GOLDMAN SACHS GROUP INC
Form 10-Q
July 07, 2008

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

FORM 10-Q

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

For the quarterly period ended May 30, 2008

or

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

For the transition period from to

Commission File Number: 001-14965

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

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

(212) 902-1000
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of accelerated filer, large accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer o

Non-accelerated filer (Do not check if a smaller reporting company) o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x No

APPLICABLE ONLY TO CORPORATE ISSUERS

As of June 27, 2008, there were 393,804,838 shares of the registrant s common stock outstanding.

THE GOLDMAN SACHS GROUP, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE FISCAL QUARTER ENDED MAY 30, 2008

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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements (Unaudited)

THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)

	Three Months Ended May		Six Months Ended May	
	2008	2007	2008	2007
	(in millions, except per share amounts)			
Revenues				
Investment banking	$ 1,685	$ 1,720	$ 2,851	$ 3,436
Trading and principal investments	5,239	6,242	10,116	15,315
Asset management and securities services	1,221	1,107	2,562	2,240
Interest income	9,498	11,282	20,743	21,640
Total revenues	17,643	20,351	36,272	42,631
Interest expense	8,221	10,169	18,515	19,719
Revenues, net of interest expense	9,422	10,182	17,757	22,912
Operating expenses				
Compensation and benefits	4,522	4,887	8,523	10,998
Brokerage, clearing, exchange and distribution fees	741	638	1,531	1,189
Market development	126	144	270	276
Communications and technology	192	161	379	312
Depreciation and amortization	183	140	353	272
Amortization of identifiable intangible assets	37	50	121	101
Occupancy	234	210	470	414
Professional fees	185	161	363	322
Other expenses	370	360	772	738
Total non-compensation expenses	2,068	1,864	4,259	3,624
Total operating expenses	6,590	6,751	12,782	14,622
Pre-tax earnings	2,832	3,431	4,975	8,290
Provision for taxes	745	1,098	1,377	2,760

Net earnings	2,087	2,333	3,598	5,530
Preferred stock dividends	36	46	80	95
Net earnings applicable to common shareholders	$ 2,051	$ 2,287	$ 3,518	$ 5,435
Earnings per common share				
Basic	$ 4.80	$ 5.25	$ 8.18	$ 12.35
Diluted	4.58	4.93	7.81	11.61
Dividends declared and paid per common share	$ 0.35	$ 0.35	$ 0.70	$ 0.70
Average common shares outstanding				
Basic	427.5	435.8	430.3	440.2
Diluted	447.4	464.1	450.6	468.0

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

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THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)

	As of	
	May 2008	**November 2007**
	(in millions, except share and per share amounts)	
Assets		
Cash and cash equivalents	$ 13,781	$ 11,882
Cash and securities segregated for regulatory and other purposes (includes $63,732 and $94,018 at fair value as of May 2008 and November 2007, respectively)	84,880	119,939
Receivables from brokers, dealers and clearing organizations	23,122	19,078
Receivables from customers and counterparties (includes $1,100 and $1,950 at fair value as of May 2008 and November 2007, respectively)	99,935	129,105
Collateralized agreements:		
Securities borrowed (includes $69,200 and $83,277 at fair value as of May 2008 and November 2007, respectively)	298,424	277,413
Financial instruments purchased under agreements to resell, at fair value	130,897	85,717
Financial instruments owned, at fair value	373,811	406,457
Financial instruments owned and pledged as collateral, at fair value	37,383	46,138
Total financial instruments owned, at fair value	411,194	452,595
Other assets	25,912	24,067
Total assets	$ 1,088,145	$ 1,119,796
Liabilities and shareholders equity		
Unsecured short-term borrowings, including the current portion of unsecured long-term borrowings (includes $38,678 and $48,331 at fair value as of May 2008 and November 2007, respectively)	$ 71,176	$ 71,557
Bank deposits (includes $728 and $463 at fair value as of May 2008 and November 2007, respectively)	29,518	15,370
Payables to brokers, dealers and clearing organizations	10,894	8,335
Payables to customers and counterparties	335,481	310,118
Collateralized financings:		
Securities loaned (includes $7,353 and $5,449 at fair value as of May 2008 and November 2007, respectively)	34,439	28,624
Financial instruments sold under agreements to repurchase, at fair value	115,733	159,178
Other secured financings (includes $26,289 and $33,581 at fair value as of May 2008 and November 2007, respectively)	53,090	65,710
Financial instruments sold, but not yet purchased, at fair value	182,869	215,023
Other liabilities and accrued expenses	28,076	38,907

