 45	\$ 68	\$35
Equity prices	84	54	106	49
Currency rates	15	10	47	9
Commodity prices	21	18	49	17
Diversification effect <sup>(2)</sup>	(52)	(44)		
Total	\$119	\$ 83	\$135	\$73

<sup>(1)</sup> Beginning in the first quarter of 2006, we excluded from our calculation of VaR certain equity positions generally due to their transfer restrictions or illiquidity. The effect of excluding these positions 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 positions, see "—Other Market Risk Measures" below.

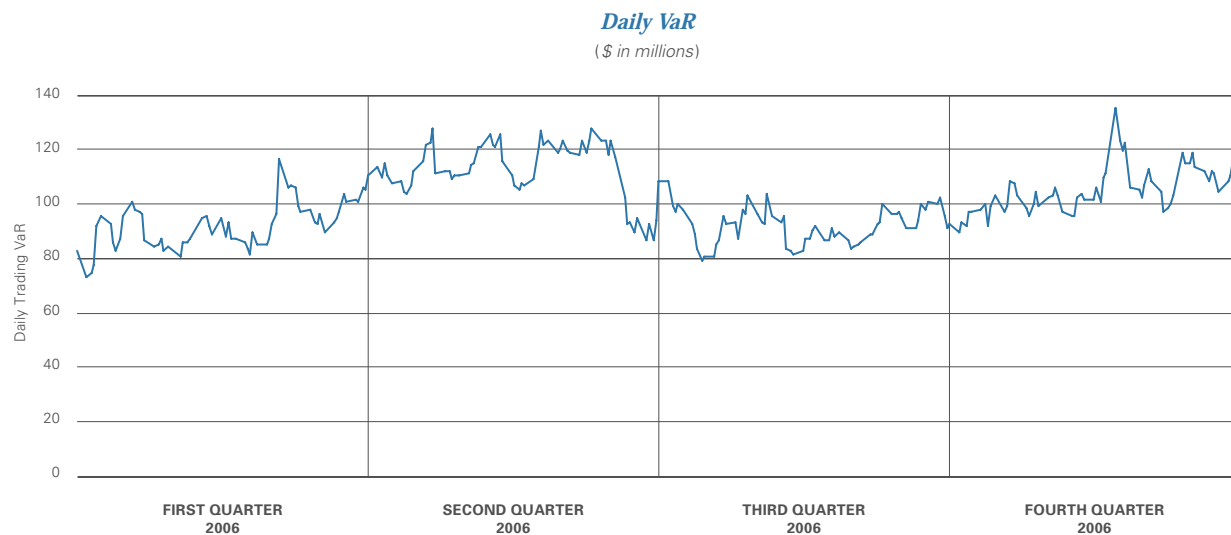
<sup>(2)</sup> Equals the difference between total VaR and the sum of the VaRs for the four risk categories. This effect arises because the four market risk categories are not perfectly correlated.



## Management's Discussion and Analysis

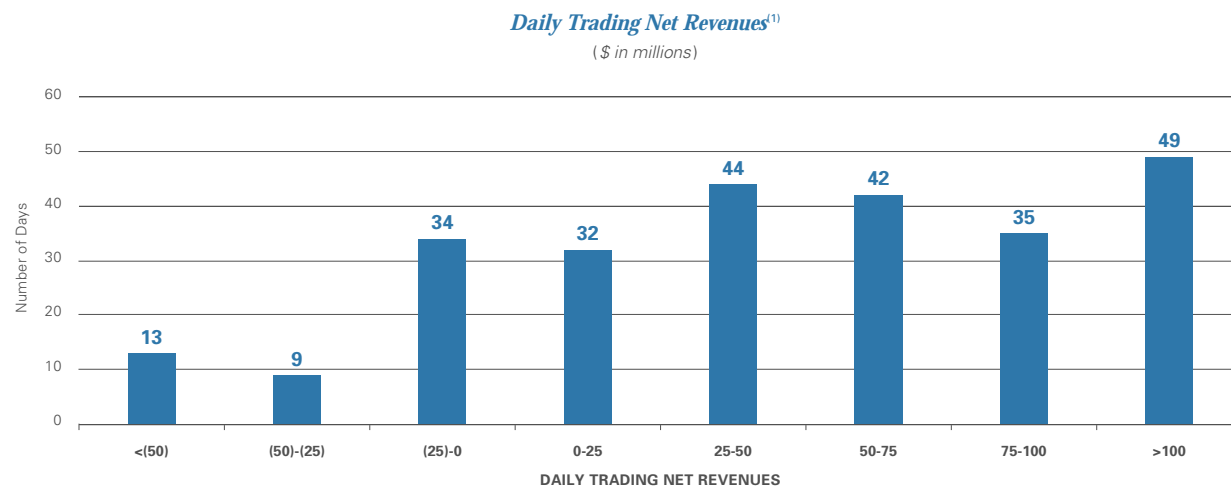
Our daily VaR increased to \$119 million as of November 2006 from \$83 million as of November 2005. We increased our level of exposure across all risk categories, particularly equity prices.

The following chart presents our daily VaR during 2006:



### 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 year ended November 2006:



<sup>(1)</sup>Beginning in the fourth quarter of 2006, we excluded daily net revenues from our insurance business and our power generation facilities from this chart. Amounts for the full year have been adjusted accordingly.

## Management's Discussion and Analysis

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 exceeded our 95% one-day VaR on three occasions during 2006.

### Other Market Risk Measures

Certain portfolios and individual positions are not included in VaR, where VaR is not the most appropriate measure of risk (e.g., due to transfer restrictions and/or illiquidity). The market risk related to our investments in the convertible preferred stock of SMFG and the ordinary shares of ICBC is measured by estimating the potential reduction in net revenues associated with a 10% decline in the SMFG common stock price and a 10% decline in the ICBC ordinary share price, respectively. The market risk related to the remaining positions is measured by estimating the potential reduction in net revenues associated with a 10% decline in asset values.

The sensitivity analyses for equity and debt positions in our trading portfolio and equity, debt (primarily mezzanine instruments) and real estate positions in our non-trading portfolio are measured by the impact of a decline in the asset values (including the

impact of leverage in the underlying investments for real estate positions in our non-trading portfolio) of such positions. The fair values of the underlying positions may be sensitive to changes in a number of factors, including, but not limited to, the financial performance of the companies or properties relative to budgets or projections, the projected timing and amount of future cash flows, discount rates, trends within sectors and/or regions, underlying business models and equity prices.

The sensitivity analysis of our investment in the convertible preferred stock of SMFG, net of the economic hedge on the unrestricted shares of common stock underlying a portion of our investment, is measured by the impact of a decline in the SMFG common stock price. This sensitivity should not be extrapolated to a significant decline in the SMFG common stock price, as the relationship between the fair value of our investment and the SMFG common stock price would be nonlinear due to downside protection on the conversion stock price.

The sensitivity analysis of our investment in the ordinary shares of ICBC excludes interests held by investment funds managed by Goldman Sachs.

The following table sets forth market risk for positions not included in VaR. These measures do not reflect diversification benefits across asset categories and, given the differing likelihood of such events occurring, these measures have not been aggregated:

(in millions)		10% SENSITIVITY MEASURE	
		AMOUNT AS OF NOVEMBER	
ASSET CATEGORIES	10% SENSITIVITY MEASURE	2006	2005 <sup>(1)</sup>
<b>Trading Risk<sup>(2)</sup></b>			
Equity	Underlying asset value	<b>\$377</b>	\$127
Debt	Underlying asset value	<b>725</b>	634
<b>Non-trading Risk</b>			
SMFG	SMFG common stock price	<b>140</b>	262
ICBC	ICBC ordinary share price	<b>191</b>	N/A
Other Equity	Underlying asset value	<b>390</b>	172
Debt	Underlying asset value	<b>199</b>	63
Real Estate <sup>(3)</sup>	Underlying asset value	<b>341</b>	145

<sup>(1)</sup> Beginning in the first quarter of 2006, we excluded from our calculation of VaR certain equity positions generally due to their transfer restrictions or illiquidity. The effect of excluding these positions from VaR was not material to prior periods and, accordingly, VaR for such periods has not been adjusted. We have calculated the 10% sensitivity measure for these equity positions (i.e., Trading Risk—Equity) as of November 2005 to provide a period-to-period comparison. To the extent that other market risk measures in the above table were affected, such measures have been adjusted to conform to the current presentation.

<sup>(2)</sup> In addition to the positions in these portfolios, which are accounted for at fair value, we make investments accounted for under the equity method and we also make direct investments in real estate, both of which are included in "Other assets" in the consolidated statements of financial condition. Direct investments in real estate are accounted for at cost less accumulated depreciation. See Note 10 to the consolidated financial statements for information on "Other assets."

<sup>(3)</sup> Relates to interests in our real estate investment funds.

## Management's Discussion and Analysis

During 2006, the market risk for equity positions in our trading portfolio increased due to new investments as well as an increase in the fair value of the portfolio. The increase in market risk in 2006 for debt positions in our trading portfolio and debt, real estate and other equity positions in our non-trading portfolio was primarily due to new investments.

The decrease in market risk in 2006 for SMFG was primarily due to the impact of additional hedging with respect to the second one-third installment of unrestricted shares underlying our investment, partially offset by the increase in the fair value of our investment due to the passage of time in respect of the transfer restrictions on the underlying common stock.

### Credit Risk

Credit risk represents the loss that we would incur if a counterparty or an issuer of securities or other instruments we hold fails to perform under its contractual obligations to us, or upon a deterioration in the credit quality of third parties whose securities or other instruments, including OTC derivatives, we hold. Our exposure to credit risk principally arises through our trading, investing and financing activities. To reduce our credit exposures, we seek to enter into netting agreements with counterparties that permit us to offset receivables and payables with such counterparties. In addition, we attempt to further reduce credit risk with certain counterparties by (i) entering into agreements that enable us to obtain collateral from a counterparty on an upfront or contingent basis, (ii) seeking third-party guarantees of the counterparty's obligations, and/or (iii) transferring our credit risk to third parties using credit derivatives and/or other structures and techniques.

To measure and manage our credit exposures, we use a variety of tools, including credit limits referenced to both current exposure and potential exposure. Potential exposure is generally based on projected worst-case market movements over the life of a transaction. In addition, as part of our market risk management process, for positions measured by changes in credit spreads, we use VaR and other sensitivity measures. To supplement our primary credit exposure measures, we also use scenario analyses, such as credit spread widening scenarios, stress tests and other quantitative tools.

Our global credit management systems monitor credit exposure to individual counterparties and on an aggregate basis to counterparties and their affiliates. These systems also provide management, including the Firmwide Risk and Credit Policy Committees, with information regarding credit risk by product, industry sector, country and region.

While our activities expose us to many different industries and counterparties, we routinely execute a high volume of transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment funds and other institutional clients, resulting in significant credit concentration with respect to this industry. In the ordinary course of business, we may also be subject to a concentration of credit risk to a particular counterparty, borrower or issuer.

As of both November 2006 and November 2005, we held U.S. government and federal agency obligations that represented 6% and 7% of our total assets, respectively. In addition, most of our financial instruments purchased under agreements to resell as well as some derivatives are collateralized by U.S. government, federal agency and other sovereign obligations. As of November 2006 and November 2005, we did not have credit exposure to any other counterparty that exceeded 5% of our total assets. However, over the past several years, the amount and duration of our credit exposures have been increasing, due to, among other factors, the growth of our lending and OTC derivative activities and market evolution towards longer dated transactions. A further discussion of our derivative activities follows below.

### Credit Risk on 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 to facilitate client 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 manage currency exposure on 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 all of the underlying assets or risks being hedged, or as part of a broader trading strategy. Accordingly, the market risk of derivative positions is managed together with our nonderivative positions.

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 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.

## Management's Discussion and Analysis

The following table sets forth the distribution, by credit rating, of substantially all of our exposure with respect to OTC derivatives as of November 2006 and November 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	AS OF NOVEMBER				PERCENTAGE OF TOTAL EXPOSURE NET OF COLLATERAL
	2006			2005	
	EXPOSURE <sup>(1)</sup>	COLLATERAL HELD	EXPOSURE NET OF COLLATERAL	PERCENTAGE OF TOTAL EXPOSURE NET OF COLLATERAL	PERCENTAGE OF TOTAL EXPOSURE NET OF COLLATERAL
AAA/Aaa	\$ 5,185	\$ 514	\$ 4,671	12%	12%
AA/Aa2	12,499	1,447	11,052	29	22
A/A2	16,039	4,810	11,229	29	28
BBB/Baa2	8,616	2,964	5,652	15	21
BB/Ba2 or lower	8,906	3,760	5,146	13	15
Unrated	1,891	954	937	2	2
<b>Total</b>	<b>\$53,136</b>	<b>\$14,449</b>	<b>\$38,687</b>	<b>100%</b>	<b>100%</b>

<sup>(1)</sup>Net of cash received pursuant to credit support agreements of \$24.06 billion.

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 <sup>(1)</sup>
AAA/Aaa	\$ 1,011	\$ 116	\$ 1,263	\$1,002	\$1,279	\$ 4,671
AA/Aa2	2,204	1,496	2,521	2,834	1,997	11,052
A/A2	3,850	1,304	3,094	1,867	1,114	11,229
BBB/Baa2	1,480	660	2,478	247	787	5,652
BB/Ba2 or lower	1,729	451	1,550	581	835	5,146
Unrated	477	348	5	52	55	937
<b>Total</b>	<b>\$10,751</b>	<b>\$4,375</b>	<b>\$10,911</b>	<b>\$6,583</b>	<b>\$6,067</b>	<b>\$38,687</b>

CONTRACT TYPE	0 - 6 MONTHS	6 - 12 MONTHS	1 - 5 YEARS	5 - 10 YEARS	10 YEARS OR GREATER	TOTAL <sup>(1)</sup>
Interest rates <sup>(2)</sup>	\$ 2,300	\$1,524	\$ 3,720	\$3,802	\$3,753	\$15,099
Currencies	4,418	882	2,521	1,186	946	9,953
Commodities	3,469	992	3,898	585	231	9,175
Equities	564	977	772	1,010	1,137	4,460
<b>Total</b>	<b>\$10,751</b>	<b>\$4,375</b>	<b>\$10,911</b>	<b>\$6,583</b>	<b>\$6,067</b>	<b>\$38,687</b>

<sup>(1)</sup>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.

<sup>(2)</sup>Includes credit-related derivatives.

## Management's Discussion and Analysis

Derivative transactions may also involve legal risks including the risk 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. In addition, certain derivative transactions (e.g., credit derivative contracts) involve the risk that we may have difficulty obtaining, or be unable to obtain, the underlying security or obligation in order to satisfy any physical settlement requirement.

### Liquidity and Funding 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 Goldman Sachs-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**—We maintain substantial excess liquidity to meet a broad range of potential cash outflows in a stressed environment including financing obligations.
- **Asset-Liability Management**—We ensure our funding sources are sufficiently long-term in order to withstand a prolonged or severe liquidity-stressed environment without having to rely on asset sales.
- **Conservative Liability Structure**—We access funding across a diverse range of markets, products and counterparties, emphasize less credit-sensitive sources of funding and conservatively manage the distribution of funding across our entity structure.
- **Crisis Planning**—We base our liquidity and funding management on stress-scenario planning and maintain a crisis plan detailing our response to a liquidity threatening event.

### Excess Liquidity

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 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:

- The first days or weeks of a liquidity crisis are the most critical to a company's survival.
- 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 have 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 size of our Global Core Excess is based on 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;

## Management's Discussion and Analysis

- 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;
- potential cash outflows associated with our prime brokerage business;
- additional collateral that could be called in the event of a two-notch downgrade in our credit ratings;
- draws on our unfunded commitments not supported by William Street Funding Corporation<sup>(1)</sup>; and
- upcoming cash outflows, such as tax and other large payments.

The following table sets forth the average loan value (the estimated amount of cash that would be advanced by counterparties against these securities) of our Global Core Excess:

(in millions)	YEAR ENDED NOVEMBER	
	2006	2005
U.S. dollar-denominated	<b>\$40,862</b>	\$35,310
Non-U.S. dollar-denominated	<b>10,202</b>	11,029
Total Global Core Excess	<b>\$51,064</b>	\$46,339

The U.S. dollar-denominated excess is comprised of only unencumbered U.S. government and agency securities and highly liquid mortgage securities, all of which are Federal Reserve repo-eligible, as well as overnight cash deposits. Our non-U.S. dollar-denominated excess is comprised of 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 that we believe are highly liquid, even in a difficult funding environment.

<sup>(1)</sup> The Global Core Excess excludes liquid assets of \$6.93 billion held separately by William Street Funding Corporation. See "—Contractual Obligations and Commitments" above for a further discussion of the William Street credit extension program.

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 primarily held to better match the currency and timing requirements for potential liquidity obligations of our principal non-U.S. operating entities.

In addition to our Global Core Excess, 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 12 months. We assume conservative loan values that are based on stress-scenario borrowing capacity and we regularly review these assumptions asset class by asset class.

### Asset-Liability Management

We seek to maintain a highly liquid balance sheet and substantially all of our inventory is marked-to-market daily. We utilize aged inventory limits for certain financial instruments as a disincentive to our businesses to hold inventory over longer periods of time. We believe that these limits provide a complementary mechanism for ensuring appropriate balance sheet liquidity in addition to our standard position limits. Although our balance sheet fluctuates due to seasonal activity, market conventions and periodic market opportunities in certain of our businesses, our total assets and adjusted assets at financial statement dates are not materially different than those occurring within our reporting periods.

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 do not rely on immediate sales of assets (other than our Global Core Excess) to maintain liquidity in a distressed environment, although we recognize orderly asset sales may be prudent and necessary in a persistent liquidity crisis.

## Management's Discussion and Analysis

In order to avoid reliance on asset sales, our goal is to ensure that we have sufficient total capital (unsecured long-term borrowings plus total shareholders' equity) to fund our balance sheet for at least one year. The amount of our total capital is based on an internal liquidity model, which incorporates, among other things, 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;
- derivative and other margin and collateral requirements;
- anticipated draws on our unfunded loan commitments; and
- capital or other forms of financing in our regulated subsidiaries that is in excess of their long-term financing requirements. See "—Conservative Liability Structure" below for a further discussion of how we fund our subsidiaries.

Certain financial instruments may be more difficult to fund on a secured basis during times of market stress. Accordingly, we generally hold higher levels of total 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:

<i>(in millions)</i>	AS OF NOVEMBER	
	2006	2005
Mortgage whole loans and collateralized debt obligations <sup>(1)</sup>	<b>\$41,017</b>	\$31,459
Bank loans <sup>(2)</sup>	<b>28,196</b>	13,843
High-yield securities	<b>11,054</b>	8,822
Emerging market debt securities	<b>2,291</b>	1,789
SMFG convertible preferred stock	<b>4,505</b>	4,058
ICBC ordinary shares <sup>(3)</sup>	<b>5,194</b>	—
Other corporate principal investments <sup>(4)</sup>	<b>3,675</b>	1,723
Other private equity and restricted public equity securities	<b>3,736</b>	1,297
Real estate principal investments <sup>(4)</sup>	<b>588</b>	745

<sup>(1)</sup>Includes certain mortgage-backed interests held in QSPEs. See Note 3 to the consolidated financial statements for further information regarding our securitization activities.

<sup>(2)</sup>Includes funded commitments and inventory held in connection with our origination and secondary trading activities.

<sup>(3)</sup>Includes interests of \$3.28 billion as of November 2006 held by investment funds managed by Goldman Sachs.

<sup>(4)</sup>Excludes assets related to consolidated merchant banking funds of \$6.03 billion and \$1.93 billion as of November 2006 and November 2005, respectively, for which Goldman Sachs is not at risk.

A large portion of these assets are funded through secured funding markets or nonrecourse financing. We focus on demonstrating a consistent ability to fund these assets on a secured basis for extended periods of time to reduce refinancing risk and to help ensure that they have an established amount of loan value in order that they can be funded in periods of market stress.

See Note 3 to the consolidated financial statements for further information regarding the financial instruments we hold.

### Conservative Liability Structure

We seek to structure our liabilities conservatively to reduce refinancing risk and the risk that we may redeem or repurchase certain of our borrowings prior to their contractual maturity. Our conservative liability structure reflects the following policies:

- We fund a substantial portion of our inventory on a secured basis. We believe secured financing provides Goldman Sachs with a more stable source of liquidity than unsecured financing, as it is less sensitive to changes in our credit due to underlying collateral.
- Our liquidity depends to an important degree on the stability of our short-term unsecured financing base. Accordingly, we prefer the use of promissory notes (in which Goldman Sachs does not make a market) over commercial paper, which we may repurchase prior to maturity through the ordinary course of business as a market maker. As of November 2006 and November 2005, our unsecured short-term borrowings, including the current portion of unsecured long-term borrowings was \$47.9 billion and \$47.2 billion, respectively. See Note 4 to the consolidated financial statements for further information regarding our unsecured short-term borrowings.
- We recognize that secured funding transactions have greater refinancing risk when the underlying collateral is more difficult to fund. Consequently, we seek longer maturities for secured funding transactions collateralized by these assets. In some cases, we use extendible maturity features to obtain a rolling minimum term to the funding.
- We issue substantially all of our unsecured debt without provisions that would, based solely upon an adverse change in our credit ratings, financial ratios, earnings, cash flows or 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.

