CONSOLIDATED STATEMENTS OF EARNINGS

(in millions, except per share amounts)	Year Ended November 2000	1999	1998
Revenues			
Global capital markets			
Investment banking	**$ 5,339**	$ 4,359	$ 3,368
Trading and principal investments	**6,528**	5,758	2,015
Asset management and securities services	**3,737**	2,524	2,085
Interest income	**17,396**	12,722	15,010
Total revenues	**33,000**	25,363	22,478
Interest expense	**16,410**	12,018	13,958
Revenues, net of interest expense	**16,590**	13,345	8,520
Operating expenses			
Compensation and benefits	**7,773**	6,459	3,838
Nonrecurring employee initial public offering and acquisition awards	**290**	2,257	—
Amortization of employee initial public offering and acquisition awards	**428**	268	—
Brokerage, clearing and exchange fees	**573**	446	424
Market development	**506**	364	287
Communications and technology	**435**	306	265
Depreciation and amortization	**486**	337	242
Occupancy	**440**	314	207
Professional services and other	**639**	402	336
Charitable contribution	**—**	200	—
Total operating expenses	**11,570**	11,353	5,599
Pre-tax earnings	**5,020**	1,992	2,921
Provision/(benefit) for taxes	**1,953**	(716)	493
Net earnings	**$ 3,067**	$ 2,708	$ 2,428
Earnings per share			
Basic	**$ 6.33**	$ 5.69	—
Diluted	**6.00**	5.57	—
Average common shares outstanding			
Basic	**484.6**	475.9	—
Diluted	**511.5**	485.8	—

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

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(in millions, except share and per share amounts)	As of November 2000	1999
Assets		
Cash and cash equivalents	**$ 3,870**	$ 3,055
Cash and securities segregated in compliance with U.S. federal and other regulations	**17,132**	9,135
Receivables from brokers, dealers and clearing organizations	**6,226**	4,490
Receivables from customers and counterparties	**33,060**	30,140
Securities borrowed	**82,409**	78,418
Securities purchased under agreements to resell	**37,324**	37,106
Right to receive securities	**4,264**	1,604
Financial instruments owned, at fair value		
Commercial paper, certificates of deposit and time deposits	**866**	1,435
U.S. government, federal agency and sovereign obligations	**24,038**	22,193
Corporate debt	**13,317**	9,821
Equities and convertible debentures	**21,481**	16,381
State, municipal and provincial obligations	**499**	756
Derivative contracts	**34,627**	30,661
Physical commodities	**432**	562
Other assets	**10,215**	4,734
	$289,760	$250,491
Liabilities and Shareholders' Equity		
Short-term borrowings, including commercial paper	**$ 33,471**	$ 37,756
Payables to brokers, dealers and clearing organizations	**3,871**	2,129
Payables to customers and counterparties	**78,277**	57,405
Securities loaned	**9,215**	9,169
Securities sold under agreements to repurchase	**30,996**	40,183
Obligation to return securities	**3,355**	1,595
Financial instruments sold, but not yet purchased, at fair value		
U.S. government, federal agency and sovereign obligations	**23,580**	19,170
Corporate debt	**3,988**	2,642
Equities and convertible debentures	**8,829**	14,002
Derivative contracts	**37,815**	28,488
Physical commodities	**677**	586
Other liabilities and accrued expenses	**7,761**	6,269
Long-term borrowings	**31,395**	20,952
	273,230	240,346
Commitments and contingencies		
Shareholders' Equity		
Preferred stock, par value $0.01 per share; 150,000,000 shares authorized, no shares issued and outstanding	**—**	—
Common stock, par value $0.01 per share; 4,000,000,000 shares authorized, 489,964,838 and 441,421,899 shares issued as of November 2000 and November 1999, respectively	**5**	4
Restricted stock units	**4,760**	4,339
Nonvoting common stock, par value $0.01 per share; 200,000,000 shares authorized, no shares issued and outstanding as of November 2000; 7,440,362 shares issued and outstanding as of November 1999	**—**	—
Additional paid-in capital	**11,127**	7,359
Retained earnings	**3,294**	444
Unearned compensation	**(1,878)**	(2,038)
Accumulated other comprehensive (loss)/income	**(130)**	37
Treasury stock, at cost, par value $0.01 per share; 6,490,145 shares as of November 2000	**(648)**	—
Total shareholders' equity	**16,530**	10,145
	$289,760	$250,491

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY AND PARTNERS' CAPITAL

	Year Ended November		
(in millions, except per share amounts)	**2000**	1999	1998
Partners' capital			
Balance, beginning of year	**$ —**	$ 6,310	$ 6,107
Transfer of beginning partners' capital allocated for income taxes and potential withdrawals	**—**	74	—
Net earnings	**—**	2,264[1]	2,428
Capital contributions	**—**	48	9
Return on capital and certain distributions to partners	**—**	(306)	(619)
Termination of profit participation plans	**—**	—	(368)
Transfers to partners' capital allocated for income taxes and potential withdrawals, net	**—**	—	(1,247)
Distributions of remaining partners' capital	**—**	(4,520)[2]	—
Exchange of partnership interests for shares of common stock	**—**	(3,901)	—
Transfer to accumulated other comprehensive income	**—**	31	—
Balance, end of year	**—**	—	6,310
Common stock, par value $0.01 per share			
Balance, beginning of year	**4**	—	—
Issued	**1**	4	—
Balance, end of year	**5**	4	—
Restricted stock units			
Balance, beginning of year	**4,339**	—	—
Granted	**1,150**	4,381	—
Delivered	**(507)**	—	—
Forfeited	**(222)**	(42)	—
Balance, end of year	**4,760**	4,339	—
Nonvoting common stock, par value $0.01 per share			
Balance, beginning of year	**—**	—	—
Issued	**—**	—	—
Exchanged	**—**	—	—
Balance, end of year	**—**	—	—
Additional paid-in capital			
Balance, beginning of year	**7,359**	—	—
Exchange of partnership interests for shares of common stock	**—**	3,901	—
Issuance of common stock	**3,651**	2,891	—
Issuance of common stock contributed to a defined contribution plan	**1**	674	—
Tax benefit related to delivery of equity-based awards	**116**	—	—
Dividends paid	**—**	(107)[3]	—
Balance, end of year	**11,127**	7,359	—
Retained earnings			
Balance, beginning of year	**444**	—	—
Net earnings	**3,067**	444[4]	—
Dividends paid	**(217)**	—	—
Balance, end of year	**3,294**	444	—
Unearned compensation			
Balance, beginning of year	**(2,038)**	—	—
Restricted stock units granted	**(842)**	(2,334)	—
Restricted stock units forfeited	**163**	23	—
Amortization of restricted stock units	**839**	273	—
Balance, end of year	**(1,878)**	(2,038)	—
Accumulated other comprehensive (loss)/income			
Balance, beginning of year	**37**	—	—
Transfer from partners' capital	**—**	(31)	—
Currency translation adjustment	**(167)**	68	—
Balance, end of year	**(130)**	37	—
Treasury stock, at cost, par value $0.01 per share			
Balance, beginning of year	**—**	—	—
Shares repurchased	**(648)**	—	—
Balance, end of year	**(648)**	—	—
	$16,530	$10,145	$ 6,310