Unsecured long-term borrowings (includes $22,845 and $15,928 at fair value as of May 2008 and November 2007, respectively)	182,051	164,174
Total liabilities	1,043,327	1,076,996
Commitments, contingencies and guarantees		
Shareholders equity		
Preferred stock, par value $0.01 per share; 150,000,000 shares authorized, 124,000 shares issued and outstanding as of both May 2008 and November 2007, with liquidation preference of $25,000 per share	3,100	3,100
Common stock, par value $0.01 per share; 4,000,000,000 shares authorized, 631,702,706 and 618,707,032 shares issued as of May 2008 and November 2007, respectively, and 394,721,798 and 390,682,013 shares outstanding as of May 2008 and November 2007, respectively	6	6
Restricted stock units and employee stock options	8,653	9,302
Nonvoting common stock, par value $0.01 per share; 200,000,000 shares authorized, no shares issued and outstanding		
Additional paid-in capital	23,463	22,027
Retained earnings	41,646	38,642
Accumulated other comprehensive income/(loss)	(136)	(118)
Common stock held in treasury, at cost, par value $0.01 per share; 236,980,908 and 228,025,019 shares as of May 2008 and November 2007, respectively	(31,914)	(30,159)
Total shareholders equity	44,818	42,800
Total liabilities and shareholders equity	$ 1,088,145	$ 1,119,796

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

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THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

	Period Ended May 2008	Period Ended November 2007
	(in millions, except per share amounts)	
Preferred stock		
Balance, beginning of year	$ 3,100	$ 3,100
Issued		
Balance, end of period	3,100	3,100
Common stock, par value $0.01 per share		
Balance, beginning of year	6	6
Issued		
Balance, end of period	6	6
Restricted stock units and employee stock options		
Balance, beginning of year	9,302	6,290
Issuance and amortization of restricted stock units and employee stock options	1,428	4,684
Delivery of common stock underlying restricted stock units	(1,993)	(1,548)
Forfeiture of restricted stock units and employee stock options	(83)	(113)
Exercise of employee stock options	(1)	(11)
Balance, end of period	8,653	9,302
Additional paid-in capital		
Balance, beginning of year	22,027	19,731
Issuance of common stock, including the delivery of common stock underlying restricted stock units and proceeds from the exercise of employee stock options	2,153	2,338
Cancellation of restricted stock units in satisfaction of withholding tax requirements	(1,313)	(929)
Stock purchase contract fee related to automatic preferred enhanced capital securities		(20)
Excess net tax benefit related to share-based compensation	596	908
Cash settlement of share-based compensation		(1)
Balance, end of period	23,463	22,027
Retained earnings		
Balance, beginning of year, as previously reported	38,642	27,868
Cumulative effect of adjustment from adoption of FIN No. 48	(201)	
Cumulative effect of adjustment from adoption of SFAS No. 157, net of tax		51
Cumulative effect of adjustment from adoption of SFAS No. 159, net of tax		(45)
Balance, beginning of year, after cumulative effect of adjustments	38,441	27,874
Net earnings	3,598	11,599
	(313)	(639)

Dividends and dividend equivalents declared on common stock and restricted stock units		
Dividends declared on preferred stock	(80)	(192)
Balance, end of period	41,646	38,642
Accumulated other comprehensive income/(loss)		
Balance, beginning of year	(118)	21
Adjustment from adoption of SFAS No. 158, net of tax		(194)
Currency translation adjustment, net of tax	(12)	39
Pension and postretirement liability adjustment, net of tax	6	38
Net gains/(losses) on cash flow hedges, net of tax		(2)
Net unrealized gains/(losses) on available-for-sale securities, net of tax	(12)	(12)
Reclassification to retained earnings from adoption of SFAS No. 159, net of tax		(8)
Balance, end of period	(136)	(118)
Common stock held in treasury, at cost		
Balance, beginning of year	(30,159)	(21,230)
Repurchased	(1,764)	(8,956)
Reissued	9	27
Balance, end of period	(31,914)	(30,159)
Total shareholders equity	$ 44,818	$ 42,800

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

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THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended May	
	2008	**2007**
	(in millions)	
Cash flows from operating activities		
Net earnings	$ 3,598	$ 5,530
Non-cash items included in net earnings		
Depreciation and amortization	533	416
Amortization of identifiable intangible assets	121	137
Share-based compensation	894	713
Changes in operating assets and liabilities		
Cash and securities segregated for regulatory and other purposes	35,265	2,643
Net receivables from brokers, dealers and clearing organizations	(1,485)	(1,165)
Net payables to customers and counterparties	54,916	(28,905)
Securities borrowed, net of securities loaned	(15,196)	(8,636)
Financial instruments sold under agreements to repurchase, net of financial instruments purchased under agreements to resell	(88,625)	9,861
Financial instruments owned, at fair value	28,881	(48,688)
Financial instruments sold, but not yet purchased, at fair value	(32,154)	20,829
Other, net	35	2,094
Net cash used for operating activities	(13,217)	(45,171)
Cash flows from investing activities		
Purchase of property, leasehold improvements and equipment	(1,033)	(1,029)
Proceeds from sales of property, leasehold improvements and equipment	55	15
Business acquisitions, net of cash acquired	(2,199)	(631)
Proceeds from sales of investments	80	321
Purchase of available-for-sale securities	(2,556)	(450)
Proceeds from sales of available-for-sale securities	2,090	388
Net cash used for investing activities	(3,563)	(1,386)
Cash flows from financing activities		
Unsecured short-term borrowings, net	(7,286)	8,736
Other secured financings (short-term), net	(8,341)	12,731
Proceeds from issuance of other secured financings (long-term)	5,014	5,135
Repayment of other secured financings (long-term), including the current portion	(3,648)	(2,104)
Proceeds from issuance of unsecured long-term borrowings	31,790	30,744
Repayment of unsecured long-term borrowings, including the current portion	(11,751)	(8,193)
Derivative contracts with a financing element, net	155	2,145
Bank deposits, net	14,148	2,233
Common stock repurchased	(1,761)	(3,820)
	(393)	(419)