## Management's Discussion and Analysis

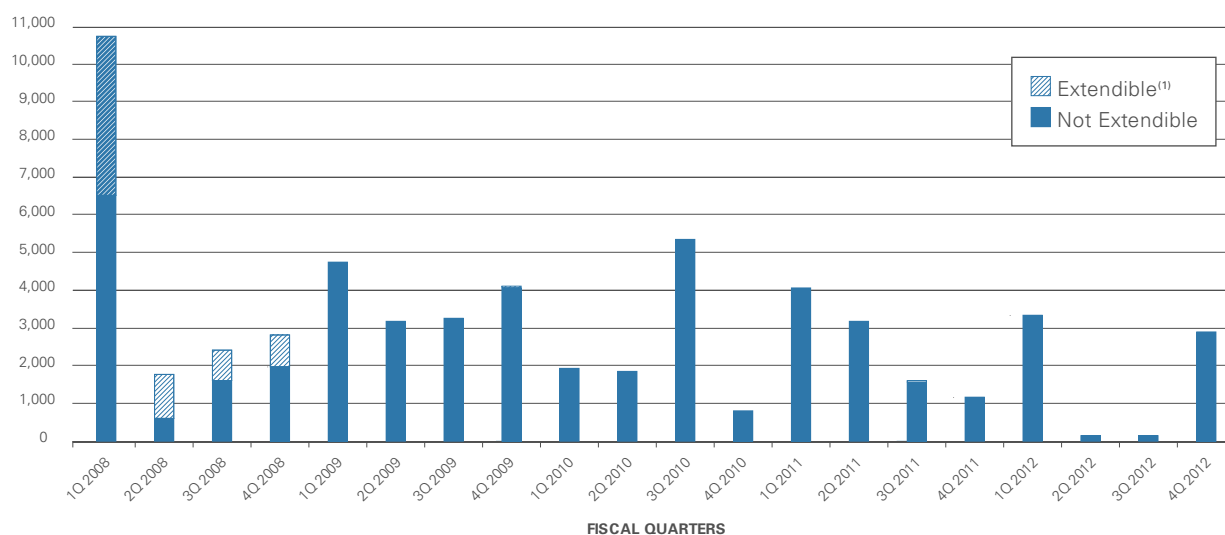
We seek to maintain broad and diversified funding sources globally for both secured and unsecured funding. We make extensive use of the repurchase agreement and securities lending markets, as well as other secured funding markets. In addition, we issue debt through syndicated U.S. registered offerings, U.S. registered and 144A medium-term note programs, offshore medium-term note offerings and other bond offerings, U.S. and non-U.S. commercial paper and promissory note issuances, and other methods. We also arrange for letters of credit to be issued on our behalf.

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. Our creditors include banks, governments, securities lenders, pension funds, insurance companies and mutual funds. We access funding in a variety of markets in the United States, Europe and Asia. We have imposed various internal guidelines on investor concentration, 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.

To mitigate refinancing risk, we have created internal guidelines on the principal amount of debt maturing on any one day or during any week or year. The following table sets forth our quarterly unsecured long-term borrowings maturity profile through 2012:

### Unsecured Long-Term Borrowings Maturity Profile

(\$ in millions)



<sup>(1)</sup> Our unsecured long-term borrowings include extendible debt if the earliest maturity is one year or greater from our financial statement date. Extendible debt is categorized in the maturity profile at the earliest possible maturity even though the debt can be, and in the past generally has been, extended.



## Management's Discussion and Analysis

The weighted average maturity of our unsecured long-term borrowings as of November 2006 was approximately eight 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.

For a discussion of factors that could impair our ability to access the capital markets, see “—Certain Risk Factors That May Affect Our Business” above as well as “Risk Factors” in Part I, Item 1A of the Annual Report on Form 10-K.

**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 with the necessary capital to meet their regulatory requirements. The benefits of this approach to subsidiary funding include enhanced control and greater flexibility to meet the funding requirements of our subsidiaries.

Our intercompany funding policies are predicated on an 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 liquidity risk 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 to the parent company to cover their intercompany borrowings (other than subordinated debt) in order to mitigate parent company liquidity risk.

Group Inc. has provided substantial amounts of equity and subordinated indebtedness, directly or indirectly, to its regulated subsidiaries; for example, as of November 2006, Group Inc. had \$17.32 billion of such equity and subordinated indebtedness invested in Goldman, Sachs & Co., its principal U.S. registered broker-dealer; \$23.87 billion invested in Goldman Sachs International, a regulated U.K. broker-dealer; \$2.50 billion invested in Goldman Sachs Execution & Clearing, L.P., a U.S. registered broker-dealer; and \$2.79 billion invested in Goldman Sachs Japan Co., Ltd. (GSJCL) a regulated Japanese broker-dealer. Group Inc. also had \$46.25 billion of unsubordinated loans to these entities as of November 2006, as well as significant amounts of capital invested in and loans to its other regulated subsidiaries.

### 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 assumptions. Our planning incorporates several market-based and operational stress scenarios. We also periodically conduct liquidity crisis drills to test our lines of communication and backup funding procedures.

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.

### 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, credit and operational risk management practices, the level and variability of our earnings, our capital base, our franchise, reputation and management, our corporate governance and the external operating environment. See “—Certain Risk Factors That May Affect Our Business” above for a discussion of the risks associated with a reduction in our credit ratings.

## Management's Discussion and Analysis

The following table sets forth our unsecured credit ratings as of November 2006:

	SHORT-TERM DEBT	LONG-TERM DEBT	SUBORDINATED DEBT <sup>(1)</sup>	PREFERRED STOCK
Dominion Bond Rating Service Limited	R-1 (middle)	AA (low)	Not applicable	Not applicable
Fitch, Inc.	F1+	AA-	A+	A+
Moody's Investors Service	P1	Aa3	A1	A2
Standard & Poor's <sup>(2)</sup>	A-1+	AA-	A+	A

<sup>(1)</sup> During 2006, we issued \$4.46 billion of subordinated debt. See Note 5 to the consolidated financial statements for further information regarding our subordinated debt.

<sup>(2)</sup> During the fourth quarter of 2006, Standard & Poor's raised our short-term debt rating from A-1 to A-1+, our long-term debt rating from A+ to AA-, our subordinated debt from A to A+ and our preferred stock from A- to A.

As of November 2006, collateral or termination payments pursuant to bilateral agreements with certain counterparties of approximately \$595 million would have been required in the event of a one-notch reduction in our long-term credit ratings. In evaluating our liquidity requirements, we consider additional collateral or termination payments that would be required in the event of a two-notch downgrade in our long-term credit ratings, as well as collateral that has not been called by counterparties, but is available to them.

### 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.

**Year Ended November 2006**—Our cash and cash equivalents decreased by \$3.97 billion to \$6.29 billion at the end of 2006. We raised \$53.40 billion in net cash from financing activities, primarily in long-term borrowings as well as through secured financings, partially offset by common stock repurchases. We used net cash of \$57.37 billion in our operating and investing activities, primarily to capitalize on trading and investing opportunities for our clients and ourselves.

**Year Ended November 2005**—Our cash and cash equivalents increased by \$5.90 billion to \$10.26 billion at the end of 2005. We raised \$19.37 billion in net cash from financing activities, primarily in long-term borrowings, in light of the favorable debt financing environment, as well as through secured financings, partially offset by common stock repurchases. We used net cash of \$13.48 billion in our operating and investing activities, primarily to capitalize on trading and investing opportunities for our clients and ourselves.

**Year Ended November 2004**—Our cash and cash equivalents decreased by \$2.72 billion to \$4.37 billion at the end of 2004. We raised \$31.75 billion in net cash from financing activities, primarily in long-term borrowings, in light of the favorable debt financing environment, as well as through secured financings. We used net cash of \$34.48 billion in our operating and investing activities, primarily to capitalize on trading and investing opportunities for our clients and ourselves, to meet additional collateral requirements at securities exchanges and clearing organizations and to provide additional funding support for our William Street loan commitments program.

### Operational Risk

Operational risk relates to the risk of loss arising from shortcomings or failures in internal processes, people or systems, and from external events. Operational risk can arise from many factors ranging from routine processing errors to potentially costly incidents arising, for example, from major systems failures. Operational risk may also cause reputational harm. Thus, efforts to identify, manage and mitigate operational risk must be equally sensitive to the risk of reputational damage as well as the risk of financial loss.

We manage operational risk through the application of long-standing, but continuously evolving, firmwide control standards: the training, supervision and development of our people; the active participation and commitment of senior management in a continuous process of identifying and mitigating key operational risks across Goldman Sachs; and a framework of strong and independent control departments that monitor operational risk on a daily basis. Together, these elements form a strong firmwide control culture that serves as the foundation of our efforts to minimize events that create operational risk and the damage they can cause.

## Management's Discussion and Analysis

The Operational Risk Department, an independent risk management function, is responsible for developing and implementing a standardized framework to identify, measure, monitor and manage operational risk across Goldman Sachs. This framework, which evolves with the changing needs of our businesses and regulatory guidance, takes into account internal and external operational risk events, business environment and internal control factors, the ongoing analysis of business-specific risk metrics and the use of scenario analysis. While individual business units have direct responsibility for the control and mitigation of operational risk, this framework provides a consistent methodology for identifying and monitoring operational risk factors at the business unit and firmwide level. For a further discussion of operational risk see “—Risk Factors” in Part I, Item 1A of the Annual Report on Form 10-K.

### RECENT ACCOUNTING DEVELOPMENTS

**SFAS No. 123-R**—In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123-R, “Share-Based Payment,” which is a revision to SFAS No. 123, “Accounting for Stock-Based Compensation.” SFAS No. 123-R focuses primarily on accounting for transactions in which an entity obtains employee services in exchange for share-based payments. Under SFAS No. 123-R, the cost of employee services received in exchange for an award of equity instruments is generally measured based on the grant-date fair value of the award. Under SFAS No. 123-R, share-based awards that do not require future service (i.e., vested awards) are expensed immediately. Share-based employee awards that require future service are amortized over the relevant service period. We adopted SFAS No. 123-R under the modified prospective adoption method. Under that method of adoption, the provisions of SFAS No. 123-R are generally applied only to share-based awards granted subsequent to adoption. The accounting treatment of share-based awards granted to retirement-eligible employees prior to our adoption of SFAS No. 123-R has not changed and financial statements for periods prior to adoption are not restated for the effects of adopting SFAS No. 123-R.

SFAS No. 123-R requires the immediate expensing of share-based awards granted to retirement-eligible employees, including awards subject to non-compete agreements. Share-based awards held by employees that were retirement-eligible on the date of adoption of SFAS No. 123-R must continue to be amortized over the stated service period of the award (and accelerated if the employee actually retires). Consequently, our compensation and benefits expenses in 2006 included (and, to a lesser extent, 2007 and 2008 will include) both the amortization of awards held by employees that were retirement-eligible on the date of adoption of SFAS No. 123-R as well

as the full grant-date fair value of new awards granted to such employees under SFAS No. 123-R. If we had amortized share-based compensation prior to the adoption of SFAS No. 123-R over a period beginning on the date of grant and ending on the earlier of the vesting date or the date of retirement eligibility, compensation and benefits expenses would have been \$637 million lower in 2006, approximately \$350 million higher in 2005 and approximately \$375 million higher in 2004.

SFAS No. 123-R requires expected forfeitures to be included in determining share-based employee compensation expense. Prior to the adoption of SFAS No. 123-R, forfeiture benefits were recorded as a reduction to compensation and benefits expense when an employee left Goldman Sachs and forfeited the award. In the first quarter of 2006, we recorded a benefit for expected forfeitures on all outstanding share-based awards. The transition impact of adopting SFAS No. 123-R as of the first day of our 2006 fiscal year, including the effect of accruing for expected forfeitures on outstanding share-based awards, was not material to our results of operations.

**EITF Issue No. 04-5**—In June 2005, the EITF reached consensus on Issue No. 04-5, “Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights,” which requires general partners to consolidate their partnerships or to provide limited partners with rights to remove the general partner or to terminate the partnership. Goldman Sachs, as the general partner of numerous merchant banking and asset management partnerships, was required to adopt the provisions of EITF Issue No. 04-5 (i) immediately for partnerships formed or modified after June 29, 2005 and (ii) in the first quarter of 2007 for partnerships formed on or before June 29, 2005 that have not been modified. We have generally provided limited partners in these funds with rights to remove Goldman Sachs as the general partner or to terminate the partnerships. Therefore, the adoption of EITF Issue No. 04-5 did not have a material effect on our financial condition, results of operations or cash flows in 2006 for partnerships formed or modified after June 29, 2005 and is not expected to have a material effect in 2007.

**SFAS No. 155**—In February 2006, the FASB issued SFAS No. 155, “Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140.” SFAS No. 155 permits an entity to measure at fair value any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. As permitted, we early adopted SFAS No. 155 in the first quarter of 2006. Adoption did not have a material effect on our financial condition, results of operations or cash flows.

## Management's Discussion and Analysis

**SFAS No. 156**—Effective for the first quarter of 2006, we adopted SFAS No. 156, “Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140,” which permits entities to elect to measure servicing assets and servicing liabilities at fair value and report changes in fair value in earnings. Goldman Sachs acquires residential mortgage servicing rights in connection with its mortgage securitization activities and has elected under SFAS No. 156 to account for these servicing rights at fair value. Adoption did not have a material effect on our financial condition, results of operations or cash flows.

**FIN No. 46-R-6**—In April 2006, the FASB issued FASB Staff Position (FSP) FIN No. 46-R-6, “Determining the Variability to Be Considered in Applying FASB Interpretation No. 46-R.” This FSP addresses how a reporting enterprise should determine the variability to be considered in applying FIN No. 46-R by requiring an analysis of the purpose for which an entity was created and the variability that the entity was designed to create. This FSP must be applied prospectively to all entities with which a reporting enterprise first becomes involved and to all entities previously required to be analyzed under FIN No. 46-R when a reconsideration event has occurred. As permitted, we early adopted FSP FIN No. 46-R-6 in the third quarter of 2006. Adoption did not have a material effect on our financial condition, results of operations or cash flows.

**FIN No. 48**—In June 2006, the FASB issued FIN No. 48, “Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109.” FIN No. 48 requires that management determine whether a tax position is more likely than not to be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets this recognition threshold, the position is measured to determine the amount of benefit to be recognized in the financial statements. We expect to adopt the provisions of FIN No. 48 beginning in the first quarter of 2008. We are currently evaluating the impact of adopting FIN No. 48 on our financial condition, results of operations and cash flows.

**SFAS No. 157**—In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements.” SFAS No. 157 clarifies that fair value is an exit price, representing the amount that would be exchanged to sell an asset or transfer a liability in an orderly transaction between market participants. SFAS No. 157 nullifies the consensus reached in EITF Issue No. 02-3 prohibiting the recognition of day one gain or loss on derivative contracts (and hybrid instruments measured at fair value under SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as modified by SFAS No. 155) where we cannot verify all of the significant model inputs to observable market data and verify

the model to market transactions. However, SFAS No. 157 requires that a fair value measurement technique include an adjustment for risks inherent in a particular valuation technique (such as a pricing model) and/or the risks inherent in the inputs to the model, if market participants would also include such an adjustment. In addition, SFAS No. 157 prohibits the recognition of “block discounts” for large holdings of unrestricted financial instruments where quoted prices are readily and regularly available in an active market. The provisions of SFAS No. 157 are to be applied prospectively, except for changes in fair value measurements that result from the initial application of SFAS No. 157 to existing derivative financial instruments measured under EITF Issue No. 02-3, existing hybrid instruments measured at fair value and block discounts, which are to be recorded as an adjustment to opening retained earnings in the year of adoption.

We intend to adopt SFAS No. 157 in the first quarter of 2007. To determine the transition adjustment to opening retained earnings, we have performed an analysis of existing derivative instruments measured under EITF Issue 02-3, hybrid financial instruments and block discounts. To determine the prospective transition adjustment that will be recorded in net revenues in the first quarter of 2007, we will perform an analysis of all other positions. With respect to principal investments, the prospective transition adjustment may include positive changes to investment valuations based on available market evidence even if there have been no third-party transactions in the capital structure of the underlying investee. The transition adjustment to opening retained earnings will not have a material effect on our financial condition. We are currently evaluating the impact of SFAS No. 157 on our results of operations for the first quarter of 2007.

**SFAS No. 158**—In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132-R.” SFAS No. 158 requires an entity to recognize in its statement of financial condition the funded status of its defined benefit pension and postretirement plans, measured as the difference between the fair value of the plan assets and the benefit obligation. SFAS No. 158 also requires an entity to recognize changes in the funded status of a defined benefit pension and postretirement plan within accumulated other comprehensive income, net of tax, to the extent such changes are not recognized in earnings as components of periodic net benefit cost. SFAS No. 158 is effective as of the end of the fiscal year ending after December 15, 2006. We will adopt SFAS No. 158 as of the end of 2007. We do not expect that the adoption of SFAS No. 158 will have a material effect on our financial condition, results of operations or cash flows.

## Management's Report on Internal Control over Financial Reporting

Management of The Goldman Sachs Group, Inc., together with its consolidated subsidiaries (the firm), is responsible for establishing and maintaining adequate internal control over financial reporting. The firm's internal control over financial reporting is a process designed under the supervision of the firm's principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the firm's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

As of the end of the firm's 2006 fiscal year, management conducted an assessment of the effectiveness of the firm's internal control over financial reporting based on the framework established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the firm's internal control over financial reporting as of November 24, 2006 was effective.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the firm; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the firm's assets that could have a material effect on our financial statements.

Management's assessment of the effectiveness of the firm's internal control over financial reporting as of November 24, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing on page 73, which expresses unqualified opinions on management's assessment and on the effectiveness of the firm's internal control over financial reporting as of November 24, 2006.

# Report of Independent Registered Public Accounting Firm

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

We have completed integrated audits of The Goldman Sachs Group, Inc.'s consolidated financial statements and of its internal control over financial reporting as of November 24, 2006, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

### Consolidated Financial Statements

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of earnings, changes in shareholders' equity, cash flows and comprehensive income present fairly, in all material respects, the financial position of The Goldman Sachs Group, Inc. and its subsidiaries (the Company) at November 24, 2006 and November 25, 2005, and the results of its operations and its cash flows for each of the three fiscal years in the period ended November 24, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

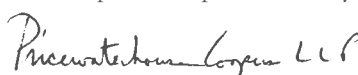
### Internal Control Over Financial Reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control over Financial Reporting appearing on page 72, that the Company maintained effective internal control over financial reporting as of November 24, 2006 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of November 24, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its

assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



PricewaterhouseCoopers LLP

New York, New York

January 31, 2007

## Consolidated Statements of Earnings

<i>(in millions, except per share amounts)</i>	YEAR ENDED NOVEMBER		
	2006	2005	2004
<b>Revenues</b>			
Investment banking	<b>\$ 5,613</b>	\$ 3,599	\$ 3,286
Trading and principal investments	<b>24,027</b>	15,452	11,984
Asset management and securities services	<b>4,527</b>	3,090	2,655
Interest income	<b>35,186</b>	21,250	11,914
Total revenues	<b>69,353</b>	43,391	29,839
Interest expense	<b>31,688</b>	18,153	8,888
Revenues, net of interest expense	<b>37,665</b>	25,238	20,951
<b>Operating expenses</b>			
Compensation and benefits	<b>16,457</b>	11,758	9,681
Brokerage, clearing, exchange and distribution fees	<b>1,985</b>	1,416	1,172
Market development	<b>492</b>	378	374
Communications and technology	<b>544</b>	490	461
Depreciation and amortization	<b>521</b>	501	499
Amortization of identifiable intangible assets	<b>173</b>	124	125
Occupancy	<b>850</b>	728	646
Professional fees	<b>545</b>	475	338
Cost of power generation	<b>406</b>	386	372
Other expenses	<b>1,132</b>	709	607
Total non-compensation expenses	<b>6,648</b>	5,207	4,594
Total operating expenses	<b>23,105</b>	16,965	14,275
Pre-tax earnings	<b>14,560</b>	8,273	6,676
Provision for taxes	<b>5,023</b>	2,647	2,123
Net earnings	<b>9,537</b>	5,626	4,553
Preferred stock dividends	<b>139</b>	17	—
Net earnings applicable to common shareholders	<b>\$ 9,398</b>	\$ 5,609	\$ 4,553
<b>Earnings per common share</b>			
Basic	<b>\$ 20.93</b>	\$ 11.73	\$ 9.30
Diluted	<b>19.69</b>	11.21	8.92
<b>Average common shares outstanding</b>			
Basic	<b>449.0</b>	478.1	489.5
Diluted	<b>477.4</b>	500.2	510.5