[1] Represents net earnings of the partnership from November 28, 1998 through May 6, 1999.
[2] Represents the retired limited partners' exchanges of partnership interests for cash and junior subordinated debentures, the redemption of senior limited partnership interests for cash and other distributions of partners' capital in accordance with the partnership agreement.
[3] Represents two quarterly dividends of $0.12 per common share each.
[4] Represents net earnings of the corporation from May 7, 1999 through November 26, 1999.
The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)	Year Ended November 2000	1999	1998
Cash flows from operating activities			
Net earnings	**$ 3,067**	$ 2,708	$ 2,428
Noncash items included in net earnings			
Depreciation and amortization	**486**	337	242
Deferred income taxes	**(352)**	(1,387)	23
Stock-based compensation	**1,345**	2,989	—
Changes in operating assets and liabilities			
Cash and securities segregated in compliance with U.S. federal and other regulations	**(5,389)**	(1,248)	(2,984)
Net receivables from brokers, dealers and clearing organizations	**336**	1,453	(789)
Net payables to customers and counterparties	**14,570**	(3,990)	14,664
Securities borrowed, net	**(916)**	(11,179)	(21,158)
Financial instruments owned, at fair value	**(8,386)**	(13,718)	148
Financial instruments sold, but not yet purchased, at fair value	**5,507**	9,059	7,559
Other, net	**867**	2,387	(71)
Net cash provided by/(used for) operating activities	**11,135**	(12,589)	62
Cash flows from investing activities			
Property, leasehold improvements and equipment	**(1,552)**	(656)	(476)
Financial instruments owned, at fair value	**(116)**	189	(180)
Business combinations, net of cash acquired	**(1,988)**	(187)	—
Net cash used for investing activities	**(3,656)**	(654)	(656)
Cash flows from financing activities			
Short-term borrowings, net	**(11,550)**	755	2,193
Issuance of long-term borrowings	**16,060**	11,000	10,527
Repayment of long-term borrowings	**(782)**	(753)	(2,058)
Securities sold under agreements to repurchase, net	**(9,528)**	4,304	(5,909)
Common stock repurchased	**(648)**	—	—
Dividends paid	**(217)**	(107)	—
Proceeds from issuance of common stock	**1**	2,633	—
Capital contributions	**—**	48	9
Returns on capital and certain distributions to partners	**—**	(306)	(619)
Termination of the profit participation plans	**—**	—	(368)
Partners' capital distributions, net	**—**	(4,112)	—
Partners' capital allocated for income taxes and potential withdrawals	**—**	—	(1,673)
Net cash (used for)/provided by financing activities	**(6,664)**	13,462	2,102
Net increase in cash and cash equivalents	**815**	219	1,508
Cash and cash equivalents, beginning of year	**3,055**	2,836	1,328
Cash and cash equivalents, end of year	**$ 3,870**	$ 3,055	$ 2,836

SUPPLEMENTAL DISCLOSURES:

Cash payments for interest approximated the related expense for each of the fiscal years presented.

Payments of income taxes were $1.96 billion and $463 million for the years ended November 2000 and November 1999, respectively, and were immaterial for the year ended November 1998.

Noncash activities:

Common stock issued in connection with business combinations was $3.41 billion and $245 million for the years ended November 2000 and November 1999, respectively.

In connection with the firm's conversion to corporate form in 1999, junior subordinated debentures of $371 million were issued to retired limited partners in exchange for their partnership interests.

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)	2000	1999	1998
	Year Ended November		
Net earnings	**$3,067**	$2,708	$2,428
Currency translation adjustment, net of tax	**(167)**	37	(31)
Comprehensive income	**$2,900**	$2,745	$2,397

The accompanying notes are an integral part of these 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 global investment banking and securities firm that provides a wide range of financial services worldwide to a substantial and diversified client base. On May 7, 1999, the firm converted from a partnership to a corporation and completed its initial public offering.

The firm's activities are divided into two segments:

Global Capital Markets. This segment comprises Investment Banking, which includes Financial Advisory and Underwriting, and Trading and Principal Investments, which includes Fixed Income, Currency and Commodities (FICC), Equities and Principal Investments (Principal Investments primarily represents net revenues from the firm's merchant banking investments); and

Asset Management and Securities Services. This segment comprises Asset Management, Securities Services and Commissions.

Note 2/Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Group Inc. and its U.S. and international subsidiaries including Goldman, Sachs & Co. (GS&Co.), J. Aron & Company and Spear, Leeds & Kellogg, L.P. in New York, Goldman Sachs International (GSI) in London and Goldman Sachs (Japan) Ltd. (GSJL) in Tokyo. Certain reclassifications have been made to prior-year amounts to conform to the current-year presentation. All material intercompany transactions and balances have been eliminated.

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles that require management to make estimates and assumptions regarding trading inventory valuations, the outcome of pending litigation, and other matters that affect the consolidated financial statements and related disclosures. These estimates and assumptions are based on judgment and available information and, consequently, actual results could be materially different from these estimates.

Unless otherwise stated herein, all references to 2000, 1999 and 1998 refer to the firm's fiscal year ended, or the date, as the context requires, November 24, 2000, November 26, 1999 and November 27, 1998, respectively.

Cash and Cash Equivalents

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

Repurchase Agreements and Collateralized Financing Arrangements

Securities purchased under agreements to resell and securities sold under agreements to repurchase, principally U.S. government, federal agency and investment-grade non-U.S. sovereign obligations, represent short-term collateralized financing transactions and are carried at their contractual amounts plus accrued interest. These amounts are presented on a net-by-counterparty basis when the applicable requirements of Financial Accounting Standards Board Interpretation No. 41 are satisfied. The firm takes possession of securities purchased under agreements to resell, monitors the market value of these securities on a daily basis and obtains additional collateral as appropriate.

Securities borrowed and loaned are recorded on the statements of financial condition based on the amount of cash collateral advanced or received. These transactions are generally collateralized by either cash, securities or letters of credit. The firm takes possession of securities borrowed, monitors the market value of securities loaned and obtains additional collateral as appropriate. Income or expense is recognized as interest over the life of the transaction.

Financial Instruments

Gains and losses on financial instruments and commission income and related expenses are recorded on a trade date basis in the consolidated statements of earnings. The consolidated statements of financial condition generally reflect purchases and sales of financial instruments, including agency transactions, on a trade date basis.

Substantially all financial instruments used in the firm's trading and nontrading activities are carried at fair value or amounts that approximate fair value, and unrealized gains and losses are recognized in earnings. Fair value is based generally on listed market prices or broker or dealer price quotations. To the extent that prices are not readily available, or if liquidating the firm's position is reasonably expected to affect market prices, fair value is based on either internal valuation models or management's estimate of amounts that could be realized under current market conditions, assuming an orderly liquidation over a reason-

able period of time. Certain over-the-counter (OTC) derivative instruments are valued using pricing models that consider, among other factors, current and contractual market prices, time value, and yield curve and/or volatility factors of the underlying positions. The fair value of the firm's trading and nontrading assets and liabilities is discussed further in Notes 4, 5 and 6.

Principal Investments

Principal investments are carried at fair value, generally based upon quoted market prices or comparable substantial third-party transactions. Where fair value is not readily ascertainable, principal investments are recorded at cost or management's estimate of the realizable value.

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 fund's investments exceeds certain threshold returns. Overrides are based on investment performance over the life of each merchant banking fund, and future investment underperformance may require amounts previously distributed to the firm to be returned to the funds. Accordingly, overrides are recognized in earnings only when management determines that the probability of return is remote. Overrides are included in "Asset management and securities services" on the consolidated statements of earnings.