Dividends and dividend equivalents paid on common stock, preferred stock and restricted stock units		
Proceeds from issuance of common stock	170	453
Excess tax benefit related to share-based compensation	582	632
Net cash provided by financing activities	18,679	48,273
Net increase/(decrease) in cash and cash equivalents	1,899	1,716
Cash and cash equivalents, beginning of year	11,882	6,293
Cash and cash equivalents, end of period	$ 13,781	$ 8,009

SUPPLEMENTAL DISCLOSURES:

Cash payments for interest, net of capitalized interest, were $18.68 billion and $18.88 billion during the six months ended May 2008 and May 2007, respectively.

Cash payments for income taxes, net of refunds, were $1.39 billion and $3.63 billion during the six months ended May 2008 and May 2007, respectively.

Non-cash activities:
The firm assumed $610 million and $135 million of debt in connection with business acquisitions during the six months ended May 2008 and May 2007, respectively. The firm issued $17 million of common stock in connection with business acquisitions for the six months ended May 2007.

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

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THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended May		Six Months Ended May	
	2008	**2007**	**2008**	**2007**
	(in millions)			
Net earnings	$ 2,087	$ 2,333	$ 3,598	$ 5,530
Currency translation adjustment, net of tax	(21)	15	(12)	20
Pension and postretirement liability adjustment, net of tax	6		6	
Net gains/(losses) on cash flow hedges, net of tax		(4)		(2)
Net unrealized gains/(losses) on available-for-sale securities, net of tax	23	(6)	(12)	(8)
Comprehensive income	$ 2,095	$ 2,338	$ 3,580	$ 5,540

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

THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Description of Business

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

The firm s activities are divided into three segments:

Investment Banking. The firm provides a broad range of investment banking services to a diverse group of corporations, financial institutions, 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 market-making and specialist 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 separately managed accounts and commingled vehicles, such as mutual funds and private investment 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 condensed consolidated financial statements include the accounts of Group Inc. and all other entities in which the firm has a controlling financial interest. All material intercompany transactions and balances have been eliminated.

The firm determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity, a variable interest entity (VIE) or a qualifying special-purpose entity (QSPE) under generally accepted accounting principles.

Voting Interest Entities. Voting interest entities are entities in which (i) the total equity investment at risk is sufficient to enable 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. 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.

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THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

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 for which it is the primary beneficiary. The firm determines whether it is the primary beneficiary of a VIE by first performing a qualitative analysis of the VIE s expected losses and expected residual returns. This analysis includes a review of, among other factors, the VIE s 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. The firm reassesses its initial evaluation of an entity as a VIE and its initial determination of whether the firm is the primary beneficiary of a VIE upon the occurrence of certain reconsideration events as defined in FIN No. 46-R.

QSPEs. QSPEs are passive entities that are commonly used in mortgage and other securitization transactions. Statement of Financial Accounting Standards (SFAS) No. 140, 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, such as whether a derivative is considered passive and the level of discretion a servicer may exercise, including, for example, determining when default is reasonably foreseeable. 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 either in accordance with Accounting Principles Board Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock or at fair value in accordance with SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. In general, the firm accounts for investments acquired subsequent to the adoption of SFAS No. 159 at fair value. In certain cases, the firm may apply the equity method of accounting to new investments that are strategic in nature or closely related to the firm s principal business activities, where the firm has a significant degree of involvement in the cash flows or operations of the investee, or where cost-benefit considerations are less significant. See Revenue Recognition Other Financial Assets and Financial Liabilities at Fair Value below for a discussion of the firm s application of SFAS No. 159.

THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

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 generally does not hold a majority of the economic interests in these funds. The firm has generally provided the third-party investors with rights to terminate the funds or to remove the firm as the general partner. As a result, the firm does not consolidate these funds. These fund investments are included in Financial instruments owned, at fair value in the condensed consolidated statements of financial condition.

These condensed consolidated financial statements are unaudited and should be read in conjunction with the audited consolidated financial statements included in the firm s Annual Report on Form 10-K for the fiscal year ended November 30, 2007. The condensed consolidated financial information as of November 30, 2007 has been derived from audited consolidated financial statements not included herein.