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

## Consolidated Statements of Financial Condition

<i>(in millions, except share and per share amounts)</i>	AS OF NOVEMBER	
	2006	2005
<b>Assets</b>		
Cash and cash equivalents	<b>\$ 6,293</b>	\$ 10,261
Cash and securities segregated for regulatory and other purposes	<b>80,990</b>	51,405
Receivables from brokers, dealers and clearing organizations	<b>13,223</b>	15,150
Receivables from customers and counterparties	<b>79,790</b>	60,231
Collateralized agreements:		
Securities borrowed	<b>219,342</b>	191,800
Financial instruments purchased under agreements to resell	<b>82,126</b>	83,619
Financial instruments owned, at fair value	<b>298,563</b>	238,043
Financial instruments owned and pledged as collateral, at fair value	<b>35,998</b>	38,983
Total financial instruments owned, at fair value	<b>334,561</b>	277,026
Other assets	<b>21,876</b>	17,312
Total assets	<b>\$838,201</b>	\$706,804
<b>Liabilities and shareholders' equity</b>		
Unsecured short-term borrowings, including the current portion of unsecured long-term borrowings	<b>\$ 47,904</b>	\$ 47,247
Payables to brokers, dealers and clearing organizations	<b>6,293</b>	10,014
Payables to customers and counterparties	<b>217,581</b>	178,304
Collateralized financings:		
Securities loaned	<b>22,208</b>	23,331
Financial instruments sold under agreements to repurchase	<b>147,492</b>	149,026
Other secured financings	<b>50,424</b>	23,641
Financial instruments sold, but not yet purchased, at fair value	<b>155,805</b>	149,071
Other liabilities and accrued expenses	<b>31,866</b>	13,830
Unsecured long-term borrowings	<b>122,842</b>	84,338
Total liabilities	<b>802,415</b>	678,802
<b>Commitments, contingencies and guarantees</b>		
<b>Shareholders' equity</b>		
Preferred stock, par value \$0.01 per share; 150,000,000 shares authorized, 124,000 and 70,000 shares issued and outstanding as of November 2006 and November 2005, respectively, with liquidation preference of \$25,000 per share	<b>3,100</b>	1,750
Common stock, par value \$0.01 per share; 4,000,000,000 shares authorized, 599,697,200 and 573,970,935 shares issued as of November 2006 and November 2005, respectively, and 412,666,084 and 437,170,695 shares outstanding as of November 2006 and November 2005, respectively	<b>6</b>	6
Restricted stock units and employee stock options	<b>6,290</b>	3,415
Nonvoting common stock, par value \$0.01 per share; 200,000,000 shares authorized, no shares issued and outstanding	<b>—</b>	—
Additional paid-in capital	<b>19,731</b>	17,159
Retained earnings	<b>27,868</b>	19,085
Accumulated other comprehensive income	<b>21</b>	—
Common stock held in treasury, at cost, par value \$0.01 per share; 187,031,116 and 136,800,240 shares as of November 2006 and November 2005, respectively	<b>(21,230)</b>	(13,413)
Total shareholders' equity	<b>35,786</b>	28,002
Total liabilities and shareholders' equity	<b>\$838,201</b>	\$706,804

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



## Consolidated Statements of Changes in Shareholders' Equity

<i>(in millions, except per share amounts)</i>	YEAR ENDED NOVEMBER		
	2006	2005	2004
<b>Preferred stock</b>			
Balance, beginning of year	<b>\$ 1,750</b>	\$ —	\$ —
Issued	<b>1,350</b>	1,750	—
Balance, end of year	<b>3,100</b>	1,750	—
<b>Common stock, par value \$0.01 per share</b>			
Balance, beginning of year	<b>6</b>	6	5
Issued	<b>—</b>	—	1
Balance, end of year	<b>6</b>	6	6
<b>Restricted stock units and employee stock options</b>			
Balance, beginning of year	<b>3,415</b>	2,013	2,984
Issuance and amortization of restricted stock units and employee stock options	<b>3,787</b>	1,871	1,050
Delivery of common stock underlying restricted stock units	<b>(781)</b>	(423)	(1,948)
Forfeiture of restricted stock units and employee stock options	<b>(129)</b>	(37)	(62)
Exercise of employee stock options	<b>(2)</b>	(9)	(11)
Balance, end of year	<b>6,290</b>	3,415	2,013
<b>Additional paid-in capital</b>			
Balance, beginning of year	<b>17,159</b>	15,501	13,562
Issuance of common stock, including proceeds from exercise of employee stock options	<b>2,432</b>	1,580	2,479
Cancellation of restricted stock units in satisfaction of withholding tax requirements	<b>(375)</b>	(163)	(870)
Preferred stock issuance costs	<b>(1)</b>	(31)	—
Excess net tax benefit related to share-based compensation	<b>653</b>	272	330
Cash settlement of share-based compensation	<b>(137)</b>	—	—
Balance, end of year	<b>19,731</b>	17,159	15,501
<b>Retained earnings</b>			
Balance, beginning of year	<b>19,085</b>	13,970	9,914
Net earnings	<b>9,537</b>	5,626	4,553
Dividends and dividend equivalents declared on common stock and restricted stock units	<b>(615)</b>	(494)	(497)
Dividends declared on preferred stock	<b>(139)</b>	(17)	—
Balance, end of year	<b>27,868</b>	19,085	13,970
<b>Unearned compensation</b>			
Balance, beginning of year	<b>—</b>	(117)	(339)
Restricted stock units forfeited	<b>—</b>	—	11
Amortization of restricted stock units	<b>—</b>	117	211
Balance, end of year	<b>—</b>	—	(117)
<b>Accumulated other comprehensive income/(loss)</b>			
Balance, beginning of year	<b>—</b>	11	6
Currency translation adjustment, net of tax	<b>45</b>	(27)	5
Minimum pension liability adjustment, net of tax	<b>(27)</b>	(11)	—
Net gains/(losses) on cash flow hedges, net of tax	<b>(7)</b>	9	—
Net unrealized gains/(losses) on available-for-sale securities, net of tax	<b>10</b>	18	—
Balance, end of year	<b>21</b>	—	11
<b>Common stock held in treasury, at cost</b>			
Balance, beginning of year	<b>(13,413)</b>	(6,305)	(4,500)
Repurchased	<b>(7,817)</b>	(7,108)	(1,805)
Balance, end of year	<b>(21,230)</b>	(13,413)	(6,305)
<b>Total shareholders' equity</b>	<b>\$ 35,786</b>	\$ 28,002	\$25,079

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

## Consolidated Statements of Cash Flows

(in millions)	YEAR ENDED NOVEMBER		
	2006	2005	2004
<b>Cash flows from operating activities</b>			
Net earnings	<b>\$ 9,537</b>	\$ 5,626	\$ 4,553
Non-cash items included in net earnings			
Depreciation and amortization	<b>749</b>	689	720
Amortization of identifiable intangible assets	<b>246</b>	165	125
Deferred income taxes	<b>(1,505)</b>	(450)	1,040
Share-based compensation	<b>3,654</b>	1,756	1,224
Changes in operating assets and liabilities			
Cash and securities segregated for regulatory and other purposes	<b>(21,044)</b>	(3,226)	(18,437)
Net receivables from brokers, dealers and clearing organizations	<b>(1,794)</b>	1,322	(776)
Net payables to customers and counterparties	<b>20,520</b>	2,953	36,669
Securities borrowed, net of securities loaned	<b>(28,666)</b>	(32,777)	(24,102)
Financial instruments sold under agreements to repurchase, net of financial instruments purchased under agreements to resell	<b>(42)</b>	62,269	(12,912)
Financial instruments owned, at fair value	<b>(48,479)</b>	(66,899)	(52,366)
Financial instruments sold, but not yet purchased, at fair value	<b>6,384</b>	16,974	29,429
Other, net	<b>12,823</b>	(815)	1,442
Net cash used for operating activities	<b>(47,617)</b>	(12,413)	(33,391)
<b>Cash flows from investing activities</b>			
Purchase of property, leasehold improvements and equipment	<b>(1,744)</b>	(1,421)	(829)
Proceeds from sales of property, leasehold improvements and equipment	<b>69</b>	639	—
Business acquisitions, net of cash acquired	<b>(1,661)</b>	(556)	(255)
Proceeds from sales of investments	<b>2,114</b>	274	—
Purchase of available-for-sale securities	<b>(12,922)</b>	—	—
Proceeds from sales of available-for-sale securities	<b>4,396</b>	—	—
Net cash used for investing activities	<b>(9,748)</b>	(1,064)	(1,084)
<b>Cash flows from financing activities</b>			
Other secured financings (short-term), net	<b>16,856</b>	2,238	4,600
Proceeds from issuance of other secured financings (long-term)	<b>14,451</b>	7,279	7,584
Repayment of other secured financings (long-term), including the current portion	<b>(7,420)</b>	(5,941)	(754)
Unsecured short-term borrowings, net	<b>(4,031)</b>	(5)	(699)
Proceeds from issuance of unsecured long-term borrowings	<b>48,839</b>	35,898	31,699
Repayment of unsecured long-term borrowings, including the current portion	<b>(13,510)</b>	(16,399)	(9,444)
Derivative contracts with a financing element, net	<b>3,494</b>	1,060	548
Common stock repurchased	<b>(7,817)</b>	(7,108)	(1,805)
Dividends and dividend equivalents paid on common stock, preferred stock and restricted stock units	<b>(754)</b>	(511)	(497)
Proceeds from issuance of common stock	<b>1,613</b>	1,143	521
Proceeds from issuance of preferred stock, net of issuance costs	<b>1,349</b>	1,719	—
Excess tax benefit related to share-based compensation	<b>464</b>	—	—
Cash settlement of share-based compensation	<b>(137)</b>	—	—
Net cash provided by financing activities	<b>53,397</b>	19,373	31,753
Net increase/(decrease) in cash and cash equivalents	<b>(3,968)</b>	5,896	(2,722)
Cash and cash equivalents, beginning of year	<b>10,261</b>	4,365	7,087
Cash and cash equivalents, end of year	<b>\$ 6,293</b>	\$ 10,261	\$ 4,365

### Supplemental Disclosures:

Cash payments for interest, net of capitalized interest, were \$30.98 billion, \$17.49 billion and \$8.55 billion for the years ended November 2006, November 2005 and November 2004, respectively.

Cash payments for income taxes, net of refunds, were \$4.56 billion, \$2.47 billion and \$1.02 billion for the years ended November 2006, November 2005 and November 2004, respectively.

### Non-cash activities:

The firm assumed \$498 million, \$1.15 billion and \$1.63 billion of debt in connection with business acquisitions for the years ended November 2006, November 2005 and November 2004, respectively.

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

## Consolidated Statements of Comprehensive Income

<i>(in millions)</i>	YEAR ENDED NOVEMBER		
	2006	2005	2004
Net earnings	<b>\$9,537</b>	\$5,626	\$4,553
Currency translation adjustment, net of tax	<b>45</b>	(27)	5
Minimum pension liability adjustment, net of tax	<b>(27)</b>	(11)	—
Net gains/(losses) on cash flow hedges, net of tax	<b>(7)</b>	9	—
Net unrealized gains/(losses) on available-for-sale securities, net of tax	<b>10</b>	18	—
Comprehensive income	<b>\$9,558</b>	\$5,615	\$4,558

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

# Notes to 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, investment funds, governments and individuals.
- **Trading and Principal Investments**—The firm facilitates client transactions with a diverse group of corporations, financial institutions, investment funds, governments and individuals and takes proprietary positions through market making in, trading of and investing in fixed income and equity products, currencies, commodities and derivatives on these products. In addition, the firm engages in specialist and market-making activities on equities and options exchanges and clears client transactions on major stock, options and futures exchanges worldwide. In connection with the firm's merchant banking and other investing activities, the firm makes principal investments directly and through funds that the firm raises and manages.
- **Asset Management and Securities Services**—The firm provides investment advisory and financial planning services and offers investment products (primarily through separate accounts and funds) across all major asset classes to a diverse group of institutions and individuals worldwide and provides prime brokerage services, financing services and securities lending services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and to high-net-worth individuals worldwide.

## Note 2

### SIGNIFICANT ACCOUNTING POLICIES

#### **Basis of Presentation**

These 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 the entity to finance its activities 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 a majority 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 VIEs of 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 a review of, among other factors, its capital structure, contractual terms, which 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 its 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 are commonly used in mortgage and other securitization transactions. Statement of Financial Accounting Standards (SFAS) No. 140,

## Notes to Consolidated Financial Statements

“Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” sets forth the criteria an entity must satisfy to be a QSPE. These criteria include the types of assets a QSPE may hold, limits on asset sales, the use of derivatives and financial guarantees, and the level of discretion a servicer may exercise in attempting to collect receivables. These criteria may require management to make judgments about complex matters, including whether a derivative is considered passive and the degree of discretion a servicer may exercise. In accordance with SFAS No. 140 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 investment 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. For funds established on or before June 29, 2005 in which the firm holds more than a minor interest and for funds established or modified after June 29, 2005, the firm has generally provided the third-party investors with rights to remove the firm as the general partner or to terminate the funds (see “—Recent Accounting Developments” below for a discussion of the impact of Emerging Issues Task Force (EITF) Issue No. 04-5, “Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights”). These fund investments are included in “Financial instruments owned, at fair value” in the consolidated statements of financial condition.

Unless otherwise stated herein, all references to November 2006, November 2005 and November 2004 refer to the firm’s fiscal years ended, or the dates, as the context requires, November 24, 2006, November 25, 2005 and November 26, 2004, respectively. Certain reclassifications have been made to previously reported amounts to conform to the current presentation.

### Use of Estimates

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

### Revenue Recognition

#### Investment Banking

Underwriting revenues and fees from mergers and acquisitions and other financial advisory assignments are recognized in the consolidated statements of earnings 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 financial advisory transactions are recorded as non-compensation expenses, net of client reimbursements.

#### Financial Instruments

“Total financial instruments owned, at fair value” and “Financial instruments sold, but not yet purchased, at fair value” are reflected in the consolidated statements of financial condition on a trade-date basis and consist of financial instruments carried at fair value or amounts that approximate fair value, with related unrealized gains or losses generally recognized in “Trading and principal investments” in the consolidated statements of earnings. 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 its 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 and high-yield corporate bonds, listed equities, money market securities, state, municipal and provincial obligations, and physical commodities.

## Notes to Consolidated Financial Statements

Certain cash trading instruments trade infrequently and have little or no price transparency. Such instruments include certain corporate bank loans, mortgage whole loans and distressed debt. The firm values these instruments initially at cost and generally does not adjust valuations 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 or changes in the credit ratings of the underlying companies). Where there is evidence supporting a change in the value, the firm uses valuation methodologies such as the present value of known or estimated cash flows.

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. In certain circumstances, such as for positions that are illiquid or have transfer restrictions, the fair value reflects liquidity valuation adjustments based on market evidence or predetermined policies. For certain highly illiquid positions, management's estimates are used to determine these liquidity valuation adjustments. See "—Recent Accounting Developments" below for a discussion of the impact of SFAS No. 157, "Fair Value Measurements" on the valuation of financial instruments.

- **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 and option-pricing 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 these markets. 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. 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 spreads 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 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 its valuation models only to the extent that changes in these 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. See "—Recent Accounting Developments" below for a discussion of the impact of SFAS No. 157 on the valuation of financial instruments.

- **Principal Investments**—In valuing corporate and real estate principal investments included within the Principal Investments component of our Trading and Principal Investments segment, the firm's portfolio is separated into private investments, investments in the convertible preferred stock of Sumitomo Mitsui Financial Group, Inc. (SMFG) and the ordinary shares of Industrial and Commercial Bank of China Limited (ICBC), and other public investments.

## Notes to Consolidated Financial Statements

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. See "—Recent Accounting Developments" below for a discussion of the impact of SFAS No. 157 on the valuation of financial instruments.

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 less a liquidity valuation adjustment 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 investment in the convertible preferred stock of SMFG is generally nontransferable without the consent of SMFG, but is freely convertible into SMFG common stock. As of November 2006, the firm had hedged two-thirds of the common stock underlying its investment in SMFG. Restrictions on the firm's ability to hedge or sell the remaining shares will lapse on February 7, 2007. As of November 2006, the conversion price was ¥318,800, 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 ¥105,100).

The firm's investment in the ordinary shares of ICBC is carried at fair value using quoted market prices less a liquidity valuation adjustment. The ordinary shares acquired from ICBC are subject to transfer restrictions that, among other things, prohibit any sale, disposition or other transfer until April 28, 2009. From April 28, 2009 to October 20, 2009, the firm may transfer up to 50% of the aggregate ordinary shares of ICBC that the firm owned as of October 20, 2006. The firm may transfer the remaining shares after October 20, 2009. A portion of the firm's interest is held by investment funds managed by the firm.

### Transfers of Financial Assets

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 financings, with the related interest expense recognized in net revenues over the lives of the transactions.

### Collateralized Agreements and Financings

Collateralized agreements consist of resale agreements and securities borrowed. Collateralized financings consist of repurchase agreements, securities loaned and other secured financings. Interest income or expense on collateralized agreements and collateralized financings is recognized in net revenues over the life of the transaction.

- **Resale and Repurchase Agreements**—Financial instruments purchased under agreements to resell and financial instruments sold under agreements to repurchase, principally U.S. government, federal agency and investment-grade sovereign obligations, represent short-term collateralized financing transactions and are carried in the 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 financial instruments purchased under agreements to resell, makes delivery of financial instruments sold under agreements to repurchase, monitors the market value of these financial instruments on a daily basis and delivers or obtains additional collateral as appropriate.
- **Securities Borrowed and Loaned**—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.
- **Other Secured Financings**—In addition to repurchase agreements and securities loaned, the firm funds assets through the use of other secured financing arrangements and pledges financial instruments and other assets as collateral in these transactions. The firm records these financings based on the amount of cash received. See Note 3 for further information regarding these arrangements.

## Notes to Consolidated Financial Statements

### Power Generation

Power generation revenues associated with the firm's consolidated power generation facilities are included in "Trading and principal investments" in the consolidated statements of earnings

when power is delivered. These revenues were \$553 million, \$496 million and \$488 million for the years ended November 2006, November 2005 and November 2004, respectively.

Beginning in the fourth quarter of 2006, "Cost of power generation" in the consolidated statements of earnings was reclassified to operating expenses. "Cost of power generation" was previously reported as a reduction to revenues. "Compensation and benefits" includes direct employee costs associated with the firm's consolidated power generation facilities and "Cost of power generation" includes the other direct costs associated with these power generation facilities and related contractual assets. Prior periods have been reclassified to conform to the current presentation, with no impact to our reported net earnings. This reclassification increased operating expenses as follows:

(in millions)	YEAR ENDED NOVEMBER		
	2006	2005	2004
Compensation and benefits	\$ 78	\$ 70	\$ 29
Cost of power generation	406	386	372
Total	\$484	\$456	\$401

### Commissions

Commission revenues from executing and clearing client transactions on stock, options and futures markets worldwide are recognized in "Trading and principal investments" in the consolidated statements of earnings on a trade-date basis.

### Insurance Activities

Revenues from variable annuity and variable life insurance contracts, and from providing reinsurance of such contracts, generally consist of fees assessed on contract holder account balances for mortality charges, policy administration and surrender charges. These fees are recognized within "Trading and principal investments" in the consolidated statements of earnings in the period that services are provided.

Interest credited to variable annuity and life insurance account balances and changes in reserves are recognized in "Other expenses" in the consolidated statements of earnings.

Premiums earned for providing property catastrophe reinsurance are recognized within "Trading and principal investments" in the consolidated statements of earnings over the coverage period, net of premiums ceded for the cost of reinsurance. Expenses for liabilities related to property catastrophe reinsurance claims, including estimates of claims that have been incurred but not reported, are recognized within "Other expenses" in the 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 of override previously distributed to the firm to be returned to the funds. Accordingly, overrides are recognized in the consolidated statements of earnings only when all material contingencies have been resolved. Overrides are included in "Trading and principal investments" in the consolidated statements of earnings.

### Asset Management

Management fees are recognized over the period that the related service is provided based upon average net asset values. In certain circumstances, the firm is also entitled to receive incentive fees based on a percentage of a fund's return or when the return on assets under management exceeds specified benchmark returns or other performance targets. Incentive fees are generally based on investment performance over a 12-month period and are subject to adjustment prior to the end of the measurement period. Accordingly, incentive fees are recognized in the 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 consolidated statements of earnings.

### Share-Based Compensation

In the first quarter of 2006, the firm adopted SFAS No. 123-R, "Share-Based Payment," which is a revision to SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123-R focuses primarily on accounting for transactions in which an entity obtains employee services in exchange for share-based payments. Under SFAS No. 123-R, the cost of employee services received in exchange for an award of equity instruments is generally measured based on the grant-date fair value of the award. Under SFAS No. 123-R, share-based awards that do not require future service (i.e., vested awards) are expensed immediately. Share-based



## Notes to Consolidated Financial Statements

employee awards that require future service are amortized over the relevant service period. The firm adopted SFAS No. 123-R under the modified prospective adoption method. Under that method of adoption, the provisions of SFAS No. 123-R are generally applied only to share-based awards granted subsequent to adoption. The accounting treatment of share-based awards granted to retirement-eligible employees prior to the firm's adoption of SFAS No. 123-R has not changed and financial statements for periods prior to adoption are not restated for the effects of adopting SFAS No. 123-R.