Derivative Contracts

Derivatives used for trading purposes are reported at fair value and are included in "Derivative contracts" on the consolidated statements of financial condition. Gains and losses on derivatives used for trading purposes are generally included in "Trading and principal investments" on the consolidated statements of earnings.

Derivatives used for nontrading purposes include interest rate futures contracts and interest rate and currency swap agreements, which are primarily utilized to convert a substantial portion of the firm's fixed rate debt into U.S. dollar-based floating rate obligations. Gains and losses on these derivatives are generally deferred and recognized as adjustments to interest expense over the life of the derivative contract. Gains and losses resulting from the early termination of derivatives used for nontrading purposes are generally deferred and recognized over the remaining life of the underlying debt. If the underlying debt is terminated prior to its stated maturity, gains and losses on these transactions, including the associated hedges, are recognized in earnings immediately.

Derivatives are reported on a net-by-counterparty basis on the consolidated statements of financial condition where management believes a legal right of setoff exists under an enforceable netting agreement.

Property, Leasehold Improvements and Equipment

Depreciation and amortization generally are computed using accelerated cost recovery methods for all property and equipment and for leasehold improvements where the term of the lease is greater than the economic useful life of the asset. All other leasehold improvements are amortized on a straight-line basis over the term of the lease. Certain internal use software costs are capitalized and amortized on a straight-line basis over the expected useful life.

Goodwill

The cost of acquired companies in excess of the fair value of net assets at acquisition date is recorded as goodwill and amortized over periods of 15 to 20 years on a straight-line basis.

Investment Banking

Underwriting revenues and fees from mergers and acquisitions and other corporate finance advisory assignments are recorded when the underlying transaction is completed under the terms of the engagement. Syndicate expenses related to securities offerings in which the firm acts as an underwriter or agent are deferred until the related revenue is recognized.

Earnings Per Share

Earnings per share (EPS) is computed in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings Per Share." Basic EPS is calculated by dividing net earnings by the weighted average number of common shares outstanding. Common shares outstanding includes common stock and nonvoting common stock as well as 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.

Stock-Based Compensation

The firm has elected to account for stock-based employee compensation plans in accordance with Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," as permitted by SFAS No. 123, "Accounting for Stock-Based Compensation." In accordance with APB No. 25, compensation expense is not recognized for stock options that have no intrinsic value on the date of grant. Compensation expense is recognized immediately for restricted stock units for which future service is not required as a condition to the delivery of the underlying shares of common stock. For restricted stock units with future service requirements, compensation expense is recognized over the relevant vesting period using an accelerated amortization methodology.

Income Taxes

The firm accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which requires the recognition of tax benefits or expenses on the temporary differences between the financial reporting and tax bases of its assets and liabilities. As a partnership, the firm was primarily subject to unincorporated business taxes and taxes in foreign jurisdictions on certain of its operations. As a corporation, the earnings of the firm are subject to U.S. federal, foreign, state and local taxes. As a result of its conversion to corporate form, the firm recognized the tax effect of the change in its income tax rate on both its deferred tax assets and liabilities and the earnings attributable to the period from May 7, 1999 to the end of fiscal year 1999. The firm's tax assets and liabilities are presented as a component of "Other assets" and "Other liabilities and accrued expenses," respectively, on the consolidated statements of financial condition.

Foreign Currency Translation

Assets and liabilities denominated in non-U.S. currencies are translated at rates of exchange prevailing on the date of the statement of financial condition, and revenues and expenses are translated at average rates of exchange for the fiscal year. Gains or losses on translation of the financial statements of a non-U.S. operation, where the functional currency is other than the U.S. dollar, are reflected as a separate component of equity. Gains or losses on foreign currency transactions are included in the consolidated statements of earnings.

Note 3/Spear, Leeds & Kellogg

On October 31, 2000, the firm completed its combination with SLK LLC (SLK), a leader in securities clearing and execution, floor-based market making and off-floor market making. The combination was accounted for under the purchase method of accounting for business combinations. In exchange for the membership interests in SLK and subordinated debt of certain retired members, the firm issued 35.3 million shares of common stock valued at $3.5 billion, issued $149 million in debentures and paid $2.1 billion in cash. The purchase price has been preliminarily allocated to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the effective date of the combination. The excess of consideration paid over the estimated fair value of net assets acquired has been recorded as goodwill. Goodwill and identifiable intangible assets of approximately $4.0 billion will be amortized as a charge to earnings over a weighted average life of approximately 20 years. The final allocation of the purchase price will be determined after appraisals and a comprehensive evaluation of the fair value of the SLK assets acquired and liabilities assumed are completed. The firm does not expect the change in amortization expense to be material.

As part of the combination with SLK, the firm established a $702 million retention pool of restricted stock units for all SLK employees. A charge of $290 million ($180 million after taxes) related to restricted stock units for which future service was not required as a condition to the delivery of the underlying shares of common stock was included in the firm's operating results in the fourth quarter of 2000. The remaining restricted stock units, for which future service is required, will be amortized over the five-year service period following the date of the consummation of the combination as follows: 25%, 25%, 25%, 18% and 7% in years one, two, three, four and five, respectively.

The following table sets forth the unaudited pro forma combined operating results of the firm and SLK for the years ended November 2000 and November 1999. These pro forma results were prepared as if the firm's combination with SLK had taken place at the beginning of the periods presented.

Pro Forma Operating Results
(unaudited)

	Year Ended November	
(in millions, except per share amounts)	**2000**	1999
Revenues, net of interest expense	**$18,630**	$14,652
Net earnings	**3,459**	2,595
Basic EPS	**6.66**	5.06
Diluted EPS	**6.32**	4.97

Note 4/Financial Instruments

Financial instruments, including both cash instruments and derivatives, are used to manage market risk, facilitate customer transactions, engage in proprietary transactions and meet financing objectives. These instruments can be either executed on an exchange or negotiated in the OTC market.

Transactions involving financial instruments sold, but not yet purchased, entail an obligation to purchase a financial instrument at a future date. The firm may incur a loss if the market value of the financial instrument subsequently increases prior to the purchase of the instrument.

Fair Value of Financial Instruments

Substantially all of the firm's assets and liabilities are carried at fair value or amounts that approximate fair value.

Trading assets and liabilities, including derivative contracts used for trading purposes, are carried at fair value and reported as "Financial instruments owned" and "Financial instruments sold, but not yet purchased," on the consolidated statements of financial condition. Nontrading assets and liabilities are generally carried at fair value or amounts that approximate fair value.

Nontrading assets include cash and cash equivalents; cash and securities segregated in compliance with U.S. federal and other regulations; receivables from brokers, dealers and clearing organizations; receivables from customers and counterparties; securities borrowed; securities purchased under agreements to resell; right to receive securities; and certain investments, primarily those made in connection with the firm's merchant banking activities.

Nontrading liabilities include short-term borrowings; payables to brokers, dealers and clearing organizations; payables to customers and counterparties; securities loaned; securities sold under agreements to repurchase; obligation to return securities; other liabilities and accrued expenses; and long-term borrowings. The fair value of the firm's long-term borrowings and associated hedges is discussed in Note 6.

Trading and Principal Investments

The firm's Trading and Principal Investments business, a component of the Global Capital Markets segment, facilitates customer transactions, takes proprietary positions through market making in and trading of securities, currencies, commodities and swaps, and other derivatives, and engages in floor-based market making as a specialist on U.S. equities and options exchanges. Derivative financial instruments are often used to hedge cash instruments or other derivative financial instruments as an integral part of the firm's strategies. As a result, it is necessary to view the results of any activity on a fully integrated basis, including cash positions, the effect of related derivatives and the financing of the underlying positions.