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

Unless specifically stated otherwise, all references to May 2008 and May 2007 refer to the firm s fiscal periods ended, or the dates, as the context requires, May 30, 2008 and May 25, 2007, respectively. All references to November 2007, unless specifically stated otherwise, refer to the firm s fiscal year ended, or the date, as the context requires, November 30, 2007. All references to 2008, unless specifically stated otherwise, refer to the firm s fiscal year ending, or the date, as the context requires, November 28, 2008. Certain reclassifications have been made to previously reported amounts to conform to the current presentation.

Use of Estimates

These condensed 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 condensed 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.

THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

Financial Instruments. Total financial instruments owned, at fair value and Financial instruments sold, but not yet purchased, at fair value are reflected in the condensed consolidated statements of financial condition on a trade-date basis. Related unrealized gains or losses are generally recognized in Trading and principal investments in the condensed consolidated statements of earnings. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Instruments that the firm owns (long positions) are marked to bid prices, and instruments that the firm has sold, but not yet purchased (short positions), are marked to offer prices. Fair value measurements do not include transaction costs.

SFAS No. 157, Fair Value Measurements, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

Basis of Fair Value Measurement

Level 1	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
Level 2	Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly;
Level 3	Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial instrument s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

In determining fair value, the firm separates its Financial instruments owned, at fair value and its Financial instruments sold, but not yet purchased, at fair value into two categories: cash instruments and derivative contracts.

Cash Instruments. The firm s cash instruments are generally classified within level 1 or level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets include most U.S. government and sovereign obligations, active listed equities and most money market securities. Such instruments are generally classified within level 1 of the fair value hierarchy. The firm does not adjust the quoted price for such instruments, even in situations where the firm holds a large position and a sale could reasonably impact the quoted price.

The types of instruments that trade in markets that are not considered to be active, but are valued based on quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most government agency securities, investment-grade corporate bonds, certain mortgage products, certain bank loans and bridge loans, less liquid listed equities, state, municipal and provincial obligations, most physical commodities and certain loan commitments. Such instruments are generally classified within level 2 of the fair value hierarchy.

THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) (UNAUDITED)

Certain cash instruments are classified within level 3 of the fair value hierarchy because they trade infrequently and therefore have little or no price transparency. Such instruments include private equity and real estate fund investments, certain bank loans and bridge loans (including certain mezzanine financing, leveraged loans arising from capital market transactions and other corporate bank debt), less liquid corporate debt securities and other debt obligations (including less liquid high-yield corporate bonds, distressed debt instruments and collateralized debt obligations (CDOs) backed by corporate obligations), less liquid mortgage whole loans and securities (backed by either commercial or residential real estate), and acquired portfolios of distressed loans. The transaction price is initially used as the best estimate of fair value. Accordingly, when a pricing model is used to value such an instrument, the model is adjusted so that the model value at inception equals the transaction price. This valuation is adjusted only when changes to inputs and assumptions are corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt capital markets, and changes in financial ratios or cash flows.

For positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management s best estimate is used.

Derivative Contracts. Derivative contracts can be exchange-traded or over-the-counter (OTC). Exchange-traded derivatives typically fall within level 1 or level 2 of the fair value hierarchy depending on whether they are deemed to be actively traded or not. The firm generally values exchange-traded derivatives within portfolios using models which calibrate to market-clearing levels and eliminate timing differences between the closing price of the exchange-traded derivatives and their underlying cash instruments. In such cases, exchange-traded derivatives are classified within level 2 of the fair value hierarchy.

OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market-clearing transactions, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. Where models are used, the selection of a particular 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. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, swaps and options, model inputs can generally be verified and model selection does not involve significant management judgment. OTC derivatives are classified within level 2 of the fair value hierarchy when all of the significant inputs can be corroborated to market evidence.

Certain OTC derivatives trade in less liquid markets with limited pricing information, and the determination of fair value for these derivatives is inherently more difficult. Such instruments are classified within level 3 of the fair value hierarchy. Where the firm does not have corroborating market evidence to support significant model inputs and cannot verify the model to market transactions, transaction price is initially used as the best estimate of fair value. Accordingly, when a pricing model is used to value such an instrument, the model is adjusted so that the model value at inception equals the transaction price. The valuations of these less

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liquid OTC derivatives are typically based on level 1 and/or level 2 inputs that can be observed in the market, as well as unobservable level 3 inputs. Subsequent to initial recognition, the firm updates the level 1 and level 2 inputs to reflect observable market changes, with resulting gains and losses reflected within level 3. Level 3 inputs are only changed when corroborated by evidence such as similar market transactions, third-party pricing services and/or broker or dealer quotations, or other empirical market data. In circumstances where the firm cannot verify the model value to market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value.

When appropriate, valuations are adjusted for various factors such as liquidity, bid/offer spreads and credit considerations. Such adjustments are generally based on available market evidence. In the absence of such evidence, management s best estimate is used.