SFAS No. 123-R requires the immediate expensing of share-based awards granted to retirement-eligible employees, including awards subject to non-compete agreements. Share-based awards held by employees that were retirement-eligible on the date of adoption of SFAS No. 123-R must continue to be amortized over the stated service period of the award (and accelerated if the employee actually retires). Consequently, the firm's compensation and benefits expenses in 2006 included (and, to a lesser extent, 2007 and 2008 will include) both the amortization of awards held by employees that were retirement-eligible on the date of adoption of SFAS No. 123-R as well as the full grant-date fair value of new awards granted to such employees under SFAS No. 123-R. If the firm had amortized share-based compensation prior to the adoption of SFAS No. 123-R over a period beginning on the date of grant and ending on the earlier of the vesting date or the date of retirement eligibility, compensation and benefits expenses would have been \$637 million lower in 2006, approximately \$350 million higher in 2005 and approximately \$375 million higher in 2004.

SFAS No. 123-R requires expected forfeitures to be included in determining share-based employee compensation expense. Prior to the adoption of SFAS No. 123-R, forfeiture benefits were recorded as a reduction to compensation and benefits expense when an employee left the firm and forfeited the award. In the first quarter of 2006, the firm recorded a benefit for expected forfeitures on all outstanding share-based awards. The transition impact of adopting SFAS No. 123-R as of the first day of the firm's 2006 fiscal year, including the effect of accruing for expected forfeitures on outstanding share-based awards, was not material to the firm's results of operations.

The firm began to account for share-based awards 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," in 2003. Share-based employee awards granted for the year ended November 29, 2002 and prior years were 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 was recognized for unmodified stock options issued for years prior to fiscal 2003 that had no intrinsic value on the date of grant.

If the firm were to recognize compensation expense over the relevant service period, generally three years, under the fair value method per SFAS No. 123 with respect to stock options granted for the year ended November 29, 2002 and prior years, net earnings would have decreased, resulting in pro forma net earnings and earnings per common share (EPS) as set forth below:

<i>(in millions, except per share amounts)</i>	YEAR ENDED NOVEMBER	
	2005	2004
Net earnings applicable to common shareholders, as reported	\$5,609	\$4,553
Add: Share-based compensation expense, net of related tax effects, included in reported net earnings	1,133	790
Deduct: Share-based compensation expense, net of related tax effects, determined under the fair value method for all awards	(1,178)	(947)
Pro forma net earnings applicable to common shareholders	\$5,564	\$4,396
Earnings per common share, as reported		
Basic	\$11.73	\$ 9.30
Diluted	11.21	8.92
Pro forma earnings per common share		
Basic	\$11.64	\$ 8.98
Diluted	11.12	8.61

## Notes to Consolidated Financial Statements

The firm pays cash dividend equivalents on outstanding restricted stock units. Dividend equivalents paid on restricted stock units accounted for under SFAS No. 123 and SFAS No. 123-R are charged to retained earnings when paid. SFAS No. 123-R requires dividend equivalents paid on restricted stock units expected to be forfeited to be included in compensation expense. Prior to the adoption of SFAS No. 123-R, dividend equivalents paid on restricted stock units that were later forfeited by employees were reclassified to compensation expense from retained earnings. Dividend equivalents paid on restricted stock units granted prior to 2003 were accounted for under APB Opinion No. 25 and charged to compensation expense. The tax benefit related to dividend equivalents paid on restricted stock units is accounted for as a reduction of income tax expense.

Prior to the adoption of SFAS No. 123-R, the firm presented all tax benefits resulting from share-based compensation as cash flows from operating activities in the consolidated statements of cash flows. SFAS No. 123-R requires cash flows resulting from tax deductions in excess of the grant-date fair value of share-based awards to be included in cash flows from financing activities.

In certain cases, primarily related to the death of an employee or conflicted employment (as outlined in the applicable award agreements), the firm may cash settle share-based compensation awards. "Additional paid-in capital" is adjusted to the extent of the difference between the current value of the award and the grant-date value of the award.

### 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 customer lists, above-market power contracts, specialist rights and the value of business acquired (VOBA) and deferred acquisition costs (DAC) in the firm's insurance subsidiaries, are amortized over their estimated 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 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 on a straight-line basis 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 capitalized and 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 requirements. Rent expense relating to space held for growth is included in "Occupancy" in the 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 consolidated statement of financial condition, and revenues and expenses are translated at average rates of exchange for the year. Gains or losses on translation of the financial statements of a

## Notes to Consolidated Financial Statements

non-U.S. operation, when the functional currency is other than the U.S. dollar, are included, net of hedges and taxes, on the 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 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 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 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 (see "—Recent Accounting Developments" below for a discussion of the impact of FIN No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109," on SFAS No. 109).

### 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

#### EITF Issue No. 04-5

In June 2005, the EITF reached consensus on Issue No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights," which requires general partners to consolidate their partnerships or to provide limited partners with rights to remove the general partner or to terminate the partnership. The firm, as the general partner of numerous merchant banking and asset management partnerships, was required to adopt the provisions of EITF Issue No. 04-5 (i) immediately for partnerships formed or modified after June 29, 2005 and (ii) in the first quarter of 2007 for partnerships formed on or before June 29, 2005 that have not been modified. The firm has generally provided limited partners in these funds with rights to remove the firm as the general partner or to terminate the partnerships. Therefore, the adoption of EITF Issue No. 04-5 did not have a material effect on the firm's financial condition, results of operations or cash flows in 2006 for partnerships formed or modified after June 29, 2005 and is not expected to have a material effect in 2007.

#### SFAS No. 155

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140." SFAS No. 155 permits an entity to measure at fair value any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. As permitted, the firm early adopted SFAS No. 155 in the first quarter of 2006. Adoption did not have a material effect on the firm's financial condition, results of operations or cash flows.

#### SFAS No. 156

Effective for the first quarter of 2006, the firm adopted SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140," which permits entities to elect to measure servicing assets and servicing liabilities at fair value and report changes in fair value in earnings. The firm acquires residential mortgage servicing rights in connection with its mortgage securitization activities and has elected under SFAS No. 156 to account for these servicing rights at fair value. Adoption did not have a material effect on the firm's financial condition, results of operations or cash flows.

## Notes to Consolidated Financial Statements

### FIN No. 46-R-6

In April 2006, the FASB issued FASB Staff Position (FSP) FIN No. 46-R-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46-R." This FSP addresses how a reporting enterprise should determine the variability to be considered in applying FIN No. 46-R by requiring an analysis of the purpose for which an entity was created and the variability that the entity was designed to create. This FSP must be applied prospectively to all entities with which a reporting enterprise first becomes involved and to all entities previously required to be analyzed under FIN No. 46-R when a reconsideration event has occurred. As permitted, the firm early adopted FSP FIN No. 46-R-6 in the third quarter of 2006. Adoption did not have a material effect on the firm's financial condition, results of operations or cash flows.

### FIN No. 48

In June 2006, the FASB issued FIN No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109." FIN No. 48 requires that the firm determine whether a tax position is more likely than not to be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets this recognition threshold, the position is measured to determine the amount of benefit to be recognized in the financial statements. The firm expects to adopt the provisions of FIN No. 48 beginning in the first quarter of 2008. The firm is currently evaluating the impact of adopting FIN No. 48 on its financial condition, results of operations and cash flows.

### SFAS No. 157

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 clarifies that fair value is an exit price, representing the amount that would be exchanged to sell an asset or transfer a liability in an orderly transaction between market participants. SFAS No. 157 nullifies the consensus reached in EITF Issue No. 02-3 prohibiting the recognition of day one gain or loss on derivative contracts (and hybrid instruments measured at fair value under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as modified by SFAS No. 155) where the firm cannot verify all of the significant model inputs to observable market data and verify the model to market transactions. However, SFAS No. 157 requires that a fair value measurement technique include an adjustment for risks inherent in a particular valuation technique (such as a pricing model) and/or the risks inherent in the inputs to the model, if market

participants would also include such an adjustment. In addition, SFAS No. 157 prohibits the recognition of "block discounts" for large holdings of unrestricted financial instruments where quoted prices are readily and regularly available in an active market. The provisions of SFAS No. 157 are to be applied prospectively, except for changes in fair value measurements that result from the initial application of SFAS No. 157 to existing derivative financial instruments measured under EITF Issue No. 02-3, existing hybrid instruments measured at fair value and block discounts, which are to be recorded as an adjustment to opening retained earnings in the year of adoption.

The firm intends to adopt SFAS No. 157 in the first quarter of 2007. To determine the transition adjustment to opening retained earnings, the firm has performed an analysis of existing derivative instruments measured under EITF Issue 02-3, hybrid financial instruments and block discounts. To determine the prospective transition adjustment that will be recorded in net revenues in the first quarter of 2007, the firm will perform an analysis of all other positions. With respect to principal investments, the prospective transition adjustment may include positive changes to investment valuations based on available market evidence even if there have been no third-party transactions in the capital structure of the underlying investee. The transition adjustment to opening retained earnings will not have a material effect on the firm's financial condition. The firm is currently evaluating the impact of SFAS No. 157 on its results of operations for the first quarter of 2007.

### SFAS No. 158

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132-R." SFAS No. 158 requires an entity to recognize in its statement of financial condition the funded status of its defined benefit pension and postretirement plans, measured as the difference between the fair value of the plan assets and the benefit obligation. SFAS No. 158 also requires an entity to recognize changes in the funded status of a defined benefit pension and postretirement plan within accumulated other comprehensive income, net of tax, to the extent such changes are not recognized in earnings as components of periodic net benefit cost. SFAS No. 158 is effective as of the end of the fiscal year ending after December 15, 2006. The firm will adopt SFAS No. 158 as of the end of 2007. The firm does not expect that the adoption of SFAS No. 158 will have a material effect on its financial condition, results of operations or cash flows.

# Notes to Consolidated Financial Statements

## Note 3

### FINANCIAL INSTRUMENTS

#### Fair Value of Financial Instruments

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

(in millions)	AS OF NOVEMBER			
	2006		2005	
	ASSETS	LIABILITIES	ASSETS	LIABILITIES
Commercial paper, certificates of deposit, time deposits and other money market instruments	\$ 14,723 <sup>(1)</sup>	\$ —	\$ 14,609 <sup>(1)</sup>	\$ —
U.S. government, federal agency and sovereign obligations	64,383	51,200	68,688	51,458
Corporate and other debt obligations				
Mortgage whole loans and collateralized debt obligations	41,017	253	31,459	223
Investment-grade corporate bonds	17,485	4,745	12,415	4,232
Bank loans	28,196	1,154	13,843	288
High-yield securities	11,054	2,064	8,822	2,072
Preferred stock	7,927	118	7,315	71
Other	1,267	241	877	278
	<b>106,946</b>	<b>8,575</b>	74,731	7,164
Equities and convertible debentures	75,355	30,323	56,656	32,565
State, municipal and provincial obligations	3,688	—	2,524	—
Derivative contracts	67,543 <sup>(2)</sup>	65,496 <sup>(3)</sup>	58,532 <sup>(2)</sup>	57,829 <sup>(3)</sup>
Physical commodities	1,923	211	1,286	55
Total	<b>\$334,561<sup>(4)</sup></b>	<b>\$155,805</b>	\$277,026	\$149,071

<sup>(1)</sup> Includes \$6.93 billion and \$6.12 billion, as of November 2006 and November 2005, respectively, of money market instruments held by William Street Funding Corporation to support the William Street credit extension program (see Note 6 for further information regarding the William Street program).

<sup>(2)</sup> Net of cash received pursuant to credit support agreements of \$24.06 billion and \$22.61 billion as of November 2006 and November 2005, respectively.

<sup>(3)</sup> Net of cash paid pursuant to credit support agreements of \$16.00 billion and \$16.10 billion as of November 2006 and November 2005, respectively.

<sup>(4)</sup> Includes securities held by the firm's bank and insurance subsidiaries, which are accounted for as "available-for-sale" (AFS) under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The following table sets forth the types of AFS securities and their maturity profile:

(in millions)	AS OF NOVEMBER 2006				
	UNDER ONE YEAR	1-5 YEARS	5-10 YEARS	10 YEARS OR GREATER	TOTAL
Mortgage-backed and other federal agency securities	\$2,374	\$1,031	\$146	\$111	\$3,662
Investment-grade corporate bonds	23	1,403	42	51	1,519
Collateralized debt obligations	192	4,199	—	121	4,512
Other debt securities	115	31	52	54	252
Total	<b>\$2,704</b>	<b>\$6,664</b>	<b>\$240</b>	<b>\$337</b>	<b>\$9,945</b>

#### Credit Concentrations

Credit concentrations may arise from trading, investing and financing activities and may be impacted by changes in economic, industry or political factors. The firm seeks to mitigate credit risk by actively monitoring exposures and obtaining collateral as deemed appropriate. While the firm's activities expose it to many different industries and counterparties, the firm routinely executes a high volume of transactions with counterparties in

the financial services industry, including brokers and dealers, commercial banks, investment funds and other institutional clients, resulting in significant credit concentration with respect to this industry. In the ordinary course of business, the firm may also be subject to a concentration of credit risk to a particular counterparty, borrower or issuer.

## Notes to Consolidated Financial Statements

As of both November 2006 and November 2005, the firm held U.S. government and federal agency obligations that represented 6% and 7% of the firm's total assets, respectively. In addition, most of the firm's financial instruments purchased under agreements to resell are collateralized by U.S. government, federal agency and other sovereign obligations. As of November 2006 and November 2005, the firm did not have credit exposure to any other counterparty that exceeded 5% of the firm's total assets.

### 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 the assets to be delivered under the contract are readily convertible into cash.

The firm enters into derivative transactions to facilitate client transactions, to take proprietary positions and as a means of risk management. Risk exposures are managed through diversification, by controlling position sizes and by entering into offsetting positions. For example, the firm may manage the risk related to a portfolio of common stock by entering into an offsetting position in a related equity-index futures contract.

The firm applies hedge accounting under SFAS No. 133 to certain derivative contracts. The firm uses these derivatives to manage certain interest rate and currency exposures, including the firm's net investment in non-U.S. operations. The firm designates certain interest rate swap contracts as fair value hedges. These interest rate swap contracts hedge changes in the relevant benchmark interest rate (e.g., London Interbank Offered Rate (LIBOR)), effectively converting a substantial

portion of the firm's unsecured long-term and certain unsecured short-term borrowings into floating rate obligations. In addition, the firm applies cash flow hedge accounting to a limited number of foreign currency forward contracts that hedge currency exposure on certain forecasted transactions in its consolidated power generation facilities. See Note 2 for information regarding the firm's policy on foreign currency forward contracts used to hedge its net investment in non-U.S. operations.

The firm applies a long-haul method to substantially all of its hedge accounting relationships to perform an ongoing assessment of the effectiveness of these relationships in achieving offsetting changes in fair value or offsetting cash flows attributable to the risk being hedged. The firm utilizes a dollar-offset method, which compares the change in the fair value of the hedging instrument to the change in the fair value of the hedged item, excluding the effect of the passage of time, to prospectively and retrospectively assess hedge effectiveness. The firm's prospective dollar-offset assessment utilizes scenario analyses to test hedge effectiveness via simulations of numerous parallel and slope shifts of the relevant yield curve. Parallel shifts change the interest rate of all maturities by identical amounts. Slope shifts change the curvature of the yield curve. For both the prospective assessment, in response to each of the simulated yield curve shifts, and the retrospective assessment, a hedging relationship is deemed to be effective if the fair values of the hedging instrument and the hedged item change inversely within a range of 80% to 125%.

For fair value hedges, gains or losses on derivative transactions are recognized in "Interest expense" in the consolidated statements of earnings. The change in fair value of the hedged item attributable to the risk being hedged is reported as an adjustment to its carrying value and is subsequently amortized into interest expense over its remaining life. For cash flow hedges, the effective portion of gains or losses on derivative transactions is reported as a component of "Other comprehensive income." Gains or losses related to hedge ineffectiveness for all hedges are generally included in "Interest expense." These gains or losses and the component of gains or losses on derivative transactions excluded from the assessment of hedge effectiveness (e.g., the effect of the passage of time on fair value hedges of the firm's borrowings) were not material to the firm's results of operations for the years ended November 2006, November 2005 and November 2004. Gains and losses on derivatives used for trading purposes are included in "Trading and principal investments" in the consolidated statements of earnings.

## Notes to Consolidated Financial Statements

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 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:

<i>(in millions)</i>	AS OF NOVEMBER			
	2006		2005	
	ASSETS	LIABILITIES	ASSETS	LIABILITIES
Forward settlement contracts	<b>\$11,751</b>	<b>\$14,335</b>	\$13,921	\$15,345
Swap agreements	<b>28,012</b>	<b>22,471</b>	25,865	22,001
Option contracts	<b>27,780</b>	<b>28,690</b>	18,746	20,483
Total	<b>\$67,543</b>	<b>\$65,496</b>	\$58,532	\$57,829

The fair values of derivatives accounted for as qualifying hedges under SFAS No. 133 consisted of \$2.66 billion and \$2.10 billion in assets as of November 2006 and November 2005, respectively, and \$551 million and \$443 million in liabilities as of November 2006 and November 2005, respectively.

The firm also has embedded derivatives that have been bifurcated from related borrowings under SFAS No. 133. Such derivatives, which are classified in unsecured short-term and unsecured long-term borrowings, had a carrying value of \$1.13 billion and \$607 million (excluding the debt host contract) as of November 2006 and November 2005, respectively. See Notes 4 and 5 for further information regarding the firm's unsecured borrowings.

### Securitization Activities

The firm securitizes commercial and residential mortgages, home equity and auto 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, primarily in the form of senior or subordinated securities, including residual interests. Retained interests are accounted for at fair value and are included in "Total financial instruments owned, at fair value" in the consolidated statements of financial condition.

During the years ended November 2006 and November 2005, the firm securitized \$103.92 billion and \$92.00 billion, respectively, of financial assets, including \$67.73 billion and \$65.18 billion, respectively, of residential mortgage loans and securities. Cash flows received on retained interests were approximately \$801 million and \$908 million for the years ended November 2006 and November 2005, respectively.

As of November 2006 and November 2005, the firm held \$7.08 billion and \$6.07 billion of retained interests, respectively, including \$5.18 billion and \$5.62 billion, respectively, held in QSPEs.

## Notes to Consolidated Financial Statements

The following table sets forth the weighted average key economic assumptions used in measuring the fair values of the firm's retained interests and the sensitivity of those fair values to immediate adverse changes of 10% and 20% in those assumptions<sup>(1)</sup>:

(\$ in millions)	AS OF NOVEMBER 2006			AS OF NOVEMBER 2005		
	TYPE OF RETAINED INTERESTS			TYPE OF RETAINED INTERESTS		
	MORTGAGE-BACKED	CDOS	CORPORATE DEBT <sup>(4)</sup>	MORTGAGE-BACKED	CDOS	CORPORATE DEBT <sup>(4)</sup>
Fair value of retained interests	\$4,013	\$1,973	\$1,097	\$4,190	\$592	\$1,283
Weighted average life (years)	6.0	7.0	2.2	6.0	5.3	2.2
Constant prepayment rate	21.2%	24.5%	N/A	19.1%	21.1%	N/A
Impact of 10% adverse change	\$ (121)	\$ (2)	\$ —	\$ (66)	\$ (1)	\$ —
Impact of 20% adverse change	(221)	(6)	—	(121)	(1)	—
Anticipated credit losses <sup>(2)</sup>	2.0%	2.0%	N/A	2.5%	2.5%	N/A
Impact of 10% adverse change <sup>(3)</sup>	\$ (81)	\$ (3)	\$ —	\$ (36)	\$ (4)	\$ —
Impact of 20% adverse change <sup>(3)</sup>	(155)	(4)	—	(64)	(8)	—
Discount rate	9.4%	6.9%	2.4%	7.4%	4.8%	3.7%
Impact of 10% adverse change	\$ (136)	\$ (35)	\$ (9)	\$ (114)	\$ (8)	\$ (10)
Impact of 20% adverse change	(266)	(70)	(17)	(221)	(14)	(21)

<sup>(1)</sup> Beginning in the fourth quarter of 2006, all retained interests have been included in the sensitivity analysis. Previously, the analysis only included retained interests not valued using quoted market prices in active markets. Also, the firm changed its methodology for quantifying the sensitivity to changes in assumptions to consider negative impacts on a bond-by-bond basis rather than at the overall portfolio level and for applying anticipated credit losses. The prior year amounts have been adjusted to conform to the current presentation.

<sup>(2)</sup> Anticipated credit losses are computed only on positions in which expected credit loss is a key assumption in the determination of fair values.

<sup>(3)</sup> The impacts of adverse change take into account credit mitigants incorporated in the retained interests, including over-collateralization and subordination provisions.

<sup>(4)</sup> 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 mitigate risks inherent in these retained interests. Changes in fair value based on an 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 purchased in connection with secondary market-making activities. These purchased interests approximated \$8 billion and \$5 billion as of November 2006 and November 2005, respectively.