Net revenues 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, the underlying positions. See Note 14 for further information regarding the firm's segments.

The following table sets forth the net revenues of Trading and Principal Investments:

	Year Ended November		
(in millions)	**2000**	1999	1998
FICC	**$3,004**	$2,862	$1,438
Equities	**3,489**	1,961	795
Principal Investments	**134**	950	146
Total	**$6,627**	$5,773	$2,379

Risk Management

The firm seeks to monitor and control its risk exposure through a variety of separate but complementary financial, credit, operational and legal reporting systems. Management believes that it has effective procedures for evaluating and managing the market, credit and other risks to which it is exposed. The Management Committee, the firm's primary decision-making body, determines (both directly and through delegated authority) the types of business in which the firm engages, approves guidelines for accepting customers for all product lines, outlines the terms under which customer business is conducted and establishes the parameters for the risks that the firm is willing to undertake in its business.

The Firmwide Risk Committee, which reports to senior management and meets weekly, is responsible for managing and monitoring all of the firm's risk exposures. In addition, the firm maintains segregation of duties, with credit review and risk-monitoring functions performed by groups that are independent from revenue-producing departments.

Market Risk. The potential for changes in the market value of the firm's trading positions is referred to as "market risk." The firm's trading positions result from underwriting, market making, specialist and proprietary trading activities.

Categories of market risk include exposures to interest rates, currency rates, equity prices 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.
- Currency rate risks result from exposures to changes in spot prices, forward prices and volatilities of currency rates.
- Equity price risks result from exposures to changes in prices and volatilities of individual equities, equity baskets and equity indices.
- 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.

These risk exposures are managed through diversification, by controlling position sizes and by establishing hedges in related securities or derivatives. For example, the firm may hedge a portfolio of common stock by taking an offsetting position in a related equity-index futures contract. The ability to manage these exposures 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 the related hedge instrument.

Credit Risk. Credit risk represents the loss that the firm would incur if a counterparty or issuer of securities or other instruments held by the firm fails to perform its contractual obligations to the firm. To reduce credit exposures, the firm seeks to enter into netting agreements with counterparties that permit the firm to offset receivables and payables with such counterparties. In addition, the firm attempts to further reduce credit risk by entering into agreements that enable us to obtain collateral from a counterparty, to terminate or reset the terms of transactions after specified time periods or upon the occurrence of credit-related events, by seeking third-party guarantees of the counterparty's obligations, and through the use of credit derivatives.

Credit concentrations may arise from trading, underwriting and securities borrowing activities and may be impacted by changes in economic, industry or political factors. The firm's concentration of credit risk is monitored actively by the Credit Policy Committee. As of November 2000 and 1999, U.S. government and federal agency obligations represented 6% and 7%, respectively, of the firm's total assets. In addition, most of the firm's securities purchased under agreements to resell are collateralized by U.S. government, federal agency and other sovereign obligations.

Derivative Activities

Most of the firm's derivative transactions are entered into for trading purposes. The firm uses derivatives in its trading activities to facilitate customer transactions, to take proprietary positions and as a means of risk management. The firm also enters into nontrading derivative contracts to manage the interest rate and currency exposure on its long-term borrowings. Nontrading derivatives related to the firm's long-term borrowings are discussed in Note 6.

Derivative contracts are financial 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. Derivatives may involve future commitments to purchase or sell financial instruments or commodities, or to exchange currency or interest pay-

ment streams. The amounts exchanged are based on the specific terms of the contract with reference to specified rates, securities, commodities or indices.

Derivative contracts exclude certain cash instruments, such as mortgage-backed securities, interest-only and principal-only obligations, and indexed debt instruments, that derive their values or contractually required cash flows from the price of some other security or index. Derivatives also exclude option features that are embedded in cash instruments, such as the conversion features and call provisions embedded in bonds. The firm has elected to include commodity-related contracts in its derivative disclosure, although not required to do so, as these contracts may be settled in cash or are readily convertible into cash.

The gross notional (or contractual) amounts of derivative financial instruments represent the volume of these transactions and not the amounts potentially subject to market risk. In addition, measurement of market risk is meaningful only when all related and offsetting transactions are taken into consideration. Gross notional (or contractual) amounts of derivative financial instruments used for trading purposes with off-balance-sheet market risk are set forth below:

	As of November	
(in millions)	**2000**	1999
Interest Rate		
Financial futures and forward settlement contracts	**$ 320,811**	$ 422,465
Swap agreements	**3,588,814**	2,581,100
Written option contracts	**350,977**	509,841
Equity		
Financial futures and forward settlement contracts	**12,508**	10,082
Swap agreements	**4,520**	3,423
Written option contracts	**115,327**	113,653
Currency and Commodity		
Financial futures and forward settlement contracts	**415,282**	460,941
Swap agreements	**185,288**	110,159
Written option contracts	**226,058**	193,989

Market risk on purchased option contracts is limited to the market value of the option; therefore, purchased option contracts have no off-balance-sheet market risk. The gross notional (or contractual) amounts of purchased option contracts used for trading purposes are set forth below:

	As of November	
(in millions)	**2000**	1999
Purchased Option Contracts		
Interest rate	**$427,176**	$484,104
Equity	**123,645**	114,680
Currency and commodity	**212,583**	210,421

The firm utilizes replacement cost as its measure of derivative credit risk. Replacement cost, as reported in "Financial instruments owned, at fair value" on the consolidated statements of financial condition, represents amounts receivable from various counterparties, net of any unrealized losses, where management believes a legal right of setoff exists under an enforceable netting agreement. Replacement cost for purchased option contracts is the market value of the contract. The firm controls its credit risk through an established credit approval process, by monitoring counterparty limits, obtaining collateral where appropriate and, in some cases, entering into enforceable netting agreements.

The fair value of derivative financial instruments used for trading purposes, computed in accordance with the firm's netting policy, is set forth below:

	As of November			
	2000		1999	
(in millions)	**Assets**	**Liabilities**	Assets	Liabilities
Year End				
Forward settlement contracts	**$ 6,315**	**$ 6,748**	$ 4,555	$ 4,625
Swap agreements	**15,767**	**15,879**	12,052	11,587
Option contracts	**12,543**	**15,118**	14,018	12,274
Total	**$34,625**	**$37,745**	$30,625	$28,486
Monthly Average				
Forward settlement contracts	**$ 5,040**	**$ 4,862**	$ 3,877	$ 3,619
Swap agreements	**14,720**	**14,639**	10,414	11,210
Option contracts	**13,438**	**13,727**	9,249	9,707
Total	**$33,198**	**$33,228**	$23,540	$24,536

Note 5/Short-Term Borrowings

The firm obtains secured short-term financing principally through the use of repurchase agreements and securities lending agreements, collateralized mainly by U.S. government, federal agency, investment-grade foreign sovereign obligations and equity securities. The firm obtains unsecured short-term borrowings through issuance of commercial paper, promissory notes and bank loans. The carrying value of these short-term obligations approximates fair value due to their short-term nature.

Short-term borrowings are set forth below:

	As of November	
(in millions)	**2000**	1999
Commercial paper	**$10,721**	$ 9,403
Promissory notes	**14,516**	11,061
Bank loans and other[1]	**8,234**	17,292
Total[2]	**$33,471**	$37,756

[1] As of November 2000 and November 1999, short-term borrowings included $4.06 billion and $10.82 billion of long-term borrowings maturing within one year, respectively.