Other Financial Assets and Financial Liabilities at Fair Value. The firm has elected to account for certain of the firm s other financial assets and financial liabilities at fair value under SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140, or SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, (i.e., the fair value option). The primary reasons for electing the fair value option are mitigating volatility in earnings from using different measurement attributes, simplification and cost-benefit considerations.

Such financial assets and financial liabilities accounted for at fair value include (i) certain unsecured short-term borrowings, consisting of all promissory notes and commercial paper and certain hybrid financial instruments; (ii) certain other secured financings, primarily transfers accounted for as financings rather than sales under SFAS No. 140, debt raised through the firm s William Street program and certain other nonrecourse financings; (iii) certain unsecured long-term borrowings, including prepaid physical commodity transactions; (iv) resale and repurchase agreements; (v) securities borrowed and loaned within Trading and Principal Investments, consisting of the firm s matched book and certain firm financing activities; (vi) corporate loans, loan commitments and certain certificates of deposit issued by Goldman Sachs Bank USA (GS Bank USA) as well as securities held by GS Bank USA (which would otherwise be accounted for as available-for-sale); (vii) receivables from customers and counterparties arising from transfers accounted for as secured loans rather than purchases under SFAS No. 140; and (viii) in general, investments acquired after the adoption of SFAS No. 159 where the firm has significant influence over the investee and would otherwise apply the equity method of accounting.

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 on collateralized agreements and collateralized financings is recognized in Interest income and Interest expense, respectively, 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 collateralized financing transactions. 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. As noted above, resale and repurchase agreements are carried in the condensed consolidated statements of financial condition at fair value as allowed by SFAS No. 159. Resale and repurchase agreements are generally valued

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based on inputs with reasonable levels of price transparency and are classified within level 2 of the fair value hierarchy. Resale and repurchase agreements 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.

Securities Borrowed and Loaned. Securities borrowed and loaned 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. Securities borrowed and loaned within Securities Services, relating to both customer activities and, to a lesser extent, certain firm financing activities, are recorded based on the amount of cash collateral advanced or received plus accrued interest. As these arrangements generally can be terminated on-demand, they exhibit little, if any, sensitivity to changes in interest rates. As noted above, securities borrowed and loaned within Trading and Principal Investments, which are related to the firm s matched book and certain firm financing activities, are recorded at fair value as allowed by SFAS No. 159. These securities borrowed and loaned transactions are generally valued based on inputs with reasonable levels of price transparency and are classified within level 2 of the fair value hierarchy.

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. As noted above, the firm has elected to apply SFAS No. 159 to transfers accounted for as financings rather than sales under SFAS No. 140, debt raised through the firm s William Street program and certain other nonrecourse financings, for which the use of fair value eliminates non-economic volatility in earnings that would arise from using different measurement attributes. These other secured financing transactions are generally valued based on inputs with reasonable levels of price transparency and are classified within level 2 of the fair value hierarchy. Other secured financings that are not recorded at fair value are recorded based on the amount of cash received plus accrued interest. See Note 3 for further information regarding other secured financings.

Hybrid Financial Instruments. Hybrid financial instruments are instruments that contain bifurcatable embedded derivatives under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and do not require settlement by physical delivery of non-financial assets (e.g., physical commodities). If the firm elects to bifurcate the embedded derivative, it is accounted for at fair value and the host contract is accounted for at amortized cost, adjusted for the effective portion of any fair value hedge accounting relationships. If the firm does not elect to bifurcate, the entire hybrid financial instrument is accounted for at fair value under SFAS No. 155. See Notes 3 and 4 for additional information about hybrid financial instruments.

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 life of the transaction.

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

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Insurance Activities. Revenues from variable annuity and 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 condensed 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 condensed consolidated statements of earnings.

Premiums earned for providing property catastrophe reinsurance are recognized within Trading and principal investments in the condensed 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 condensed consolidated statements of earnings.

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

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 condensed consolidated statements of earnings when the measurement period ends. Asset management fees and incentive fees are included in Asset management and securities services in the condensed consolidated statements of earnings.

Share-Based Compensation

The firm accounts for share-based compensation in accordance with SFAS No. 123-R, Share-Based Payment. The cost of employee services received in exchange for a share-based award is generally measured based on the grant-date fair value of the award. Share-based awards that do not require future service (i.e., vested awards, including awards granted to retirement-eligible employees) are expensed immediately. Share-based employee awards that require future service are amortized over the relevant service period. Expected forfeitures are included in determining share-based employee compensation expense. 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. 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).

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The firm pays cash dividend equivalents on outstanding restricted stock units. Dividend equivalents paid on restricted stock units are generally charged to retained earnings. Dividend equivalents paid on restricted stock units expected to be forfeited are included in compensation expense. The tax benefit related to dividend equivalents paid on restricted stock units is accounted for as a reduction of income tax expense (see Recent Accounting Developments for a discussion of Emerging Issues Task Force (EITF) Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards).