### Variable Interest Entities (VIEs)

The firm, in the ordinary course of business, retains interests in VIEs in connection with its securitization activities. The firm also purchases and sells variable interests in VIEs, which primarily issue mortgage-backed and other asset-backed securities and collateralized debt obligations (CDOs), in connection with its

market-making activities and makes investments in and loans to VIEs that hold performing and nonperforming debt, equity, real estate, power-related and other assets. In addition, the firm utilizes VIEs to provide investors with principal-protected notes, credit-linked notes and asset-repackaged notes designed to meet their objectives.

VIEs generally purchase assets by issuing debt and equity instruments. In certain instances, the firm provides guarantees to VIEs or holders of variable interests in 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 VIEs include senior and subordinated debt; loan commitments; 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 and CDOs. The firm's exposure to the obligations of VIEs is generally limited to its interests in these entities.



## Notes to Consolidated Financial Statements

The following tables set forth 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. The firm has aggregated nonconsolidated VIEs based on principal business activity, as reflected in the first column. The nature of the firm's variable interests can take different forms, as described in the columns under maximum exposure to loss.

AS OF NOVEMBER 2006						
MAXIMUM EXPOSURE TO LOSS IN NONCONSOLIDATED VIES						
<i>(in millions)</i>	VIE ASSETS	PURCHASED AND RETAINED INTERESTS	COMMITMENTS AND GUARANTEES	DERIVATIVES <sup>(1)</sup>	LOANS AND INVESTMENTS	TOTAL
Collateralized debt obligations	<b>\$37,610</b>	<b>\$2,406</b>	<b>\$ —</b>	<b>\$ 9,782</b>	<b>\$ —</b>	<b>\$12,188</b>
Real estate, credit-related and other investing <sup>(2)</sup>	<b>16,300</b>	—	<b>113</b>	<b>8</b>	<b>2,088</b>	<b>2,209</b>
Municipal bond securitizations	<b>1,182</b>	—	<b>1,182</b>	—	—	<b>1,182</b>
Mortgage-backed and other asset-backed	<b>8,239</b>	<b>477</b>	—	<b>66</b>	—	<b>543</b>
Power-related	<b>3,422</b>	<b>10</b>	<b>73</b>	—	<b>597</b>	<b>680</b>
Principal-protected notes	<b>4,363</b>	—	—	<b>3,437</b>	—	<b>3,437</b>
Asset repackagings and credit-linked notes	<b>1,360</b>	—	—	<b>355</b>	—	<b>355</b>
<b>Total</b>	<b>\$72,476</b>	<b>\$2,893</b>	<b>\$1,368</b>	<b>\$13,648</b>	<b>\$2,685</b>	<b>\$20,594</b>

AS OF NOVEMBER 2005						
MAXIMUM EXPOSURE TO LOSS IN NONCONSOLIDATED VIES						
<i>(in millions)</i>	VIE ASSETS	PURCHASED AND RETAINED INTERESTS	COMMITMENTS AND GUARANTEES	DERIVATIVES <sup>(1)</sup>	LOANS AND INVESTMENTS	TOTAL
Collateralized debt obligations	\$24,295	\$780	\$ —	\$4,536	\$ —	\$ 5,316
Real estate, credit-related and other investing <sup>(2)</sup>	16,065	—	259	—	1,508	1,767
Municipal bond securitizations	—	—	—	—	—	—
Mortgage-backed and other asset-backed	4,545	208	—	52	—	260
Power-related	6,667	2	95	—	1,070	1,167
Principal-protected notes	1,387	—	—	1,312	—	1,312
Asset repackagings and credit-linked notes	1,181	—	—	215	—	215
<b>Total</b>	<b>\$54,140</b>	<b>\$990</b>	<b>\$354</b>	<b>\$6,115</b>	<b>\$2,578</b>	<b>\$10,037</b>

<sup>(1)</sup> Derivatives related to CDOs consist of total return swaps on investment-grade securities issued by VIEs and out-of-the-money written put options on investment-grade collateral held by VIEs. Derivatives related to principal-protected notes consist of out-of-the-money written put options that provide principal protection to clients invested in various fund products, with risk to the firm mitigated through portfolio rebalancing. Derivatives related to asset repackagings and credit-linked notes consist of interest rate swaps, equity swaps, commodity swaps and purchased credit default protection, through which the firm creates structured notes designed for specific needs of investors. The derivative transactions included in the above table do not expose the firm to a majority of the VIE's expected losses or expected residual returns and, consequently, the firm is not the primary beneficiary of the VIE. In certain cases, the firm is the primary beneficiary in these types of transactions (see table of consolidated VIEs below).

<sup>(2)</sup> The firm obtains interests in these VIEs in connection with making proprietary investments in real estate, distressed loans and other types of debt, mezzanine instruments and equities. The transactions included in the above table do not expose the firm to a majority of the VIE's expected losses or expected residual returns and, consequently, the firm is not the primary beneficiary of the VIE. In certain cases, the firm is the primary beneficiary in these types of transactions (see table of consolidated VIEs below).

## Notes to Consolidated Financial Statements

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. The firm has aggregated consolidated VIEs based on principal business activity, as reflected in the first column.

<i>(in millions)</i>	AS OF NOVEMBER 2006		AS OF NOVEMBER 2005	
	VIE ASSETS <sup>(1)</sup>	MAXIMUM EXPOSURE TO LOSS	VIE ASSETS <sup>(1)</sup>	MAXIMUM EXPOSURE TO LOSS
Real estate, credit-related and other investing	\$3,077	\$1,368	\$2,999	\$1,268
Municipal bond securitizations	2,715	2,715	1,587	1,587
Mortgage-backed and other asset-backed	1,537	20	172	4
Foreign exchange and commodities	433	340	600	205
Principal-protected notes	894	774	894	876
Asset repackagings and credit-linked notes	388	36	372	4
Total	\$9,044	\$5,253	\$6,624	\$3,944

<sup>(1)</sup> Consolidated VIE assets include assets financed on a nonrecourse basis.

### Collateralized Transactions

The firm receives financial instruments as collateral, primarily in connection with resale agreements, securities borrowed, derivative transactions and customer margin loans. Such financial instruments may include obligations of the U.S. government, federal agencies, sovereigns and corporations, as well as equities and convertibles.

In many cases, the firm is permitted to deliver or repledge these financial instruments in connection with entering into repurchase agreements, securities lending agreements and other secured financings, collateralizing derivative transactions and meeting firm or customer settlement requirements. As of November 2006 and November 2005, the fair value of financial instruments received as collateral by the firm that it was permitted to deliver or repledge was \$746.08 billion and \$629.94 billion, respectively, of which the firm delivered or repledged \$639.87 billion and \$550.76 billion, respectively.

The firm also pledges assets that it owns to counterparties who may or may not have the right to deliver or repledge them. Financial instruments owned and pledged to counterparties that have the right to deliver or repledge are reported as "Financial instruments owned and pledged as collateral, at fair value" in the consolidated statements of financial condition and were \$36.00 billion and \$38.98 billion as of November 2006 and November 2005, respectively. Financial

instruments owned and pledged in connection with repurchase agreements, securities lending agreements and other secured financings to counterparties that did not have the right to sell or repledge are included in "Financial instruments owned, at fair value" in the consolidated statements of financial condition and were \$134.31 billion and \$116.27 billion as of November 2006 and November 2005, respectively. Other assets (primarily real estate, power generation facilities and related assets, and cash) owned and pledged in connection with other secured financings to counterparties that did not have the right to sell or repledge were \$5.34 billion and \$5.04 billion as of November 2006 and November 2005, respectively.

In addition to repurchase agreements and securities lending agreements, the firm obtains secured funding through the use of other arrangements. Other secured financings include arrangements that are nonrecourse, that is, only the subsidiary that executed the arrangement or a subsidiary guaranteeing the arrangement is obligated to repay the financing. Other secured financings consist of liabilities related to the firm's William Street program, consolidated variable interest entities, collateralized central bank financings, transfers of financial assets that are accounted for as financings rather than sales (primarily pledged bank loans and mortgage whole loans), consolidated power generation facilities and other structured financing arrangements.

## Notes to Consolidated Financial Statements

Other secured financings are set forth in the table below:

<i>(in millions)</i>	AS OF NOVEMBER	
	2006	2005
Other secured financings (short-term) <sup>(1) (2) (3)</sup>	<b>\$24,290</b>	\$ 7,972
Other secured financings (long-term):		
2007	—	2,159
2008	<b>5,535</b>	702
2009	<b>877</b>	3,420
2010	<b>1,894</b>	3,352
2011	<b>5,105</b>	812
2012-thereafter	<b>12,723</b>	5,224
Total other secured financings (long-term) <sup>(4) (5)</sup>	<b>26,134</b>	15,669
Total other secured financings <sup>(6) (7)</sup>	<b>\$50,424</b>	\$23,641

<sup>(1)</sup> As of November 2006, consists of U.S. dollar-denominated financings of \$14.28 billion with a weighted average interest rate of 5.22% and non-U.S. dollar-denominated financings of \$10.01 billion with a weighted average interest rate of 2.00%. As of November 2005, consists of U.S. dollar-denominated financings of \$5.01 billion with a weighted average interest rate of 4.16% and non-U.S. dollar-denominated financings of \$2.96 billion with a weighted average interest rate of 3.25%.

<sup>(2)</sup> Includes \$3.30 billion of hybrid financial instruments accounted for at fair value under SFAS No. 155 as of November 2006.

<sup>(3)</sup> Includes other secured financings maturing within one year of the financial statement date and other secured financings that are redeemable within one year of the financial statement date at the option of the holder.

<sup>(4)</sup> As of November 2006, consists of U.S. dollar-denominated financings of \$16.97 billion with a weighted average interest rate of 5.61% and non-U.S. dollar-denominated financings of \$9.16 billion with a weighted average interest rate of 3.81%. As of November 2005, consists of U.S. dollar-denominated financings of \$9.65 billion with a weighted average interest rate of 4.65% and non-U.S. dollar-denominated financings of \$6.02 billion with a weighted average interest rate of 3.08%.

<sup>(5)</sup> Secured long-term financings that are repayable prior to maturity at the option of the firm are reflected at their contractual maturity dates. Secured long-term financings that are redeemable prior to maturity at the option of the holder are reflected at the dates such options become exercisable.

<sup>(6)</sup> Includes \$19.79 billion and \$14.29 billion of nonrecourse financings as of November 2006 and November 2005, respectively.

<sup>(7)</sup> As of November 2006, \$47.22 billion of these financings were collateralized by financial instruments and \$3.20 billion by other assets (primarily real estate, power generation facilities and related assets, and cash). As of November 2005, \$20.51 billion of these financings were collateralized by financial instruments and \$3.13 billion by other assets.

## Notes to Consolidated Financial Statements

### Note 4

#### UNSECURED SHORT-TERM BORROWINGS

The firm obtains unsecured short-term borrowings primarily through the issuance of promissory notes, commercial paper and hybrid debt instruments. As of November 2006 and November 2005, these borrowings were \$47.90 billion and \$47.25 billion, respectively. Such amounts include the portion of unsecured long-term borrowings maturing within one year of the financial statement date and unsecured long-term borrowings that are redeemable within one year of the financial statement date at the option of the holder. The carrying value of these short-term obligations approximates fair value due to their short-term nature.

Unsecured short-term borrowings are set forth below:

<i>(in millions)</i>	AS OF NOVEMBER	
	2006	2005
Promissory notes	<b>\$13,811</b>	\$17,339
Commercial paper	<b>1,489</b>	5,154
Current portion of unsecured long-term borrowings	<b>14,115</b>	15,819
Hybrid debt instruments <sup>(1)</sup>	<b>14,060</b>	3,901
Other short-term borrowings	<b>4,429</b>	5,034
<b>Total<sup>(2)</sup></b>	<b>\$47,904</b>	\$47,247

<sup>(1)</sup> Hybrid debt instruments are financial instruments that contain bifurcated embedded derivatives, \$10.22 billion of which were accounted for at fair value under SFAS No. 155 as of November 2006.

<sup>(2)</sup> The weighted average interest rates for these borrowings were 5.13% and 4.01% as of November 2006 and November 2005, respectively. The weighted average interest rates, after giving effect to hedging activities, were 5.16% and 3.99% as of November 2006 and November 2005, respectively. The weighted average interest rates as of November 2006 excluded hybrid debt instruments accounted for at fair value under SFAS No. 155.

### Note 5

#### UNSECURED LONG-TERM BORROWINGS

The firm obtains unsecured long-term borrowings that consist principally of senior borrowings with maturities extending to 2036. As of November 2006 and November 2005, these borrowings were \$122.84 billion and \$84.34 billion, respectively.

Unsecured long-term borrowings are set forth below:

<i>(in millions)</i>	AS OF NOVEMBER	
	2006	2005
Fixed rate obligations <sup>(1)</sup>		
U.S. dollar	<b>\$ 41,719</b>	\$34,792
Non-U.S. dollar	<b>22,854</b>	16,079
Floating rate obligations <sup>(2)</sup>		
U.S. dollar	<b>38,342</b>	23,041
Non-U.S. dollar	<b>19,927</b>	10,426
<b>Total<sup>(3)</sup></b>	<b>\$122,842</b>	\$84,338

<sup>(1)</sup> As of both November 2006 and November 2005, interest rates on U.S. dollar fixed rate obligations ranged from 3.88% to 12.00%. As of November 2006 and November 2005, interest rates on non-U.S. dollar fixed rate obligations ranged from 0.31% to 8.88% and from 0.67% to 8.88%, respectively.

<sup>(2)</sup> 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.

<sup>(3)</sup> Includes \$7.25 billion of hybrid financial instruments accounted for at fair value under SFAS No. 155 as of November 2006.

## Notes to Consolidated Financial Statements

Unsecured long-term borrowings by maturity date are set forth below:

(in millions)	AS OF NOVEMBER					
	2006 <sup>(1)(2)</sup>			2005 <sup>(1)(2)</sup>		
	U.S. DOLLAR	NON-U.S. DOLLAR	TOTAL	U.S. DOLLAR	NON-U.S. DOLLAR	TOTAL
2007	\$ —	\$ —	\$ —	\$11,597	\$ 766	\$12,363
2008	14,848	3,038	17,886	5,662	2,725	8,387
2009	12,398	2,978	15,376	6,123	2,793	8,916
2010	5,034	4,945	9,979	5,163	5,595	10,758
2011	5,675	4,389	10,064	4,434	1,024	5,458
2012-thereafter	42,106	27,431	69,537	24,854	13,602	38,456
Total	\$80,061	\$42,781	\$122,842	\$57,833	\$26,505	\$84,338

<sup>(1)</sup> Unsecured long-term borrowings maturing within one year of the financial statement date and certain unsecured long-term borrowings that are redeemable within one year of the financial statement date at the option of the holder are included as unsecured short-term borrowings in the consolidated statements of financial condition.

<sup>(2)</sup> Unsecured long-term borrowings that are repayable prior to maturity at the option of the firm are reflected at their contractual maturity dates. Unsecured long-term borrowings that are 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 and indexed contracts, to effectively convert a substantial portion of its unsecured

long-term borrowings into U.S. dollar-based floating rate obligations. Accordingly, the carrying value of unsecured long-term borrowings approximated fair value as of November 2006 and November 2005.

The effective weighted average interest rates for unsecured long-term borrowings are set forth below:

(\$ in millions)	AS OF NOVEMBER			
	2006		2005	
	AMOUNT	RATE	AMOUNT	RATE
Fixed rate obligations	\$ 1,997	6.13%	\$ 2,289	6.05%
Floating rate obligations <sup>(1)</sup>	120,845	5.75	82,049	4.42
Total	\$122,842	5.75	\$84,338	4.46

<sup>(1)</sup> Includes fixed rate obligations that have been converted into floating rate obligations through derivative contracts.

### Subordinated Borrowings

Unsecured long-term borrowings include \$7.51 billion and \$2.99 billion of subordinated borrowings as of November 2006 and November 2005, respectively, as set forth below.

**Subordinated Notes**—As of November 2006, the firm had \$4.67 billion of subordinated notes outstanding with maturities ranging from 2007 to 2036. The effective weighted average interest rate on these subordinated notes was 6.24%, after giving effect to derivative contracts used to convert fixed rate obligations into floating rate obligations. As of November 2005, the firm had \$150 million of subordinated notes outstanding with maturities ranging from 2006 to 2019 and with an effective weighted average interest rate of 6.39%. These notes are junior in right of payment to all of the firm's senior indebtedness.

**Junior Subordinated Debentures**—The firm issued \$2.84 billion of junior subordinated debentures in its first quarter of 2004 to Goldman Sachs Capital Trust I (the Trust), a Delaware statutory trust created 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 issued by the firm 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 November 2006 and November 2005, the firm held all the common beneficial interests. The Trust is a wholly owned finance subsidiary of the firm for regulatory and legal purposes but is not consolidated for accounting purposes.

## Notes to Consolidated Financial Statements

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 the payment dates applicable to the beneficial interests are the same as the interest rate and payment dates applicable to the debentures. The firm has the right, from time to time, to defer payment of interest on the debentures, and, therefore, cause payment on the Trust's preferred beneficial interests to be deferred, in each case up to ten consecutive semiannual periods. During any such extension period, the firm 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. These notes are junior in right of payment to all of the firm's senior indebtedness and all of the firm's subordinated notes (described above). See Note 6 for information regarding the firm's guarantee of the preferred beneficial interests issued by the Trust.

### Note 6

#### COMMITMENTS, CONTINGENCIES AND GUARANTEES

##### **Commitments**

##### ***Forward Starting Collateralized Agreements and Financings—***

The firm had forward starting resale agreements and securities borrowing agreements of \$18.29 billion and \$20.83 billion as of November 2006 and November 2005, respectively. The firm had forward starting repurchase agreements and securities lending agreements of \$17.15 billion and \$29.10 billion as of November 2006 and November 2005, respectively.

***Commitments to Extend Credit—***In connection with its lending activities, the firm had outstanding commitments to extend credit of \$100.48 billion and \$61.12 billion as of November 2006 and November 2005, respectively. The firm's commitments to extend credit are agreements to lend to counterparties that have fixed termination dates and are contingent on the satisfaction of all conditions to borrowing set forth in the contract. Since these commitments may expire unused or be reduced or cancelled at the counterparty's request, the total commitment amount does not necessarily reflect the actual future cash flow requirements. The firm accounts for these commitments at fair value.

The following table summarizes the firm's commitments to extend credit at November 2006 and November 2005:

##### ***Commitments to Extend Credit***

(in millions)	YEAR ENDED NOVEMBER	
	2006	2005
William Street program	<b>\$ 18,831</b>	\$14,505
Other commercial lending commitments		
Investment-grade	<b>7,604</b>	17,592
Non-investment-grade	<b>57,017</b>	18,536
Warehouse financing	<b>17,026</b>	10,489
Total commitments to extend credit	<b>\$100,478</b>	\$61,122

- ***William Street program—***Substantially all of the commitments provided under the William Street credit extension program are to investment-grade corporate borrowers. Commitments under the program are primarily extended by William Street Commitment Corporation (Commitment Corp.), a consolidated wholly owned subsidiary of Group Inc. whose assets and liabilities are legally separated from other assets and liabilities of the firm, and, to a lesser extent, by William Street Credit Corporation, another consolidated wholly owned subsidiary of Group Inc. A majority of the commitments extended by Commitment Corp. are supported by funding raised by William Street Funding Corporation (Funding Corp.), another consolidated wholly owned subsidiary of Group Inc. whose assets and liabilities

are also legally separated from other assets and liabilities of the firm. 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. With respect to substantially all of the William Street commitments, SMFG provides the firm with credit loss protection that is generally limited to 95% of the first loss the firm realizes on approved loan commitments, up to a maximum of \$1.00 billion. In addition, subject to the satisfaction of certain conditions, upon the firm's request, SMFG will provide protection for 70% of the second loss

## Notes to Consolidated Financial Statements

on such commitments, up to a maximum of \$1.13 billion. The firm also uses other financial instruments to mitigate credit risks related to certain William Street commitments not covered by SMFG.

- **Other commercial lending commitments**—In addition to the commitments issued under the William Street credit extension program, the firm extends other credit commitments, primarily in connection with contingent acquisition financing and other types of corporate lending. The total commitment amount does not necessarily reflect the actual future cash flow requirements, as the firm often syndicates all or substantial portions of these commitments, the commitments may expire unused, or the commitments may be cancelled or reduced at the request of the counterparty. In addition, commitments that are extended for contingent acquisition financing are often short-term in nature, as borrowers often replace them with other funding sources.

- **Warehouse financing**—The firm provides financing for the warehousing of financial assets to be securitized, primarily in connection with CDOs and mortgage securitizations. These financings are expected to be repaid from the proceeds of the related securitizations for which the firm may or may not act as underwriter. These arrangements are secured by the warehoused assets, primarily consisting of mortgage-backed and other asset-backed securities, residential and commercial mortgages and corporate debt instruments.

**Letters of Credit**—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 \$5.73 billion and \$9.23 billion as of November 2006 and November 2005, respectively.

**Merchant Banking Commitments**—The firm acts as an investor in merchant banking transactions, which includes making long-term investments in equity and debt instruments in privately negotiated transactions, corporate acquisitions and real estate transactions. In connection with these activities, the firm had commitments to invest up to \$6.36 billion and \$3.54 billion in corporate and real estate investment funds as of November 2006 and November 2005, respectively.