[2] As of November 2000 and November 1999, weighted average interest rates for short-term borrowings, including commercial paper, were 6.43% and 5.66%, respectively.

The firm maintains unencumbered securities with a market value in excess of all uncollateralized short-term borrowings.

Note 6/Long-Term Borrowings

The firm's long-term borrowings are set forth below:

(in millions)	As of November 2000	1999
Fixed Rate Obligations[1]		
U.S. dollar	**$11,825**	$ 8,236
Non-U.S. dollar	**3,238**	1,980
Floating Rate Obligations[2]		
U.S. dollar	**13,873**	9,697
Non-U.S. dollar	**2,459**	1,039
Total[3]	**$31,395**	$20,952

[1] During 2000 and 1999, interest rates on U.S. dollar fixed rate obligations ranged from 5.75% to 12.00%, and from 5.56% to 12.00%, respectively. During 2000 and 1999, non-U.S. dollar fixed rate obligations interest rates ranged from 0.55% to 8.88%, and from 0.85% to 9.51%, respectively.

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

[3] Long-term borrowings have maturities that range from one to 30 years from the date of issue.

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

	As of November					
	2000			1999		
(in millions)	U.S. Dollar	Non-U.S. Dollar	Total	U.S. Dollar	Non-U.S. Dollar	Total
Maturity Dates						
2000	**$ —**	**$ —**	**$ —**	$ 2,527	$ 114	$ 2,641
2001	**3,506**	**—**	**3,506**	3,145	327	3,472
2002	**6,041**	**804**	**6,845**	1,638	594	2,232
2003	**2,853**	**341**	**3,194**	1,522	404	1,926
2004	**2,011**	**116**	**2,127**	1,857	134	1,991
2005	**4,256**	**2,562**	**6,818**	1,421	172	1,593
2006-Thereafter	**7,031**	**1,874**	**8,905**	5,823	1,274	7,097
Total	**$25,698**	**$5,697**	**$31,395**	$17,933	$3,019	$20,952

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

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

	As of November			
	2000		1999	
($ in millions)	Amount	Rate	Amount	Rate
Fixed rate obligations	**$ 852**	**10.41%**	$ 650	10.17%
Floating rate obligations	**30,543**	**6.96**	20,302	6.03
Total	**$31,395**	**7.06**	$20,952	6.16

As of November 2000 and November 1999, the notional amounts of the related swap agreements used for nontrading purposes were $26.26 billion and $12.94 billion, respectively. The fair value and carrying value of these agreements are set forth below:

	As of November			
	2000		1999	
(in millions)	**Assets**	**Liabilities**	Assets	Liabilities
Fair value	**$3**	**$442**	$ 3	$159
Carrying value	**2**	**70**	36	2

Note 7/Commitments and Contingencies

Litigation

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 might be material to the firm's operating results for any particular period, depending, in part, upon the operating results for such period.

Leases

The firm has obligations under long-term noncancelable lease agreements, principally for office space, expiring on various dates through 2029. Certain agreements are subject to periodic escalation provisions for increases in real estate taxes and other charges. Minimum rental commitments, net of minimum sublease rentals, under noncancelable leases for 2001 and the succeeding four years and thereafter and rent charged to operating expense for the last three years are set forth below:

(in millions)	
Minimum Rental Commitments	
2001	$ 355
2002	334
2003	335
2004	391
2005	374
2006–Thereafter	2,524
Total	$4,313
Net Rent Expense	
2000	**$ 240**
1999	154
1998	104

Other Commitments

The firm had commitments to enter into repurchase and resale agreements of $37.36 billion and $30.58 billion as of November 2000 and November 1999, respectively.

The firm had pledged securities of $34.91 billion and $35.83 billion as collateral for securities borrowed of approximately equivalent value as of November 2000 and November 1999, respectively.

In connection with loan origination and participation, the firm had loan commitments of $10.43 billion and $9.38 billion as of November 2000 and November 1999, respectively. These commitments are agreements to lend to counterparties, have fixed termination dates and are contingent on all conditions to borrowing set forth in the contract having been met. Since these commitments may expire unused, the total commitment amount does not necessarily reflect the actual future cash flow requirements.

The firm provides letters of credit issued by various banks to counterparties in lieu of securities or cash to satisfy various collateral and margin deposit requirements. Letters of credit outstanding were $9.61 billion and $10.30 billion as of November 2000 and November 1999, respectively.

The firm acts as an investor in merchant banking transactions, which includes making long-term investments in equity and debt securities in privately negotiated transactions, corporate acquisitions and real estate transactions. In connection with these activities, the firm had commitments to invest up to $1.74 billion and $1.09 billion in corporate and real estate merchant banking investment funds and a bridge loan fund as of November 2000 and November 1999, respectively.

The firm also had outstanding guarantees of $284 million and $575 million relating primarily to its fund management activities as of November 2000 and November 1999, respectively.

Note 8/Equity Capital

On August 21, 2000, Sumitomo Bank Capital Markets, Inc. exchanged all 7.4 million shares of its nonvoting common stock, par value $0.01 per share, of Group Inc. for an equal number of shares of voting common stock.

On March 20, 2000, the Board of Directors of Group Inc. approved a common stock repurchase program authorizing the repurchase of up to 15 million shares of the firm's common stock. For the year ended November 2000, the firm repurchased approximately 6.5 million shares of its common stock at a cost of $648 million.

On May 7, 1999, the firm converted from a partnership to a corporation and completed its initial public offering. In that offering, the firm sold 51 million shares of common stock. In addition, the firm completed a number of transactions to have Group Inc. succeed to the business of The Goldman Sachs Group, L.P. These transactions included the exchange of the partnership interests of the participating limited partners, retired limited partners, Sumitomo Bank Capital Markets, Inc. and Kamehameha Activities Association for shares of common stock.

Note 9/Earnings Per Share

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

	Year Ended November	
(in millions, except per share amounts)	**2000**	1999
Numerator for basic and diluted EPS — earnings available to common shareholders	**$3,067**	$2,708
Denominator for basic EPS — weighted average number of common shares	**484.6**	475.9
Effect of dilutive securities		
Restricted stock units	**16.2**	5.6
Stock options	**10.7**	4.3
Dilutive potential common shares	**26.9**	9.9
Denominator for diluted EPS — weighted average number of common shares and dilutive potential common shares	**511.5**	485.8
Basic EPS	**$ 6.33**	$ 5.69
Diluted EPS	**6.00**	5.57

Note 10/Employee Benefit Plans

The firm sponsors various pension plans and certain other postretirement benefit plans, primarily healthcare and life insurance, which cover most employees worldwide. The firm also provides certain benefits to former or inactive employees prior to retirement. A summary of these plans is set forth below:

Defined Benefit Pension Plans and Postretirement Plans

The firm maintains a defined benefit pension plan for substantially all U.S. employees. Employees of certain non-U.S. subsidiaries participate in various local defined benefit plans. These plans generally provide benefits based on years of credited service and a percentage of the employee's eligible compensation. In addition, the firm has unfunded postretirement benefit plans that provide medical and life insurance for eligible retirees, employees and dependents in the United States.