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. For awards accounted for as equity instruments, 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 recognized if the estimated fair value of an operating segment, which is a component one level below the firm s three business segments, 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, 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 lives in accordance with SFAS No. 142 or, in the case of insurance contracts, in accordance with SFAS No. 60, Accounting and Reporting by Insurance Enterprises, and SFAS No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments. Identifiable intangible assets are tested for impairment whenever events or changes in circumstances suggest that an asset s or asset group s carrying value may not be fully recoverable in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. An impairment loss, calculated as the difference between the estimated fair value and the carrying value of an asset or asset group, is recognized if the sum of the estimated undiscounted cash flows relating to the asset or asset group is less than the corresponding carrying value.

Property, Leasehold Improvements and Equipment

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

Substantially all property and equipment are depreciated on a straight-line basis over the useful life of the asset. 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.

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Property, leasehold improvements and equipment are tested for 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 condensed consolidated statements of earnings. In accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, the firm records a liability, based on the fair value of the remaining lease rentals reduced by any potential or existing sublease rentals, for leases where the firm has ceased using the space and management has concluded that the firm will not derive any future economic benefits. Costs to terminate a lease before the end of its term are recognized and measured at fair value upon termination.

Foreign Currency Translation

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

Income Taxes

Deferred tax assets and liabilities are recognized for temporary differences between the financial reporting and tax bases of the firm s assets and liabilities. Valuation allowances are established to reduce deferred tax assets to the amount that more likely than not will be realized. The firm s tax assets and liabilities are presented as a component of Other assets and Other liabilities and accrued expenses, respectively, in the condensed consolidated statements of financial condition. Tax provisions are computed in accordance with SFAS No. 109, Accounting for Income Taxes.

The firm adopted the provisions of FIN No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109, as of December 1, 2007, and recorded a transition adjustment resulting in a reduction of $201 million to beginning retained earnings (see Note 13 for further information regarding the firm s adoption of FIN No. 48). A tax position can be recognized in the financial statements only when it is more likely than not that the position will be sustained upon examination by the relevant taxing authority based on the technical merits of the position. A position that meets this standard is measured at the largest amount of benefit that will more likely than not be realized upon settlement. A liability is established for differences between positions taken in a tax return and amounts recognized in the financial statements. FIN No. 48 also provides guidance on

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derecognition, classification, interim period accounting and accounting for interest and penalties. Prior to the adoption of FIN No. 48, contingent liabilities related to income taxes were recorded when the criteria for loss recognition under SFAS No. 5, Accounting for Contingencies, as amended, had been met.

Earnings Per Common Share (EPS)

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. 06-11. In June 2007, the EITF reached consensus on Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF Issue No. 06-11 requires that the tax benefit related to dividend equivalents paid on restricted stock units, which are expected to vest, be recorded as an increase to additional paid-in capital. The firm currently accounts for this tax benefit as a reduction to income tax expense. EITF Issue No. 06-11 is to be applied prospectively for tax benefits on dividends declared in fiscal years beginning after December 15, 2007, and the firm expects to adopt the provisions of EITF Issue No. 06-11 beginning in the first quarter of 2009. The firm does not expect the adoption of EITF Issue No. 06-11 to have a material effect on its financial condition, results of operations or cash flows.

FASB Staff Position (FSP) FAS No. 140-3. In February 2008, the FASB issued FSP FAS No. 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. FSP No. 140-3 requires an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously or in contemplation of the initial transfer to be evaluated as a linked transaction under SFAS No. 140 unless certain criteria are met, including that the transferred asset must be readily obtainable in the marketplace. FSP No. 140-3 is effective for fiscal years beginning after November 15, 2008, and will be applied to new transactions entered into after the date of adoption. Early adoption is prohibited. The firm is currently evaluating the impact of adopting FSP No. 140-3 on its financial condition and cash flows. Adoption of FSP No. 140-3 will have no effect on the firm s results of operations.

SFAS No. 161. In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133. SFAS No. 161 requires enhanced disclosures about an entity s derivative and hedging activities, and is effective for financial statements issued for fiscal years beginning after November 15, 2008, with early application encouraged. The firm will adopt SFAS No. 161 in the first quarter of 2009. Since SFAS No. 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS No. 161 will not affect the firm s financial condition, results of operations or cash flows.

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FASB Staff Position (FSP) No. EITF 03-6-1. In June 2008, the FASB issued FSP EITF No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. The FSP addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and therefore need to be included in the earnings allocation in calculating earnings per share under the two-class method described in SFAS No. 128, Earnings per Share. The FSP requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividend or dividend equivalents as a separate class of securities in calculating earnings per share. The FSP is effective for fiscal years beginning after December 15, 2008; earlier application is not permitted. The firm does not expect adoption of FSP EITF No. 03-6-1 to have a material effect on its results of operations or earnings per share.

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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. At any point in time, the firm may use cash instruments as well as derivatives to manage a long or short risk position.