**Construction-Related Commitments**—As of November 2006 and November 2005, the firm had construction-related commitments of \$1.63 billion and \$579 million, respectively, including commitments of \$1.07 billion and \$481 million, respectively, related to the development of wind energy projects. Construction-related commitments also include outstanding commitments of \$500 million and \$47 million as of November 2006 and November 2005, respectively, related to the firm's new world headquarters in New York City, which is expected to cost between \$2.3 billion and \$2.5 billion.

**Underwriting Commitments**—As of November 2006, the firm had commitments to purchase \$2.62 billion of securities in connection with its underwriting activities. As of November 2005, the firm had no such commitments.

**Other**—The firm had other purchase commitments of \$393 million and \$563 million as of November 2006 and November 2005, respectively. In addition, the firm had other investment commitments of \$1.88 billion and \$81 million as of November 2006 and November 2005, respectively.

**Leases**—The firm has contractual obligations under long-term noncancelable lease agreements, principally for office space, expiring on various dates through 2069. 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, and rent charged to operating expense for the last three years are set forth below:

<i>(in millions)</i>	
Minimum rental payments	
2007	\$ 564
2008	387
2009	371
2010	285
2011	250
2012-thereafter	2,195
Total	\$4,052
Net rent expense	
2004	\$ 356
2005	359
2006	404

## Notes to Consolidated Financial Statements

### 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 and regulatory matters, particularly in cases or proceedings in which substantial or indeterminate damages or fines are sought, the firm cannot estimate losses or ranges of losses for cases or proceedings where there is only a reasonable possibility that a loss may be incurred.

In connection with its insurance business, the firm is contingently liable to provide guaranteed minimum death benefits to certain contract holders. The total account balances of contract holders to whom the firm has provided such guaranteed minimum death benefits was \$8.04 billion as of November 2006, and the weighted average attained age of these contract holders was 70 years. The net amount at risk, representing guaranteed minimum death benefits in excess of contract holder account balances, was \$1.27 billion as of November 2006. The firm has established a reserve for its liability related to guaranteed minimum death benefits (see Note 10 for more information on the firm's insurance liabilities).

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

In the ordinary course of business, the firm provides other financial guarantees of the obligations of third parties (e.g., standby letters of credit and other guarantees to enable clients to complete transactions and merchant banking fund-related guarantees). These guarantees represent obligations to make payments to beneficiaries if the guaranteed party fails to fulfill its obligation under a contractual arrangement with that beneficiary.



## Notes to Consolidated Financial Statements

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 November 2006 and November 2005:

<i>(in millions)</i>	AS OF NOVEMBER 2006				
	MAXIMUM PAYOUT/NOTIONAL AMOUNT BY PERIOD OF EXPIRATION <sup>(5)</sup>				
	2007	2008-2009	2010-2011	2012-THEREAFTER	TOTAL
Derivatives <sup>(1)</sup>	\$379,256	\$428,258	\$460,088	\$399,449	\$1,667,051
Securities lending indemnifications <sup>(2)</sup>	19,023	—	—	—	19,023
Guarantees of trust preferred beneficial interest <sup>(3)</sup>	174	349	349	6,676	7,548
Other financial guarantees <sup>(4)</sup>	592	99	76	86	853

<i>(in millions)</i>	AS OF NOVEMBER 2005				
	MAXIMUM PAYOUT/NOTIONAL AMOUNT BY PERIOD OF EXPIRATION <sup>(5)</sup>				
	2006	2007-2008	2009-2010	2011-THEREAFTER	TOTAL
Derivatives <sup>(1)</sup>	\$356,131	\$244,163	\$259,332	\$289,459	\$1,149,085
Securities lending indemnifications <sup>(2)</sup>	16,324	—	—	—	16,324
Guarantees of trust preferred beneficial interest <sup>(3)</sup>	174	349	349	6,851	7,723
Other financial guarantees <sup>(4)</sup>	516	144	230	177	1,067

<sup>(1)</sup> The aggregate carrying value of these derivatives as of November 2006 was an asset of \$1.12 billion, consisting of contracts with an asset value of \$11.06 billion and contracts with a liability value of \$9.94 billion. The aggregate carrying value as of November 2005 was a liability of \$8.22 billion, consisting of contracts with an asset value of \$1.91 billion and contracts with a liability value of \$10.13 billion. The carrying value excludes the effect of a legal right of setoff that may exist under an enforceable netting agreement.

<sup>(2)</sup> Collateral held by the lenders in connection with securities lending indemnifications was \$19.70 billion and \$16.89 billion as of November 2006 and November 2005, respectively.

<sup>(3)</sup> 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 redeems the junior subordinated debentures issued to fund the Trust. See Note 5 for further information regarding the Trust.

<sup>(4)</sup> The carrying value of these guarantees was a liability of \$15 million and \$4 million as of November 2006 and November 2005, respectively.

<sup>(5)</sup> Such amounts do not represent the anticipated losses in connection with these contracts.

In the ordinary course of 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 sub-custodians 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 agrees 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 any material payments under these arrangements, and no liabilities related to these guarantees and indemnifications have been recognized in the consolidated statements of financial condition as of November 2006 and November 2005.

## Notes to Consolidated Financial Statements

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 ordinary 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 and indemnifications. However, management believes that it is unlikely the firm will have to make any material payments under these arrangements, and no liabilities related to these arrangements have been recognized in the consolidated statements of financial condition as of November 2006 and November 2005.

During 2006, the firm issued 54,000 shares of perpetual Floating Rate Non-Cumulative Preferred Stock, Series D. As of November 2006, the firm had 124,000 shares of perpetual non-cumulative preferred stock outstanding in four series as set forth in the following table:

### *Preferred Stock by Series*

SERIES	SHARES ISSUED	SHARES AUTHORIZED	DIVIDEND RATE	EARLIEST REDEMPTION DATE	REDEMPTION VALUE (IN MILLIONS)
A	30,000	50,000	3 month LIBOR + 0.75%, with floor of 3.75% per annum	April 25, 2010	\$ 750
B	32,000	50,000	6.20% per annum	October 31, 2010	800
C	8,000	25,000	3 month LIBOR + 0.75%, with floor of 4% per annum	October 31, 2010	200
D	54,000	60,000	3 month LIBOR + 0.67%, with floor of 4% per annum	May 24, 2011	1,350
	124,000	185,000			\$3,100

Each share of preferred stock has a par value of \$0.01, has a liquidation preference of \$25,000, is represented by 1,000 depositary shares and is redeemable at the firm's option at a redemption price equal to \$25,000 plus declared and unpaid dividends. Dividends on each series of preferred stock, if declared, are payable quarterly in arrears. The firm's ability to declare or pay dividends on, or purchase, redeem or otherwise acquire, its common stock is subject to certain restrictions in the event that the firm fails to pay or set aside full dividends on the preferred stock for the latest completed dividend period. All preferred stock also has a preference over the firm's common stock upon liquidation.

## Note 7

### SHAREHOLDERS' EQUITY

Dividends declared per common share were \$1.30 in 2006, \$1.00 in 2005, and \$1.00 in 2004. On December 11, 2006, the Board of Directors of Group Inc. (the Board) declared a dividend of \$0.35 per common share to be paid on February 22, 2007, to common shareholders of record on January 23, 2007.

During 2006, the firm repurchased 50.2 million shares of its common stock at a total cost of \$7.82 billion, and during 2005, the firm repurchased 63.7 million shares of its common stock at a total cost of \$7.11 billion. The average price paid per share for repurchased shares was \$155.64 and \$111.57 for the years ended November 2006 and November 2005, respectively. In addition, to satisfy minimum statutory employee tax withholding requirements related to the delivery of common stock underlying restricted stock units, the firm cancelled 3.0 million restricted stock units with a total value of \$375 million in 2006, and it cancelled 1.6 million restricted stock units with a total value of \$163 million in 2005.

Dividends declared per preferred share were \$1,434.79, \$1,593.06, \$1,465.19 and \$709.10 for Series A, Series B, Series C and Series D preferred stock, respectively, in 2006. Dividends declared per share of Series A preferred stock were \$578.72 in 2005. On December 11, 2006, the Board declared a dividend per preferred share of \$391.28, \$387.50, \$391.28 and \$386.17 for Series A, Series B, Series C and Series D preferred stock, respectively, to be paid on February 10, 2007 to preferred shareholders of record on January 26, 2007.

## Notes to Consolidated Financial Statements

The following table sets forth the firm's accumulated other comprehensive income by type:

<i>(in millions)</i>	AS OF NOVEMBER	
	2006	2005
Currency translation adjustment, net of tax	<b>\$ 29</b>	\$(16)
Minimum pension liability adjustment, net of tax	<b>(38)</b>	(11)
Net gains/(losses) on cash flow hedges, net of tax	<b>2</b>	9
Net unrealized gains on available-for-sale securities, net of tax	<b>28<sup>(1)</sup></b>	18
Total accumulated other comprehensive income, net of tax	<b>\$ 21</b>	\$ —

<sup>(1)</sup> Consists of net unrealized gains of \$10 million on available-for-sale securities held by the firm's bank and insurance subsidiaries and net unrealized gains of \$18 million on available-for-sale securities held by investees accounted for under the equity method.

### Note 8

#### EARNINGS PER COMMON SHARE

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

<i>(in millions, except per share amounts)</i>	YEAR ENDED NOVEMBER		
	2006	2005	2004
Numerator for basic and diluted EPS—net earnings			
applicable to common shareholders	<b>\$9,398</b>	\$5,609	\$4,553
Denominator for basic EPS—weighted average number of common shares	<b>449.0</b>	478.1	489.5
Effect of dilutive securities			
Restricted stock units	<b>13.6</b>	9.9	9.6
Stock options	<b>14.8</b>	12.2	11.4
Dilutive potential common shares	<b>28.4</b>	22.1	21.0
Denominator for diluted EPS—weighted average number of common shares and dilutive potential common shares <sup>(1)</sup>	<b>477.4</b>	500.2	510.5
Basic EPS	<b>\$20.93</b>	\$11.73	\$ 9.30
Diluted EPS	<b>19.69</b>	11.21	8.92

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

<i>(in millions)</i>	YEAR ENDED NOVEMBER		
	2006	2005	2004
Number of antidilutive options, end of period	—	1	1

# Notes to Consolidated Financial Statements

## Note 9

### GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

#### Goodwill

The following table sets forth the carrying value of the firm's goodwill by operating segment, which is included in "Other assets" in the consolidated statements of financial condition:

<i>(in millions)</i>	AS OF NOVEMBER	
	2006	2005
Investment Banking		
Financial Advisory	\$ —	\$ —
Underwriting	125	125
Trading and Principal Investments		
FICC	136	91
Equities <sup>(1)</sup>	2,381	2,390
Principal Investments	4	1
Asset Management and Securities Services		
Asset Management <sup>(2)</sup>	421	424
Securities Services	117	117
Total	<b>\$3,184</b>	\$3,148

<sup>(1)</sup> Primarily related to SLK LLC (SLK).

<sup>(2)</sup> Primarily related to The Ayco Company, L.P. (Ayco).

## Notes to Consolidated Financial Statements

### Identifiable Intangible Assets

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

<i>(in millions)</i>		AS OF NOVEMBER	
		2006	2005
Customer lists <sup>(1)</sup>	Gross carrying amount	\$1,034	\$1,021
	Accumulated amortization	(297)	(244)
	Net carrying amount	\$ 737	\$ 777
Power contracts <sup>(2)</sup>	Gross carrying amount	\$ 750	\$ 497
	Accumulated amortization	(83)	(16)
	Net carrying amount	\$ 667	\$ 481
New York Stock Exchange (NYSE) specialist rights	Gross carrying amount	\$ 714	\$ 714
	Accumulated amortization	(172)	(134)
	Net carrying amount	\$ 542	\$ 580
Insurance-related assets <sup>(3)</sup>	Gross carrying amount	\$ 396	\$ —
	Accumulated amortization	(34)	—
	Net carrying amount	\$ 362	\$ —
Exchange-traded fund (ETF) specialist rights	Gross carrying amount	\$ 138	\$ 138
	Accumulated amortization	(33)	(27)
	Net carrying amount	\$ 105	\$ 111
Other <sup>(4)</sup>	Gross carrying amount	\$ 335	\$ 312
	Accumulated amortization	(246)	(206)
	Net carrying amount	\$ 89	\$ 106
Total	Gross carrying amount	\$3,367	\$2,682
	Accumulated amortization	(865)	(627)
	Net carrying amount	\$2,502	\$2,055

<sup>(1)</sup> Primarily includes the firm's clearance and execution and NASDAQ customer lists related to SLK and financial counseling customer lists related to Ayco.

<sup>(2)</sup> Primarily relates to above-market power contracts of consolidated power generation facilities related to Cogentrix Energy, Inc. and National Energy & Gas Transmission, Inc. (NEGT). Substantially all of these power contracts have been pledged to counterparties in connection with the firm's secured financings. The weighted average remaining life of these power contracts is approximately 11 years. The increase in the carrying value of power contracts in 2006 was due to a restructuring of certain contracts, which resulted in the consolidation of the associated power generation facilities that had been previously accounted for under the equity method.

<sup>(3)</sup> Consists of VOBA and DAC. VOBA represents the present value of estimated future gross profits of the variable annuity and variable life insurance business acquired in 2006. DAC results from commissions paid by the firm to the primary insurer (ceding company) on life and annuity reinsurance agreements as compensation to place the business with the firm and to cover the ceding company's acquisition expenses. VOBA and DAC are amortized over the estimated life of the underlying contracts based on estimated gross profits, and amortization is adjusted based on actual experience. The weighted average remaining amortization period for VOBA and DAC is seven years as of the end of 2006.

<sup>(4)</sup> Primarily includes technology-related and other assets related to SLK.

Substantially all of the firm's identifiable intangible assets are considered to have finite lives and are amortized over their estimated useful lives. The weighted average remaining life of the firm's identifiable intangibles is approximately 12 years.

Amortization expense associated with identifiable intangible assets was \$246 million, \$165 million and \$125 million for the years ended November 2006, November 2005 and November 2004, respectively. Amortization expense associated with the firm's consolidated power generation facilities is reported within "Cost of power generation" in the consolidated statements of earnings.

The estimated future amortization for existing identifiable intangible assets through 2011 is set forth below:

<i>(in millions)</i>	
2007	\$265
2008	223
2009	210
2010	198
2011	190

# Notes to Consolidated Financial Statements

## 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:

<i>(in millions)</i>	AS OF NOVEMBER	
	2006	2005
Goodwill and identifiable intangible assets <sup>(1)</sup>	\$ 5,686	\$ 5,203
Property, leasehold improvements and equipment <sup>(2)</sup>	6,990	5,097
Equity-method investments	2,764	2,965
Income tax-related assets	3,427	1,304
Miscellaneous receivables and other	3,009	2,743
<b>Total</b>	<b>\$21,876</b>	<b>\$17,312</b>

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

<sup>(2)</sup> Net of accumulated depreciation and amortization of \$5.06 billion and \$4.62 billion for November 2006 and November 2005, respectively.

#### Other Liabilities

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

<i>(in millions)</i>	AS OF NOVEMBER	
	2006	2005
Insurance-related liabilities <sup>(1)</sup>	\$11,471	\$ —
Compensation and benefits	9,165	6,598
Minority interest <sup>(2)</sup>	4,759	3,164
Income tax-related liabilities	2,639	868
Accrued expenses and other payables	3,832	3,200
<b>Total</b>	<b>\$31,866</b>	<b>\$13,830</b>

<sup>(1)</sup> Insurance-related liabilities are set forth in the table below:

<i>(in millions)</i>	AS OF NOVEMBER	
	2006	2005
Separate account liabilities	\$ 7,957	\$ —
Liabilities for future benefits and unpaid claims	2,123	—
Contract holder account balances	1,134	—
Reserves for guaranteed minimum death and income benefits	257	—
<b>Total insurance-related liabilities</b>	<b>\$11,471</b>	<b>\$ —</b>

Separate account liabilities are offset by separate account assets, representing segregated contract holder funds under variable annuity and variable life insurance contracts. Separate account assets are included in "Cash and securities segregated for regulatory and other purposes" in the consolidated statements of financial condition.

Liabilities for future benefits and unpaid claims include liabilities arising from reinsurance provided by the firm to other insurers. The firm has a receivable for \$1.33 billion related to such reinsurance contracts, which is reported in "Receivables from customers and counterparties" in the consolidated statements of financial condition. In addition, the firm has ceded risks to reinsurers related to certain of its liabilities for future benefits and unpaid claims and has a receivable of \$786 million related to such reinsurance contracts, which is reported in "Receivables from customers and counterparties" in the consolidated statements of financial condition. Contracts to cede risks to reinsurers do not relieve the firm from its obligations to contract holders.

Reserves for guaranteed minimum death and income benefits represent a liability for the expected value of guaranteed benefits in excess of projected annuity account balances. These reserves are computed in accordance with AICPA Statement of Position 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts," and are based on total payments expected to be made less total fees expected to be assessed over the life of the contract.

<sup>(2)</sup> Includes \$3.31 billion and \$2.04 billion related to consolidated merchant banking funds as of November 2006 and November 2005, respectively.

## Notes to Consolidated Financial Statements

### Note 11

#### EMPLOYEE BENEFIT PLANS

The firm sponsors various pension plans and certain other post-retirement benefit plans, primarily healthcare and life insurance. The firm also provides certain benefits to former or inactive employees prior to retirement.

#### Defined Benefit Pension Plans and Postretirement Plans

Employees of certain non-U.S. subsidiaries participate in various defined benefit pension plans. These plans generally provide

benefits based on years of credited service and a percentage of the employee's eligible compensation. The firm also maintains a defined benefit pension plan for substantially all U.S. employees hired prior to November 1, 2003. As of November 2004, this plan has been closed to new participants and no further benefits will be accrued to existing participants. In addition, the firm has unfunded postretirement benefit plans that provide medical and life insurance for eligible retirees and their dependents covered under these programs.

The following table provides a summary of the changes in the plans' benefit obligations and the fair value of assets for November 2006 and November 2005 and a statement of the funded status of the plans as of November 2006 and November 2005:

(in millions)	AS OF OR FOR THE YEAR ENDED NOVEMBER					
	2006			2005		
	U.S. PENSION	NON-U.S. PENSION	POST-RETIREMENT	U.S. PENSION	NON-U.S. PENSION	POST-RETIREMENT
<b>Benefit obligation</b>						
Balance, beginning of year	\$393	\$ 486	\$ 277	\$355	\$474	\$ 215
Service cost	—	58	19	—	44	23
Interest cost	21	25	19	19	20	13
Plan amendments	—	1	48	—	—	—
Actuarial loss	(13)	38	17	25	65	32
Benefits paid	(6)	(4)	(8)	(6)	(67)	(6)
Effect of foreign exchange rates	—	69	—	—	(50)	—
Balance, end of year	\$395	\$ 673	\$ 372	\$393	\$486	\$ 277
<b>Fair value of plan assets</b>						
Balance, beginning of year	\$354	\$ 392	\$ —	\$318	\$382	\$ —
Actual return on plan assets	55	58	—	32	64	—
Firm contributions	20	4	8	10	30	6
Employee contributions	—	1	—	—	1	—
Benefits paid	(6)	(3)	(8)	(6)	(43)	(6)
Effect of foreign exchange rates	—	54	—	—	(42)	—
Balance, end of year	\$423	\$ 506	\$ —	\$354	\$392	\$ —
<b>Prepaid/(accrued) benefit cost</b>						
Funded status	\$ 28	\$(167)	\$(372)	\$ (39)	\$ (94)	\$(277)
Unrecognized loss	77	159	101	129	143	88
Unrecognized transition (asset)/obligation	(17)	5	1	(20)	5	1
Unrecognized prior service cost	—	5	46	—	4	12
Adjustment to recognize additional minimum liability	(10)	(46)	—	(18)	(1)	—
Prepaid/(accrued) benefit cost	\$ 78	\$ (44)	\$(224)	\$ 52	\$ 57	\$(176)

The accumulated benefit obligation for all defined benefit pension plans was \$944 million and \$795 million as of November 2006 and November 2005, respectively.

## Notes to Consolidated Financial Statements

For plans in which the accumulated benefit obligation exceeded plan assets, the aggregate projected benefit obligation and accumulated benefit obligation was \$771 million and \$647 million, respectively, as of November 2006, and

\$135 million and \$126 million, respectively, as of November 2005. The fair value of plan assets for each of these plans was \$583 million and \$64 million as of November 2006 and November 2005, respectively.

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

<i>(in millions)</i>	YEAR ENDED NOVEMBER		
	2006	2005	2004
U.S. pension			
Service cost	<b>\$ —</b>	\$ —	\$ 10
Interest cost	<b>21</b>	19	18
Expected return on plan assets	<b>(26)</b>	(27)	(23)
Net amortization	<b>7</b>	6	5
Total	<b>\$ 2</b>	\$ (2)	\$ 10
Non-U.S. pension			
Service cost	<b>\$ 58</b>	\$ 44	\$ 44
Interest cost	<b>25</b>	20	16
Expected return on plan assets	<b>(29)</b>	(23)	(20)
Net amortization	<b>11</b>	12	8
Other <sup>(1)</sup>	<b>—</b>	(17)	—
Total	<b>\$ 65</b>	\$ 36	\$ 48
Postretirement			
Service cost	<b>\$ 19</b>	\$ 23	\$ 9
Interest cost	<b>19</b>	13	12
Net amortization	<b>18</b>	4	11
Total	<b>\$ 56</b>	\$ 40	\$ 32

<sup>(1)</sup> Represents a benefit as a result of the termination of a Japanese pension plan.