The following table provides a summary of the changes in the plans' projected benefit obligations and the fair value of assets for 2000 and 1999, and a statement of the funded status of the plans as of November 2000 and November 1999:

	November 2000			November 1999		
(in millions)	**U.S. Pension**	**Non-U.S. Pension**[1]	**Post-retirement**	U.S. Pension	Non-U.S. Pension	Post-retirement
Benefit Obligation						
Balance, beginning of year	**$108**	**$148**	**$ 61**	$108	$120	$ 60
Service cost	**4**	**28**	**2**	4	15	3
Interest cost	**8**	**7**	**4**	8	5	4
Plan amendments	**—**	**1**	**—**	—	—	—
Actuarial loss/(gain)	**2**	**6**	**(9)**	(10)	(4)	(4)
Benefits paid	**(2)**	**(6)**	**(2)**	(2)	(4)	(2)
Effect of foreign exchange rates	**—**	**(21)**	**—**	—	6	—
Balance, end of year	**$120**	**$163**	**$ 56**	$108	$138	$ 61
Fair Value of Plan Assets						
Balance, beginning of year	**$148**	**$116**	**$ —**	$133	$ 75	$ —
Actual return on plan assets	**2**	**6**	**—**	17	11	—
Firm contributions	**—**	**29**	**2**	—	26	2
Benefits paid	**(2)**	**(6)**	**(2)**	(2)	(4)	(2)
Effect of foreign exchange rates	**—**	**(17)**	**—**	—	2	—
Balance, end of year	**$148**	**$128**	**$ —**	$148	$110	$ —
Prepaid/(Accrued) Benefit Cost						
Funded status	**$ 28**	**$ (35)**	**$(56)**	$ 40	$ (28)	$(61)
Unrecognized actuarial loss/(gain)	**11**	**19**	**(5)**	2	14	5
Unrecognized transition (asset)/obligation	**(34)**	**19**	**—**	(37)	23	—
Unrecognized prior service cost	**—**	**3**	**(2)**	—	—	(2)
Prepaid/(accrued) benefit cost	**$ 5**	**$ 6**	**$(63)**	$ 5	$ 9	$(58)

[1] Includes certain plans for the fiscal year ended November 1999 that had previously been deemed immaterial.

For plans in which the accumulated benefit obligation exceeded plan assets, the projected benefit obligation and aggregate accumulated benefit obligation was $57 million and $35 million as of November 2000, respectively, and $138 million and $121 million as of November 1999, respectively. The fair value of plan assets for these plans was $19 million and $110 million as of November 2000 and November 1999, respectively. For plans in which the accumulated benefit obligation exceeded the fair value of plan assets, the effect of recognizing this amount would not have been material to the consolidated statements of financial condition or comprehensive income.

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

(in millions)	Year Ended U.S. Pension	Non-U.S. Pension	Post-retirement
November 2000			
Service cost	**$ 4**	**$28**	**$2**
Interest cost	**8**	**7**	**4**
Expected return on plan assets	**(10)**	**(8)**	**—**
Net amortization	**(3)**	**1**	**—**
Total	**$ (1)**	**$28**	**$6**
November 1999			
Service cost	$ 4	$15	$3
Interest cost	8	5	4
Expected return on plan assets	(10)	(5)	—
Net amortization	(2)	3	—
Total	$ —	$18	$7
November 1998			
Service cost	$ 3	$11	$2
Interest cost	7	4	4
Expected return on plan assets	(10)	(4)	—
Net amortization	(3)	2	—
Total	$ (3)	$13	$6

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

	Year Ended November 2000	1999	1998
Defined Benefit Pension Plans			
U.S. Plans			
Discount rate	**7.5%**	7.5%	7.0%
Rate of increase in future compensation levels	**5.0**	5.0	5.0
Expected long-term rate of return on plan assets	**8.5**	7.5	7.5
International Plans			
Discount rate	**4.7**	4.6	5.0
Rate of increase in future compensation levels	**4.3**	4.3	4.7
Expected long-term rate of return on plan assets	**5.8**	6.0	6.0
Postretirement Plans			
Discount rate	**7.5**	7.5	7.0
Rate of increase in future compensation levels	**5.0**	5.0	5.0

For measurement purposes, a 7.6% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for the fiscal year ending November 2001. The rate was assumed to decrease gradually to 5.0% for the fiscal year ending November 2008 and remain at that level thereafter.

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

	1% Increase		1% Decrease	
(in millions)	2000	1999	2000	1999
Cost	**$1**	$1	**$(1)**	$(1)
Obligation	**7**	9	**(6)**	(8)

Defined Contribution Plans

The firm contributes to employer-sponsored U.S. and international defined contribution plans. The firm's contribution to these plans was $129 million, $94 million and $70 million for 2000, 1999 and 1998, respectively.

The firm has also established a nonqualified defined contribution plan (the Plan) for certain senior employees. Shares of common stock contributed to the Plan and outstanding as of November 2000 were 12.7 million. The shares of common stock will vest and generally be distributable to the participant on specified future dates if the participant satisfies certain conditions and the participant's employment with the firm has not been terminated, with certain exceptions for terminations of employment due to death or a change in control. Dividends on the underlying shares of common stock are paid currently to the participants. Forfeited shares remain in the Plan and are reallocated to other participants. Contributions to the Plan are expensed on the date of grant. Plan expense was immaterial for the year ended November 2000 and was $674 million for the year ended November 1999, which included $666 million granted in connection with the firm's initial public offering.

Note 11/Employee Incentive Plans

Stock Incentive Plan

The firm sponsors a stock incentive plan that provides for grants of incentive stock options, nonqualified stock options, stock appreciation rights, dividend equivalent rights, restricted stock, restricted stock units and other stock-based awards.

The total number of shares of common stock that may be issued under the stock incentive plan through fiscal 2002 may not exceed 300 million shares and, in each fiscal 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 fiscal year, increased by the number of shares available for awards in previous fiscal years but not covered by awards granted in such years. As of November 2000 and November 1999, 156.2 million shares and 183.4 million shares were available for grant under the stock incentive plan, respectively.

Restricted Stock Units

The firm issued restricted stock units to employees under the stock incentive plan, primarily in connection with its initial public offering and as part of year-end compensation. Of the total restricted stock units outstanding as of November 2000 and November 1999, (i) 46.3 million units and 40.3 million units, respectively, required future service as a condition to the delivery of the underlying shares of common stock, and (ii) 33.5 million units and 35.7 million units, respectively, did not require future service. In all cases, delivery of the underlying shares of common stock is conditioned on the grantee's satisfying certain other requirements outlined in the award agreements.

The activity related to these restricted stock units during 2000 and 1999 is set forth below:

	Restricted Stock Units Outstanding	
	No Future Service Required	Future Service Required
Outstanding, November 1998	—	—
Granted	36,127,314	40,780,999
Forfeited	(355,177)	(436,518)
Delivered	(68,214)	—
Outstanding, November 1999	35,703,923	40,344,481
Granted[1]	6,401,796	10,900,941
Forfeited	(1,189,406)	(2,752,278)
Delivered	(9,571,298)	—
Vested	2,157,204	(2,157,204)
Outstanding, November 2000	**33,502,219**	**46,335,940**

[1] Includes restricted stock units granted in connection with the combination with SLK and restricted stock units granted to employees, subsequent to November 2000, as part of year-end compensation for fiscal 2000.

Noncash compensation expense, net of forfeitures, was $1.35 billion and $2.32 billion for the years ended November 2000 and November 1999, respectively.