	As of			
	May 2008		November 2007	
	Assets	Liabilities	Assets	Liabilities
	(in millions)			
Commercial paper, certificates of deposit, time deposits and other money market instruments	$ 16,949 [1]	$	$ 8,985 [1]	$
U.S. government, federal agency and sovereign obligations	62,583	44,194	70,774	58,637
Mortgage and other asset-backed loans and securities	37,523	687	54,073 [6]	
Bank loans and bridge loans	35,949	1,600 [4]	49,154	3,563 [4]
Corporate debt securities and other debt obligations	35,197	8,147	39,219	8,280
Equities and convertible debentures	101,295	30,172	122,205	45,130
Physical commodities	1,248	47	2,571	35
Derivative contracts	120,450 [2]	98,022 [5]	105,614 [2]	99,378 [5]
Total	$ 411,194 [3]	$ 182,869	$ 452,595 [3]	$ 215,023

(1) Includes $5.13 billion and $6.17 billion as of May 2008 and November 2007, respectively, of money market instruments held by William Street Funding Corporation (Funding Corp.) to support the William Street credit extension program (see Note 6 for further information regarding the William Street program).

(2) Net of cash received pursuant to credit support agreements of $84.56 billion and $59.05 billion as of May 2008 and November 2007, respectively.

(3) Includes $1.87 billion and $1.17 billion as of May 2008 and November 2007, respectively, of securities held within the firm s insurance subsidiaries which are accounted for as available-for-sale under SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities.

(4) Includes the fair value of commitments to extend credit.

(5) Net of cash paid pursuant to credit support agreements of $33.90 billion and $27.76 billion as of May 2008 and November 2007, respectively.

(6) Includes $7.64 billion as of November 2007, of mortgage whole loans that were transferred to securitization vehicles where such transfers were accounted for as secured financings rather than sales under SFAS No. 140. The firm distributed to investors the securities that were issued by the securitization vehicles and therefore did not bear economic exposure to the underlying mortgage whole loans.

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Fair Value Hierarchy

The firm s financial assets at fair value classified within level 3 of the fair value hierarchy are summarized below:

	As of May 2008	As of November 2007
	($ in millions)	
Total level 3 assets	$ 78,088 [2]	$ 69,151
Level 3 assets for which the firm bears economic exposure [1]	67,341	54,714
Total assets	1,088,145	1,119,796
Total financial assets at fair value	676,123	717,557
Total level 3 assets as a percentage of Total assets	7%	6%
Level 3 assets for which the firm bears economic exposure as a percentage of Total assets	6	5
Total level 3 assets as a percentage of Total financial assets at fair value	12	10
Level 3 assets for which the firm bears economic exposure as a percentage of Total financial assets at fair value	10	8

(1) Excludes assets which are financed by nonrecourse debt, attributable to minority investors or attributable to employee interests in certain consolidated funds.

(2) Total level 3 assets as of February 2008 were $96.39 billion.

The following tables set forth by level within the fair value hierarchy Financial instruments owned, at fair value, Financial instruments sold, but not yet purchased, at fair value and other financial assets and financial liabilities accounted for at fair value under SFAS No. 155 and SFAS No. 159 as of May 2008 and November 2007 (see Note 2 for further information on the fair value hierarchy). As required by SFAS No. 157, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

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	Financial Assets at Fair Value as of May 2008				
	Level 1	**Level 2**	**Level 3**	**Netting and Collateral**	**Total**
			(in millions)		
Commercial paper, certificates of deposit, time deposits and other money market instruments	$ 6,274	$ 10,675	$	$	$ 16,949
U.S. government, federal agency and sovereign obligations	35,172	27,411			62,583
Mortgage and other asset-backed loans and securities		19,676	17,847		37,523
Bank loans and bridge loans		22,648	13,301		35,949
Corporate debt securities and other debt obligations	138	23,213	11,846		35,197
Equities and convertible debentures	57,725	26,893	16,677 (6)		101,295
Physical commodities		1,248			1,248
Cash instruments	99,309	131,764	59,671		290,744
Derivative contracts	108	190,587	18,417	(88,662) (7)	120,450
Financial instruments owned, at fair value	99,417	322,351	78,088	(88,662)	411,194
Securities segregated for regulatory and other purposes	25,090 (4)	38,642 (5)			63,732
Receivables from customers and counterparties (1)		1,100			1,100
Securities borrowed (2)		69,200			69,200
Financial instruments purchased under agreements to resell, at fair value		130,897			130,897
Total assets at fair value	$ 124,507	$ 562,190	$ 78,088	$ (88,662)	$ 676,123
Level 3 assets for which the firm does not bear economic exposure (3)			(10,747)		
Level 3 assets for which the firm bears economic exposure			$ 67,341		

(1) Principally consists of transfers accounted for as secured loans rather than purchases under SFAS No. 140 and prepaid variable share forwards.

(2) Reflects securities borrowed within Trading and Principal Investments. Excludes securities borrowed within Securities Services, which are accounted for based on the amount of cash collateral advanced plus accrued interest.