## Notes to Consolidated Financial Statements

The weighted average assumptions used to develop the actuarial present value of the projected benefit obligation and net periodic pension cost are set forth below. These assumptions represent a weighted average of the assumptions used for the U.S. and non-U.S. plans and are based on the economic environment of each applicable country.

	YEAR ENDED NOVEMBER		
	2006	2005	2004
Defined benefit pension plans			
U.S. pension—projected benefit obligation			
Discount rate	<b>5.50%</b>	5.25%	5.50%
Rate of increase in future compensation levels	<b>N/A</b>	N/A	N/A
U.S. pension—net periodic benefit cost			
Discount rate	<b>5.25</b>	5.50	6.00
Rate of increase in future compensation levels	<b>N/A</b>	N/A	5.00
Expected long-term rate of return on plan assets	<b>7.50</b>	7.50	8.50
Non-U.S. pension—projected benefit obligation			
Discount rate	<b>4.85</b>	4.81	4.63
Rate of increase in future compensation levels	<b>4.98</b>	4.75	4.49
Non-U.S. pension—net periodic benefit cost			
Discount rate	<b>4.81</b>	4.63	4.76
Rate of increase in future compensation levels	<b>4.75</b>	4.49	4.37
Expected long-term rate of return on plan assets	<b>6.93</b>	6.35	6.25
Postretirement plans—benefit obligation			
Discount rate	<b>5.50%</b>	5.25%	5.50%
Rate of increase in future compensation levels	<b>5.00</b>	5.00	5.00
Postretirement plans—net periodic benefit cost			
Discount rate	<b>5.25</b>	5.50	6.00
Rate of increase in future compensation levels	<b>5.00</b>	5.00	5.00

Generally, the firm determined the discount rates for its defined benefit plans by referencing indices for long-term, high-quality bonds and ensuring that the discount rate does not exceed the yield reported for those indices after adjustment for the duration of the plans' liabilities.

The firm's approach in determining the long-term rate of return for plan assets is based upon historical financial market

relationships that have existed over time with the presumption that this trend will generally remain constant in the future.

For measurement purposes, an annual growth rate in the per capita cost of covered healthcare benefits of 10.74% was assumed for the year ending November 2007. The rate was assumed to decrease ratably to 5.00% for the year ending November 2015 and remain at that level thereafter.

## Notes to Consolidated Financial Statements

The assumed cost of healthcare has an effect on the amounts reported for the firm's postretirement plans. A 1% change in the assumed healthcare cost trend rate would have the following effects:

<i>(in millions)</i>	1% INCREASE		1% DECREASE	
	2006	2005	2006	2005
Cost	\$ 9	\$ 6	\$ (7)	\$ (5)
Obligation	79	48	(62)	(37)

The following table sets forth the composition of plan assets for the U.S. and non-U.S. defined benefit pension plans by asset category:

	AS OF NOVEMBER			
	2006		2005	
	U.S. PENSION	NON-U.S. PENSION	U.S. PENSION	NON-U.S. PENSION
Equity securities	64%	61%	64%	70%
Debt securities	22	8	21	8
Other	14	31	15	22
Total	100%	100%	100%	100%

The investment approach of the firm's U.S. and major non-U.S. defined benefit pension plans involves employing a sufficient level of flexibility to capture investment opportunities as they occur, while maintaining reasonable parameters to ensure that prudence and care are exercised in the execution of the investment programs. The plans employ a total return on investment approach, whereby a mix, which is broadly similar to the actual asset allocation as of November 2006, of equity securities, debt securities and other assets, is targeted to maximize the long-term return on assets for a given level of risk. Investment risk is measured and monitored on an ongoing basis by the firm's Retirement Committee through periodic portfolio reviews, meetings with investment managers and annual liability measurements.

The firm will contribute a minimum of \$30 million to its pension plans and \$9 million to its postretirement plans in 2007.

The following table sets forth benefits projected to be paid from the firm's U.S. and non-U.S. defined benefit pension and post-retirement plans (net of Medicare subsidy receipts) and reflects expected future service, where appropriate:

<i>(in millions)</i>	U.S. PENSION	NON-U.S. PENSION	POST-RETIREMENT
2007	\$ 7	\$ 6	\$ 9
2008	7	6	10
2009	8	6	11
2010	9	6	12
2011	10	6	13
2012-2016	67	35	83

### Defined Contribution Plans

The firm contributes to employer-sponsored U.S. and non-U.S. defined contribution plans. The firm's contribution to these plans was \$230 million, \$305 million and \$189 million for the years ended November 2006, November 2005 and November 2004, respectively.

# Notes to Consolidated Financial Statements

## Note 12

### EMPLOYEE INCENTIVE PLANS

#### Stock Incentive Plan

The firm sponsors a stock incentive plan, The Goldman Sachs Amended and Restated Stock Incentive Plan (the Amended SIP), which provides for grants of incentive stock options, non-qualified stock options, stock appreciation rights, dividend equivalent rights, restricted stock, restricted stock units and other share-based awards. In the second quarter of 2003, the Amended SIP was approved by the firm's shareholders, effective for grants after April 1, 2003, and no further awards were or will be made under the original plan after that date, although awards granted under the original plan prior to that date remain outstanding.

The total number of shares of common stock that may be issued under the Amended SIP through 2008 may not exceed 250 million shares and, in each year thereafter, may not exceed 5% of the issued and outstanding shares of common stock, determined as of the last day of the immediately preceding year, increased by the number of shares available for awards in previous years but not covered by awards granted in such years. As of November 2006 and November 2005, 180.0 million and 196.6 million shares, respectively, were available for grant under the Amended SIP, after taking into account stock-based compensation awards that were issued subsequent to year end, as part of year-end compensation.

#### Other Compensation Arrangements

In November 2004, the firm adopted new deferred compensation plans for eligible employees. In general, under the plans, participants are able to defer payment of a portion of their cash year-end compensation. During the deferral period, participants are able to nominally invest their deferrals in certain alternatives available under the plans. Generally, under current tax law, participants are not subject to income tax on amounts deferred or on any notional investment earnings until the returns are distributed, and the firm is not entitled to a corresponding tax deduction until the amounts are distributed. The firm has recognized compensation expense for the amounts deferred under these plans. As of November 2006 and November 2005, \$245 million and \$134 million, respectively, related to these plans was included in "Other liabilities and accrued expenses" in the consolidated statements of financial condition.

In November 2004, the firm adopted a discount stock program through which eligible senior executives may acquire restricted stock units in 2006 and 2005 under the firm's Amended SIP at an effective 25% discount. The 25% discount is effected by an additional grant of restricted stock units equal to one-third of the number of restricted stock units purchased by qualifying participants. The purchased restricted stock units are 100% vested when granted, but the shares underlying them are not able to be sold or transferred (other than to satisfy tax obligations) before the third anniversary of the grant date. The shares underlying the restricted stock units that are granted in order to effect the 25% discount will generally vest in equal installments on the second and third anniversaries following the grant date and will not be transferable before the third anniversary of the grant date. Compensation expense related to these restricted stock units is recognized over the vesting period. The total value of restricted stock units granted in 2006 and 2005 in order to effect the 25% discount was \$72 million and \$79 million, respectively.

## Notes to Consolidated Financial Statements

### Restricted Stock Units

The firm issued restricted stock units to employees under the Amended SIP, primarily in connection with year-end compensation and acquisitions. Year-end restricted stock units generally vest as outlined in the applicable restricted stock unit agreements and deliver shortly after the third anniversary of the grant date. All employee restricted stock unit agreements provide that vesting is accelerated in certain circumstances, such as upon retirement, death and extended absence. Of the total restricted stock units outstanding as of November 2006 and November 2005, (i) 26.4 million units and 30.1 million

units, respectively, required future service as a condition to the delivery of the underlying shares of common stock and (ii) 38.9 million units and 25.0 million units, respectively, did not require future service. In all cases, delivery of the underlying shares of common stock is conditioned on the grantees satisfying certain vesting and other requirements outlined in the award agreements. When delivering the underlying shares to employees, the firm generally issues new shares of common stock, as opposed to reissuing treasury shares. The activity related to these restricted stock units is set forth below:

	RESTRICTED STOCK UNITS OUTSTANDING		WEIGHTED AVERAGE GRANT-DATE FAIR VALUE OF RESTRICTED STOCK UNITS OUTSTANDING	
	FUTURE SERVICE REQUIRED	NO FUTURE SERVICE REQUIRED	FUTURE SERVICE REQUIRED	NO FUTURE SERVICE REQUIRED
Outstanding, November 2005 <sup>(1)</sup>	30,117,820	24,993,866	\$112.01	\$107.18
Granted <sup>(2)(3)(4)</sup>	7,499,157	12,217,441	191.08	200.62
Forfeited	(940,930)	(189,715)	109.85	98.95
Delivered <sup>(5)</sup>	—	(8,399,126)	—	92.00
Vested <sup>(4)</sup>	(10,295,675)	10,295,675	101.08	101.08
Outstanding, November 2006	26,380,372	38,918,141	\$138.83	\$138.22

<sup>(1)</sup> Includes restricted stock units granted to employees during the year ended November 2006 as part of compensation for 2005.

<sup>(2)</sup> Includes restricted stock units granted to employees subsequent to November 2006 as part of compensation for 2006.

<sup>(3)</sup> The weighted average grant-date fair value of restricted stock units granted during the years ended November 2006, November 2005 and November 2004 was \$196.99, \$129.03 and \$104.15, respectively.

<sup>(4)</sup> The aggregate fair value of awards vested during the years ended November 2006, November 2005 and November 2004 was \$4.40 billion, \$2.05 billion and \$1.64 billion, respectively.

<sup>(5)</sup> Includes restricted stock units that were cash settled.

## Notes to Consolidated Financial Statements

### Stock Options

Stock options granted to employees generally vest as outlined in the applicable stock option agreement and first become exercisable on or after the third anniversary of the grant date. Year-end stock options for 2006 and 2005 become exercisable in January 2010 and January 2009, respectively, and expire on November 25, 2016 and November 27, 2015, respectively. Shares received on exercise prior to January 2011 for year-end 2006 options and January 2010 for year-end 2005 options can not be sold, transferred or otherwise disposed of until January 2011 and January 2010, respectively. All employee

stock option agreements provide that vesting is accelerated in certain circumstances, such as upon retirement, death and extended absence. In general, all stock options expire on the tenth anniversary of the grant date, although they may be subject to earlier termination or cancellation under certain circumstances in accordance with the terms of the Amended SIP and the applicable stock option agreement. The dilutive effect of the firm's outstanding stock options is included in "Average common shares outstanding—Diluted" on the consolidated statements of earnings.

The activity related to these stock options is set forth below:

	OPTIONS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE	AGGREGATE INTRINSIC VALUE (IN MILLIONS)	WEIGHTED AVERAGE REMAINING LIFE (YEARS)
Outstanding, November 2005 <sup>(1)</sup>	64,237,687	\$ 83.24		
Granted <sup>(2)</sup>	2,937,772	199.84		
Exercised <sup>(3)</sup>	(21,323,726)	78.09		
Forfeited	(204,637)	90.27		
Outstanding, November 2006	45,647,096	\$ 93.12	\$4,952	5.31
Exercisable, November 2006	38,781,928	81.87	4,643	4.62

<sup>(1)</sup>Includes stock options granted to employees during the year ended November 2006 as part of compensation for 2005.

<sup>(2)</sup>Includes stock options granted to employees subsequent to November 2006 as part of compensation for 2006.

<sup>(3)</sup>Includes stock options that were cash settled.

The total intrinsic value of options exercised during the years ended November 2006, November 2005 and November 2004 was \$1.52 billion, \$766 million and \$363 million, respectively.

The options outstanding as of November 2006 are set forth below:

EXERCISE PRICE	OPTIONS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE	WEIGHTED AVERAGE REMAINING LIFE (YEARS)
\$ 45.00–\$ 59.99	5,037,067	\$ 52.97	2.50
60.00– 74.99	—	—	—
75.00– 89.99	17,604,474	81.12	4.89
90.00– 104.99	16,938,811	91.91	5.09
105.00– 119.99	—	—	—
120.00– 134.99	3,128,972	131.64	9.00
135.00– 194.99	—	—	—
195.00– 209.99	2,937,772	199.84	10.00
Outstanding, November 2006	45,647,096		

The weighted average fair value of options granted for 2006, 2005 and 2004 was \$49.96 per option, \$32.91 per option and \$32.22 per option, respectively. Fair value was estimated as of the grant date based on a Black-Scholes option-pricing model using the following weighted average assumptions:

	YEAR ENDED NOVEMBER		
	2006	2005	2004
Risk-free interest rate	4.6%	4.5%	3.4%
Expected volatility	27.5	30.0	35.0
Dividend yield	0.7	0.9	1.0
Expected life	7.5 years	7.5 years	5 years

## Notes to Consolidated Financial Statements

The fair value of options granted in 2006 and 2005 reflects an additional discount for sales restrictions on the shares of common stock underlying such options that apply until January 2011 and January 2010, respectively. The expected

life of the options granted in 2006 and 2005 has been extended to 7.5 years to reflect the estimated impact of the sales restrictions on the expected life of the awards.

The following table sets forth share-based compensation and the related tax benefit:

(in millions)	YEAR ENDED NOVEMBER		
	2006	2005	2004
Share-based compensation	<b>\$3,669</b>	\$1,758	\$1,225
Excess tax benefit related to options exercised	<b>542</b>	268	124
Excess tax benefit related to share-based compensation <sup>(1)</sup>	<b>653</b>	272	330

<sup>(1)</sup> Represents the tax benefit, recognized in additional paid-in capital, on stock options exercised and the delivery of common stock underlying restricted stock units.

As of November 2006, there was \$2.51 billion of total unrecognized compensation cost related to nonvested share-based compensation arrangements. This cost is expected to be recognized over a weighted average period of 2.15 years.

The firm's stock repurchase program is intended to maintain its total shareholders' equity at appropriate levels and to substantially offset increases in share count over time resulting from employee share-based compensation. The repurchase program has been effected primarily through regular open-market purchases and is influenced by, among other factors, the level of the firm's common shareholders' equity, its overall capital position, share-based awards and exercises of employee stock options, the prevailing market price of its common stock and general market conditions.

### Note 13

#### TRANSACTIONS WITH AFFILIATED FUNDS

The firm has formed numerous nonconsolidated investment funds with third-party investors. The firm generally acts as the investment manager for these funds and, as such, is entitled to receive management fees and, in certain cases, advisory fees, incentive fees or overrides from these funds. These fees amounted to \$3.37 billion, \$2.08 billion and \$1.72 billion for the years ended November 2006, November 2005 and November 2004, respectively. As of November 2006 and November 2005, the fees receivable from these funds were \$362 million and \$388 million, respectively. Additionally, the firm may invest alongside the third-party investors in certain funds. The aggregate carrying value of the firm's interests in these funds was \$3.94 billion and \$2.17 billion as of November 2006 and November 2005, respectively. In the ordinary course of business, the firm may also engage in other activities with these funds, including, among others, securities lending, trade execution, trading and custody. See Note 6 for the firm's commitments related to these funds.

## Notes to Consolidated Financial Statements

### Note 14

#### INCOME TAXES

The components of the net tax expense reflected in the consolidated statements of earnings are set forth below:

<i>(in millions)</i>	YEAR ENDED NOVEMBER		
	2006	2005	2004
Current taxes			
U.S. federal	<b>\$3,736</b>	\$1,504	\$ 374
State and local	<b>627</b>	213	46
Non-U.S.	<b>2,165</b>	1,380	663
Total current tax expense	<b>6,528</b>	3,097	1,083
Deferred taxes			
U.S. federal	<b>(635)</b>	3	827
State and local	<b>(262)</b>	(4)	98
Non-U.S.	<b>(608)</b>	(449)	115
Total deferred tax (benefit)/expense	<b>(1,505)</b>	(450)	1,040
Net tax expense	<b>\$5,023</b>	\$2,647	\$2,123

Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities. These temporary differences result in taxable or deductible amounts in future years and are measured using the tax rates and laws that will be in effect when such differences are expected to reverse.

Significant components of the firm's deferred tax assets and liabilities are set forth below:

<i>(in millions)</i>	AS OF NOVEMBER	
	2006	2005
Deferred tax assets		
Compensation and benefits	<b>\$2,763</b>	\$1,563
Other, net	<b>1,104</b>	319
	<b>3,867</b>	1,882
Valuation allowance <sup>(1)</sup>	<b>(81)</b>	(6)
Total deferred tax assets	<b>3,786</b>	1,876
Deferred tax liabilities		
Depreciation and amortization	<b>1,040</b>	625
Unrealized gains	<b>367</b>	455
Total deferred tax liabilities	<b>\$1,407</b>	\$1,080

<sup>(1)</sup>Relates primarily to the ability to utilize losses in various tax jurisdictions.

The firm permanently reinvests eligible earnings of certain foreign subsidiaries and, accordingly, does not accrue any U.S. income taxes that would arise if such earnings were repatriated. As of November 2006, this policy resulted in an unrecognized net deferred tax liability of \$210 million attributable to reinvested earnings of \$2.90 billion.

During 2006, the valuation allowance was increased by \$75 million, primarily due to the acquisition of deferred tax assets considered more likely than not to expire unused. Net operating loss carryforwards were \$1.78 billion and \$352 million as of November 2006 and November 2005, respectively.

The firm had federal net operating loss carryforwards, primarily resulting from acquisitions, of \$203 million and \$24 million as of November 2006 and November 2005, respectively. The firm recorded a related net deferred income tax asset of \$69 million and \$8 million as of November 2006 and November 2005, respectively. These carryforwards are subject to annual limitations on utilization and will begin to expire in 2010. Acquired alternative minimum tax credit carryforwards of \$7 million as of November 2005 were fully utilized in 2006.

## Notes to Consolidated Financial Statements

The firm had state and local net operating loss carryforwards, primarily resulting from acquisitions, of \$1.52 billion and \$328 million as of November 2006 and November 2005, respectively. The firm recorded a related net deferred income tax asset of \$31 million and \$24 million as of November 2006 and November 2005, respectively. These carryforwards are subject to annual limitations on utilization and will begin to expire in 2007.

The firm had foreign net operating loss carryforwards of \$50 million as of November 2006 and recorded a related net deferred income tax asset of \$13 million. These carryforwards are subject to limitation on utilization and can be carried forward indefinitely.

The firm is subject to examination by the U.S. Internal Revenue Service (IRS) and other taxing authorities in certain countries, such as Japan, the United Kingdom, Korea and U.S. states in which the firm has significant business operations, such

as New York. The IRS is currently examining the firm's 2003 and 2004 fiscal years. During fiscal 2006, the Japanese taxing authority concluded their examination of the tax years 2000 through 2004. During fiscal 2005, the IRS concluded its examination of fiscal years 1999 through 2002, and New York State and City substantially concluded their examinations covering periods through fiscal year 2003. The firm regularly assesses the likelihood of additional assessments by each jurisdiction to which the firm pays taxes resulting from the impact of current and future examinations. Tax reserves have been established, which the firm believes are adequate in relation to the potential for additional assessments. The resolution of tax matters is not expected to have a material effect on the firm's financial condition but may be material to the firm's operating results for a particular period, depending, in part, upon the operating results for that period and the firm's effective tax rate for that period.

A reconciliation of the U.S. federal statutory income tax rate to the firm's effective income tax rate is set forth below:

	YEAR ENDED NOVEMBER		
	2006	2005	2004
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
Increase related to state and local taxes, net of U.S. income tax effects	1.6	1.6	1.4
Tax credits	(0.6)	(1.6)	(3.6)
Foreign operations	(1.3)	(1.2)	(1.2)
Tax-exempt income, including dividends	(0.4)	(0.6)	(0.7)
Other	0.2	(1.2) <sup>(1)</sup>	0.9
Effective income tax rate	34.5%	32.0%	31.8%

<sup>(1)</sup> Primarily includes the effect of audit settlements.

Tax benefits of approximately \$653 million in November 2006, \$272 million in November 2005 and \$330 million in November 2004, related to the delivery of common stock underlying restricted stock units and the exercise of options, were credited directly to "Additional paid-in capital" in the consolidated statements of financial condition and changes in shareholders' equity.

### Note 15

#### REGULATION

The firm is regulated by the U.S. Securities and Exchange Commission (SEC) as a Consolidated Supervised Entity (CSE). As such, it is subject to group-wide supervision and examination by the SEC and to minimum capital requirements on a consolidated basis. As of November 2006 and November 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, and also require that a significant part of the registrants' assets be kept in relatively liquid form. GS&Co. and GSEC have elected to compute their minimum capital requirements in accordance with the "Alternative Net Capital Requirement" as permitted by Rule 15c3-1. As of November 2006 and November 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



## Notes to Consolidated Financial Statements

than \$5 billion. As of November 2006 and November 2005, GS&Co. had tentative net capital and net capital in excess of both the minimum and the notification requirements.