Stock Options

Stock options granted to employees will generally become exercisable in installments on or about the third, fourth and fifth anniversaries of the date of grant if the grantee has satisfied certain conditions and the grantee's employment with the firm has not been terminated, with certain exceptions for terminations of employment due to death, retirement, extended absence or a change in control. Once service requirements have been met, these options will generally remain exercisable, subject to satisfaction of certain conditions, until the tenth anniversary of the date of grant. Pursuant to APB No. 25, compensation expense was not recognized for those options that had no intrinsic value on the date of grant. The dilutive effect of these options is included in diluted common shares outstanding under SFAS No. 128.

The activity of these stock options during 2000 and 1999 is set forth below:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Life (years)
Outstanding, November 1998	—	$ —	
Granted	40,863,172	52.91	
Exercised	—	—	
Forfeited	(503,506)	53.00	
Outstanding, November 1999	40,359,666	52.91	9.42
Granted[1]	19,685,230	82.89	
Exercised	(18,901)	48.13	
Forfeited	(2,590,237)	52.88	
Outstanding, November 2000	**57,435,758**	**63.19**	**8.96**
Exercisable, November 2000	**131,432**	**$48.13**	

[1] Includes stock options granted to employees, subsequent to November 2000, as part of year-end compensation for fiscal 2000.

The weighted average fair value of options granted during 2000 and 1999 was $28.13 per option and $16.13 per option, respectively. Fair value was estimated as of the grant date based on a binomial option pricing model using the following weighted average assumptions:

	Year Ended November	
	2000	1999
Risk-free interest rate	**5.6%**	6.1%
Expected volatility	**35.0**	30.0
Dividend yield	**0.6**	1.0
Expected life	**7 years**	7 years

Pro Forma Effect of SFAS No. 123

If the firm were to recognize compensation expense under the fair value-based method of SFAS No. 123 with respect to options granted, net earnings would have decreased resulting in pro forma net earnings and EPS as set forth below:

	Year Ended November	
(in millions, except per share amounts)	2000	1999
Net earnings, as reported	**$3,067**	$2,708
Pro forma net earnings	**2,971**	2,650
EPS, as reported		
Basic	**$ 6.33**	$ 5.69
Diluted	**6.00**	5.57
Pro forma EPS		
Basic	**$ 6.13**	$ 5.57
Diluted	**5.81**	5.45

In the preceding table, pro forma compensation expense associated with option grants is recognized over the relevant vesting period.

Note 12/Income Taxes

Prior to its conversion to corporate form, the firm operated as a partnership and generally was not subject to U.S. federal and state income taxes. The earnings of the firm, however, were subject to local unincorporated business taxes. In addition, certain non-U.S. subsidiaries were subject to income taxes in their local jurisdictions. The partners of the firm's predecessor partnership were taxed on their proportionate share of the partnership's taxable income or loss. Effective with the conversion from a partnership to a corporation on May 7, 1999, the firm became subject to U.S. federal, state and local corporate income taxes.

The components of the net tax expense/(benefit) reflected on the consolidated statements of earnings are set forth below:

	Year Ended November		
(in millions)	**2000**	1999	1998
Current Taxes			
U.S. federal	**$1,063**	$ 16	$ 16
State and local	**285**	67	28
Non-U.S.	**957**	588	426
Total current tax expense	**2,305**	671	470
Deferred Taxes			
U.S. federal	**(299)**	(688)	—
State and local	**49**	(342)	(3)
Non-U.S.	**(102)**	(357)	26
Total deferred tax (benefit)/expense	**(352)**	(1,387)	23
Net tax expense/(benefit)	**$1,953**	$ (716)	$493

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. In connection with the conversion from a partnership to a corporation, the firm recognized a deferred tax benefit related to the revaluation of net deferred tax assets recorded as a partnership.

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

	As of November	
(in millions)	**2000**	1999
Deferred Tax Assets		
Compensation and benefits	**$1,781**	$1,397
Foreign tax credits	**114**	140
Depreciation and amortization	**—**	57
Other, net	**219**	226
	2,114	1,820
Less: valuation allowance[1]	**(37)**	(83)
Total deferred tax assets	**2,077**	1,737
Deferred Tax Liabilities		
Depreciation and amortization	**35**	—
Unrealized gains	**158**	257
Total deferred tax liabilities	**193**	257
Net deferred tax assets	**$1,884**	$1,480

[1] Relates primarily to the ability to recognize tax benefits associated with non-U.S. operations.

The decrease of $46 million in the valuation allowance was primarily due to increased utilization of foreign tax credits. Foreign tax credits of $114 million will begin to expire in 2005.

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		
	2000	1999	1998[1]
U.S. federal statutory income tax rate	**35.0%**	35.0%	—%
Increase related to			
State and local taxes, net of U.S. income tax effects	**4.3**	5.0	0.9
Foreign	**—**	—	15.5
Other	**(0.4)**	—	0.5
Rate before one-time events	**38.9**	40.0	16.9
Revaluation of deferred tax assets upon change in tax status	**—**	(41.4)[2]	—
Rate benefit for partnership period	**—**	(37.7)[3]	—
Other	**—**	3.2	—
Effective income tax rate	**38.9%**	(35.9)%	16.9%

[1] The U.S. federal statutory income tax rate is not applicable to 1998 because the firm operated as a partnership and generally was not subject to corporate federal income taxes. U.S. federal taxes paid by subsidiary corporations are included in "Other" for 1998.

[2] The deferred tax benefit recognized upon the firm's change in tax status from partnership to corporate form primarily reflects the revaluation of the deferred tax assets and liabilities at the firm's corporate income tax rate.

[3] The rate benefit for the partnership period relates to the firm's earnings prior to its conversion to corporate form, which generally were not subject to corporate income taxes.

A tax benefit of approximately $116 million, related to the delivery of restricted stock units and the exercise of options, was included in "Additional paid-in capital" on the consolidated statements of financial condition and changes in shareholders' equity and partners' capital as of November 2000.

Note 13/Regulated Subsidiaries

GS&Co. and Spear, Leeds & Kellogg, L.P. are registered U.S. broker-dealers and futures commission merchants subject to Rule 15c3-1 of the Securities and Exchange Commission and Rule 1.17 of the Commodity Futures Trading Commission which specify uniform minimum net capital requirements, as defined, for their registrants. They have elected to compute their net capital in accordance with the "Alternative Net Capital Requirement" as permitted by Rule 15c3-1. As of November 2000 and November 1999, GS&Co. had regulatory net capital, as defined, of $4.50 billion and $2.92 billion, respectively, which exceeded the amounts required by $3.81 billion and $2.31 billion, respectively. As of November 2000, Spear, Leeds & Kellogg, L.P. had regulatory net capital, as defined, of $837 million, which exceeded the amounts required by $803 million.

GSI, a registered U.K. broker-dealer, is subject to the capital requirements of the Securities and Futures Authority Limited, and GSJL, a Tokyo-based broker-dealer, is subject to the capital requirements of the Financial Services Agency. As of November 2000 and November 1999, GSI and GSJL were in compliance with their local capital adequacy requirements.

Certain other subsidiaries of the firm are also subject to capital adequacy requirements promulgated by authorities of the countries in which they operate. As of November 2000 and November 1999, these subsidiaries were in compliance with their local capital adequacy requirements.

Note 14/Business Segments

In reporting to management, the firm's operating results are categorized into the following two principal segments: Global Capital Markets, and Asset Management and Securities Services.

Global Capital Markets

The Global Capital Markets segment includes services related to the following:

Investment Banking. The firm provides a broad range of investment banking services to a diverse group of corporations, financial institutions, governments and individuals.