(3) Consists of level 3 assets which are financed by nonrecourse debt, attributable to minority investors or attributable to employee interests in certain consolidated funds.

(4) Consists of U.S. Treasury securities and money market instruments as well as insurance separate account assets measured at fair value under AICPA SOP 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts.

(5) Principally consists of securities borrowed and resale agreements. The underlying securities have been segregated to satisfy certain regulatory requirements.

(6) Consists of private equity and real estate fund investments.

(7) Represents cash collateral and the impact of netting across the levels of the fair value hierarchy. Netting among positions classified within the same level is included in that level.

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	Financial Liabilities at Fair Value as of May 2008				
	Level 1	**Level 2**	**Level 3**	**Netting and Collateral**	**Total**
			(in millions)		
U.S. government, federal agency and sovereign obligations	$ 42,094	$ 2,100	$	$	$ 44,194
Mortgage and other asset-backed loans and securities		674	13		687
Bank loans and bridge loans		1,258	342		1,600
Corporate debt securities and other debt obligations		7,927	220		8,147
Equities and convertible debentures	29,200	966	6		30,172
Physical commodities		47			47
Cash instruments	71,294	12,972	581		84,847
Derivative contracts	55	124,067	11,909	(38,009) [7]	98,022
Financial instruments sold, but not yet purchased, at fair value	71,349	137,039	12,490	(38,009)	182,869
Unsecured short-term borrowings [1]	15	34,826	3,837		38,678
Bank deposits [2]		728			728
Securities loaned [3]		7,353			7,353
Financial instruments sold under agreements to repurchase, at fair value		115,733			115,733
Other secured financings [4]		25,409	880		26,289
Unsecured long-term borrowings [5]		20,843	2,002		22,845
Total liabilities at fair value	$ 71,364	$ 341,931	$ 19,209 [6]	$ (38,009)	$ 394,495

(1) Consists of promissory notes, commercial paper and hybrid financial instruments.

(2) Consists of certain certificates of deposit issued by GS Bank USA.

(3) Reflects securities loaned within Trading and Principal Investments. Excludes securities loaned within Securities Services, which are accounted for based on the amount of cash collateral received plus accrued interest.

(4) Primarily includes transfers accounted for as financings rather than sales under SFAS No. 140, debt raised through the firm s William Street program and certain other nonrecourse financings.

(5) Primarily includes hybrid financial instruments and prepaid physical commodity transactions.

(6) Level 3 liabilities were 5% of Total liabilities at fair value.

(7) Represents cash collateral and the impact of netting across the levels of the fair value hierarchy. Netting among positions classified within the same level is included in that level.

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	Financial Assets at Fair Value as of November 2007				
	Level 1	**Level 2**	**Level 3**	**Netting and Collateral**	**Total**
			(in millions)		
Commercial paper, certificates of deposit, time deposits and other money market instruments	$ 6,237	$ 2,748	$	$	$ 8,985
U.S. government, federal agency and sovereign obligations	37,966	32,808			70,774
Mortgage and other asset-backed loans and securities		38,073	16,000		54,073
Bank loans and bridge loans		35,820	13,334		49,154
Corporate debt securities and other debt obligations	915	32,193	6,111		39,219
Equities and convertible debentures	68,727	35,472	18,006 (6)		122,205
Physical commodities		2,571			2,571
Cash instruments	113,845	179,685	53,451		346,981
Derivative contracts	286	153,065	15,700	(63,437) (7)	105,614
Financial instruments owned, at fair value	114,131	332,750	69,151	(63,437)	452,595
Securities segregated for regulatory and other purposes	24,078 (4)	69,940 (5)			94,018
Receivables from customers and counterparties (1)		1,950			1,950
Securities borrowed (2)		83,277			83,277
Financial instruments purchased under agreements to resell, at fair value		85,717			85,717
Total assets at fair value	$ 138,209	$ 573,634	$ 69,151	$ (63,437)	$ 717,557
Level 3 assets for which the firm does not bear economic exposure (3)			(14,437)		

Level 3 assets for which the firm bears economic exposure	$ 54,714

(1) Consists of transfers accounted for as secured loans rather than purchases under SFAS No. 140 and prepaid variable share forwards.

(2) Reflects securities borrowed within Trading and Principal Investments. Excludes securities borrowed within Securities Services, which are accounted for based on the amount of cash collateral advanced plus accrued interest.

(3) Consists of level 3 assets which are financed by nonrecourse debt, attributable to minority investors or attributable to employee interests in certain consolidated funds.

(4) Consists of U.S. Treasury securities and money market instruments as well as insurance separate account assets measured at fair value under AICPA SOP 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts.

(5) Principally consists of securities borrowed and resale agreements. The underlying securities have been segregated to satisfy certain regulatory requirements.

(6) Consists of private equity and real estate fund investments.

(7) Represents cash collateral and the impact of netting across the levels of the fair value hierarchy. Netting among positions classified within the same level is included in that level.

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THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)