Goldman Sachs Bank USA (GS Bank), a wholly owned industrial bank, is regulated by the Federal Deposit Insurance Corporation and the State of Utah Department of Financial Institutions and is subject to minimum capital requirements. As of November 2006, GS Bank was in compliance with all regulatory capital requirements. GS Bank had approximately \$10.59 billion of interest-bearing deposits as of November 2006, which are included in “Payables to customers and counterparties” in the consolidated statements of financial condition.

The firm has U.S. insurance subsidiaries that are subject to state insurance regulation in the states in which they are domiciled and in the other states in which they are licensed. In addition, certain of the firm’s insurance subsidiaries are regulated by the Bermuda Registrar of Companies. The firm’s insurance subsidiaries were in compliance with all regulatory capital requirements as of November 2006 and November 2005.

The firm’s principal non-U.S. regulated subsidiaries include Goldman Sachs International (GSI) and Goldman Sachs Japan Co., Ltd. (GSJCL). GSI, the firm’s regulated U.K. broker-dealer, is subject to the capital requirements of the U.K.’s Financial Services Authority. GSJCL, the firm’s regulated Japanese broker-dealer, is subject to the capital requirements of Japan’s Financial Services Agency. Prior to October 1, 2006, Goldman Sachs (Japan) Ltd. (GSJL), the predecessor to GSJCL, was the primary regulated subsidiary based in Japan. As of November 2006 and November 2005, GSI, GSJCL and GSJL were in compliance with their local capital adequacy requirements. Certain other non-U.S. subsidiaries of the firm are also subject to capital adequacy requirements promulgated by authorities of the countries in which they operate. As of November 2006 and November 2005, these subsidiaries were in compliance with their local capital adequacy requirements.

The regulatory requirements referred to above restrict Group Inc.’s ability to withdraw capital from its regulated subsidiaries. As of November 2006, approximately \$14.15 billion of net assets of regulated subsidiaries were restricted as to the payment of dividends to Group Inc.

## Note 16

### 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 and benefits expenses within the firm’s segments reflect, among other factors, the overall performance of the firm as well as the 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 firm allocates revenues and expenses among the three segments. Due to the integrated nature of the business segments, estimates and judgments have been made in allocating certain revenue and expense items. Transactions between segments are based on specific criteria or approximate third-party rates. Total operating expenses include corporate items that have not been allocated to individual business segments. The allocation process is based on the manner in which management views the business of the firm.

The segment information presented in the table below is prepared according to the following methodologies:

- Revenues and expenses directly associated with each segment are included in determining pre-tax earnings.
- Net revenues in the firm’s 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. Net interest is included within segment net revenues as it is consistent with the way in which management assesses segment performance.
- Overhead expenses not directly allocable to specific segments are allocated ratably based on direct segment expenses.

# Notes to Consolidated Financial Statements

## 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:

(in millions)		AS OF OR FOR THE YEAR ENDED NOVEMBER		
		2006	2005	2004
Investment Banking	Net revenues	\$ 5,629	\$ 3,671	\$ 3,374
	Operating expenses	4,062	3,258	2,973
	Pre-tax earnings	\$ 1,567	\$ 413	\$ 401
	Segment assets	\$ 4,967	\$ 4,869	\$ 4,759
Trading and Principal Investments	Net revenues <sup>(1)</sup>	\$ 25,562	\$ 16,818	\$ 13,728
	Operating expenses <sup>(1)</sup>	14,962	10,600	8,688
	Pre-tax earnings	\$ 10,600	\$ 6,218	\$ 5,040
	Segment assets	\$566,499	\$505,536	\$358,137
Asset Management and Securities Services	Net revenues	\$ 6,474	\$ 4,749	\$ 3,849
	Operating expenses	4,036	3,070	2,430
	Pre-tax earnings	\$ 2,438	\$ 1,679	\$ 1,419
	Segment assets	\$266,735	\$196,399	\$167,957
Total	Net revenues <sup>(1)(2)</sup>	\$ 37,665	\$ 25,238	\$ 20,951
	Operating expenses <sup>(3)</sup>	23,105	16,965	14,275
	Pre-tax earnings <sup>(4)</sup>	\$ 14,560	\$ 8,273	\$ 6,676
	Total assets <sup>(5)</sup>	\$838,201	\$706,804	\$531,379

<sup>(1)</sup> Beginning in the fourth quarter of 2006, "Cost of power generation" in the consolidated statements of earnings was reclassified to operating expenses. "Cost of power generation" was previously reported as a reduction to revenues. Prior periods have been reclassified to conform to the current presentation, with no impact to the firm's reported pre-tax earnings.

<sup>(2)</sup> Net revenues include net interest as set forth in the table below:

(in millions)	YEAR ENDED NOVEMBER		
	2006	2005	2004
Investment Banking	\$ 16	\$ 72	\$ 88
Trading and Principal Investments	1,535	1,366	1,744
Asset Management and Securities Services	1,947	1,659	1,194
Total net interest	\$3,498	\$3,097	\$3,026

<sup>(3)</sup> Includes the following expenses that have not been allocated to the firm's segments: (i) net provisions for a number of litigation and regulatory proceedings of \$45 million, \$37 million and \$103 million for the years ended November 2006, November 2005 and November 2004, respectively; (ii) \$62 million in connection with the establishment of the firm's joint venture in China for the year ended November 2004; and (iii) the amortization of employee initial public offering awards, net of forfeitures, of \$19 million for the year ended November 2004.

<sup>(4)</sup> Pre-tax earnings include total depreciation and amortization as set forth in the table below:

(in millions)	YEAR ENDED NOVEMBER		
	2006	2005	2004
Investment Banking	\$119	\$143	\$183
Trading and Principal Investments	725	565	513
Asset Management and Securities Services	151	146	149
Total depreciation and amortization	\$995	\$854	\$845

<sup>(5)</sup> Includes deferred tax assets relating to the firm's conversion to corporate form and certain assets that management believes are not allocable to a particular segment for the year ended November 2004.

## Geographic Information

Due to the highly integrated nature of international financial markets, the firm manages its businesses based on the profitability of the enterprise as a whole. Accordingly, management believes that profitability by geographic region is not necessarily meaningful. In addition, as a significant portion of the firm's activities require cross-border coordination in order to facilitate

the needs of the firm's clients, the methodology for allocating the firm's profitability to geographic regions is dependent on the judgment of management. During 2006, the firm amended its methodology for allocating profitability by geographic region. Prior periods have been reclassified to conform to the current presentation.

## Notes to Consolidated Financial Statements

Geographic results are generally allocated as follows:

- Investment Banking: location of the client and investment banking team.
- Fixed Income, Currency and Commodities, and Equities: location of the trading desk.
- Principal Investments: location of the investment.
- Asset Management: location of the sales team.
- Securities Services: location of the primary market for the underlying security.

The following table sets forth the total net revenues and pre-tax earnings of the firm and its consolidated subsidiaries by geographic region allocated on the methodology described above:

<i>(in millions)</i>	YEAR ENDED NOVEMBER		
	2006	2005	2004
Net revenues			
Americas <sup>(1)</sup>	<b>\$20,361</b>	\$14,639	\$12,312
EMEA <sup>(2)</sup>	<b>9,354</b>	6,063	5,107
Asia	<b>7,950</b>	4,536	3,532
Total net revenues	<b>\$37,665</b>	\$25,238	\$20,951
Pre-tax earnings			
Americas <sup>(1)</sup>	<b>\$ 7,515</b>	\$ 4,977	\$ 3,976
EMEA <sup>(2)</sup>	<b>3,075</b>	1,457	1,212
Asia	<b>4,015</b>	1,876	1,672
Corporate <sup>(3)</sup>	<b>(45)</b>	(37)	(184)
Total pre-tax earnings	<b>\$14,560</b>	\$ 8,273	\$ 6,676

<sup>(1)</sup> Substantially all relates to U.S. results.

<sup>(2)</sup> EMEA (Europe, Middle East and Africa).

<sup>(3)</sup> Includes the following expenses that have not been allocated to the firm's segments: (i) net provisions for a number of litigation and regulatory proceedings of \$45 million, \$37 million and \$103 million for the years ended November 2006, November 2005 and November 2004, respectively; (ii) \$62 million in connection with the establishment of the firm's joint venture in China for the year ended November 2004; and (iii) the amortization of employee initial public offering awards, net of forfeitures, of \$19 million for the year ended November 2004.

## Supplemental Financial Information

### QUARTERLY RESULTS (UNAUDITED)

The following represents the firm's unaudited quarterly results for 2006 and 2005. These quarterly results were prepared in accordance with generally accepted accounting principles and reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results. These adjustments are of a normal recurring nature.

<i>(in millions, except per share data)</i>	2006 QUARTER			
	FIRST	SECOND	THIRD	FOURTH
Total revenues	<b>\$17,246</b>	<b>\$18,002</b>	<b>\$15,979</b>	<b>\$18,126</b>
Interest expense	<b>6,813</b>	<b>7,761</b>	<b>8,395</b>	<b>8,719</b>
Revenues, net of interest expense <sup>(1)</sup>	<b>10,433</b>	<b>10,241</b>	<b>7,584</b>	<b>9,407</b>
Operating expenses <sup>(1)(2)</sup>	<b>6,744</b>	<b>6,717</b>	<b>5,222</b>	<b>4,422</b>
Pre-tax earnings	<b>3,689</b>	<b>3,524</b>	<b>2,362</b>	<b>4,985</b>
Provision for taxes	<b>1,210</b>	<b>1,212</b>	<b>768</b>	<b>1,833</b>
Net earnings	<b>2,479</b>	<b>2,312</b>	<b>1,594</b>	<b>3,152</b>
Preferred stock dividends	<b>26</b>	<b>26</b>	<b>39</b>	<b>48</b>
Net earnings applicable to common shareholders	<b>\$ 2,453</b>	<b>\$ 2,286</b>	<b>\$ 1,555</b>	<b>\$ 3,104</b>
Earnings per common share				
Basic	<b>\$ 5.36</b>	<b>\$ 5.08</b>	<b>\$ 3.46</b>	<b>\$ 7.06</b>
Diluted	<b>5.08</b>	<b>4.78</b>	<b>3.26</b>	<b>6.59</b>
Dividends declared and paid per common share	<b>0.25</b>	<b>0.35</b>	<b>0.35</b>	<b>0.35</b>

<i>(in millions, except per share data)</i>	2005 QUARTER			
	FIRST	SECOND	THIRD	FOURTH
Total revenues	\$9,964	\$8,949	\$12,333	\$12,145
Interest expense	3,449	4,022	4,940	5,742
Revenues, net of interest expense <sup>(1)</sup>	6,515	4,927	7,393	6,403
Operating expenses <sup>(1)(2)</sup>	4,370	3,683	4,988	3,924
Pre-tax earnings	2,145	1,244	2,405	2,479
Provision for taxes	633	379	788	847
Net earnings	1,512	865	1,617	1,632
Preferred stock dividends	—	—	9	8
Net earnings applicable to common shareholders	\$1,512	\$ 865	\$ 1,608	\$ 1,624
Earnings per common share				
Basic	\$ 3.06	\$ 1.78	\$ 3.40	\$ 3.53
Diluted	2.94	1.71	3.25	3.35
Dividends declared and paid per common share	0.25	0.25	0.25	0.25

<sup>(1)</sup>Beginning in the fourth quarter of 2006, "Cost of power generation" in the consolidated statements of earnings was reclassified to operating expenses. "Cost of power generation" was previously reported as a reduction to revenues. Prior periods have been reclassified to conform to the current presentation, with no impact to the firm's reported net earnings.

<sup>(2)</sup>The timing and magnitude of changes in the firm's bonus accruals can have a significant effect on results in a given quarter.

## Supplemental Financial Information

### COMMON STOCK PRICE RANGE

The following table sets forth, for the quarters indicated, the high and low sales prices per share of the firm's common stock as reported by the Consolidated Tape Association.

	SALES PRICE					
	2006		2005		2004	
	HIGH	LOW	HIGH	LOW	HIGH	LOW
First quarter	<b>\$146.35</b>	<b>\$124.23</b>	\$113.93	\$101.79	\$108.00	\$95.73
Second quarter	<b>169.31</b>	<b>139.18</b>	114.25	95.16	109.29	90.08
Third quarter	<b>157.00</b>	<b>136.79</b>	114.87	94.75	95.15	83.29
Fourth quarter	<b>203.35</b>	<b>145.66</b>	134.99	108.86	105.40	88.46

As of January 26, 2007, there were 6,804 holders of record of the firm's common stock.

On January 26, 2007, the last reported sales price for the firm's common stock on the New York Stock Exchange was \$213.50 per share.

## Supplemental Financial Information

### SELECTED FINANCIAL DATA

	AS OF OR FOR THE YEAR ENDED NOVEMBER				
	2006	2005	2004	2003	2002
<i>Income statement data (in millions)</i>					
Total revenues	<b>\$ 69,353</b>	\$ 43,391	\$ 29,839	\$ 23,623	\$ 22,854
Interest expense	<b>31,688</b>	18,153	8,888	7,600	8,868
Revenues, net of interest expense <sup>(1)</sup>	<b>37,665</b>	25,238	20,951	16,023	13,986
Compensation and benefits <sup>(1)</sup>	<b>16,457</b>	11,758	9,681	7,515	7,037
Other operating expenses <sup>(1)</sup>	<b>6,648</b>	5,207	4,594	4,063	3,696
Pre-tax earnings	<b>\$ 14,560</b>	\$ 8,273	\$ 6,676	\$ 4,445	\$ 3,253
<i>Balance sheet data (in millions)</i>					
Total assets	<b>\$838,201</b>	\$706,804	\$531,379	\$403,799	\$355,574
Other secured financings (long-term)	<b>26,134</b>	15,669	12,087	6,043	530
Unsecured long-term borrowings	<b>122,842</b>	84,338	68,609	51,439	38,181
Total liabilities	<b>802,415</b>	678,802	506,300	382,167	336,571
Total shareholders' equity	<b>35,786</b>	28,002	25,079	21,632	19,003
<i>Common share data (in millions, except per share amounts)</i>					
<i>Earnings per common share</i>					
Basic	<b>\$ 20.93</b>	\$ 11.73	\$ 9.30	\$ 6.15	\$ 4.27
Diluted	<b>19.69</b>	11.21	8.92	5.87	4.03
Dividends declared and paid per common share	<b>1.30</b>	1.00	1.00	0.74	0.48
Book value per common share <sup>(2)</sup>	<b>72.62</b>	57.02	50.77	43.60	38.69
<i>Average common shares outstanding</i>					
Basic	<b>449.0</b>	478.1	489.5	488.4	495.6
Diluted	<b>477.4</b>	500.2	510.5	511.9	525.1
<i>Selected data (unaudited)</i>					
<i>Employees</i>					
United States	<b>15,477</b>	14,466	13,846	13,189	12,928
Non-U.S.	<b>10,990</b>	9,157	7,890	7,170	7,705
Total employees <sup>(3)</sup>	<b>26,467</b>	23,623	21,736	20,359	20,633
<i>Assets under management (in billions)<sup>(4) (5)</sup></i>					
<i>Asset class</i>					
Alternative investments <sup>(6)</sup>	<b>\$ 145</b>	\$ 110	\$ 95	\$ 68	\$ 53
Equity	<b>215</b>	167	133	104	91
Fixed income	<b>198</b>	154	134	112	96
Total non-money market assets	<b>558</b>	431	362	284	240
Money markets	<b>118</b>	101	90	89	108
Total assets under management	<b>\$ 676</b>	\$ 532	\$ 452	\$ 373	\$ 348

<sup>(1)</sup>Beginning in the fourth quarter of 2006, "Cost of power generation" in the consolidated statements of earnings was reclassified to operating expenses. "Cost of power generation" was previously reported as a reduction to revenues. Prior periods have been reclassified to conform to the current presentation, with no impact to the firm's reported pre-tax earnings.

<sup>(2)</sup>Book value per common share is based on common shares outstanding, including restricted stock units granted to employees with no future service requirements, of 450.1 million, 460.4 million, 494.0 million, 496.1 million and 491.2 million as of November 2006, November 2005, November 2004, November 2003 and November 2002, respectively.

<sup>(3)</sup>Beginning in 2006, includes employees of the firm's consolidated property management and loan servicing subsidiaries. Prior periods have been adjusted to conform to the current presentation.

<sup>(4)</sup>Substantially all assets under management are valued as of calendar month-end.

<sup>(5)</sup>In the first quarter of 2006, the firm changed the methodology for classifying certain non-money market assets. The changes were made primarily to reclassify certain assets allocated to external investment managers out of alternative investment assets and to reclassify currency funds into alternative investment assets. The changes did not impact total assets under management and prior periods have been reclassified to conform to the current presentation.

<sup>(6)</sup>Primarily includes hedge funds, private equity, real estate, currencies, commodities and asset allocation strategies.

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### *Common Stock*

The common stock of The Goldman Sachs Group, Inc. is listed on the New York Stock Exchange and trades under the ticker symbol "GS."

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Information about the firm, including all quarterly earnings releases and financial filings with the U.S. Securities and Exchange Commission, can be accessed via our Web site at [www.gs.com](http://www.gs.com).

Shareholder inquiries can also be directed to Investor Relations via our Web site at [www.gs.com/shareholders/](http://www.gs.com/shareholders/) or by calling 1-212-902-0300.

### *2006 Annual Report on Form 10-K*

Copies of the firm's 2006 Annual Report on Form 10-K as filed with the U.S. Securities and Exchange Commission can be accessed via our Web site at [www.gs.com/shareholders/](http://www.gs.com/shareholders/).

Copies can also be obtained by contacting Investor Relations via our Web site at [www.gs.com/shareholders/](http://www.gs.com/shareholders/) or by calling 1-212-902-0300.

### *SEC Certifications*

The certifications by the Chief Executive Officer and the Chief Financial Officer of The Goldman Sachs Group, Inc., required under Section 302 of the Sarbanes-Oxley Act of 2002, have also been filed as exhibits to the firm's 2006 Annual Report on Form 10-K.

### *NYSE Certification*

In April 2006, the then Chief Executive Officer of The Goldman Sachs Group, Inc. made an unqualified certification to the NYSE with respect to the firm's compliance with the NYSE corporate governance listing standards.

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## The Goldman Sachs Business Principles

### I.

Our clients' interests always come first. Our experience shows that if we serve our clients well, our own success will follow.

### II.

Our assets are our people, capital and reputation.

If any of these is ever diminished, the last is the most difficult to restore. We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us.

Our continued success depends upon unswerving adherence to this standard.

### III.

Our goal is to provide superior returns to our shareholders. Profitability is critical to achieving superior returns, building our capital, and attracting and keeping our best people. Significant employee stock ownership aligns the interests of our employees and our shareholders.

### IV.

We take great pride in the professional quality of our work. We have an uncompromising determination to achieve excellence in everything we undertake.

Though we may be involved in a wide variety and heavy volume of activity, we would, if it came to a choice, rather be best than biggest.

### V.

We stress creativity and imagination in everything we do.

While recognizing that the old way may still be the best way, we constantly strive to find a better solution to a client's problems. We pride ourselves on having pioneered many of the practices and techniques that have become standard in the industry.

### VI.

We make an unusual effort to identify and recruit the very best person for every job. Although our activities are measured in billions of dollars, we select our people one by one. In a service business, we know that without the best people, we cannot be the best firm.

### VII.

We offer our people the opportunity to move ahead more rapidly than is possible at most other places. Advancement depends on merit and we have yet to find the limits to the responsibility our best people are able to assume. For us to be successful, our men

and women must reflect the diversity of the communities and cultures in which we operate. That means we must attract, retain and motivate people from many backgrounds and perspectives. Being diverse is not optional; it is what we must be.

### VIII.

We stress teamwork in everything we do. While individual creativity is always encouraged, we have found that team effort often produces the best results. We have no room for those who put their personal interests ahead of the interests of the firm and its clients.

### IX.

The dedication of our people to the firm and the intense effort they give their jobs are greater than one finds in most other organizations. We think that this is an important part of our success.

### X.

We consider our size an asset that we try hard to preserve.

We want to be big enough to undertake the largest project that any of our clients could contemplate, yet small enough to maintain the loyalty, the intimacy and the esprit de corps that we all treasure and that contribute greatly to our success.

### XI.

We constantly strive to anticipate the rapidly changing needs of our clients and to develop new services to meet those needs. We know that the world of finance will not stand still and that complacency can lead to extinction.

### XII.

We regularly receive confidential information as part of our normal client relationships. To breach a confidence or to use confidential information improperly or carelessly would be unthinkable.

### XIII.

Our business is highly competitive, and we aggressively seek to expand our client relationships. However, we must always be fair competitors and must never denigrate other firms.

### XIV.

Integrity and honesty are at the heart of our business.

We expect our people to maintain high ethical standards in everything they do, both in their work for the firm and in their personal lives.





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