The firm's investment banking activities are divided into two categories:

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

- **Underwriting.** Underwriting includes public offerings and private placements of equity and debt securities.

Trading and Principal Investments. The firm's Trading and Principal Investments business facilitates transactions with a diverse group of corporations, financial institutions, governments and individuals and takes proprietary positions through market making in and trading of fixed income and equity products, currencies, commodities, and swaps and other derivatives. In addition, the firm engages in floor-based market making as a specialist on U.S. equities and options exchanges. Trading and Principal Investments is divided into three categories:

- **FICC.** The firm makes markets in and trades fixed income products, currencies and commodities, structures and enters into a wide variety of derivative transactions, and engages in proprietary trading and arbitrage activities;

- **Equities.** The firm makes markets in, acts as a specialist for, and trades equities and equity-related products, structures and enters into equity derivative transactions, and engages in proprietary trading and equity arbitrage; and

- **Principal Investments.** Principal Investments primarily represents net revenues from the firm's merchant banking investments.

Asset Management and Securities Services

The Asset Management and Securities Services segment includes services related to the following:

- **Asset Management.** Asset Management generates management fees by providing investment advisory services to a diverse client base of institutions and individuals;

- **Securities Services.** Securities Services includes prime brokerage, financing services and securities lending, and the firm's matched book businesses, all of which generate revenue primarily in the form of fees or interest rate spreads; and

- **Commissions.** Commissions include clearing and agency transactions for clients on major stock, options and futures exchanges and revenues from the increased share of the income and gains derived from the firm's merchant banking funds.

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 firm allocates revenues and expenses between the two 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 either business segment. 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, the 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.

- The nonrecurring expenses associated with the firm's acquisition awards and conversion to corporate form and related transactions are not allocated to individual segments as management excludes them in evaluating segment performance.

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)		Year Ended November 2000	1999	1998[6]
Global Capital Markets	Net revenues[1]	**$ 11,998**	$ 10,132	$ 5,747
	Operating expenses[2]	**7,844**	6,232	3,978
	Pre-tax earnings	**$ 4,154**	$ 3,900	$ 1,769
	Segment assets	**$149,459**	$127,515	$102,724
Asset Management and Securities Services	Net revenues[1]	**$ 4,592**	$ 3,213	$ 2,773
	Operating expenses[2]	**3,008**	2,396	1,621
	Pre-tax earnings	**$ 1,584**	$ 817	$ 1,152
	Segment assets	**$139,215**	$121,693	$114,293
Total	Net revenues[1]	**$ 16,590**	$ 13,345	$ 8,520
	Operating expenses[2]	**11,570**	11,353	5,599
	Pre-tax earnings	**$ 5,020**[4]	$ 1,992[5]	$ 2,921
	Total assets[3]	**$289,760**	$250,491	$217,380

[1] Net revenues include net interest as set forth in the table below:

(in millions)	Year Ended November 2000	1999	1998
Global Capital Markets	**$131**	$ 15	$ 364
Asset Management and Securities Services	**855**	689	688
Total net interest	**$986**	$704	$1,052

[2] Operating expenses include depreciation and amortization as set forth in the table below:

(in millions)	Year Ended November 2000	1999	1998
Global Capital Markets	**$336**	$228	$158
Asset Management and Securities Services	**150**	109	84
Total depreciation and amortization	**$486**	$337	$242

[3] Includes deferred tax assets relating to the firm's conversion to corporate form, acquisition awards and certain assets that management believes are not allocable to a particular segment.

[4] Pre-tax earnings for the year ended November 2000 include the following expenses that have not been allocated to the firm's segments: (i) the ongoing amortization of employee initial public offering and acquisition awards of $428 million and (ii) the acquisition awards of $290 million related to the firm's combination with SLK.

[5] Pre-tax earnings for the year ended November 1999 include the following expenses that have not been allocated to the firm's segments: (i) nonrecurring employee initial public offering awards of $2.26 billion, (ii) the ongoing amortization of employee initial public offering awards of $268 million and (iii) the charitable contribution to The Goldman Sachs Foundation of $200 million made at the time of the firm's initial public offering.

[6] As a partnership, payments for services rendered by profit participating limited partners were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, pre-tax earnings in 1998 are not comparable with 2000 or 1999.

The following table sets forth the net revenues of the firm's two segments:

	Year Ended November		
(in millions)	2000	1999	1998
Financial Advisory	**$ 2,592**	$ 2,270	$1,774
Underwriting	**2,779**	2,089	1,594
Investment Banking	**5,371**	4,359	3,368
FICC	**3,004**	2,862	1,438
Equities	**3,489**	1,961	795
Principal Investments	**134**	950	146
Trading and Principal Investments	**6,627**	5,773	2,379
Total Global Capital Markets	**11,998**	10,132	5,747
Asset Management	**1,345**	919	675
Securities Services	**940**	772	730
Commissions	**2,307**	1,522	1,368
Total Asset Management and Securities Services	**4,592**	3,213	2,773
Total net revenues	**$16,590**	$13,345	$8,520

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.

The firm's revenues, expenses and identifiable assets are generally allocated based on the country of domicile of the legal entity providing the service.

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

	As of or for Year Ended November		
(in millions)	**2000**	1999	1998[4]
Net Revenues			
United States	**$ 9,767**	$ 8,536	$ 5,133
Other Americas	**189**	327	308
United Kingdom	**4,400**	3,103	1,893
Other Europe	**622**	375	333
Asia	**1,612**	1,004	853
Total net revenues	**$ 16,590**	$ 13,345	$ 8,520
Pre-tax Earnings			
United States	**$ 2,845**	$ 2,878	$ 1,315
Other Americas	**104**	184	209
United Kingdom	**1,882**	1,203	746
Other Europe	**391**	198	216
Asia	**516**	254	435
Other	**(718)**	(2,725)	—
Total pre-tax earnings	**$ 5,020**[2]	$ 1,992[3]	$ 2,921
Identifiable Assets			
United States	**$ 287,938**	$ 238,875	$ 213,971
Other Americas	**7,791**	6,118	6,596
United Kingdom	**121,257**	119,350	94,025
Other Europe	**7,979**	11,737	8,820
Asia	**16,848**	18,088	19,536
Eliminations and other[1]	**(152,053)**	(143,677)	(125,568)
Total identifiable assets	**$ 289,760**	$ 250,491	$ 217,380

[1] Reflects eliminations and certain assets that are not allocable to a particular geographic region.

[2] Pre-tax earnings for the year ended November 2000 include the following expenses that have not been allocated to the firm's segments: (i) the ongoing amortization of employee initial public offering and acquisition awards of $428 million and (ii) the acquisition awards of $290 million related to the firm's combination with SLK.

[3] Pre-tax earnings for the year ended November 1999 include the following expenses that have not been allocated to the firm's segments: (i) nonrecurring employee initial public offering awards of $2.26 billion, (ii) the ongoing amortization of employee initial public offering awards of $268 million and (iii) the charitable contribution to The Goldman Sachs Foundation of $200 million made at the time of the firm's initial public offering.

[4] As a partnership, payments for services rendered by profit participating limited partners were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, pre-tax earnings in 1998 are not comparable with 2000 or 1999.

Note 15/Subsequent Event

The Board of Directors of Group, Inc. declared a dividend of $0.12 per share to be paid on February 22, 2001 to common shareholders of record on January 22, 2001.